78th Annual Report 1991

Board of Governors of the Federal Reserve System

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Letter of Transmittal

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
Washington, D.C., April 15, 1992

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

This report covers operations of the Board during calendar year 1991.

Sincerely,

Chairman

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Part 1

Monetary Policy and the U.S. Economy in 1991

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Introduction

The year 1991 started with the economy in recession. Output fell sharply in the first quarter, and unemployment continued to climb. By early spring, activity had bottomed out, and for a few months recovery seemed to be taking hold in a fashion roughly typical of that seen in the very early phases of previous postwar expansions. But as the year wore on, the incipient recovery lost its momentum. Consumer spending turned down after mid-summer, and business and household sentiment began to erode. Inventories at wholesale and retail trade establishments began to increase relative to sales, inducing a new outbreak of production adjustments and layoffs that continued through year-end. Growth of the economy—as measured by its gross domestic product—came almost to a standstill in the fourth quarter, and the gain over the year as a whole was less than ½ percent.

By contrast, the inflation picture brightened considerably in 1991. After accelerating moderately in 1989 and 1990, the rate of price increase turned down in the first half of 1991, and by the end of the year an underlying trend toward disinflation seemed to have become well-established in the labor and product markets. The consumer price index excluding food and energy—a widely accepted measure of core inflation—rose 4.4 percent in 1991, after an increase of more than 5 percent in 1990. Labor costs also slowed, as did various measures of inflation expectations.

At the start of 1991 the Federal Reserve already had moved to ease money market conditions in response to the weakening of the economy in the latter part of 1990, and a further progressive easing took place during the first several months of 1991. Then, with the stance of policy seemingly conducive to supporting the upturn in activity that began in the spring, a more neutral money market posture was maintained through the spring and early summer.

The Federal Reserve resumed its easing of money market conditions in the second half of 1991 against the backdrop of flagging economic activity, diminishing inflationary pressures, and a weakening of the broader monetary aggregates—M2 and M3. The federal funds rate fell from 5¾ percent in July to 4 percent by year-end, and most other short-term rates followed suit. The discount rate also was reduced over this period, from 5½ percent to 3½ percent, the lowest rate in nearly thirty years. Long-term interest rates, which had failed to respond to declines in money market rates in the early months of the year, came down significantly in the latter part of 1991, partly in response to the easing in inflationary expectations.

The faltering of the recovery process in the second half of 1991 apparently resulted from the convergence of a variety of forces. Burdened by heavy debts and weak asset values—particularly in real estate—households and corporations restrained spending. In addition, financial intermediaries, chastened by their negative experience with earlier loans, became more hesitant to extend new

NOTE. The discussion here and in the following two chapters is adapted from *Monetary Policy Report to the Congress Pursuant to the Full Employment and Balanced Growth Act of 1978* (Board of Governors, February 1992).

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credit; the resultant tightening of lending standards deepened the decline in economic activity early in the year and inhibited the subsequent recovery. In the government sector, where deficits remained large at the federal level as well as in many state and local jurisdictions, efforts to curb spending and increase revenues constituted a further drag on aggregate demand.

The sluggishness of spending in 1991 was accompanied by a striking slowdown in the growth of credit. The volume of outstanding debt in the domestic nonfinancial sector increased 4½ percent in 1991, roughly half the average pace of the three previous years. Excluding federal government debt, which continued to climb briskly, the growth of nonfinancial sector debt over the year was 2½ percent, the smallest rise in decades. Households, nonfinancial businesses, and state and local governments all retrenched in order to buttress deteriorating financial positions.

At the end of 1991, the speed with which the monetary easing might translate effectively into increases in production and employment was still a matter of considerable uncertainty. The low level of consumer confidence evident at year-end seemed likely to exert a negative influence on near-term activity. In addition, severe structural problems still were evident in some sectors. Most notably, the persistent overhang of vacant space in office and other commercial buildings appeared certain to inhibit new construction in that sector for some time, and the budgetary constraints that had capped government spending in 1991 seemed likely to linger.

At the same time, however, some strong positive forces also were evident. With interest rates down sharply in 1991, households and businesses took the opportunity to refinance mortgages and to replace other existing debt with new, lower-cost credit. Lower interest rates also contributed to an increase in stock prices, which induced firms to boost equity issuance, pay down debt, and thereby strengthen their balance sheets. Through such adjustments, households and businesses were becoming better positioned at year-end to begin providing more active support to the economic recovery. In addition, financial institutions had made considerable progress in strengthening their balance sheets; this strengthening will augment the ability of these institutions to lend and could reduce demands on the federal safety net.

At year-end the nation also had reason to be guardedly optimistic about the ability of American firms to compete in the world economy. The real exports of goods and services registered another solid gain in 1991 despite a further slowing in the growth of foreign industrial economies; the merchandise trade deficit for the year was the smallest since 1983. Cost restraint in manufacturing, associated in part with rapid productivity gains, has enabled U.S. producers to move more aggressively into foreign markets in recent years. That cost restraint and productivity gain will need to be maintained, of course, if domestic producers are to remain at the forefront of a rapidly changing world economy.

Our ability to compete in the world arena—and an improved economy more generally—also will require a shift over time toward higher rates of saving and investment. The rates of personal and corporate saving have been extremely low over the past decade; at the same time, rapid growth of the stock of federal debt has imposed heavy demands on the limited amount of saving that was available. The result has been a higher level of real interest rates than there would have been otherwise. Growth of

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the real capital stock, upon which our future incomes depend, has thereby been stunted. A sustained reduction in the size of the federal budget deficit continues to be the most certain way to boost total saving and bring about an easing of the pressure on long-term rates.

Monetary policy also can contribute positively to the long-run performance of the economy, by providing the noninflationary setting in which saving and investment are most likely to flourish. In that regard, it is encouraging that core inflation is slowing—at the end of 1991 it seemed headed for the lowest pace in a generation. Preserving that gain against inflation while helping to lift the economy solidly into sustained expansion is the challenge that monetary policy will have in 1992 and beyond. ■

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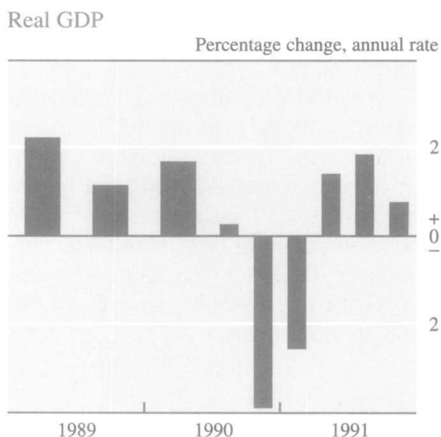
The Economy in 1991

The year began with the U.S. economy in the midst of recession. Activity had contracted sharply after the jump in oil prices that followed Iraq's invasion of Kuwait in August 1990, and the weakness continued into the first quarter of 1991, bringing further reductions in production and employment. By spring, however, economic data indicated that the decline in activity had bottomed out. The rapid conclusion of the Persian Gulf war boosted consumer confidence, and tangible support for an increase in household spending was coming from falling oil prices and the cumulative effects of declining interest rates. Construction of single-family homes had already turned up noticeably by April, and consumer spending posted a moderate rise in the second quarter. Although businesses continued to liquidate inventories at a fairly rapid pace, industrial production grew steadily from April through July, and payroll employment turned up.

But the economic pickup that emerged in the spring failed to develop momentum. The thrust to domestic demand initiated by the end of the Gulf war dissipated during the summer, and although growth of the economy was positive in the second half of 1991, it was much slower than the pace seen in the comparable phase of previous recoveries.

The absence of a more robust recovery likely reflected the drag on aggregate demand from some longer-term economic and financial adjustments. For example, imbalances long evident in the commercial and multifamily construction sectors damped enthusiasm for new projects, and difficulties in the financial sector continued to restrain credit availability. Such influences undoubtedly muted the stimulus that normally would have been forthcoming from the decline in interest rates. The fiscal restraint evident at all levels of government weighed on aggregate demand in a way not typically observed in previous economic cycles. Significant restructurings of operations in a number of sectors had the effect of retarding employment and income growth, at least in the short run. And concerns about debt-servicing burdens as well as about economic prospects made businesses and consumers reluctant to borrow or increase spending.

Despite their cautious planning, some businesses experienced inventory backups over late summer and fall, necessitating another round of production adjustments. Industrial production edged down in the fourth quarter, and the



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growth of real gross domestic product came almost to a halt. In the labor market, layoffs increased once again, and the civilian unemployment rate rose, to 7.1 percent by year-end.

Inflation slowed in 1991. Consumer prices rose 3 percent over the year, only half the increase posted during 1990. In part, the slowing of inflation was a result of the plunge in oil prices early in 1991; consumer energy prices fell sharply in the first quarter and closed the year 7½ percent below their level at the end of 1990. Food price inflation also moderated considerably in 1991; in total, food prices were up only 2 percent at retail, after three years of increases in excess of 5 percent.

Even apart from food and energy, inflation shifted to a downward trend in 1991. To be sure, there were sizable increases in the CPI excluding food and energy early in the year, as higher federal excise taxes and lagged effects of the sharp rise in energy prices boosted prices for a variety of goods and services. But, with the subsequent reversal in oil prices and no further major tax hikes, price pressures began to ease in the spring. In the second half of 1991, the CPI excluding food and energy rose less than 4 percent at an annual rate, a pace well below the 5 percent rate for 1990.

Labor cost pressures also diminished in 1991, although substantial increases in health care expenses remained a problem for employers. As measured by the employment cost index, nominal compensation per hour rose about 4½ percent over 1991, an increase somewhat less than those recorded in each of the three previous years.

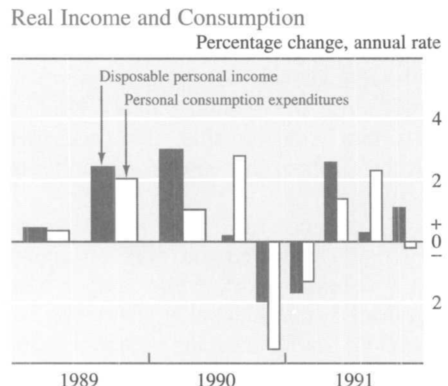
The Household Sector

With household finances adversely affected by job losses and declining real incomes, real consumer spending rose just ½ percent in 1991. After declining early in the year, spending picked up in the spring and early summer; but thereafter, it weakened once more, restrained by the failure of the recovery to take hold and households' concerns about their financial prospects and debt burdens.

The weakness in consumer spending over the year was particularly evident for durable goods. Motor vehicle sales in 1991, at 12¼ million units, were the lowest since 1983, and outlays for other durable goods were down slightly over the year, after a decline of 1½ percent in 1990. Spending on nondurable goods also declined in 1991; expenditures were down sharply in the fourth quarter, especially for apparel. The outlays for services continued to trend up at a pace similar to that of the two previous years; however, growth of spending was much slower than in earlier years of the long expansion of the 1980s.

The sluggishness of consumer spending in 1991—particularly the steep decline in outlays for durable goods—was likely related in part to the efforts of households to strengthen their balance

Real Income and Consumption



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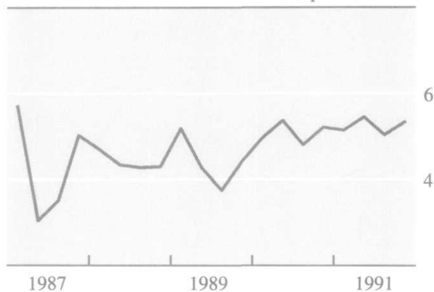
sheets. Household debt burdens rose substantially during the 1980s, when consumers stepped up spending on motor vehicles and other consumer durables; often, these purchases were financed with credit. In some parts of the nation, this spending boom spread to residential real estate as well; the associated borrowing, which was often predicated on expectations of rapidly rising family incomes, added further to the financing burdens of households. As income growth weakened in 1990 and 1991, consumers struggled to meet the monthly obligations on their accumulated debt, and they apparently deferred some discretionary spending in the process.

Renewed pessimism on the part of households also may have contributed to their reluctance to step up spending over the latter part of 1991. Consumer confidence, which was quite low at the beginning of the year, rose markedly upon the conclusion of the Gulf war. However, as the anticipated recovery in the economy failed to materialize and as announcements of layoffs resumed, confidence turned down again, falling especially sharply toward the end of the year. Concerns about longer-run economic prospects seemed to be contributing to this heightened sense of anxiety among households.

Households' real outlays for residential investment declined in the first quarter, then rose over the remainder of the year. Impetus for this rise in spending came from a reduction in mortgage rates to their lowest levels since the 1970s. Sales of new and existing single-family homes rose over the year, with the pickup in demand reportedly especially pronounced from first-time buyers. With the strengthening in demand, the excess supply of unsold new homes diminished in 1991, and after dropping sharply in January, housing starts staged a moderate recovery over the remainder of the year. The pace of single-family housing starts in the fourth quarter was up 18 percent from a year earlier.

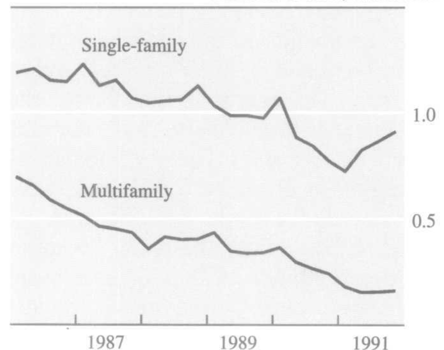
All told, however, single-family housing construction in 1991 was below that of 1990, and it was down sharply from the pace seen during the economic expansion of the 1980s. Moreover, despite the upturn in activity after January, the single-family housing market remained softer than would have been expected given the levels of mortgage rates and

Personal Saving



The data are preliminary, seasonally adjusted, and come from the Department of Commerce.

Private Housing Starts



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the rising number of consumers in their prime homebuying years. More than likely, this shortfall was a reflection of the restraint on demand exerted by weak income growth and by concerns about employment prospects. However, continued lender caution about granting loans for land acquisition and construction reportedly damped the construction of single-family housing in some locales.

In the multifamily housing market, an excess supply of vacant units and restraints on credit availability continued to depress construction in 1991. Starts of multifamily units fell about 30 percent over the year, and the annual total was the lowest since the 1950s. There were numerous reports of restrictive lending practices damping activity in this sector. But the more prominent factor retarding new construction probably was the continued excess supply. With vacancy rates for rental units exceptionally high and rents soft, the economic viability of new projects remained questionable in many areas. Under these circumstances, activity in this segment of the market seemed unlikely to show appreciable improvement in the near term.

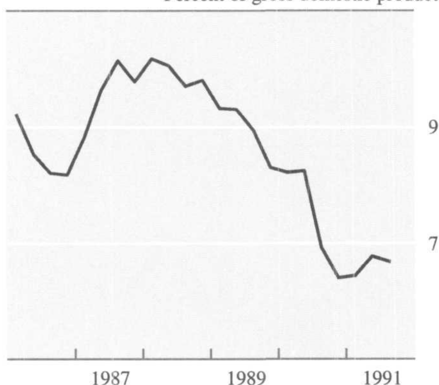
The Business Sector

At the start of 1991, businesses were striving to adjust to the cyclical contraction in demand for their products and to the surge in energy costs during the preceding half year. With profit margins down sharply and inventory imbalances emerging in a number of sectors, businesses reduced production and employment substantially between October 1990 and March 1991. Cutbacks were especially sharp in the motor vehicle sector over that period, although output of most other types of goods and materials turned down as well.

By the spring, inventories generally were better aligned with sales, and operating profits, while still low, had turned up. As a result, the improvement in aggregate demand in the second quarter was accompanied by an increase in business output, and industrial production rose, on average, 0.7 percent per month over the four-month period starting in April. Even so, businesses remained relatively cautious, and inventory levels continued to decline through midyear.

In late summer, final demand slackened, and after seven months of decline, business inventories rose appreciably from September through December. The rise in inventories was centered in wholesale and retail trade, and inventory-sales ratios in those sectors moved into ranges that appeared undesirably high in light of carrying costs and expected sales. The efforts of retailers and wholesalers to restore better inventory balance led, in turn, to cuts in manufacturing output toward the end of the year. By December, factory production had dropped back almost to its level

Corporate Profits before Taxes



Profits of nonfinancial corporations from domestic operations, with adjustments for inventory valuation and capital consumption, divided by GDP of nonfinancial corporate sector.

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of a year earlier, and the operating rate in industry was back down to near the lows of the previous spring.

Business investment in fixed capital fell 7½ percent in real terms over the four quarters of 1991. As is typical during recessions, spending was inhibited by weak profits, a rise in excess capacity, and uncertainty regarding the outlook for sales. However, investment outlays last year also were depressed by a desire of many businesses to reduce debt burdens and by a continued oversupply of office and other commercial space.

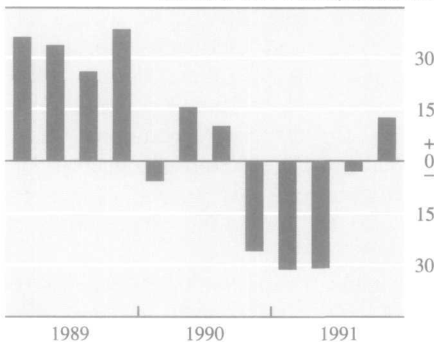
Real spending for equipment fell 4 percent over 1991; outlays plunged in the first quarter and showed only limited improvement on net over the remainder of the year. The main exception to the pattern of weakness was investment spending for computers; driven by new product introductions and by the substantial price cuts offered by computer manufacturers, these outlays rose, in real terms, at an annual rate of more than 40 percent in the second half of the year. In contrast, business investment in other types of equipment generally declined, on balance, over the course of 1991.

Outlays for industrial equipment dropped sharply in 1991 as excess capacity limited expansion in the manufacturing sector, and business purchases of motor vehicles also fell, on net. In addition, domestic orders for commercial aircraft plunged after midyear, as a number of domestic airlines trimmed investment plans. Although the large backlog of unfilled aircraft orders that still remained at year-end seemed likely to sustain production and shipments for some time, the slackening of new orders suggests that the growth surge in this sector may have run its course.

Nonresidential construction plummeted nearly 15 percent in real terms over the four quarters of 1991. The contraction was broadly based. Spending for industrial structures fell during the course of the year as low rates of capacity utilization curtailed plans for new factory construction; and petroleum drilling activity dropped sharply in response to the decline in oil prices. But the largest declines in outlays, by far, were those for office buildings and other commercial structures. Here, the fundamental problem in 1991 continued to be

Changes in Real Business Inventories

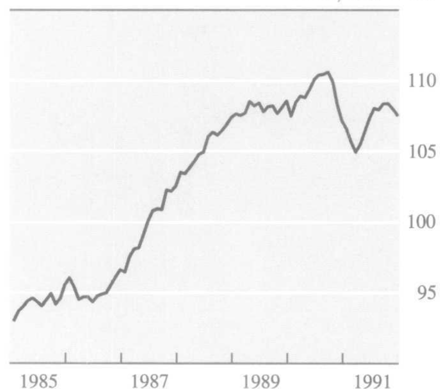
Billions of 1987 dollars, annual rate



Total nonfarm sector. The data are preliminary, seasonally adjusted, and come from the Department of Commerce.

Industrial Production

Index, 1987 = 100



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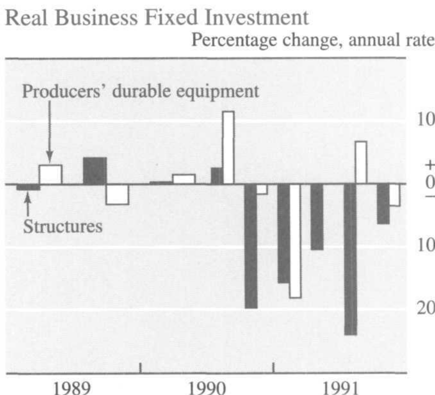
the overhang of vacant space from an earlier period of extensive overbuilding; for example, despite steep cutbacks in new construction in recent years, the vacancy rate for office buildings nationwide was still close to 20 percent at the end of the 1991.

With vacancies remaining so high, the prices of existing commercial properties weakened; the loans against those properties also lost value, a factor that contributed heavily to the substantial stress that was evident in the financial sector in 1991. Lenders, in turn, were reluctant to finance acquisitions of commercial properties; this lack of liquidity compounded the difficulties of adjustment in the commercial real estate market. In the market for office buildings, all of the indicators of construction activity remained strikingly negative at the end of 1991. For other commercial structures—primarily shopping centers and warehouses—the outlook seemed slightly less downbeat, with the data on new contracts and building permits suggesting that the steepest declines may have already occurred.

Federal banking regulators took a number of steps in 1991 to ensure that supervisory pressures would not unduly restrict real estate lending. For example, the agencies addressed issues relating to accounting and appraisal to make sure that illiquid real estate exposures were being evaluated sensibly and consistently. And they issued guidance to examiners—and simultaneously to bankers—emphasizing that banks should not be criticized for renewing loans to creditworthy borrowers whose real estate collateral had fallen in value—even when the banks need to build up capital or reduce loan concentrations over time. However, with so adverse a supply-demand imbalance in the property market, lenders understandably remained reluctant to bear the risks of real estate exposures.

Real Business Fixed Investment

Percentage change, annual rate



The data are preliminary, seasonally adjusted, and come from the Department of Commerce.

The Government Sector

Budgetary pressures were widespread in the government sector in 1991. At the federal level, the unified budget deficit increased to $269 billion in fiscal year 1991, up $48 billion from the 1990 deficit. In large part, the rise in the deficit was attributable to the slowdown in economic activity, which reduced tax receipts and added to outlays for income-support programs such as unemployment insurance and food stamps. However, as in 1990, the fiscal 1991 deficit also was affected by special factors: A pickup in net outlays for deposit insurance added to the deficit, while one-time contributions from our allies to defray the costs of Operations Desert Shield and Desert Storm reduced it. Excluding deposit insurance and these foreign contributions, the 1991 deficit totaled $246 billion.

On the revenue side, federal tax receipts rose just 2 percent in fiscal 1991, the smallest increase in many years. The slowing in receipts stemmed largely from weak growth of nominal income;

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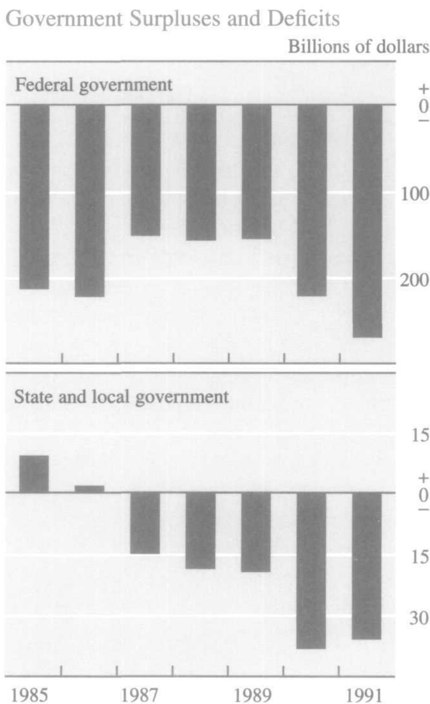
indeed, personal income tax payments in 1991, which accounted for nearly half of total receipts, were about the same as in 1990 despite changes in tax provisions that were projected to raise $16 billion in new revenues.

Meanwhile, federal spending rose nearly 6 percent in fiscal 1991. Part of this increase resulted from the slightly more rapid pace at which the Resolution Trust Corporation resolved insolvent thrift institutions. In contrast, outlays were reduced in fiscal 1991 by allied contributions to the Defense Cooperation Account. These contributions, which are scored as negative outlays in the budget accounts, exceeded the outlays made in 1991 for U.S. involvement in the conflict; the excess will be applied to the replacement of munitions in 1992 and beyond. Excluding deposit insurance and the contributions of allies, outlays rose about 9 percent in fiscal 1991. Spending for health programs continued to rise rapidly, elevated by large increases in health care costs and outlays for medicaid. Among other outlays for entitlements, those for social security and other income-support programs, which together account for one-third of total federal spending, rose more than 11 percent in fiscal 1991; the jump was related to substantial increases in the number of beneficiaries. Interest payments on the federal debt also continued to rise in fiscal 1991, but at a slower pace than in the previous fiscal year; the effect of a further big rise in the volume of federal debt outstanding was partially offset by declines in interest rates.

Government Surpluses and Deficits



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

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

Federal purchases of goods and services, the portion of federal spending that is included directly in GDP, fell 3½ percent in real terms over the four quarters of 1991. Defense purchases jumped sharply early in the year to support operations in the Persian Gulf, but declined substantially over the remainder of the year as the effects of scheduled cuts in defense outlays were augmented by a dropoff in purchases for Desert Storm; on net, real defense purchases were down about 4½ percent. In contrast, nondefense purchases changed little in 1991; increases in law enforcement, space exploration, and health research offset a drawdown in inventories held by the Commodity Credit Corporation.

The fiscal position of state and local governments, which had deteriorated sharply in 1990, remained poor in 1991. The deficit in the combined operating

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and capital accounts (excluding social insurance funds) narrowed to $34 billion in the third quarter from a high of nearly $47 billion in the fourth quarter of 1990; the shrinkage represented the first major improvement since 1984, when the state and local budget surplus peaked. Even so, relative to GDP, the deficit remained quite high on a historical basis.

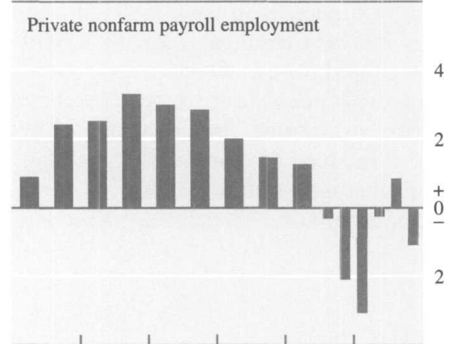
The credit quality of state and local government debt continued to deteriorate last year. For example, one rating agency downgraded the general obligation debt of eight states. Most of these rating changes were the direct result of budgetary imbalances.

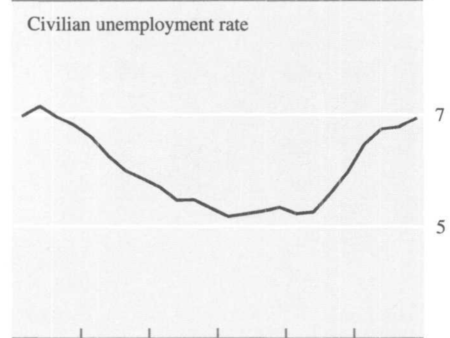
The poor fiscal position of states and localities led to both severe restraints on spending and sizable tax hikes. Overall, real purchases of goods and services by state and local governments edged down over the four quarters of 1991 after seven years of sustained increases. In nominal terms, total expenditures by these governments were up 4½ percent, only about one-half the average pace of previous years. Receipts rose an estimated 7 percent in 1991; numerous jurisdictions imposed a variety of new tax measures, and federal aid to state and local governments—especially for medicaid—increased substantially. Nonetheless, many states and localities continued to report revenue shortfalls and spending overruns, probably setting the stage for another round of budget-balancing measures.

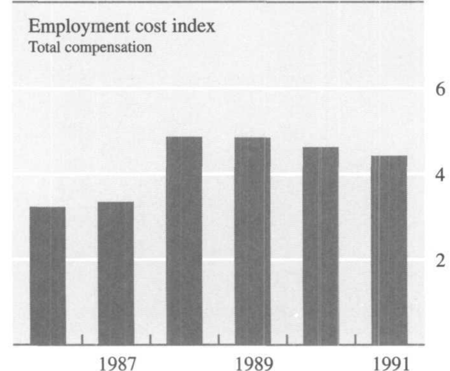
Labor Markets

Labor market conditions generally deteriorated in 1991, and the unemployment rate rose above 7 percent by the end of the year, the highest level since 1986. Employers had moved quickly to shed workers when the recession took hold during the second half of 1990, and this pattern continued into 1991, with nonfarm payroll employment down sharply

Labor Market Conditions







The employment cost index is for private industry excluding farms and households. The data are from the Department of Labor.

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over the first four months of the year. Economic conditions improved in the spring, and labor demand turned up for a time. But the subsequent weakening in activity in the late summer led to a renewed bout of layoffs that largely retraced the job gains recorded during the spring and summer. In December, payroll employment was 0.7 percent below the level of a year earlier.

The net job losses of 1991 were widespread by industry and reflected both the cyclical weakness in labor demand associated with the recession and more fundamental efforts by many businesses to restructure operations and permanently reduce the size of their work force. Employment in manufacturing, which began to decline in 1989, fell about 450,000 in 1991; most of the losses were in the durable goods sector. Construction employment also fell in 1991; the continued rapid contraction in commercial building more than offset gains associated with the moderate recovery in residential housing demand. In the finance, insurance, and real estate sector, efforts to restructure existing operations and to downsize workforce levels led to job losses in 1991—a divergence from the pattern of continued hiring in that sector during most previous recessions. Employment in trade establishments also fell substantially over the year, pushed down by the weakness in consumer spending and the high degree of financial distress among retailers. In contrast, employment in services increased, on net, over the year, as steady gains in health services more than offset sluggish hiring in the more cyclically sensitive business and personal service industries.

The unemployment rate at the end of 1991 was up nearly 2 percentage points from its level of mid-1990, when the recession had not yet begun. The distribution of job losses over that interval was especially wide when compared with experience during previous episodes of rising unemployment. Increases in unemployment were broadly based across regions, industries, and occupations, and permanent layoffs appeared to constitute an unusually large proportion of the rise in joblessness.

Nonetheless, the rise in the jobless rate was less than in most previous episodes of increasing unemployment, in large part because growth of the labor force was unusually slow. The labor force participation rate at the end of 1991 was about ½ percentage point below its average during the first half of 1990. This decline in participation appeared to stem partly from cyclical influences: The number of discouraged workers rose in 1991, and sizable increases were reported in the number of retirees, perhaps reflecting to some extent a spate of early retirement programs. However, the weak labor force growth of recent years may also represent a downshift in the trend rate of increase in labor supply that—if not offset by productivity gains—could translate into a reduction in the trend rate of growth of the economy's potential.

But at the same time, it also is possible that the recent sluggishness in labor force participation is a harbinger of more favorable longer-run developments. In particular, the number of individuals who have left the labor force in order to attend school has risen sharply in recent years. Although that increase may, to some degree, reflect declining opportunity costs associated with poor job prospects, recognition of the longer-term decline in relative wages among lower-skilled workers may also have played a role. As students reenter the labor force upon completion of their schooling, their increased skills should boost labor productivity and potential output in future years.

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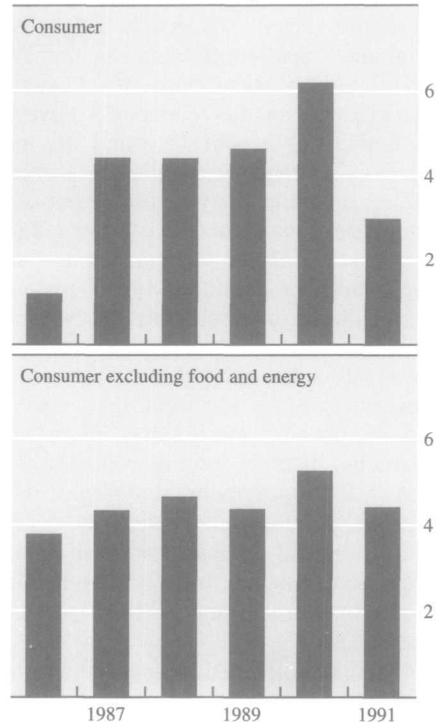
Efforts to increase labor productivity have also intensified in the business community. If the aforementioned plans to reorganize corporate structures and to downsize the labor force requirements of existing operations are successful, the possible outcome is a significant improvement in the productivity trend, much as occurred in the manufacturing sector after the considerable compression of manufacturing organizations in the early 1980s.

With layoffs widespread and the unemployment rate rising throughout the year, the upward pressures on wages that had intensified between 1987 and mid-1990 diminished somewhat in 1991. As measured by the employment cost index, the twelve-month rate of change in hourly compensation for private nonfarm workers slowed from more than 5 percent in the first half of 1990 to 4½ percent by the end of 1991. The wage and salary component of hourly compensation, which rose 3 percent at an annual rate over the second half of 1991, exhibited the most deceleration. The rate of rise in employer costs for benefits also decelerated after mid-1990, but the increases continued to be much greater than those for wages alone. Expenses for health insurance continued to soar in 1991, despite considerable effort on the part of employers to control costs by negotiating directly with providers and by increasing workers' share of health expenditures. Employer premiums for workers' compensation insurance also rose sharply last year, reflecting both a swelling in the number of claims and the rapid pace of inflation in medical care.

Price Developments

A significant slowing of inflation emerged in 1991. The consumer price index rose 3 percent over the year, after a rise of 6 percent in 1990. A sharp swing in energy prices accounted for a major part of this deceleration. However, the elements of a more fundamental diminution of inflation were in place: Labor cost increases moderated; expectations of inflation eased; and upward pressures from import prices and industrial raw material prices were virtually absent during the year.

Energy prices dropped sharply in 1991, mirroring the changes in oil prices over the year. The sequence of events in the Middle East caused the posted price of West Texas Intermediate crude oil to



Consumer prices are for all urban consumers. The data are seasonally adjusted and are from the Department of Labor.

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fall from a peak of about $39 per barrel in October 1990 to less than $20 by February 1991; as a result, the CPI for energy fell 30 percent at an annual rate in the first quarter. Oil prices subsequently held near the $20 level, but gasoline prices firmed somewhat during the summer as reduced imports and domestic refinery problems led to some tightness in inventories. However, these forces were offset by declines in natural gas and electricity rates, and energy prices changed little, on balance, in the second and third quarters. Some upward price pressures surfaced again in the fall as crude oil prices moved up in response to concerns about oil supplies from the Soviet Union. After October, however, oil prices retreated again; at year-end, prices in the spot markets were down to less than $20 per barrel.

The CPI for food rose just 2 percent over 1991, well below the increases of 5 to 5½ percent observed in the three previous years. In part, the subdued pace of food price inflation reflected an increased supply of livestock products. Beef production turned up last year in response to the strong prices that prevailed in the preceding few years, and supplies of pork and poultry rose sharply; in response, meat and poultry prices fell about 2 percent over the year. The deceleration in food prices also extended to food groups in which prices are influenced more by the cost of nonfarm inputs than by supply conditions in agriculture; for example, the increase in 1991 in the price of food away from home was the smallest since 1964. Elsewhere, there were large but temporary monthly hikes in prices for fruits and vegetables; adverse weather conditions boosted these prices for a while in the first half of the year, and prices of some fresh vegetables jumped toward the end of the year because of the whitefly infestation in California.

The consumer price index for items other than food and energy rose 4½ percent in 1991, about ¾ percentage point less than in 1990. The index was boosted early in 1991 by increases in federal excise taxes on cigarettes and alcoholic beverages and by an increase in postal rates. Price increases in early 1991 also were enlarged by the passthrough of the rise in energy prices into a wide range of nonenergy goods and services. However, the subsequent decline in energy prices soon spread to the nonenergy sector, and except for a period in the summer when there was some bunching of price increases, the remainder of the year saw a significant easing of core inflation.

Prices for nonenergy services decelerated considerably last year, rising 4½ percent after an increase of 6 percent in 1990. Reflecting weak real estate markets, rent increases slowed sharply, with both tenants' rent and owners' equivalent rent up less than 4 percent over the year. The drop in interest rates in 1991 pushed down auto financing costs more than 7 percent. And, after a brief spurt early in the year, airfares receded as energy costs fell and as the weak economy cut into demand; toward year-end, however, airfares turned up again as hard-pressed carriers sought to improve their finances. Elsewhere in the services category, the prices for medical care services rose 8 percent over the year, and tuition costs and other school fees were up nearly 10 percent.

The CPI for commodities excluding food and energy rose 4 percent in 1991, about ½ percentage point faster than in 1990. In large part, the more rapid rate of inflation in this category was a result of the aforementioned hike in excise taxes. In addition, the prices of new and used cars rose more than in 1990, despite weak sales. By contrast, a slowing in price increases was evident for a

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number of other goods, notably apparel and personal-care items.

The easing of inflationary pressures at the factory level was even more striking than at the retail level. The producer price index for finished goods edged down in 1991 after three years of increases that averaged 5 percent per year. As was true at retail, falling prices for energy and food accounted for much of the overall deceleration. But even apart from food and energy, producer prices slowed to a 3 percent pace in 1991. Prices for intermediate materials excluding food and energy fell ¾ percent over the year, reflecting declines in fuel and petroleum feedstock costs, an easing of wage pressures, and weak demand. The spot prices of industrial commodities declined gradually over most of 1991, after dropping sharply in the fourth quarter of 1990. ■

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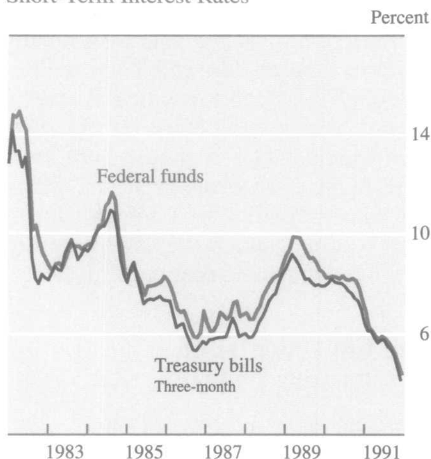
Monetary Policy and Financial Markets in 1991

The principal objective of monetary policy in 1991 was to help lay the groundwork for a sustainable expansion without sacrificing the progress against inflation that had already been set in motion. The Federal Reserve eased money market conditions during the year amid signs of continued sluggish economic activity, weak growth in the broader monetary and credit aggregates, and diminishing inflationary pressures. A more generous provision of reserves through open market operations, coupled with five separate reductions in the discount rate brought the federal funds rate and most other short-term interest rates down about 3 percentage points over the course of the year. At year-end, the discount rate stood at its lowest level in nearly thirty years, and the federal funds rate was down to 4 percent, its lowest sustained level since the 1960s. With the actions taken in 1991 building on earlier easings, the federal funds rate at year-end was also nearly 6 percentage points below its most recent peak, in the spring of 1989.

The faltering of the economic recovery in the second half of 1991 resulted in some measure from an unusually cautious approach to credit on the part of both borrowers and lenders. Efforts by debt-burdened households and businesses to pare debt in order to strengthen balance sheets that had been strained by the general slowdown in income and by declines in property values exerted further damping effects on credit demands and on aggregate spending. Faced with deteriorating asset values and pressures on capital positions, depository institutions and other lenders maintained tighter lending standards and were somewhat hesitant to extend credit. The more circumspect attitude toward credit and spending on the part of borrowers and financial intermediaries was manifest in the behavior of the aggregate debt of domestic nonfinancial sectors, which grew at a rate near the bottom of the Federal Open Market Committee's monitoring range despite burgeoning U.S. Treasury borrowing. Not only was overall credit growth subdued, but credit flows continued to be rechanneled away from depository institutions, reflecting the more restrictive lending standards at banks and thrift institutions as well as efforts by borrowers to make greater use of longer-term debt and equity in order to strengthen their balance sheets. Partly as a result, the

Short-Term Interest Rates



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 coupon-equivalent basis and is from the Department of the Treasury.

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monetary aggregates M2 and M3 also finished the year near the bottoms of their target ranges.

To prevent these forces from stifling the recovery, the Federal Reserve eased money market conditions aggressively in the latter part of the year. In light of weak aggregate demand and reduced inflationary potential, long-term interest rates—which had largely failed to respond to monetary easings earlier in the year—came down substantially toward the end of 1991. This decline prompted a flood of mortgage refinancings and additional corporate and municipal bond offerings, which helped reduce the financing burdens of nonfederal sectors. Lower interest rates also contributed to a major stock market rally, which induced firms to boost equity issuance and pay down debt, partially reversing the trend of the 1980s toward increased leverage that had severely stretched corporate balance sheets.

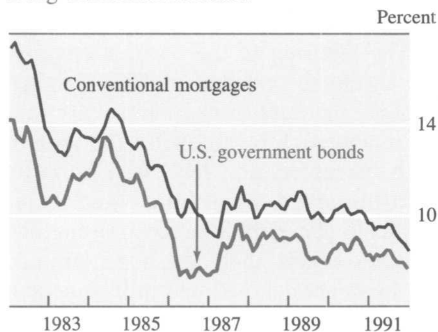
On the whole, the nation made considerable progress in strengthening its balance sheet in 1991. Less reliance on debt, greater use of equity, and lower financing costs have helped ease debt-servicing burdens for many financially troubled households and corporations. Although the trend toward deleveraging exerted a restraining effect on aggregate spending in 1991, it should help, over time, to put consumers, firms, and financial intermediaries on a sounder financial footing and pave the way for healthy, sustainable economic growth.

The Implementation of Monetary Policy

The Federal Reserve eased money market conditions several times in the first few months of 1991, extending the series of easing moves initiated in the latter stages of 1990. Against a backdrop of further declines in economic activity, abating price pressures, and continuing credit restraint by banks and other financial intermediaries, a more expansive open market posture was adopted in conjunction with two ½ percentage point reductions in the discount rate. The easing engendered a decline of 125 basis points in the federal funds rate over the first four months of the year. Short-term Treasury rates generally followed suit, and banks reduced the prime rate, in three increments of 50 basis points each, to 8½ percent.

Long-term interest rates, by contrast, were roughly unchanged on balance over the first few months of the year. At first, these rates fell somewhat in response to the continued downturn in economic activity and declining energy prices, especially in light of initial successes in the Gulf war that ensured an unimpeded flow of oil. Success in the initial phases of the war also prompted a brief dip in the exchange value of the dollar, as safe-haven demands that had been propping up the dollar's value in

Long-Term Interest Rates



The data are monthly averages.

The rate for conventional mortgages is the weighted average for thirty-year fixed-rate mortgages with level payments at major financial institutions and is from the Federal Home Loan Mortgage Corporation.

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

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the face of falling interest rates in the United States dissipated.

In March, bond yields drifted up on the post-war rebound in consumer confidence and on other evidence, particularly from the housing industry, that an economic upturn was at hand. The improving outlook for recovery also con-

Reserves, Money Stock, and Debt Aggregates

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

Item	1988	1989	1990	1991				
				Year	Q1	Q2	Q3	Q4
Depository institution reserves[2]								
Total	2.7	-.4	2.2	8.9	9.1	3.0	7.4	15.3
Nonborrowed	2.3	-.1	2.3	9.2	9.1	3.6	5.6	17.6
Required	2.6	-.1	1.8	9.5	4.5	8.9	7.9	15.5
Monetary base[3]	7.1	3.9	9.3	8.3	13.3	4.2	6.6	8.4
Concepts of money[4]								
M1	4.3	.6	4.2	8.0	5.3	7.4	7.5	11.0
Currency and travelers checks	8.1	4.6	11.1	8.0	13.2	3.8	6.4	7.7
Demand deposits	-1.3	-2.9	-.6	3.4	-3.8	4.8	2.6	10.0
Other checkable deposits	7.6	1.0	3.5	12.4	7.0	12.8	12.9	15.0
M2	5.2	4.8	4.0	2.9	3.7	4.4	.8	2.6
Non-M1 components	5.6	6.2	3.7	1.4	3.2	3.3	-1.1	.7
MMDAs, savings, and small-denomimation time deposits	5.8	3.9	2.8	1.0	2.4	3.0	-.2	-1.0
General-purpose and broker–dealer money market mutual fund assets	8.2	30.6	11.2	4.4	16.9	7.5	-3.6	-3.2
Overnight RPs and Eurodollars (n.s.a.)	-5.3	-8.5	3.4	-7.5	-41.8	-10.6	-14.6	40.3
M3	6.4	3.6	1.7	1.3	3.4	1.8	-1.2	1.2
Non-M2 components	10.8	-.9	-7.2	-5.5	2.0	-9.7	-9.8	-4.9
Large-denomination time deposits	11.7	4.3	-10.6	-11.7	-4.5	-10.6	-15.0	-18.9
Institution-only money market mutual fund assets	.5	17.8	21.8	33.4	43.0	28.9	11.4	37.0
Term RPs (n.s.a.)	14.7	-13.3	-12.4	-21.6	-31.2	-27.8	-11.5	-23.6
Term Eurodollars (n.s.a.)	11.0	-23.2	-13.7	-9.9	6.3	-35.3	-2.5	-8.3
Domestic nonfinancial sector debt	9.4	8.2	7.0	4.5	4.4	4.2	4.7	4.3
Federal	7.9	7.3	10.3	11.2	10.4	6.8	13.9	12.2
Nonfederal	9.9	8.5	6.1	2.4	2.6	3.4	1.9	1.7

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 without required reserve balances, the excess of current vault cash over the amount applied to satisfy current reserve requirements.

4. M1 consists of currency in circulation excluding vault cash; 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 thrift institutions net of money fund holdings; and overnight Eurodollars issued to U.S. residents by foreign branches of U.S. banks worldwide net of money fund holdings. M3 is M2 plus large-denomination time deposits at all depository institutions other than those due to money stock issuers; assets of institution-only money market mutual funds; wholesale term RPs issued by commercial banks and thrift institutions net of money fund holdings; and term Eurodollars held by U.S. residents in Canada and the United Kingdom and at foreign branches of U.S. banks elsewhere net of money fund holdings.

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tributed to a narrowing of risk premiums on private securities, especially on below-investment-grade issues; the premiums had reached high levels in January. The debt and equity instruments of banks performed especially well over this period, responding to lower short-term interest rates and the likelihood that an economic rebound would help limit the deterioration in their loan portfolios. The dollar's slide in foreign exchange markets was reversed by moderate official support for the dollar, better prospects for a U.S. economic recovery, a rise in U.S. long-term interest rates relative to those abroad, and concerns about an uncertain economic and political situation overseas, especially in the Soviet Union.

As evidence of a nascent economic recovery cumulated through the remainder of the spring and into early summer, interest rates and the dollar continued to firm, and quality spreads narrowed further. Although the increases in rates during this period were most pronounced at the long end of the maturity spectrum, short-term rates backed up a bit as well, as prospects for additional monetary easings faded. Indeed, with the pace of economic activity apparently quickening, and with the broader monetary aggregates near the middle of their target ranges, the Federal Reserve held money market conditions steady—the stimulus in train seemed sufficient to support an upturn in aggregate spending.

As the summer passed, however, the strength and durability of the recovery appeared less assured. Aggregate spending, production, and employment began to falter, easing wage and price pressures. In addition, the broader monetary aggregates suddenly weakened dramatically, with M2 coming to a virtual standstill and M3 actually declining in the third quarter. The softness in the aggregates was symptomatic of a warier approach to spending and borrowing on the part of households and corporations, whose balance sheet problems were exacerbated by the stagnant economy. In addition, credit standards at financial intermediaries remained restrictive, and spreads between loan and deposit rates remained high by historical standards, reinforcing households' inclinations to pay down debt rather than to accumulate assets.

To help ensure that these forces did not imperil the recovery, the Federal Reserve moved to ease money market conditions further. Pressures on reserve positions were reduced slightly in August and again in September, with the latter move accompanied by a reduction of 50 basis points in the discount rate. With the economic climate remaining stagnant, price pressures subdued, and the broader monetary aggregates still mired near the bottoms of their target ranges, the System's easing moves became more aggressive in the fourth quarter, culminating in a reduction of 1 percentage point in the discount rate on December 20. All told, these moves combined to drive the federal funds rate down from 5¾ percent in July to 4 percent by year-end. Most other short-term market interest rates declined by similar magnitudes, and the prime rate was reduced by 2 percentage points, to 6½ percent.

The decline in short-term interest rates, in combination with flagging economic activity, prospects for lower inflation, and depressed credit demands, contributed to bringing long-term interest rates down significantly in the latter part of 1991. The rate for the thirty-year Treasury bond dropped about 1 percentage point over the second half of the year, and mortgage interest rates tumbled to their lowest levels in many years. Declining interest rates prompted a spate of mortgage refinancings, corporate and

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municipal bond offerings, and a major stock market rally, which propelled most indexes to record highs. Although monetary growth bounced back a bit in the fourth quarter, both M2 and M3 remained near the lower ends of their respective growth cones. The dollar, which had begun to lose ground in foreign exchange markets in the summer—when the weakness in money and credit raised the specter of additional easings of U.S. monetary policy—depreciated further in the fourth quarter as the economic situation deteriorated and as the pace of policy easings quickened. Rising interest rates in Germany also put downward pressure on the foreign exchange value of the dollar.

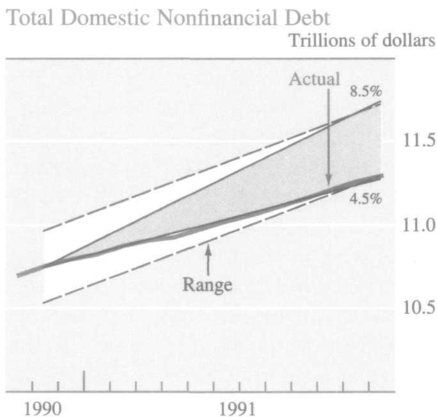
Monetary and Credit Flows

Patterns of credit usage and financial intermediation, which began to shift even before the onset of the economic downturn, continued to evolve in 1991, distorting traditional relationships between overall economic activity and the monetary and credit aggregates.

These changes were evident in the behavior of the aggregate debt of nonfinancial sectors, which expanded 4½ percent in 1991, leaving this aggregate at the bottom of its monitoring range. Robust growth in federal government debt, owing to the economic downturn and to additional outlays for federal deposit insurance, masked an even weaker picture for nonfederal debt. Households, nonfinancial corporations, and state and local governments accumulated debt at an anemic 2½ percent rate in 1991, the slowest advance in decades and smaller even than the sluggish growth rate of nominal GDP.

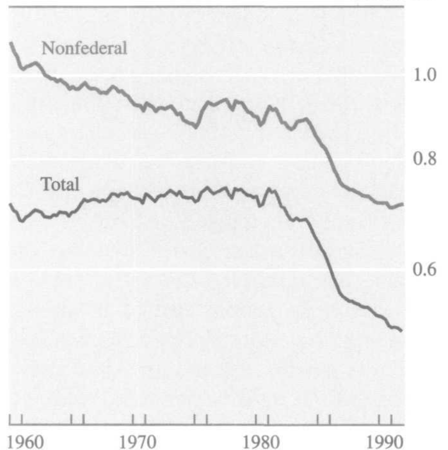
The small rise in nonfederal debt velocity in 1991 ran counter to the pattern seen in the 1980s, when the accumulation of debt vastly outstripped growth in nominal GDP. The rapid buildup of debt in the 1980s was likely a result of the deregulation of interest rates and the emergence of various financial innovations; these changes

Total Domestic Nonfinancial Debt



The range was adopted by the FOMC for the period from 1990:4 to 1991:4.

Velocity of Domestic Nonfinancial Debt



The velocity of debt is the ratio of gross domestic product, measured in current dollars, to the stock of debt. The data are quarterly averages.

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combined to lower the cost of borrowing to households and businesses and spawned a surge in leveraging activity. Greater debt burdens may also have been accumulated under the assumption that the growth of nominal income would be sustained at the elevated pace of the mid-1980s and that the prices of assets purchased with credit would continue to climb.

In recent years, however, asset values and income growth have fallen short of these expectations. In particular, depressed commercial and residential real estate values, coupled with slower income growth, have eroded the net worth of some borrowers and have severely strained the ability of highly leveraged households and corporations to service debt. These difficulties, in turn, have affected the strength of the financial intermediaries that extended the credit. In an effort to bolster depleted capital positions, reduce financing burdens, and shore up weakened balance sheets, both borrowers and lenders have adopted a more chary attitude toward additional credit.

The more cautious approach to leverage has interacted with the sluggish pace of economic activity to restrain borrowing across nearly all sectors of the economy. Nonfinancial business sector debt, held in check by the decline in financing needs associated with weak aggregate demand and by efforts of debt-laden firms to restructure their balance sheets, was virtually unchanged in 1991.

Taking advantage of a buoyant stock market, particularly in the latter part of the year, corporations turned to equity financing; net equity issuance for the year was positive for the first time since 1983, and the ratio of the book value of nonfinancial corporate debt to equity, which had soared in the 1980s amid a flurry of corporate restructurings, actually turned down in 1991. Firms also took advantage of lower interest rates to refinance higher-rate long-term bonds and to reduce uncertainty about their future financing burdens by substituting long-term debt for short-term borrowing.

Overall, the mixture of less debt, more equity, and lower interest rates had a salubrious effect on the financial positions of many firms. Indeed, the ratio of interest payments to cash flow for all nonfinancial firms declined in 1991, reversing some of the run-up seen in the late 1980s. In keeping with an improving financial picture and prospects of an economic rebound, quality spreads on corporate issues narrowed considerably from their peaks in early 1991, especially on below-investment-grade securities. In addition, downgradings of corporate bonds dropped sharply in the third and fourth quarters, although they still ran higher than the pace of upgrades.

Deleveraging was also evident in the household sector in 1991. Consumer credit declined as households reined in expenditures, curbed their accumulation of financial assets, and pared existing debt burdens. Households took advantage of declining interest rates, particularly in the fourth quarter, by refinancing outstanding mortgages; they also substituted home equity loans for installment debt and other consumer credit that carried higher financing costs and was no longer tax deductible. By reducing their net accumulation of debt and refinancing a substantial volume of their remaining borrowings at lower rates, households were able to ease their financing burdens; the ratio of scheduled debt payments to disposable personal income turned down, reversing a little of the sharp rise seen in that ratio in the 1980s. Even so, loan delinquency rates rose through much of 1991, albeit to levels not out of line with what was seen in

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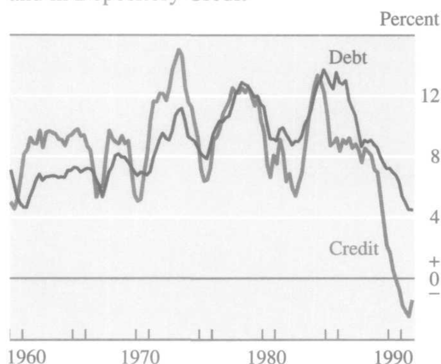
previous cyclical downturns. On the other side of the ledger, many households with net creditor positions saw their interest incomes decline last year.

Faced with intensifying budgetary pressures and numerous downgradings, state and local governments also put only limited net demands on credit markets in 1991. The outstanding debt of this sector grew only 3 percent over the year, the smallest increase in more than a decade. Gross issuance of municipal bonds was substantial, however, as states and localities moved to refinance debt at lower rates.

Efforts by borrowers to restructure balance sheets by substituting long-term debt and equity for short-term debt have affected the channels through which debt flows; these channels also have been altered by the more restrictive credit standards of some lenders and the closing and shrinkage of troubled thrift institutions. Of these changes, the most notable was a major rerouting of credit flows away from depository institutions. The decline in recent years in the importance of depository institutions, when measured by the credit they book relative to the total debt of nonfinancial sectors, has been striking, and the trend was extended in 1991. The thrift industry continued to contract as the direct result of Resolution Trust Corporation (RTC) resolutions as well as the retrenchment of marginally capitalized institutions. In addition, commercial banks cut back on their net credit extensions. The rise in bank credit over the year was about 4 percent, not even enough to offset the continued runoff at thrift institutions. Weakness was particularly evident in bank lending, which shrank ¼ percent last year; banks' holdings of government securities, by contrast, expanded at a rapid clip.

Changes in Debt of
the Domestic Nonfinancial Sector
and in Depository Credit



Domestic nonfinancial debt covers borrowing by households, farm businesses, nonfarm noncorporate businesses, corporate nonfinancial businesses, state and local governments, and the federal government.

Depository credit is the sum of credit market funds advanced by savings institutions and commercial banks.

The percentage changes are four-quarter moving averages. They are calculated by first subtracting the level at the end of the previous quarter from the level at the end of a given quarter (flow) and dividing by the level at the end of the previous quarter. The quarterly percentage rates are then used in computing four-quarter moving averages.

Although the shifting composition of bank asset flows in 1991 was reminiscent of patterns seen in previous periods of languid economic activity, the magnitude of the downturn in loan growth was more pronounced than the usual experience. Apparently, loan growth was depressed not only by reduced credit demands but by a more restrained bank lending posture as well. Faced with deterioration in the quality of their assets, higher deposit insurance premiums, and more stringent requirements for capital, banks retrenched, adopting a more cautious attitude regarding credit extensions. Concerns about capital, especially in light of rising loan delinquency rates and mounting loan loss provisions, induced many banks to continue tightening lending standards through the early part of 1991 and to maintain fairly restrictive standards over the balance of the year.

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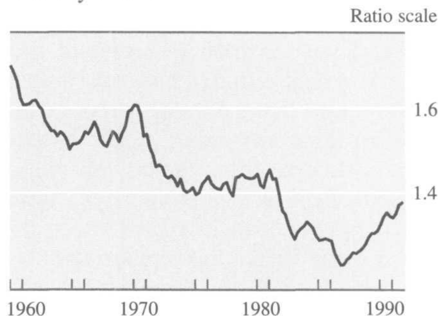
A more prudent approach to capitalization and lending decisions was, in the main, a positive development that ultimately will result in strengthened balance sheets for the nation's depository institutions. Reflecting this improved outlook, prices of outstanding bank debt and equity increased markedly from their lows in late 1990 and early 1991 and outperformed broader market indexes. Bank profits, benefitting from wide spreads between loan rates and deposit rates, also showed improvement relative to the depressed levels of recent years. However, profits remained low by broader historical standards.

Depository retrenchment appears to have had some restraining effects on aggregate borrowing in 1991. Of course, in some areas, much of the credit formerly extended by banks and thrift institutions was supplanted by supplies from other intermediaries and by credit advanced directly through securities markets, at little if any additional cost to borrowers. For example, growing markets for securitized loans largely filled the vacuum created by depository restraint in the areas of residential mortgage and consumer lending. Similarly, many large businesses turned to stock and bond markets to meet credit needs and to restructure balance sheets, reducing their reliance on banks as well. Both banks and thrift institutions, however, have cut back on other types of lending that can be rechanneled less easily; these types included construction and nonresidential real estate loans, loans to highly leveraged and lower-rated borrowers, and loans to small and medium-sized businesses. Other financial intermediaries, including life insurance companies, were afflicted by some of the same balance sheet problems plaguing depository institutions and also curbed their lending to these sectors. As a result of the pullback in credit supplies, these borrowers faced somewhat more stringent borrowing terms than they would have otherwise.

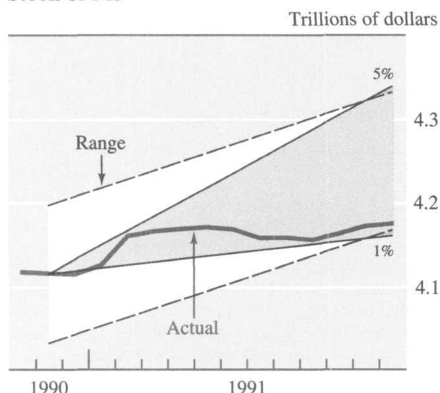
In 1991, as in 1990, the retrenchment of banks and thrift institutions and the associated redirection of credit flows away from depository institutions had profound effects on the broad monetary aggregates and their traditional relationships with aggregate economic activity. M3, which comprises most of the liabilities used by banks and thrift institutions

Velocity of M3



The velocity of M3 is the ratio of gross domestic product, measured in current dollars, to the stock of M3. The data are quarterly averages.

Stock of M3



The range was adopted by the FOMC for the period 1990:4 to 1991:4.

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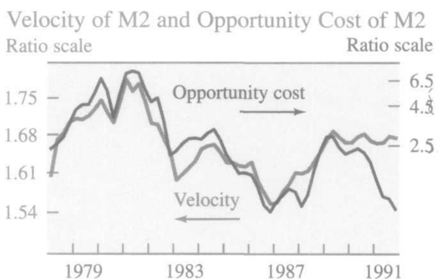
to fund credit expansion, was the aggregate most affected by the reduced importance of depository credit in funding spending. The velocity of M3, which declined through much of the 1980s, has more recently been on an uptrend that continued in 1991. M3 rose only 1¼ percent over the year, a rate of growth that was well below that of nominal GDP and near the bottom of the M3 target range.

In the first few months of the year, M3 showed surprising strength, boosted in part by a firming of its M2 component, which benefited from declining interest rates. The most important single factor contributing to strong M3 growth in the early part of 1991, however, was the rebirth of the market for certificates of deposit called Yankee CDs—large time deposits issued by foreign banks in the United States. After the 3 percent reserve requirement against nonpersonal time deposits and net Euroborrowings was lifted at the end of 1990, foreign banks showed a distinct preference for funding with such instruments rather than borrowing from their overseas affiliates or in the federal funds or RP markets. By contrast, domestic depository institutions were faced with high and rising U.S. deposit insurance premiums and exhibited no inclination to alter their funding strategies in favor of large time deposits.

The surge in issuance of Yankee CDs, which totaled nearly $40 billion over the first quarter, began to taper off a bit as the year progressed, revealing the underlying weakness in M3. After slowing somewhat in the second quarter, this aggregate contracted at an annual rate of 1¼ percent in the third quarter, reflecting feeble loan demand in a tepid economy as well as the restructuring of depository institutions. The RTC played a direct role in damping M3 growth by taking assets formerly held by thrift institutions and funded with M3 deposits onto its own books and financing them with Treasury securities. Although M3 rebounded a bit in the fourth quarter, in line with some firming of bank credit, its growth remained subdued.

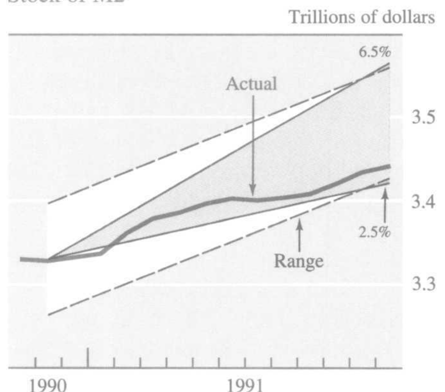
The effects of depository restructuring on M2 remained imperfectly understood at the end of 1991. In the past, the velocity of M2 had tended to move in tandem with changes in a simple measure of the opportunity cost of holding this aggregate—in tandem, that is, with

Velocity of M2 and Opportunity Cost of M2



The velocity of M2 is the ratio of gross domestic product, measured in current dollars, to the stock of M2. The opportunity cost of M2 is a two-quarter moving average of the three-month Treasury bill rate less the weighted average return on assets included in M2.

Stock of M2



The range was adopted by the FOMC for the period from 1990:4 to 1991:4.

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changes in the returns on alternative short-term investments relative to those available on assets included in M2. Typically, when the opportunity cost of holding M2 declined as decreases in money market interest rates outpaced drops in yields on deposits, holdings of M2 would strengthen relative to expenditures—and the velocity of M2 would drop.

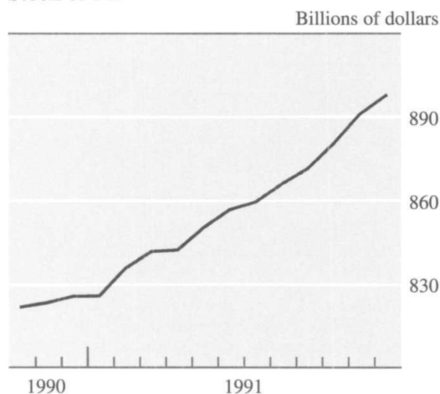
In recent years, however, this relationship appears to have broken down, with the velocity of M2 holding up despite a steep, persistent drop in this measure of its opportunity cost. The breakdown was particularly evident in 1991, when M2 expanded a bit less than nominal GDP despite a significant decline in measured opportunity costs. M2 finished the year near the bottom of its target range; its rise was much weaker than would have been expected on the basis of historical relationships among income, interest rates, and the public's appetite for monetary assets.

In the early months of 1991, M2 growth accelerated somewhat from its lackluster pace of late 1990. Narrowing opportunity costs generated substantial inflows to liquid deposits, particularly those in M1, and these inflows more than offset continued runoffs in small CDs. Money growth also was temporarily boosted by strong foreign demands for U.S. currency as a safe haven during the crisis in the Persian Gulf. Through May, growth of M2 remained broadly consistent with changes in income and opportunity costs and left the aggregate near the middle of its target range.

M2 began to slow in June, however, and it stalled in the third quarter despite expansion in nominal income and further declines in M2 opportunity costs. Growth of M2 then resumed in the fourth quarter because of additional declines in opportunity costs and the resulting surge in transactions deposits. But even so, the overall inflows to M2 remained fairly weak, and the aggregate ended the year only a little above the bottom of its target range.

Although the unusual behavior of M2 relative to income and opportunity costs is not fully understood, it surely was related to the restructuring of financial flows and to the downsizing of the banking system. With inflows of M2 deposits apparently tending to be more than sufficient to fund weak depository credit growth, banks and thrift institutions seem to have pursued additional retail deposits less aggressively than in the past. Although rates offered on these deposits did not, until very late, fall unusually rapidly in response to declining market interest rates, depository institutions seem to have acted in other ways to reduce the cost of funds, including adjustments in advertising and marketing strategies that would not show up in traditional measures of opportunity costs. In addition, by keeping deposit rates low relative to loan rates, partly in an attempt to bolster profit margins while shrinking their balance sheets, depository institutions provided households with a greater incentive to finance

Stock of M1



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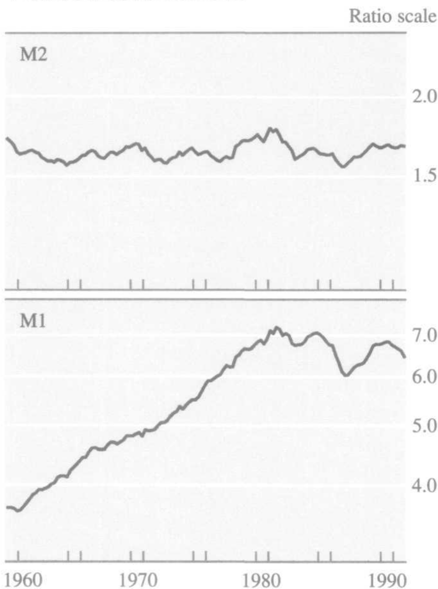
spending by holding down the accumulation of M2 assets rather than by taking on new debt. This incentive likely reinforced the impetus to borrowing restraint stemming from household concerns about their own balance sheets.

The slowdown in M2 growth, particularly in the third quarter of 1991, also appears to have been related to the configuration of returns on financial assets. Yields on small time deposits and money market mutual funds largely tracked the downward path of market interest rates, falling to their lowest levels since the deregulation of deposit rates and prompting significant outflows from these components of M2. Although some of these funds shifted into the liquid deposit components of M2—whose offering rates responded slowly, as they normally do, to the declines in market interest rates—a portion of these funds appear to have left the aggregate. The primary lure seems to have been the stock and bond markets, which offered higher returns, in part because of the steep upward slope of the yield curve. Indeed, inflows to stock and bond mutual funds were robust throughout 1991, especially after midyear, when investors seemed particularly intent on reaching for higher yields by lengthening the maturity of their portfolios. Depository institutions, faced with weak loan demand and pressures on capital positions, seemed disinclined to compete aggressively for these funds by offering competitive rates on longer-term CDs.

Velocities of M2 and M1



The velocity of the monetary aggregate is the ratio of gross domestic product, measured in current dollars, to the stock of the aggregate. The data are quarterly averages.

The rapid pace of activity by the Resolution Trust Corporation also likely depressed M2 growth in the third quarter of 1991, as it did throughout the year. The abrogation of existing retail CD contracts and the disruption of long-standing depositor relationships often attending resolutions of failed thrift institutions may have encouraged investors to reshape their portfolios, substituting nonmonetary financial assets for M2 deposits.

Despite sluggish income growth, M1 expanded 8 percent in 1991, the swiftest advance since 1986. Unlike M2, this aggregate responded to declining market interest rates about as expected given historical relationships. M1 was boosted by large inflows to NOW accounts, whose offering rates responded very slowly, until the end of the year, to declining market interest rates. Falling rates also brought new life to demand deposits, as compensating balances to pay for bank services surged. Demand deposits likely benefited as well from the pickup in mortgage refinancings, because the proceeds from mortgage prepayments are sometimes housed temporarily in demand accounts. Rapid growth in currency, derived in part from

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continued strong foreign demands, also contributed to the strength in M1, as well as in the monetary base, which increased 8¼ percent last year. ■

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International Developments

Economic growth in the major foreign industrial economies slowed further last year. From 1990 to 1991, real GDP in the foreign G-10 countries on average increased about 1½ percent (fourth quarter to fourth quarter, GNP weights), compared with 2½ percent in 1990.[1] Canada and the United Kingdom, both important U.S. trading partners, began 1991 in recession. The recession continued essentially unabated in the United Kingdom; in Canada, as in the United States, signs of a rebound appeared in the second quarter, but growth ceased again during the second half. Growth in Japan and Germany was strong early in the year; in the second half, growth slowed sharply in Japan and was negative in Germany.

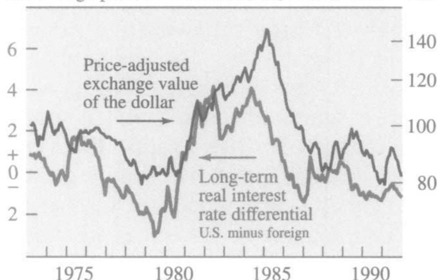
Economic growth among developing countries was very uneven, with output declining in the Middle East and picking up in Latin America. Mexico again enjoyed solid growth, at about 4 percent. Growth in the newly industrialized economies of Southeast Asia remained strong or increased.

The U.S. current account was near balance in 1991, reflecting $42 billion in grants from foreign governments related to the Persian Gulf war. Even apart from these unilateral transfers, however, the U.S. trade and current account deficits showed substantial reductions. U.S. merchandise exports continued to grow strongly, as did exports of services. Net interest payments to foreigners on portfolio investments were restrained by the substantial further decline in U.S. interest rates during the year.

The dollar appreciated, on balance, 2¾ percent in 1991 (December to De-

1. The Group of 10 consists of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States plus Switzerland.

Exchange Value of the Dollar
and Interest Rate Differential

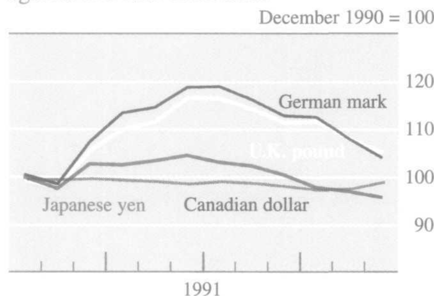


The exchange value of the U.S. dollar is its weighted average exchange value against currencies of other Group of 10 (G-10) countries using 1972–76 total trade weights adjusted by relative consumer prices.

The interest rate 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 thirty-six-month moving average of actual consumer price inflation or by staff forecasts where needed.

The data are monthly.

Exchange Value of the Dollar
against Selected Currencies



Foreign currency units per dollar. The data are monthly.

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cember) against the trade-weighted average of the foreign G-10 currencies. Adjusted for changes in relative consumer price levels, the dollar's appreciation was somewhat less, as consumer price inflation in the foreign G-10 countries exceeded that in the United States by about 1¼ percentage points.

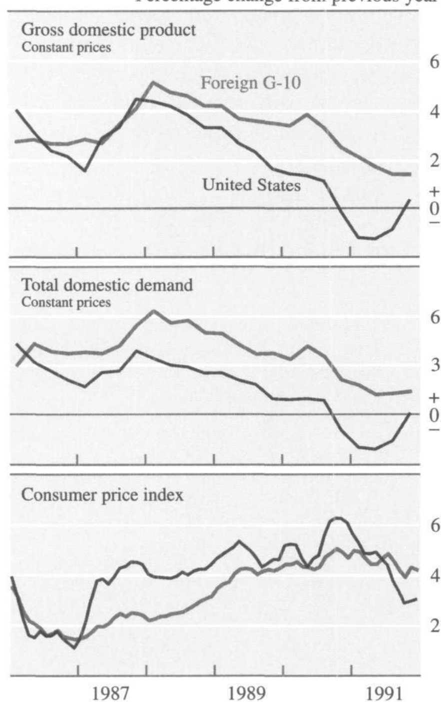
The dollar rose steeply from mid-February through early July, particularly against the German mark and its partner currencies in the European Monetary System. The dollar was buoyed by the allied victory in the war against Iraq and by expectations that the decline in oil prices and a resurgence of consumer confidence would lead to a quick U.S. economic recovery. Depressing the mark were the disillusionment over the heavy costs of German reunification, a perception that Bundesbank monetary policy was lagging the increase in inflationary pressures in Germany, and the increasing turmoil in the Soviet Union.

After mid-year, however, the dollar reversed course as evidence accumulated that the U.S. recovery was faltering and as U.S. monetary policy eased. The mark was strengthened by the Bundesbank's tightening of monetary policy and by the nonviolent breakup of the Soviet Union following the failure of the August coup. By year-end the dollar had retraced nearly all of its earlier rise against the mark; and it more than retraced its rise against the yen, which was supported by Japan's growing trade and current account surpluses. Net intervention in the exchange markets by fifteen major foreign central banks amounted to sales of nearly $12 billion. U.S. monetary authorities purchased, net, about $750 million in the market; purchases in early February to support the dollar exceeded sales in March, May, and July to moderate the dollar's rise. U.S. authorities purchased an additional $8¾ billion directly from foreign monetary authorities to reduce U.S. reserve balances of foreign currencies.

Foreign Economies

Economic growth in the major foreign industrial economies continued to slow last year from the rapid rates posted in the late 1980s. To some extent, deceleration was an ongoing response to tighter monetary policies, introduced earlier,

GDP, Demand, and Prices



Foreign data are weighted averages for the foreign G-10 countries using 1987–89 GNP-based purchasing-power-parity weights, and are from foreign official sources.

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

For GDP and domestic demand, the data are quarterly; for consumer prices, the data are monthly.

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which were designed to counter inflationary pressures and bring economic activity to more sustainable, noninflationary levels. Declines in business confidence, the need for households and businesses to reduce high levels of debt, and concerns about financial fragility in some countries also negatively affected demand. Growth rates among the major industrial countries varied. Pronounced recessions in Canada and the United Kingdom that began in 1990 extended into 1991 with only tentative signs of recovery after mid-year. Economic activity in Japan and Germany remained comparatively strong, although growth slowed during the year in those countries too. And the economic performances of France and Italy were sluggish.

Slower growth meant that output in most major industrial countries (with the possible exceptions of Germany and Japan) was below potential by year-end. Accordingly, inflation continued to moderate during the year, with average CPI inflation in the foreign G-10 countries subsiding by almost ¾ percentage point (Q4 to Q4), to near 4 percent. Particularly large reductions in inflation were evident in Canada and the United Kingdom; France and Japan also experienced significant reductions. Lower oil prices and the weakening of the dollar after midyear contributed to reduced upward pressure on prices abroad.

Labor-market developments last year also reflected the general slowdown and differences in cyclical positions. Unemployment rates moved up more than 2 percentage points in the United Kingdom and Canada, while unemployment rates remained high in France and Italy. In contrast, labor-market conditions continued to be fairly tight in Japan despite decelerating economic activity. The unemployment rate in western Germany fell almost ¾ percentage point in 1991, while employment conditions appeared to stabilize in eastern Germany.

Money market conditions eased during the past year in several key countries—including Canada, Japan, and the United Kingdom—as slower growth and lower inflation allowed authorities to reduce short-term interest rates. Japanese short-term rates declined 225 basis points, and the official discount rate was cut by a total of 1½ percentage points after midyear, in three increments. Short-term rates in the United Kingdom fell about 300 basis points during the year, while those in Canada dropped almost 450 basis points, thereby narrowing the spread against comparable U.S. maturities. In contrast, monetary conditions tightened in Germany as authorities remained concerned about inflationary pressures (arising in part from substantial expansion of budgetary expenditures for unification), and German short-term interest rates edged up during the year. Increases in official German interest rates (in February, August, and December) tended to intensify exchange rate pressures against the currencies of Germany's EMS partner countries, thereby limiting their scope for easing monetary conditions. Growth of the major monetary aggregates abroad generally slowed or remained sluggish. The chief exceptions to this pattern were in Germany and Italy.

On average, long-term interest rates abroad declined nearly 1 percentage point, reflecting slower economic growth, lower inflation, and in some cases, an easing of monetary policy. Particularly large declines occurred in Canada and France, but even in Germany long-term rates eased, by more than 50 basis points.

In 1991 the combined current account surplus of the foreign G-10 countries narrowed by about $22 billion to a small

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deficit. (About $12 billion of the change was from net transfer payments related to the war against Iraq.) The narrowing of the combined deficit occurred despite a $40 billion widening of Japan's current account surplus. Slower growth of domestic demand, reduced oil payments, and favorable price effects from earlier strength of the yen contributed to the larger Japanese surplus. In contrast, the combined German current account position deteriorated by more than $65 billion to a deficit of $20 billion, reflecting the effects of increased demand following unification and the relative strength of the western German economy. Increased German demand for imports contributed to moderate improvements in external positions for some of Germany's main trading partners.

The combined current account position of developing countries moved from near balance in 1990 to a deficit of about $80 billion in 1991. The dramatic shift from surplus to deficit in the current account of oil exporters accounted for most of the overall decline. However, the slowdown in domestic demand in the industrial countries led to slower export growth in many other developing countries and a decline in their current account balances. Economic growth was uneven across regions of the developing world in 1991; output fell in the Middle East, while activity picked up in the Western Hemisphere after declines in the previous year.

The current account of the group of fourteen heavily indebted developing countries shifted, from near balance in 1990 to a deficit of about $19 billion in 1991. Most of this shift occurred for the oil exporting countries of the group, especially Mexico and Venezuela. Investment booms, however, also contributed to higher imports in these two countries. Economic activity in the heavily indebted countries picked up in 1991, especially in the larger countries. Mexico's growth was again about 4 percent, while output in Argentina and Brazil expanded somewhat, after declines in 1990.

The combined current account surplus of the newly industrializing economies of Asia nearly halved in 1991, to about $8 billion. The decline in the overall position was more than accounted for by a large increase in Korea's current account deficit. Korea's imports expanded rapidly, partly because of strong domestic demand, especially investment. The surpluses of the other economies increased slightly or were unchanged.

Countries that had experienced debt problems in the 1980s regained some access to international capital markets. In particular, Mexico and Venezuela, which had reduced their debt to commercial banks in 1990, were successful in issuing bonds internationally and attracting substantial equity investments in connection with their privatizations of state-owned companies. These two countries, as well as Chile, provide strong evidence that foreign and domestic investors are willing to provide resources again to formerly troubled debtors once appropriate macroeconomic and structural policies have been implemented for a sustained period of time and the uncertainties related to the stock of external debt have been largely resolved.

At the close of 1991, Brazil and Argentina, both large debtors with substantial arrears to their foreign creditors, were in the initial stages of negotiating with their bank creditors on packages of debt reduction. Argentina made substantial strides toward economic stabilization in 1991, while Brazil was on the verge of undertaking a stabilization program approved by the International Monetary Fund in February 1992.

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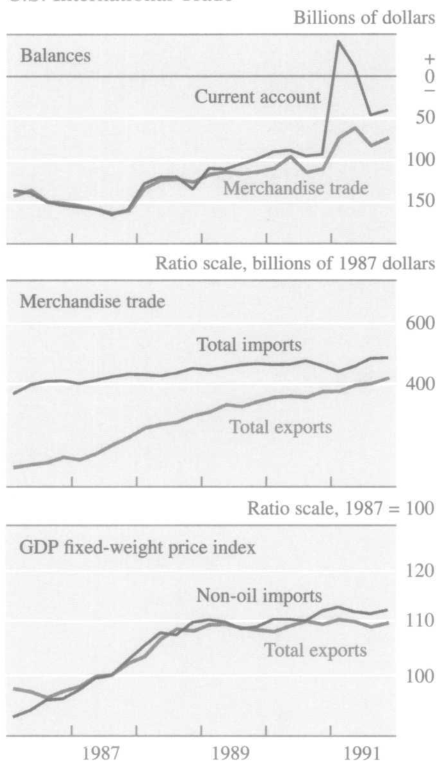
U.S. International Transactions

The U.S. merchandise trade and current account deficits narrowed substantially in 1991. A $27 billion increase in merchandise exports and an $8 billion reduction in merchandise imports yielded a trade deficit of $74 billion for the year, the smallest since 1983. The improvement in the current account balance was substantially larger, primarily because of war-related contributions by foreign governments. These cash contributions to the United States were recorded as positive government grants in the unilateral transactions component of the current account, and reduced the size of the current account deficit by $42 billion in 1991. In addition, net receipts from services expanded by $10 billion in 1991 because of a strengthening of net receipts in such areas as travel, royalties and license fees, and professional services. There was a small decline in net receipts on U.S. direct investments abroad and a marginal rise in net payments of portfolio income to foreigners.

U.S. International Trade



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

Merchandise exports rose 7 percent during the four quarters of 1991, about the same pace recorded in the preceding year. Export prices (mainly of industrial supplies) declined slightly, while the quantity grew about 9 percent.

Nearly two-thirds of the increase in the value and quantity of exports (Q4 to Q4) reflected strong growth in shipments of capital goods; two-thirds of that growth was to developing countries. Despite sluggish overall economic growth in the economies of many U.S. trading partners, high levels of investment spending in key countries—especially in developing countries in Latin America and Asia—boosted U.S. exports of capital equipment. Among developing countries, the largest increases in capital goods exports were to Mexico, Venezuela, Korea, and Saudi Arabia; among industrial countries, the largest increase was to Germany. Shipments of capital goods to both Canada and the United Kingdom declined, reflecting the recessions in those countries. Exports of items other than capital goods (accounting for nearly 60 percent of total exports) grew more slowly. On average, economic activity in the major foreign industrial countries weakened as the year wore on.

Despite the substantial slowing abroad, the quantity of U.S. exports grew appreciably over the four quarters of 1991 because of the positive influence of past gains in the price

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competitiveness of U.S. goods. This increased competitiveness reflects a combination of the large net depreciation of the dollar from 1985 to 1987 and increases in average foreign prices in local currencies relative to U.S. export prices.

Merchandise imports declined 1 percent in value but rose 6 percent in quantity in 1991 (Q4 to Q4). All of the decrease in value resulted from the sharp drop in prices of imported oil from the inflated levels at the end of 1990 that were associated with Iraq's invasion of Kuwait. The quantity of imports excluding oil grew about 5 percent in real terms during 1991. The decline of imports early in the year was the result of weak U.S. domestic demand. As the likelihood of an economic recovery in the United States increased, imports turned up—especially for automotive products, computers, and consumer goods—and continued strong into autumn.

After rebounding in the spring and summer, U.S. consumer spending faltered, and retailers accumulated undesired inventories. As a result, U.S. import growth slowed in the fourth quarter.

The quantity of oil imports, which had plunged after the surge in oil prices in the fall of 1990, generally moved up through the third quarter as refiners

U.S. International Transactions[1]

Billions of dollars, seasonally adjusted

Transaction	Year		Quarter				
			1990	1991			
	1990	1991	Q4	Q1	Q2	Q3	Q4
Merchandise trade, net	−108	−73	−27	−18	−15	−21	−19
Exports	390	417	101	101	104	104	108
Imports	498	490	128	119	119	125	127
Services, net	26	36	8	7	9	9	10
Receipts	133	145	36	34	36	38	38
Payments	107	109	28	27	27	27	28
Investment income, net	12	9	6	5	2	2	*
Direct investment, net	53	51	15	15	13	12	11
Portfolio investment, net	−41	−42	−9	−10	−11	−10	−11
Unilateral transfers, private and government, net	−22	20	−9	17	7	−3	−1
Current account balance	**−92**	**−9**	**−23**	**10**	**3**	**−12**	**−10**
Private capital flows, net	−5	−18	−20	−10	−9	5	−4
Bank-related capital, net (outflows, −)	15	−12	−7	2	−28	9	5
U.S. net purchases (−) of foreign securities	−29	−46	−8	−9	−13	−13	−11
Foreign net purchases (+) of U.S. Treasury securities	1	17	−2	3	13	−2	2
Foreign net purchases of U.S. corporate bonds	16	26	6	4	8	8	7
Foreign net purchases of U.S. corporate stock	−15	9	−5	2	7	2	−2
U.S. direct investment abroad	−33	−29	−4	−12	−2	−7	−9
Foreign direct investment in United States	37	22	5	4	8	6	4
Other corporate capital flows, net	2	−5	−4	−3	−3	1	n.a.
Foreign official assets in United States (increase, +)	32	21	20	7	−3	4	13
U.S. official reserve assets, net (increase, −)	−2	6	−1	*	1	4	1
U.S. government foreign credits and other claims, net	3	4	5	1	−1	3	−1
Total discrepancy	64	−3	19	−9	9	−4	1
Seasonal adjustment discrepancy	*	*	2	4	*	−6	1
Statistical discrepancy	64	−3	17	−13	9	2	*

1. Details may not sum to totals because of rounding.

*In absolute value, greater than zero and less than $500 million.

n.a. Not available.

SOURCE. Department of Commerce, Bureau of Economic Analysis.

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moved to rebuild inventories. In the fourth quarter, the volume of oil imports turned down again, reflecting sluggish U.S. activity and unseasonably warm weather.

Prices of non-oil imports declined slightly (Q4 to Q4), largely reflecting worldwide declines in prices of primary commodities and the effect of the dollar's appreciation on prices of finished manufactures through the third quarter. Non-oil import prices in the fourth quarter of 1991, which rose 2 percent at an annual rate, were especially influenced by a turnaround in prices of imported capital and consumer goods, as well as by higher prices of automotive products at the beginning of a new model year.

The sharp reduction in the recorded U.S. current account deficit in 1991 was mirrored by changes in recorded capital inflows and the statistical discrepancy. The statistical discrepancy in the international accounts, which jumped to $64 billion in 1990, declined to –$3 billion in 1991. There were no obvious reasons why errors and omissions in the recording of current account transactions would swell in 1990. The unusually large number of errors likely were concentrated, instead, in the reporting of capital flows. Because of the questionable data, we cannot draw any conclusions from comparisons of changes in the pattern of recorded capital flows between 1990 and 1991.

In 1991, inflows of official capital were matched in part by outflows of private capital. Net foreign official inflows amounted to $21 billion despite net intervention sales of dollars by the G-10 countries and despite the drawdown of reserves held in the United States by certain countries to finance their transfers to the United States for Operation Desert Storm. Some countries financed their contributions to Desert Storm in part by borrowing and liquidating investments in the Euromarkets rather than by drawing on their reserve holdings in the United States, while still others financed their payments in local currencies.

In 1991 the net recorded private capital outflow was $18 billion, largely accounted for by a net outflow reported by banks. Several factors probably contributed to the bank outflow: the increase in net demand for Euromarket funds to finance contributions to Desert Storm; the elimination by the Federal Reserve of certain reserve requirements in December 1990, which was followed by increased issuance of large time deposits in the United States and reduced reliance on borrowing from abroad by some U.S. agencies and branches of foreign banks; and weak overall growth of U.S. bank credit in 1991.

Securities transactions in 1991 reflected the continued internationalization of financial markets; although the net inflow was moderate, private foreigners added substantially to their holdings of U.S. stocks and bonds, while U.S. residents were net large-scale purchasers of foreign stocks and bonds. Reflecting interest rate developments that encouraged shifting from short-term to long-term financing, issues of foreign bonds in the United States and issues of Eurobonds by U.S. corporations were strong. In addition, investment funds located in the Caribbean were very active in the market for U.S. Treasury securities.

Capital outflows associated with U.S. direct investment abroad remained strong, as U.S. investors positioned themselves to take advantage of EC 1992 and participated in privatization of previously state-owned enterprises in countries such as Mexico and Venezuela. In contrast, foreign direct investment in the United States remained far below recent peaks; foreign take-

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overs of U.S. businesses declined and reinvested earnings were depressed by the recession.

Foreign Currency Operations

U.S. monetary authorities intervened in foreign exchange markets on a moderate scale in 1991. In early February, as the dollar reached historic lows against the German mark, U.S. authorities (the Federal Reserve and the Treasury's Exchange Stabilization Fund) sold German marks worth $1,336 million to support the dollar. By March the dollar had risen dramatically in occasionally unsettled markets. U.S. authorities cooperated with foreign central banks to moderate these movements and purchased $370 million of marks and $30 million of yen. In May, Sweden's announcement that it would peg its currency to the ECU rather than to a basket of currencies that included the dollar immediately led to a scramble for dollars to rebalance portfolios; to counter the resulting disorder in the New York market, U.S. authorities purchased $50 million of marks. In early July, with the dollar near its peak for the year, U.S. authorities purchased $100 million of marks in cooperation with European central banks. On net for the year, U.S. authorities sold $816 million of marks and purchased $30 million of yen. All of these market operations were split equally for the accounts of the System and the Treasury.

U.S. authorities also undertook a series of direct transactions directly with foreign central banks to adjust U.S. reserve balances to prospective needs, in the process selling $5,748.5 million of marks and $3,000 million of yen. Of these totals, $3,529.1 million of marks and $1,500 million of yen were for the System account.

During the year the Exchange Stabilization Fund repurchased $2,500 million of marks warehoused with the System. At year-end, $2,000 million remained outstanding on this facility.

The System held $27,626 million of foreign currencies at year-end, valued at current exchange rates. Of this amount, $2,000 million was in currencies held under the warehousing agreement. System foreign currency holdings were almost entirely in marks and yen.

The System realized $506 million in profits on sales of foreign currency during 1991. It recorded a translation loss of $140 million on balances held at year-end. There was no activity on the Federal Reserve swap network during the year. ▪

System Profits and Losses on Foreign Currency Operations

Millions of dollars

Year	Realized	Translation
1988	610	-1,121
1989	0	1,204
1990	0	2,139
1991	506	-140

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Monetary Policy Reports to the Congress

Given below are reports submitted to the Congress on February 20 and July 16, 1991, pursuant to the Full Employment and Balanced Growth Act of 1978.

Report on February 20, 1991

Monetary Policy and the Economic Outlook for 1991

When it reported to the Congress last July, the Federal Reserve was anticipating that the economy would continue to grow in the second half of 1990. Although the first half had been far from robust, with problems clearly evident in some industries and regions, the economy still was expanding and was afflicted with neither the inventory imbalances nor the escalating inflationary pressures that had preceded past cyclical downturns. Indeed, it seemed at midyear that the goal of achieving a reduction of inflation in the context of continued expansion might well be attainable.

But in August the economy was jolted off course by the Iraqi invasion of Kuwait. The surge in oil prices that followed the invasion gave additional impetus to inflation, and it also portended a weakening of activity as the price increases cut sharply into domestic purchasing power. Uncertainties about the course of the economy were heightened enormously, and household and business sentiment plummeted almost overnight, a response that perhaps grew in part out of memories of the difficult adjustments that had followed previous oil shocks in the 1970s. At the time of the invasion, and on into the autumn, sentiment also was being affected by the considerable uncertainty that existed regarding the course of fiscal policy.

Actual production and spending held up for a time after the oil shock, but started to decline in early autumn. The production cuts reduced real incomes still further and added to the cumulating forces of contraction, which included a continued shift toward greater caution by lenders. The economy thus fell into recession in the latter part of 1990, and, given the further declines in employment and production that were seen in January, that recession clearly has continued into the early part of 1991.

The secondary wage–price pressures that many had expected to see after the oil shock have not been much in evidence, probably because those pressures have been countered by the softening of aggregate demand. The underlying rate of increase in prices began to drop back over the last few months of 1990. In addition, the rate of increase in nominal wages and benefits, which already had started to slow in the third quarter, decelerated further in the fourth quarter. These wage and price developments, coupled with the drop in oil prices since mid-autumn, have given the Federal Reserve greater latitude in recent months to focus on steps that will aid in bringing about economic recovery without jeopardizing continued progress toward price stability.

In fact, as it became clear that the inflationary spillover of the oil shock was being effectively contained, and that an appreciable economic contraction posed the greater risk, the Federal Reserve did ease policy markedly. Earlier in the second half, policy already had moved to a slightly more accommoda-

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tive stance, first in July, to offset the effects on the economy of apparent restraint in private credit supplies, and again in October, when prospective reductions in federal budget deficits enabled interest rates to decline. Over the balance of the year and into 1991, money market rates were reduced substantially further through open market operations and two half-point decreases in the discount rate. In total, most short-term rates have fallen nearly 2 percentage points since mid-1990, with most of the decrease occurring during the last few months, and long-term rates are about ½ percentage point lower than they were at midyear. Falling interest rates have contributed to an appreciable decline in the dollar since mid-1990.

The behavior of the monetary aggregates and credit was an important consideration in the Federal Reserve's decisions to ease policy over recent months. M2 and M3 ended 1990 within the ranges set by the Federal Open Market Committee (FOMC), but they were in the lower parts of those ranges, and their expansion over the fourth quarter and into early 1991 has been quite sluggish. The sluggishness of the aggregates during this period was worrisome because it suggested that the economy was weaker than anticipated and because it indicated the possibility of some undesirable restraint on future spending through constricted credit intermediation by depository institutions. In particular, the thrift industry has been contracting, and banks, concerned about the credit quality of borrowers and facing pressures on capital positions, have become increasingly reluctant to lend, raising interest margins and tightening nonprice terms. To bolster lending incentives, the Federal Reserve in December eliminated the reserve requirements on nonpersonal time deposits and net Eurocurrency liabilities.

To a significant extent, however, overall credit flows have been sustained by sources outside depositories; thus, debt of the domestic nonfinancial sectors grew 7 percent in 1990 and ended in the middle of the FOMC's monitoring range for this aggregate. The effective substitution of non-depository credit for depository credit made it possible to achieve a greater amount of nominal income and expenditure growth for a given expansion of the money stock. One facet of this process was a shifting by the public out of assets that are included in the monetary aggregates and into holdings of Treasury issues and other securities. Velocity, the ratio of nominal GNP to the money stock, exhibited surprising strength: M2 velocity was about unchanged in 1990, even though declines in interest rates ordinarily are associated with falling velocity, and M3 velocity registered an unusually large increase.

Monetary Policy for 1991

In considering its plans for monetary policy for 1991, the Federal Open Market Committee focused on two objectives, consistent with the goals of the Full Employment and Balanced Growth Act: One was to foster an upturn in activity and thus higher levels of employment and real income; the other was to contain and reduce inflation over time to maximize the efficiency of resource allocation and long-range growth and to minimize the capricious and inequitable effects of inflation on the wealth of savers. The translation of these objectives into specific ranges for money and debt was complicated by the effects of the ongoing restructuring of credit flows. Again this year, a number of insolvent thrift institutions are likely to be closed, with many of their assets ending up at the Resolution Trust Corporation (RTC)

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or disbursed to a wide variety of investors; at other thrift institutions and at banks, restraints on lending may moderate a bit, but growth in depository credit is likely to continue to be constrained by pressures on capital positions. The rechanneling of credit outside depository institutions is expected to continue to distort the relationship of money to income, buoying the velocities of both M2 and M3.

Taking account of these effects, the Committee decided that the ranges for 1991 that were chosen on a provisional basis last July remain appropriate for achieving its objectives. The ranges for M2 and debt are ½ percentage point below those for 1990—a further step to ensuring that longer-run trends in money and credit growth are moving toward consistency with the achievement of price stability. At the same time, they allow for money and credit growth sufficient to support a rebound in the economy this year; moreover, the ranges should provide ample room for any policy adjustment that may be required by unanticipated developments in the economy or the financial sector as the year progresses.

The M2 range for 1991 is 2½ to 6½ percent. Growth in this aggregate is expected to strengthen from the sluggish pace of recent months, partly in lagged response to the substantial easing of money market conditions over the past few months. While acknowledging some uncertainty about developing velocity relationships, Committee members stressed that M2 expansion noticeably above the lower end of the range likely would be needed to foster a satisfactory performance of the economy in 1991.

Ranges for Growth of Monetary and Debt Aggregates[1]

Percent

Aggregate	1989	1990	1991
M2	3–7	3–7	2½–6½
M3	3½–7½	1–5	1–5
Debt[2]	6½–10½	5–9	½–8½

1. Change from average for fourth quarter of preceeding year to average for fourth quarter of year indicated. Ranges for monetary aggregates are targets; range for debt is a monitoring range.

2. Domestic nonfinancial sector.

The range of 1 to 5 percent for M3 was not reduced from that for 1990. That range was already at an unusually low level in recognition of the accelerated pace of the restructuring of the thrift industry. Credit growth in 1991 is expected to be moderate and to occur largely outside depositories. Consequently, total funding needs of depositories are expected to be damped, keeping the growth of M3 quite low and raising its velocity further.

The monitoring range for nonfinancial sector debt for 1991 was set at 4½ to 8½ percent. Federal borrowing is expected to be robust, owing in part to the RTC, and also to the effect of the weak economy on the federal budget deficit. By contrast, borrowing by domestic nonfederal sectors is likely to be slow, though still consistent with a rebound in the economy. On the demand side of the credit market, households and businesses appear to be returning to sounder financial practices, seeking a healthier balance between debt and the income available to service it. At the same time, restraints on the supply of credit also may continue to play a role, with some private borrowers facing higher interest rates and tighter nonprice terms on credit, in part because of the stresses faced by many intermediaries. In that regard, the Federal Reserve is working with other federal regulatory agencies to ensure that bank supervisory practices, while prudent and fair, do not unduly impede the flow of funds to creditworthy borrowers.

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Economic Projections for 1991

The economic outlook is unusually difficult to assess at this time, owing not only to the obvious uncertainties associated with the war in the Gulf, but also to some unresolved problems in the economy. However, the members of the Board of Governors and the presidents of the Reserve Banks, all of whom participate in the discussions of the FOMC, believe that the most likely outcome is that the economy will swing back into expansion later this year. At the same time, they also anticipate that inflation will be much lower in 1991 than it was in 1990.

With regard to real gross national product, the central tendency of the FOMC participants' forecasts is for a gain over the four quarters of 1991 of ¾ to 1½ percent. This is in line with the projection of the Administration, which anticipates an output gain of 0.9 percent. With these GNP forecasts so similar, the forecasts of unemployment also are about the same: The Committee's central tendency projections fall in a range of 6½ to 7 percent in the fourth quarter of 1991, a range that brackets the Administration forecast. On the other hand, the Board members and Reserve Bank presidents are more optimistic on average than is the Administration with regard to the prospects for reduced inflation. The central tendency range for the CPI increase this year—3¼ to 4 percent—compares with an Administration projection of 4.3 percent. The Administration's forecast for nominal GNP is at the upper end of the FOMC central tendency range and thus also would be compatible with the FOMC's monetary ranges.

In discussing their projections, the Board members and Reserve Bank presidents stressed that the war introduces a major imponderable into an outlook that, even before, had been subject to considerable uncertainty. The demands of the war on the economy are not fully clear at this point. Nor is it possible to forecast with any precision how household and business confidence will respond to the course of events in the Gulf. Among the significant unresolved economic and financial problems elsewhere in the economy are those in the real estate markets; commercial construction, in particular, still is plagued by a large overhang of vacant space that

Economic Projections for 1991

Item	MEMO 1990 actual	FOMC members and other FRB presidents		Administration
		Range	Central tendency	
Percent change, fourth quarter to fourth quarter[1]				
Nominal GNP	4.3	3½–5½	3¾–4¼	5.3
Real GNP	.3	–½–1½	¾–1½	.9
Consumer price index[2]	6.3	3–4½	3¼–4	4.3
Average level, fourth quarter (percent)				
Unemployment rate	5.9	6¼–7½	6½–7	6.6

1. From average for fourth quarter of 1989 to average for fourth quarter of 1990.

2. Actual values and FOMC projections are for all urban consumers (CPI–U); Administration projection is for urban wage earners and clerical workers (CPI–W).

3. Actual values and FOMC projections are for civilian labor force; Administration projection is for total labor force, including armed forces residing in the United States.

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will severely limit new construction for some time to come. On the financial side, the overexuberance and loose lending practices of the 1980s have given way to large losses and extreme caution among some lenders, who may not be able or willing at present to shift quickly back toward more normal lending behavior. Because of these problems, the Board members and Reserve Bank presidents perceive that, in the near term, the risks to the economy may be skewed to the downside.

On the other hand, some of the potential underpinnings of recovery also are evident. For example, with the further decline in oil prices since the start of 1991, much of the surge that followed the Iraqi invasion of Kuwait now has been retraced; in a reversal of the effects seen earlier, this drop in oil prices is taking pressure off inflation, and it also is augmenting real purchasing power, which will help to bolster spending. Also working in the direction of supporting spending is the decline in interest rates since the spring of 1989. In contrast to past business cycles, when declines in rates usually did not come until the economy was softening, this decline began far in advance of the peak in activity, and its effects on spending should begin to be felt, especially in sectors like housing, where affordability has been considerably enhanced over the last year and a half. Meanwhile, the prospects for exports, and for our overall trade and current account balances, continue to look favorable, given the improved competitiveness of U.S. producers. And, any pickup in final demand, whether from domestic buyers or from abroad, should translate fairly quickly into increased production, in view of the success that businesses seem to have had in preventing a buildup of inventories in recent months.

As noted above, the Board members and Reserve Bank presidents project a marked slowing of inflation in 1991. A key assumption underlying these forecasts is that oil prices will hold in their recent range, at a much lower level than prevailed through the autumn of 1990. The pass-through of these lower oil prices to consumers is expected to result in a sharp decline in retail energy prices. In addition, increases in wages and benefits seem likely to be more moderate this year, reducing the pressures of labor costs on profit margins and prices. To be sure, there are some near-term negatives in the inflation picture: Labor expenses are being boosted by legislated increases in employers' contributions for social security and by a further rise in the minimum wage, and prices are being affected by a rise in postal rates and increases in various excise taxes. All told, however, the coming year appears likely to be one in which overall price increases will be considerably smaller than in 1990 and in which the downward tilt of the underlying inflation trend should begin to stand out more clearly.

The Performance of the Economy in 1990

When 1990 began, the economy was in its eighth year of expansion, and it remained on a positive course into the summer. During this period, problems were evident in some sectors of the economy, notably construction, where activity was being damped by the persistence of high vacancy rates, and finance, where a significant number of institutions were encountering difficulties that reduced their ability or willingness to provide credit. Overall, however, production and spending still were on a course of expansion at midyear, and while the rate of price increase had not yet started to abate, there were indica-

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tions that the groundwork for achievement of slower inflation was coming into place without major disruption to the economy.

Then, in early August, the Iraqi invasion of Kuwait set off a chain of events that gave further impetus to inflation and tilted the economy from a path of slow growth to one of contraction. Declines in output and employment were widespread during the remainder of 1990. Real gross national product fell at an annual rate of about 2 percent in the fourth quarter, and the gain over the four quarters of the year amounted to only 0.3 percent. The civilian unemployment rate, which had held around 5¼ percent through the first half of the year, moved up steadily in the second half, to 6.1 percent in December. In January of this year, the rate edged up further, to 6.2 percent. The consumer price index rose 6.1 percent from December of 1989 to December of 1990, the largest annual increase in nearly a decade.

A key link in the chain of events after midyear was a surge in the price of crude oil, from around $20 per barrel in the spot markets in late July to more than $40 per barrel in early October. That surge sent the prices of energy products soaring, sapped household purchasing power, and put further pressures on business profits, compounding the squeeze brought on by rising costs and sluggish sales. Another, less tangible link was the enormous uncertainty about how, and when, tensions in the Mideast might be resolved. Symptomatic of that uncertainty, the various indicators of household and business sentiment remained low toward the end of 1990, even as oil prices dropped back part of the way from their October peaks.

While surging energy prices accounted for much of the acceleration in inflation in 1990, they were by no means the only source of upward price pressure. The year-to-year rate of increase in the CPI excluding food and energy—a rough indicator of basic inflation trends—maintained a gradual upward tilt through the first three quarters of 1990, peaking at a rate of 5.5 percent in August and September; a slight easing of price pressures over the balance of 1990 brought that rate back down to 5.2 percent by year-end. The year-to-year rate of increase in nominal labor compensation, as measured by the employment cost index, also moved up in the first half of 1990; after midyear, however, wage pressures moderated, and the rise in nominal compensation over the year ended up at 4.6 percent, slightly less than the increases recorded in each of the two previous years.

Support for growth of real activity continued to come from the external sector in 1990, as real exports of goods and services rose 5 percent over the four quarters of the year; this gain, however, was considerably smaller than the increases seen in each of the four previous years. Gross domestic purchases, the broadest indicator of domestic demand, fell about ¼ percentage point, on net, over the four quarters of 1990; within this category an increase in government purchases was more than offset by weakness in consumption, homebuilding, and business fixed investment, and a swing in inventories from moderate accumulation late in 1989 to decumulation in the fourth quarter of 1990.

As was true during much of the long expansion of the 1980s, economic trends in 1990 varied appreciably across different regions of the country. The New England economy, which had been very strong through much of the 1980s, slumped in 1990; by year-end, unemployment rates in that region had moved well above the national average. By contrast, the economies of many locales with heavy concentrations of manu-

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facturing—especially capital goods manufacturing—held up fairly well until the oil shock; the continued growth of exports supported activity in those areas. The farm economy was relatively strong again in 1990, although some indications of softening did show up in the second half. Energy producers benefited from the climb in oil prices; exploration and drilling activity was restrained, however, by the great uncertainty regarding the future course of oil prices.

The Household Sector

In midsummer, consumer spending still was on an uptrend, and it edged up a little further after the oil shock, peaking in September. But with real incomes being dragged down by slumping employment and soaring energy prices, the rise in spending eventually ran out of steam. Real outlays fell at an annual rate of 3 percent in the fourth quarter; the quarterly drop likely would have been greater but for tax changes that caused some households to make purchases in advance of the turn of the year.

The declines in real income and spending in the latter part of the year essentially reversed the moderate gains made earlier. Over the year, after-tax income was down about ½ percent in real terms; real consumption spending was up over the four quarters of 1990, but only fractionally. The personal saving rate rose over the first half of the year, but then dropped about 1 percentage point in the last two quarters. This drop in the saving rate after midyear was a little surprising from one perspective, in that an unprecedented plunge in consumer attitudes between July and October might have been expected to generate some increase in precautionary saving. Moreover, many households had suffered losses of wealth because of decreases in house prices or in the value of securities they held; these developments would seem to have called for a shift toward reduced consumption out of current income. But, while such forces may well have been at work, they apparently were outweighed by a tendency of households to dip into savings in the short run when faced with a sudden surge in expenses for energy.

Patterns of change in the various categories of consumer spending were mixed in 1990. Real outlays for services continued to trend up over the year, but at a slower pace than during most years of the expansion; on a quarterly basis, growth in these outlays was quite erratic, owing largely to weather-related volatility in gas and electric bills. Real outlays for nondurables fell 2¼ percent over the course of the year, an unusually large decline by historical standards. The drop presumably was brought on in large part by the downturn in real income over the four quarters of 1990, the first such decline since 1974.

The real outlays for consumer durables fell ¾ percent over the four quarters of 1990; they had fallen about 1½ percent in 1989. The drop in 1990 was accounted for by a second year of decline in the purchases of motor vehicles. Outlays for the other durables—furniture, household equipment, and the like—were up about ½ percent on net over the four quarters of 1990, after having grown at a moderate pace in 1989. These patterns of change in spending seemed to reflect both macroeconomic forces, notably the slower pace of real income growth after the start of 1989, and the normal workings of household investment cycles. With regard to the latter, household spending for cars, trucks, and other consumer durables over the 1983–88 period were almost 50 percent above the average for the six best years of the 1970s. By 1989 many households may have reached a

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point where they were in effect "stocked up" and therefore well positioned to delay making new purchases if the timing currently did not seem right.

Spending for residential construction got a transitory boost from good weather in the first quarter of 1990, but then fell sharply in each of the three subsequent quarters. Over the year as a whole, residential investment outlays declined 8¾ percent in real terms; they had dropped 7 percent in 1989.

This slump in homebuilding reflected a variety of influences, most of which appeared to enter on the demand side of the equation. The downshifting of real income growth after the start of 1989 may have led households to view their longer-run prospects in a more cautious light and to hold back from housing investments that they might otherwise have undertaken. In addition, the unwinding in some regions of the country of real estate booms seen in the 1980s tarnished the attractiveness of housing as a longer-term investment. These negative developments came at a time when housing demand already was being restrained by a much slower rate of growth of the adult population than was seen in the 1970s and early 1980s.

Builders cut back sharply on new construction in 1990. The annual starts of single-family units fell 11 percent from their 1989 level, and starts of multi-family units declined about 20 percent, from an already low level. However, these reductions in starts still were not large enough to balance the market. The supply of unsold new homes, measured relative to the pace of sales, jumped sharply in the first part of 1990 and then remained high over the rest of the year; the vacancy rate on multifamily rental units dipped temporarily in the spring, but later bounced back up to the high levels seen over most of the period after 1986.

In some instances, new construction activity was deterred in 1990 by the difficulty that prospective builders had in obtaining credit. Failures of thrift institutions severed established credit relationships for some builders, and the thrift institutions that survived moved toward more conservative lending policies, either out of choice or in response to the more stringent capital requirements and lending limits mandated by the Financial Institutions Reform, Recovery, and Enforcement Act. Banks also were cautious about extending credit to builders; with large volumes of problem loans already on their books, banks were very sensitive to the poor conditions in many local housing markets.

In contrast to builders, potential homebuyers did not seem to have serious problems in obtaining financing in 1990; mortgage credit remained readily available, and the spreads between mortgage rates and the rates on other long-term loans actually narrowed. For the most part, consumer credit also appeared to be readily available, as lenders exhibited only a mild tendency to tighten standards on this generally profitable line of business.

The Business Sector

The business sector began 1990 on a rather shaky note. Profits had declined during 1989, and overhangs of business inventories had developed in the second half of that year in some markets, notably autos. In manufacturing, production growth had been restrained late in 1989, and output dropped sharply in January of 1990, led by a steep cutback in auto assemblies. But conditions improved over the next few months. Industrial production rose fairly briskly, in fact, from January into midsummer, and the

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drop in business profits was halted for a time.

From August on, the business climate was dominated by the oil shock and its attendant uncertainties. After peaking in September, industrial production plummeted over the last three months of 1990, and it closed out the year about 1½ percent below the level of a year earlier. The operating rate in industry also fell sharply over the latter part of the year, back to where it had been in early 1987, before capacity pressures started developing in that year. With volume declining and costs on the rise, corporate profits undoubtedly went into renewed decline in the fourth quarter (the official data are not yet available); for 1990 as a whole, the share of profits in total GNP was the lowest of any year since 1982.

Serious overhangs of business inventories were not apparent when the oil shock hit in August, and prompt production adjustments that followed the shock forestalled stockbuilding in the ensuing months. Indeed, real manufacturing and trade inventories fell slightly on net between the end of July and the end of November. Under the circumstances, however, these reductions clearly were not great enough to get actual stocks down to desired levels. In wholesale and retail trade, sales declined sharply from July to November, and the constant-dollar ratios of inventories to sales in these sectors moved up to levels that were around the upper end of the ranges seen over the past two or three years. The inventory–sales ratio in manufacturing also edged up on net between July and November, and manufacturers continued to cut output through the end of 1990 and into early 1991. Over 1990 as a whole, the level of real business inventories declined about $3 billion, according to preliminary estimates. The rapid reductions of nonfarm inventories that were seen in the fourth quarter of 1990 accounted for all of that quarter's drop in real GNP.

After registering relatively strong gains in each year from 1987 to 1989, business outlays for fixed investment rose only 1 percent in real terms over the four quarters of 1990. Spending was affected by the squeeze on profits, the easing of pressures on capacity, and the heightened uncertainties regarding the business outlook. These influences showed through most clearly in the outlays for equipment. Real spending for computers and other information processing equipment rose 3 percent on net over the four quarters of 1990; growth had averaged 15 percent per year over the first seven years of the expansion. In addition, outlays for industrial equipment turned down in 1990, as the deterioration of profits and the falloff in operating rates took their toll. Business purchases of motor vehicles bounced around from quarter to quarter, but held in essentially the same range that they have been in for the past several years. By contrast, business outlays for aircraft, which have been very strong in recent years, rose further in 1990.

Nonresidential construction declined 5 percent over the four quarters of 1990. Weakness was concentrated mainly in the outlays for offices and other commercial structures, which together account for about one-third of the total. An excess supply of these structures developed in many cities during the building boom of the mid-1980s, and despite sharp cutbacks in construction after 1985, vacancy rates remained high through 1990. Reflecting this continued imbalance—and the reluctance of creditors to finance new projects in this troubled sector of the economy—the indicators of future activity, such as the data on new contracts and building permits, continued to have a decidedly negative

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cast through the second half of 1990. Spending for industrial structures rose over the first three quarters of 1990, but fell sharply in the fourth quarter, and the indicators of future construction continued to weaken. As noted previously, investment in oil drilling remained subdued in the second half of 1990, despite the rise in oil prices; in some instances, drillers may have been hampered by shortages of experienced crews, but, more important, the uncertainty about whether prices would remain high enough to justify stepped-up investment prompted a cautious response.

The Government Sector

In the government sector, budgetary pressures intensified in 1990. At the federal level, the rate of growth of receipts slowed to 4.1 percent in fiscal year 1990, less than half the rate of increase in the previous fiscal year and more than 1 percentage point below the rate of growth in nominal GNP. Meanwhile, spending jumped 9.4 percent in fiscal 1990, and the federal budget deficit increased to $220 billion, up $67 billion from the 1989 fiscal year and well above the target for 1990 that had been laid out in the Gramm–Rudman–Hollings legislation. Finding a way to get back on track toward deficit reduction occupied the Congress and the Administration through much of 1990; an agreement that was reached in October prescribed new targets and new procedures for the five-year period starting in the 1991 fiscal year.

Part of the slowing of receipts in the 1990 fiscal year stemmed from the weakness in corporate profits; collections from that source fell almost $10 billion. In addition, the growth of tax receipts drawn from the incomes of individuals slowed appreciably, from 11 percent in 1989 to a bit less than 5 percent in 1990; this slowdown mainly reflected the absence in 1990 of transitory factors that had led to the big jump in these receipts in 1989. On the expenditure side of the ledger, about one-third of the increase of $108 billion in nominal federal outlays in fiscal 1990 was attributable to federal deposit insurance programs; the main portion of these outlays went to honor obligations to holders of deposits in failed thrift institutions. Spending also moved up rapidly in 1990 for entitlements. The outlays for medicare rose 15 percent, pushed up by continued rapid inflation in health costs and an expansion in the number of beneficiaries. Outlays for social security and other income security programs, which together account for close to one-third of total federal spending, rose about 7½ percent in fiscal 1990, a pickup from the pace of recent years. Net interest outlays, which now account for almost 15 percent of total spending, also continued to climb rapidly.

Federal purchases of goods and services, the portion of federal spending that is included directly in GNP, increased 5.5 percent in real terms over the four quarters of 1990. Excluding changes in the inventories owned or financed by the Commodity Credit Corporation, which tend to be very volatile, federal purchases of goods and services increased 4.4 percent, on net, over the year; nondefense purchases were up 3.6 percent and defense purchases, which had registered moderate declines in each of the three previous years, increased 4.7 percent in 1990. The rise in defense purchases came mainly in the fourth quarter of the year and apparently reflected, in part, outlays associated with Operation Desert Shield.

The deficit in the combined operating and capital accounts of state and local governments (excluding social insurance funds) averaged $30 billion at an

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annual rate over the first three quarters of 1990, and it appears to have widened considerably further in the fourth quarter as the recession cut into tax receipts. State and local budgets first moved into deficit in late 1986, and they have slipped further into the red in each succeeding year. At the same time, concerns have intensified about the repayment abilities of some state and local governing units; as evidence of this, the downgradings of state and local credit ratings outnumbered upgradings by a wide margin in 1990.

In an effort to strengthen their finances, many state and local governments have raised taxes in recent years. Reflecting those increases, total state and local receipts moved up faster than nominal GNP both in 1989 and through the first three quarters of 1990. In addition, spending has been scaled back from planned levels in many cases. Overall, however, the efforts to control spending have collided with the growing demands for services that state and local government traditionally have provided for such things as education, public protection, and health and income support. Thus, while the growth of state and local outlays has slowed from the rate of rise seen earlier in the expansion, it nonetheless has been running above that of total GNP. The nominal rise in state and local purchases of goods and services over the four quarters of 1990 was 7.9 percent; in real terms, purchases grew 2.5 percent over the year.

The External Sector

The merchandise trade deficit narrowed from $115 billion in 1989 to a bit less than $110 billion in 1990, a degree of improvement that was smaller than that seen in either of the two preceding years. A surge in the price of oil imports in the second half of the year led to a jump in the value of imports. In addition, trade flows during the year were influenced to some extent by lagged effects of the firming of dollar exchange rates that had taken place in the first half of 1989. The current account balance averaged $93 billion, at an annual rate, during the first three quarters of 1990, down from a total of $110 billion in 1989; the improvement in this account was greater than that in the trade account owing to a strengthening of net receipts from service transactions, those involving such things as travel, education, and finance.

Measured in terms of the other Group of Ten (G-10) currencies, the foreign exchange value of the U.S. dollar depreciated about 12 percent from December 1989 to December 1990. This depreciation extended a decline that began in mid-1989 and more than reversed the earlier appreciation. Adjusted for movements in relative consumer price levels, the dollar's decline in 1990 was slightly less than it was in nominal terms, as inflation in the United States exceeded somewhat the weighted average of inflation rates in the other G-10 countries. In real terms, the weighted-average dollar in December 1990 was at about its low of 1980; the huge appreciation in average exchange rates in the first half of the 1980s thus has been reversed.

The decline in the dollar in 1990 was broadly based against the Japanese yen, the German mark, and other European currencies. The dollar also declined about 10 percent against the Singapore dollar, but it appreciated about 5 percent against the currencies of South Korea and Taiwan, partially reversing declines of the preceding few years. The weakness in the dollar against the G-10 currencies over the past year reflected primarily the influence of different trends in interest rates in the United States and other major industrial countries.

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Whereas U.S. short-term interest rates trended down through the year and long-term rates were about unchanged over the year as a whole, foreign short-term rates rose by an average of about ½ percentage point, and foreign long-term rates rose by an average of about 1 point. Official intervention in foreign exchange markets was small in 1990.

U.S. merchandise exports grew 7½ percent in real terms over the four quarters of 1990, after rising about 12 percent in 1989. Merchandise exports grew rapidly in the first quarter, boosted in part by a strong recovery of exports of aircraft after the Boeing strike of late 1989 ended. Over the next two quarters, real exports changed little on net. Growth of activity in the major U.S. export markets slowed noticeably in the middle of the year; outright recessions developed in Canada and the United Kingdom. In the fourth quarter, export growth picked up again, probably largely in response to the gains in U.S. price competitiveness that took place during the year. Export prices rose moderately during the year.

Merchandise imports excluding oil grew only 2 percent in real terms during 1990, less than half the pace recorded in 1989. The deceleration in imports reflected the net decline in total domestic demand in the United States during the year. The quantity of oil imports fluctuated during the year, but was up only slightly for the year as a whole. At an average rate of about 8.3 million barrels per day, oil imports accounted for roughly half of total domestic consumption of oil in 1990. The price of imported oil surged to an average level of nearly $30 per barrel in the fourth quarter, after having fluctuated in a range of $15 to $20 per barrel for nearly two years.

The current account deficit of $93 billion at an annual rate over the first three quarters of 1990 was matched by a recorded net capital inflow of $26 billion and a large positive statistical discrepancy in the international accounts. Part of the statistical discrepancy may have reflected increased holdings of U.S. currency by foreigners responding to the unsettled political conditions in many parts of the world.

The recorded net inflow of capital was more than accounted for in net transactions reported by banks, which were mainly for the banks' own accounts. Transactions in securities showed a net outflow, as foreigners reduced their rate of net purchases of U.S. corporate and Treasury bonds and actually made net sales of U.S. corporate stocks, while the rate of U.S. net purchases of foreign securities increased. The recorded inflow of direct investment from abroad dropped sharply from the rates recorded in 1988 and 1989; foreign acquisitions in the United States remained strong, but a much greater portion were being financed here rather than abroad. The flow of U.S. direct investment abroad picked up, in part reflecting strong U.S. acquisitions abroad. Foreign official assets in the United States increased $11 billion over the first three quarters of 1990, and U.S. official holdings of assets abroad declined slightly.

Labor Markets

Payroll employment increased in each month in the first half of 1990 and fell in each month of the second half. The declines of July and August, however, reflected layoffs of federal workers who had been hired temporarily to conduct the 1990 Census. In the private nonfarm sector, employment continued to edge up into August and did not turn down decisively until October. More than half a million jobs were lost over the final three months of the year. Over the year

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as a whole (December to December), the number of jobs in the private non-farm sector increased about 250,000 on net, but much of that small gain was wiped out by the further drop in employment in January of this year.

Sectoral patterns of employment change varied considerably in 1990. Employment in manufacturing fell about 585,000 from December of 1989 to December of 1990; losses of factory jobs proceeded at a slow and fairly steady pace through the first half, but then accelerated after the onset of the oil shock. The troubled construction sector shed roughly one- quarter of a million jobs over the course of the year; after a weather-related jump early in the year, the declines went on almost without interruption through December. Employment in retail and wholesale trade was down slightly on net over the course of 1990, as small gains through the first seven months of the year were more than offset by sharp declines in the fourth quarter. The number of jobs in the services industries increased in each month of 1990, but the rate of gain slowed progressively over the year; health services was the only major area in which hiring was going on with much vigor at year-end.

Growth in the supply of labor was quite subdued in 1990. The civilian labor force increased only 0.5 percent on a December-to-December basis, the smallest annual gain in almost thirty years. Part of the explanation for this slow labor force growth is that the working-age population has not been growing very rapidly in recent years. In addition, the share of the working-age population that chose to participate in the work force declined in 1990, by enough to cut labor force growth to about half of what it would have been had the participation rate remained unchanged. The sluggishness of the labor markets in 1990 no doubt discouraged some potential entrants from seeking jobs, as typically happens during cyclical slowdowns in the economy. Still, the drop in participation in 1990 left some questions regarding the future trend in the growth of labor supply. A downshifting in the growth of labor supply, to the extent that it is not due solely to cyclical factors, would tend to translate one-for-one into slower growth of potential output over time unless there were at the same time an offsetting pickup in labor productivity, of which there has been little, if any, evidence of late.

The flatness of the unemployment rate through the first half of 1990 brought to seven quarters the length of time during which the rate had held tightly around the 5¼ percent mark and extended to nearly three years the length of time during which the rate had been below 6 percent. Not since the first half of the 1970s had the unemployment rate been at such low levels for so long. This period of low unemployment, unfortunately, also was a period of sharply increased wage inflation. After rising about 3¼ percent in both 1986 and 1987, the employment cost index for compensation, which includes the cost of workers' benefits, as well as wages and salaries, moved up about 4¾ percent in both 1988 and 1989; and in the first half of 1990, the year-to-year rate of increase in this measure of compensation rose still further, to 5¼ percent.

Labor market tightness was not the only factor putting pressure on wages and compensation between the end of 1987 and the middle of 1990. The updrift in inflation caused workers to press for nominal increases in wages and benefits that were big enough to keep real incomes on a reasonably even keel, and with labor in short supply, businesses found it necessary to accede to hefty increases to attract and keep workers.

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The actions of government also added to cost pressures: A further rise in social security taxes in 1990 added 0.2 percent to total compensation, and a boost in the minimum wage may have added another 0.1 percent.

A marked slowing of wage pressures emerged in the second half of 1990, and the year-to-year rate of increase in the employment cost index for compensation dropped back to 4.6 percent by the end of the year. Although workers' real incomes were battered by the surge in energy prices during this period, attempts to regain those income losses appear to have been overwhelmed by the increase in labor market slack and associated concerns about job security. The efforts of management to contain costs in a time of declining profits probably also were a factor helping to limit wage increases during this period.

The performance of productivity was subpar for a second successive year in 1990. Output per hour in the nonfarm business sector edged down 0.1 percent over the four quarters of the year, after having dropped 1.6 percent in 1989. More than likely, the behavior of productivity over this two-year period mainly reflected typical cyclical influences, namely the tendency of firms to adjust output faster than hours in response to a slowing of demand. Unit labor costs increased about 4½ percent over the four quarters of 1990, the largest annual rise since 1982.

Price Developments

All of the major price indexes—the consumer price index, the producer price index, and the GNP price indexes—rose faster in 1990 than they did in 1989. In general, the increases seen in 1990 also were the largest since those of the early 1980s. In all of the measures, the pickup in the rate of price increase in 1990 basically reflected the effects of the oil shock in a situation in which underlying inflation pressures already were well entrenched. Acceleration was especially pronounced in those indexes, such as the CPI, that measure price change for goods and services *purchased* by domestic buyers, as the surge in oil import prices had a particularly strong effect on these measures. By contrast, the GNP price measures, which cover goods and services *produced* domestically, exhibited a less pronounced degree of acceleration this past year.

The CPI for energy rose 18 percent from December of 1989 to December of 1990. Although the bulk of the 1990 rise came after the start of August, intermittent pressures had surfaced earlier in the year. A severe bout of cold weather at the end of 1989 cut into the inventories of heating oil, disrupted operations at several refineries, and caused the prices of fuel oil and gasoline to soar. After January, fuel oil prices fell back, but gasoline prices remained relatively firm into the summer as still more supply interruptions prevented a rebuilding of stocks.

The August invasion of Kuwait set off another round of steep price increases. World oil production dropped temporarily after the invasion, and the uncertainties associated with the tensions in the Persian Gulf set off a scramble for inventories by refiners and others seeking to guard against a possible further disruption in supplies. The price of oil fluctuated widely in this period, but generally maintained an upward trend into early October. By then, however, the losses of oil from Iraq and Kuwait were being fully offset by increased production from other countries, and demand was weakening. As a result, oil prices turned down and held on a choppy downward pattern through the end of the year, retracing about half of

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the runup that had occurred between August and early October. A further steep drop came in mid-January of 1991, when initial successes of the coalition forces in the Gulf war seemed to signal a greatly diminished potential for disruption of world supplies.

The CPI for fuel oil also turned down over the last two months of the year, but gasoline prices again held firm, supported this time by a five cent per gallon rise in the federal excise tax that took effect on December 1. Over the year, fuel oil prices increased about 30 percent at the consumer level, and gasoline prices were up almost 37 percent. By contrast, increases over the year in the prices of the service fuels (natural gas and electricity) were quite small—in the range of 1½ to 2 percent; reaction of these prices to the oil shock apparently was damped by ample supplies of natural gas and coal, as well as the customary lags in adjusting rate structures at retail.

The consumer price index for food rose 5.3 percent in 1990; this increase was about the same as those seen in 1988 and 1989. Over the preceding few years, food price increases had tended to run more in the 3 to 4 percent range. To a considerable degree, the continued sharp increases in food prices in 1990 seemed to reflect underlying inflation processes similar to those at work in other sectors of the economy. In addition, prices were affected by the changing supply conditions in agriculture. Production of beef and pork declined in 1990, and their prices at retail increased 9 percent and 17 percent respectively over the course of the year. Dairy production, which had fallen in 1989, turned up in 1990; but with stocks initially at low levels, the rise in production did not have a damping effect on prices at retail until relatively late in the year. The spell of cold weather late in 1989 led to a surge in the prices of orange juice and fresh vegetables early in 1990; toward the end of 1990, another cold snap destroyed citrus crops in California and boosted citrus prices. By contrast, big wheat crops here and abroad in 1990 caused wheat prices to plunge and led to some rebuilding of stocks; at retail, the CPI for cereals and bakery products slowed from an increase of 7½ percent in 1989 to one of 4½ percent in 1990.

The CPI for nonenergy services, which accounts for more than half of the total CPI, rose 6 percent during 1990, after an increase of 5.3 percent in 1989. The prices of medical services, which have been rising rapidly for many years, were up 9.9 percent in 1990; they had increased 8.6 percent in the previous year. The cost of tuition, another category where pressures have been evident in the CPI for some time, rose more than 8 percent in 1990, about the same as in 1989. Elsewhere in the services sector, prices soared for public transportation and lodging. Airlines, which were hit hard by the surge in energy costs, raised their fares almost 23 percent over the year. Price increases for other forms of public transportation were in the 6 to 7 percent range, and the CPI for out-of-town lodging advanced nearly 16 percent over the year. Increases in the costs of many publicly provided services—such as water and sewerage maintenance and refuse collection—also were large in 1990; these increases probably reflected the needs of municipalities to raise revenue, as well as environmental imperatives in some instances.

The CPI for commodities excluding food and energy rose 3.4 percent in 1990, after increasing 2.7 percent in 1989. Within this category, tobacco prices again registered a particularly large increase, about 11 percent over the course of the year. This increase partly

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reflected the pass-through to consumers of a jump in manufacturers' prices; in addition, governments continued to view excise taxes on tobacco products as an attractive way to boost revenues. The CPI for apparel was up 5 percent in 1990; apparel prices had changed little over the course of 1989, and the 1990 rise may therefore have been, in part, an effort to restore margins. New car prices continued to rise, even as sales declined; by contrast, the prices of used cars were down a bit for a second year. The prices of many household appliances fell in 1990, extending the gradual downward trends seen in previous years.

Apart from energy, increases in producer prices were comparatively moderate in 1990. The producer price index for finished goods excluding food and energy rose 3.5 percent over the year, about ¾ percentage point less than in either of the preceding two years. In manufacturing, the pressures from rising wages and soaring energy costs were partly damped by continued rapid gains in productivity and softening demand. The prices of intermediate materials excluding food and energy rose 1.9 percent during 1990, the second year in a row in which increases for that category have been small; materials prices had increased sharply in 1987 and 1988. The spot prices of raw industrial commodities moved up on net in the first half of 1990, held firm through September, and then fell rapidly in the fourth quarter as the economy weakened; further declines in these prices have been evident in the early part of 1991.

Monetary and Financial Developments during 1990

Monetary policy has been progressively eased since mid-1990, resuming the trend begun in 1989. The Federal Reserve has acted against the backdrop of a weakening economy, sluggish money growth, improved inflation prospects, greater fiscal restraint, and indications of tightening credit to private borrowers. In response to the System's actions and to developments in economic activity and prices, short-term interest rates, as of mid-February, were nearly 2 percentage points below those prevailing at the time of the Board's July report to the Congress, and long-term rates were down about ½ percentage point.

After an initial small cut in money market rates in July, policy was held stable for a brief period, in light of the sharp jump in world oil prices that occurred in the wake of the Iraqi invasion of Kuwait. This shock implied an uncertain combination of increased prices and reduced economic activity. The magnitude of the impact would depend on the extent of the disruption in world oil markets, which could not be forecast with precision. As it became clear in the autumn that the risks of increased inflation were fading relative to the risks of a downturn in economic activity, the Federal Reserve moved aggressively, using a variety of instruments. Open market operations and a reduction of 1 percentage point in the discount rate, taken in two steps, have brought overnight rates down 1¾ percentage points since late October; in addition, reserve requirements were reduced in early December to foster easier credit conditions.

In the formulation of policy in 1990, the Federal Reserve continued to examine a variety of information bearing on developments relating to economic activity and prices. Over the year, certain developments in financial markets took on special significance for the economy and monetary policy. The cost and availability of credit was monitored in light of indications that tightening credit supplies were constraining output to a greater degree than was desirable. In

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addition, considerable attention was paid to money stock movements, especially in the latter part of 1990 and into 1991, when money growth virtually stalled. The Federal Reserve recognized that the relation of the monetary aggregates to broad measures of economic performance remained subject to considerable uncertainty, but the marked sluggishness of money growth was seen as suggesting both weak contemporaneous growth of income and spending and the existence of constraints on the availability of credit through depository institutions that could adversely affect spending in the future.

The Implementation of Monetary Policy
During the first half of 1990, the Federal Reserve took no actions in reserve markets designed to produce changes in money market interest rates. Federal funds—overnight interbank loans of immediately available funds—traded around the 8¼ percent level that had been established in December 1989, and other short-term rates were little changed as well. Throughout this period economic activity continued to grow, the unemployment rate held steady, and there were no clear signs of abatement in inflation.

Yields on longer-term debt instruments rose considerably during the early months of the year, restoring the yield curve's usual upward tilt, which had been absent for much of 1989. This rise in long-term rates reflected a stronger economy than some had expected, increased concerns about inflation, and higher foreign interest rates. As the second quarter progressed, however, bond rates began to recede, responding to a shift in sentiment about the strength of the economy and the likely path of monetary policy.

Around that time, growth of the broader monetary aggregates began to slow appreciably. To a large extent, the weakness in the aggregates was associated with a redirection of credit flows away from depository institutions, related mainly to the ongoing restructuring of the thrift industry but also to an apparent decrease in the willingness or ability of banks to lend. For the most part, the decline in depository credit was expected to be taken up by other lenders, with minimal impact on the overall cost and availability of credit. M3 velocity in particular was expected to be boosted substantially in the process, and the FOMC at its July meeting reduced the annual target range for this aggregate by 1½ percentage points. By mid-July, it was increasingly apparent that the pullback by depositories was constricting credit supplies to some classes of borrowers, and the Committee eased reserve conditions to bring down interest rates slightly to offset the effects of this tightening of credit conditions on an already soft economy.

The invasion of Kuwait at the beginning of August fundamentally altered the environment for monetary policy. World oil prices soared, and a considerable measure of uncertainty was added to the outlook for the economy, complicating the formulation of monetary policy. Business and consumer confidence plummeted, and the adverse effects of high oil prices on the public's spending plans, domestic economic activity, and inflation soon became apparent. As volatility in financial markets increased, heightened investor preference for liquidity and safety was evident: Treasury bill rates fell over August and September while private short-term rates changed little; money market mutual funds experienced large inflows, boosting growth of the monetary aggregates late in the summer as investors apparently fled stock and bond markets; and the ongoing decline in the foreign ex-

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change value of the dollar was halted for a while by safe-haven demands.

In these circumstances, the benefits of any easing action taken to cushion the possible effects on output in the near term needed to be weighed against the potential for embedding higher energy prices in the price level and, more important, into inflationary expectations, a reaction that ultimately would undercut sustainable economic growth. Policy decisions were further complicated by the fact that the military and political situation underlying the oil price shock was so fluid; in fact, it clearly was a war-risk premium rather than a current shortage of supply that was maintaining a higher price of crude oil. The possibility existed that any substantial moves in monetary policy might prove ill-advised as circumstances changed, and it appeared that the most constructive role monetary policy might play, until the balance of risks was clarified, would be to foster a sense of stability in the very nervous financial markets.

As it was, financial markets had to contend not only with the Gulf crisis during the late summer and early fall, but also with uncertainties surrounding the timing and extent of a reduction in the federal budget deficit. Yields were buffeted whenever the odds of a meaningful deficit-reduction package appeared to change. For example, Treasury bond rates fell appreciably when an initial budget accord was hammered out and rose when the government was forced to shut down temporarily after the pact failed to win congressional approval. By the end of October, long-term rates had come down again, and a budget agreement involving a major degree of fiscal restraint over a multi-year horizon was successfully concluded. In light of the budget agreement, which promised greater and more durable fiscal restraint, and with the economy weakening, the Federal Reserve took another step to ease pressures on reserve conditions.

Late in the year, indications accumulated that inflationary pressures, apart from those closely connected to the surge in energy prices, were easing. As the economy softened and wage pressures also diminished, it seemed more likely that the effects of higher oil prices would not be built into ongoing inflation trends. Market interest rates declined across the maturity spectrum, although these declines were most pronounced for government obligations owing to heightened concerns about credit quality, which drew investors toward high-grade assets.

Financial strains were experienced by more and more lending institutions, as problems emerged in many real estate portfolios and as a growing number of

Growth of Money and Debt
Percent

Period	M1	M2	M3	Debt of domestic non-financial sector
Annually, fourth quarter to fourth quarter[1]				
1980	7.4	8.9	9.5	9.4
1981	5.4 (2.5[2])	9.3	12.3	10.1
1982	8.8	9.1	9.9	9.1
1983	10.4	12.2	9.8	11.1
1984	5.4	8.0	10.7	14.2
1985	12.0	8.7	7.6	13.1
1986	15.5	9.2	9.0	13.2
1987	6.3	4.3	5.8	9.7
1988	4.2	5.2	6.3	9.2
1989	.6	4.7	3.6	7.7
1990	4.2	3.9	1.8	6.9
Quarterly (annual rate)[3]				
1990:1	5.2	6.2	2.9	6.1
2	4.2	3.9	1.3	6.9
3	3.7	3.0	1.6	7.4
4	3.4	2.2	1.3	6.4

1. From average for fourth quarter of preceding year to average for fourth quarter of year indicated.

2. Adjusted for shift to NOW accounts in 1981.

3. From average for preceding quarter to average for quarter indicated.

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highly leveraged firms ran into trouble. Efforts by banks and other lenders to protect or improve their capital positions as their loan portfolios deteriorated were reflected in widespread signs of cutbacks in the availability of credit and increases in its cost, especially to less-than-prime borrowers lacking access to securities markets. While much of the tightening of lending standards was welcome from the standpoint of safety and soundness, it exerted a contractionary influence on the economy and was reflected in the slow growth in bank credit and the broad monetary aggregates.

Against this backdrop, the Federal Reserve undertook additional actions designed to support the economy and to counter the tightening in credit terms. In mid-November, the FOMC moved to lower money market rates through open market operations, and in early December, the Board eliminated the 3 percent reserve requirement on nonpersonal time deposits and net Eurocurrency liabilities. This action was taken in response to the increased restraint on lending by commercial banks: Lower reserve requirements reduce funding costs to depository institutions, encouraging them to expand lending. Ultimately, the lower funding costs are passed through as a combination of lower rates for borrowers and higher rates offered to depositors.

Following the reduction in reserve requirements, further actions were taken in reserve markets to bring down short-term interest rates. These actions included additional steps toward a more accommodative supply of nonborrowed reserves through open market operations and two reductions in the discount rate—of a half point in December and of a like amount in January. All of these moves were made in light of further declines in economic activity, sluggish money and credit growth, and evidence of ebbing inflation pressures. In total, the federal funds rate has fallen about 2 percentage points from its mid-1990 level and about 3½ percentage points from its most recent peak in mid-1989.

Under the impetus of the easing of monetary policy and the softening of the economy, other short-term rates also fell significantly below mid-1990 levels by mid-February. The drop in yields on Treasury bills roughly paralleled that in the federal funds rate. Banks reduced their prime rates in two ½ percentage point steps in early 1991, but, as a consequence of the tightening in credit supplies, prime rates remained higher than usual relative to rates on federal funds and other sources of funds. Rates on commercial paper and CDs also fell less than those on federal funds or Treasury bills, dropping about 1¼ percentage points from mid-1990 levels. This widening of yield spreads was additional evidence of investor concern about private credits, though these spreads generally remained narrow relative to those seen in past economic downturns. However, yields on private money market instruments were under substantial upward pressure in the weeks leading up to year-end when the prospect of publishing financial statements led banks to attempt to hold down credit extension in order to bolster capital ratios and led lenders generally to intensify their focus on asset quality. Spreads soared at times in this period; but the Federal Reserve injected large amounts of reserves, the year-end passed without major dislocation, and yield spreads narrowed substantially in January.

Rates on longer-term securities came down considerably less from their levels in mid-1990 than those on short-term paper. As of mid-February, the yield on the thirty-year Treasury bond had fallen about ½ percentage point since the middle of 1989, and those on private long-

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term issues were down slightly less. Declines in these yields may have been limited in part by the increased uncertainty and volatility that followed the invasion of Kuwait. Some major stock market indexes had reached record highs in July, but the uncertain outlook both at home and abroad after the invasion of Kuwait and the slump in economic activity pushed stock prices significantly lower in the ensuing months. Since the war broke out in mid-January of this year, however, stock price indexes have moved up sharply, with some indexes reaching new record highs in mid-February. The foreign exchange value of the dollar declined about 10 percent over the second half of 1990; the dollar turned up early this year, but fell again in February.

Behavior of Money and Credit

M2 grew unexpectedly slowly in 1990, about 4 percent for the year, well down in the lower half of the FOMC's range. After a robust first quarter, M2 growth weakened markedly over the balance of the year. The expansion of this aggregate was well below what the historical relationships based on income and interest rates would suggest. The substantial declines in interest rates from their earlier levels would ordinarily be expected to offset to some extent the effects of the slowdown in nominal income in the second half of the year. M2 velocity was fairly stable through 1990, but historical relationships suggest that velocity should have fallen given the decline in interest rates.

The shortfall of money growth, relative to historical patterns, probably reflected the shifting of financial flows associated with the contraction of the thrift industry and the increased reluctance or inability of commercial banks to expand their balance sheets. Indeed, the slowdown of M2 growth emerged at about the time that RTC activity picked up. The drop in depository credit, which had its primary effect on the M3 aggregate, also may have damped M2 by lessening the need of commercial banks and thrift institutions to bid for retail deposits. One indication is the apparent cutback in advertising for these deposits during the year. And, as a result of the diminished need for retail deposits, deposit rates were held down relative to returns available on market instruments. In addition, some high-rate contracts were abrogated in the process of closing failed thrift institutions, reducing the attractiveness of these deposits; depositors who were dislodged from existing relationships when thrift institutions were closed may have reallocated their assets in other directions.

Nevertheless, even taking account of these factors affecting the relative attractiveness of yields on M2 assets, M2 growth remains much slower than seems explainable, indicating an underlying reevaluation of, and shift away from, M2 assets. One factor behind such a shift may have been concerns generated by the publicity about savings and loan failures and about credit quality problems at banks. To the extent that households moved assets to money market funds, which grew rapidly in the second half of the year, M2 would not be affected; however, direct purchases of market instruments would reduce M2. For example, noncompetitive tenders at Treasury auctions have been unusually strong, suggesting a shift toward holding these assets directly. In addition, households may have chosen to deplete liquid assets instead of increasing borrowing to maintain spending in the face of higher prices for energy products and the sudden plunge in real income; consumer credit growth was especially slow in the fourth quarter.

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The slowdown in M2 last year would have been even more pronounced had it not been for the rapid expansion of currency. At 11 percent, currency growth was more than twice its 1989 rate and was at the most rapid yearly rate of the postwar period. The bulk of the pickup appears attributable to increased demands for U.S. currency outside our borders, however. Information on shipments overseas suggests that demands for U.S. currency were particularly heavy in areas experiencing economic and political turmoil, especially Eastern Europe, Latin America, and, after the Iraqi invasion of Kuwait, the Middle East. The faster growth of currency, along with the effects of lower market interest rates on incentives to hold transactions balances, boosted M1 growth from near zero in 1989 to 4 percent in 1990. The monetary base grew 8½ percent over the year, also propelled by strong currency growth. By contrast, the total reserves portion of the monetary base was about unchanged, reflecting little net growth in reservable liabilities; transactions deposits increased slightly, but declines were registered in nonpersonal time deposits and net Eurodollar borrowing (abstracting from the effects of the reserve requirement decrease at year-end).

M3 grew 1¾ percent in 1990, somewhat less than had been anticipated early in the year. Roughly similar to the quarterly pattern of M2, M3 growth fell off noticeably after the first quarter and ended the year somewhat above the lower bound of its target range. That range itself had been lowered at midyear by 1½ percentage points amid evidence that the drop in thrift assets was proceeding more rapidly than had been expected and that credit flows were being directed away from depository institutions. Banks acquired a substantial amount of deposits from thrift institutions resolved by the RTC, but, unlike in 1989, they did not use newly acquired deposits to expand their balance sheets. Significant loan losses in 1990 limited the ability of banks to generate capital internally and raised the cost of external capital as investors reevaluated risks. At the same time, banks were facing the prospect of new capital standards. Banks used the deposits they acquired from thrift institutions to pay down other liabilities, especially large time deposits, with the result that the shift of M2 deposits from thrift institutions to banks contributed to sharp declines in M3 managed liabilities at banks.

Much of the difficulty in the banking industry can be traced to problems with commercial real estate loans. Before the mid-1980s, developers typically arranged permanent financing for construction and land development projects, usually from institutional investors, before obtaining initial bank financing. But during the period of rapidly rising real estate values in the latter 1980s, many banks no longer required such prearranged "takeouts," and when the real estate market cracked, those banks found themselves holding a substantial volume of undercollateralized loans. At about the same time, there was a significant reevaluation of the prospects for many of the highly leveraged transactions (HLTs) that had been undertaken in recent years; while bank losses attributable to HLTs have not yet been significant, the virtual disappearance of the market for new low-rated bonds has implied that many HLT loans will not be repaid as promptly as hoped. Growing uneasiness about banks' assets has contributed to increases in their cost of capital and, for some banks, of wholesale funding.

Banks by and large are sound and well capitalized, but concerns about the strength of the industry intensified

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Senior loan officer opinion survey, 1990–91[1]
Percentage of banks reporting tighter standards for approving business loan applications

Type of bank and size of customer firm	May	August	October	January
Domestic bank				
Large	n.a.	36	50	35
Middle	58	43	48	37
Small	54	34	41	32
U.S. branches and agencies of foreign banks	n.a.	61[2]	72	89

1. Survey of sixty large domestically chartered banks and eighteen U.S. branches and agencies of foreign banks. Data are for three months ending with survey date.

2. For six-month period from February to August.
n.a. Not available.

throughout 1990. The General Accounting Office and the Congressional Budget Office issued reports questioning the financial health of some large banks and exploring the implications of possible difficulties with those banks for the Bank Insurance Fund. Banks had to make large provisions for loan losses as delinquency and loss rates rose on most major categories of loans, but especially on real estate loans. By mid-September, rates on the subordinated debt obligations of some major banking institutions had jumped appreciably as investors reevaluated the health of these organizations. Several major bank holding companies chose to redeem portions of their outstanding auction-rate preferred stock rather than pay sharply higher rates. Spreads between bank and Treasury obligations widened significantly, and bank stock prices tumbled. These price movements began to be reversed subsequently. Partly under the influence of lower interest rates, bank stock prices have risen substantially in 1991, reversing much, though not all, of the declines since the summer; spreads on subordinated and other bank obligations have narrowed over the last few months, but remain well above their levels of last summer.

Other financial institutions also have encountered difficulty. Finance companies and, to a lesser extent, insurance companies took a beating in the securities markets beginning in September, as investors reevaluated the holdings of commercial real estate and HLT loans in light of expectations of a weaker economy. Yield spreads widened significantly. Furthermore, signs of mounting financial stress were not limited to the financial sector last year. The number of corporations reducing, omitting, or deferring dividends in the fourth quarter was the highest in more than thirty years. A record dollar amount of corporate bonds defaulted in 1990. Calculated as a percentage of the par amount of noninvestment grade bonds outstanding, the default rate of 8.7 percent was the highest in twenty years and more than double the rate in 1989. While the number of downgradings also reached a record high, most of the downgradings were attributable to deteriorating conditions affecting below-investment-grade nonfinancial corporations and, notably, financial institutions.

Not surprisingly, banks tightened standards and raised lending margins in response to the rising cost of funds, capital shortages, and perceptions of greater risk of default. In the wake of HLT disclosure guidelines, banks instituted management-imposed caps on their exposure to HLTs. Banks with low capital have cut back lending, while adequately capitalized banks—though maintaining substantial credit growth—appeared to be unwilling to step into the breach

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and increase their lending pace. Survey responses and other information on lending terms suggest especially severe constraints on credit for real estate development and commercial mortgages, but also some cutbacks for business lending more generally. Some of these business borrowers have limited alternative sources, and so the restriction of credit by banks probably has reduced their access to funds.

As a result of the tightening of credit standards and lending terms, but also owing importantly to the ebbing of borrowing demand as the economy turned down, the growth of bank assets slowed in 1990, especially in the fourth quarter. Total loan growth fell to roughly half its 1989 rate, with slowing evident in business, real estate, and consumer lending. There was, however, a strong regional disparity in the slowdown of bank lending, a disparity that was visible in total bank loans as well as in each loan category. In the Southwest, bank loans continued their pre-1990 decline, while, in New England, bank loans experienced a sharp turnaround at the beginning of 1990 from robust growth to outright decline. New England banks were particularly aggressive in selling loans into securities markets, which contributed to the overall drop, as did loan write-offs. For the rest of the country, loans continued to grow.

The slowdown in bank credit growth in 1990 occurred despite a pickup in bank holdings of government securities early in the year and the large transfers of deposits from failed thrift institutions. Thrift credit shrank rapidly during the year as the RTC resolved insolvent thrift institutions, acquiring the bulk of their assets in the process, and as many viable thrift institutions shed assets in an effort to meet the new capital guidelines. The credit contraction at depository institutions probably reduced total credit to some extent, but by far less than one for one. Both the secondary market in mortgages and the securitization of consumer loans substituted to a large extent for bank and thrift intermediation in those sectors. Securitization alone is estimated to have removed more than $40 billion in consumer loans from bank balance sheets during 1990 as banks pared their asset totals to improve capital ratios. Overall, the markets for home mortgages and consumer credit showed little indication that supply conditions were a significant factor restraining growth of these types of credit. Spreads on both asset-backed and mortgage-backed securities did widen a bit in the fourth quarter, but remained well within historical ranges and appeared to have little impact on the cost of funds to consumers. Sluggish expansion of both consumer credit and residential mortgage borrowing in 1990 seemed to reflect ebbing demands associated with slumping markets for housing and consumer durable goods.

Business borrowing slackened further in 1990, reflecting developments on both the demand and supply sides of the market. Although credit needs to finance corporate restructuring diminished—as indicated by the falloff in net equity retirements to roughly half the pace of the previous two years—the mismatch between corporate capital expenditures and internal funds increased in the second half of the year. A tightening of credit availability for all but investment-grade firms became increasingly evident. The pullback in lending to lower-rated borrowers was not limited to domestic banks; it included U.S. offices of foreign banks, which previously had been aggressive suppliers of funds to U.S. borrowers, as well as domestic non-bank lenders such as insurance companies. In addition, bond markets remained

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unreceptive to offerings of below-investment grade issues.

State and local governments reduced new borrowing and retired sizable amounts of debt that had been advance-refunded earlier, as pressures on municipal credit ratings mounted in 1990. A significant number of local housing issues had their ratings downgraded in response to the slipping credit quality of several banks and insurance companies that provide credit enhancements. Also, late in the year, certain municipalities and some states found themselves paying substantially higher rates in light of their own financial difficulties.

Growth of the debt of all domestic nonfinancial sectors was boosted last year by the federal government, which borrowed in part to fund acquisitions of thrift assets by the RTC. Borrowing for the RTC accounted for about ½ percentage point of the 7 percent growth of total debt in 1990. The growth of debt has slowed over recent years, but, even abstracting from the effects of RTC activity, remained well in excess of last year's expansion of nominal income.

Report on July 16, 1991

Monetary Policy and the Economic Outlook for 1991 and 1992

When the Federal Reserve presented its most recent monetary policy report to the Congress, in February of this year, the economy was still in a downswing that had been precipitated by Iraq's invasion of Kuwait in August 1990 and the associated spike in oil prices. To be sure, several developments early in the year had created conditions that promised to help foster a turnaround in the economy: Not only had oil prices reversed most of their earlier run-up, but monetary policy had been eased substantially in the final months of 1990 and the early part of this year. However, the economy continued to weaken for a time, and in the spring, policy was eased further, with the objective of ensuring a satisfactory recovery.

Recent evidence suggests that a pickup in activity probably is now under way. Much of the uncertainty that had depressed business and consumer sentiment was removed by the successful end of hostilities in the Persian Gulf. The resulting increase in confidence, combined with the boost to real purchasing power provided by the retreat in oil prices, raised consumer spending on balance over the late winter and spring. These same factors, as well as lower mortgage rates, also have spurred a gradual recovery in the housing sector. Reflecting the stimulus from housing and consumer demand, along with the continued growth in U.S. exports, industrial production turned up in April and has advanced appreciably since then; in addition, labor demand showed signs of stabilizing during the spring.

As anticipated earlier this year, inflation has slowed from its pace in 1990. Retail energy prices came down substantially during the first half of the year, and the rise in consumer food prices moderated after several years of relatively large increases. More generally, the softness of labor and product markets has attenuated price pressures for a range of goods and services. This downdrift in "core" inflation was difficult to discern earlier in the year because of a bunching of price increases in January and February; however, most of the significant increases in those months either did not continue or were reversed.

The Federal Reserve's easing moves over the first part of the year not only were taken in light of the contraction of economic activity and the progress in reducing inflationary pressures, but also were prompted by the continued slow

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growth of the monetary aggregates early in the year and continuing credit restraint by banks and other intermediaries. Reserve market conditions were held steady after April, however, as evidence began to accumulate that the economy was on track toward recovery. Reflecting the Federal Reserve's policy actions and generally weak credit demands, short-term interest rates declined appreciably during the first half of the year. Longer-term rates, which had moved down markedly in the final months of 1990, were mixed over the first half; with bond market participants focusing on signs of an emerging recovery, Treasury bond yields rose a bit, while rates on bonds issued by businesses fell as risk premiums narrowed sharply. In the stock market, share prices have registered sizable increases since January, and broad indexes remain within a few percent of the all-time highs set in the spring. Meanwhile, the value of the dollar has climbed substantially on foreign exchange markets, supported by the successful conclusion of military operations in the Gulf, by expectations of a recovery in the U.S. economy, and by economic developments in Germany and political difficulties in the Soviet Union.

In response to Federal Reserve easings and associated declines in short-term interest rates, growth of both M2 and M3 strengthened somewhat during the first half of 1991 relative to the slow pace of the second half of 1990. M2 expanded more than nominal GNP, and thus its velocity fell, although not as much as might have been expected considering the decline in short-term interest rates. The continued muted response of M2 to the easings in short-term rates probably reflected the ongoing rerouting of credit outside of depositories and an effort on the part of savers to maintain yields on their assets by turning to the stock and bond markets, sometimes via mutual funds. Growth of M3 was boosted early in the year by strong issuance of large time deposits by U.S. branches and agencies of foreign banks in response to a reduction in reserve requirements around the end of 1990. In the second quarter, however, the expansion of M3 slowed as issuance of time deposits at foreign banks waned, and depository credit and associated funding needs contracted. Through June, both M2 and M3 had grown at rates somewhat below the midpoint of their targeted annual growth ranges.

Credit growth was slow in the first half of the year. The federal government's borrowing requirements were held down by reduced activity by the Resolution Trust Corporation (RTC) and by contributions from foreign countries to cover the costs of Operation Desert Storm. Growth of private-sector debt was restrained by slack demand associated with the weakness of the economy and by a reduced appetite for leveraging. On the latter score, a lasting shift toward more conservative patterns of credit use would be a fundamentally healthy development; the excesses of the 1980s clearly left us with problems in our financial sector that will take some time to resolve. In part reflecting earlier credit losses, banks continued to

Ranges for Growth of Monetary and Debt Aggregates[1]

Percent

Aggregate	1990	1991	Provisional range for 1992
M2	3–7	2½–6½	2½–6½
M3	1–5	1–5	1–5
Debt[2]	5–9	4½–8½	4½–8½

1. Change from average for fourth quarter of preceding year to average for fourth quarter of year indicated. Ranges for monetary aggregates are targets; range for debt is a monitoring range.

2. Domestic nonfinancial sector.

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be cautious lenders through the first half of 1991. However, private borrowers who turned to securities markets found readier access to capital as the economic outlook brightened and risk premiums narrowed dramatically; financial intermediaries as well as nonfinancial firms issued large volumes of equity and longer-term debt, making significant progress in strengthening their balance sheets.

Monetary Objectives for 1991 and 1992

At its meeting earlier this month, the FOMC reaffirmed its previously established ranges for money and credit for 1991. The target range for M2 had been lowered in February to 2½ to 6½ percent from the 3 to 7 percent range that had been in place for 1990. To date this year, M2 has grown at an annual rate of a little less than 4 percent, placing it well within the target range for 1991 as a whole. This, in effect, leaves the Committee some room to maneuver as events unfold in the coming months, while remaining within the annual range. The potential need for such maneuvering room arises in part in connection with the significant uncertainties attending the prospects for the velocity of M2. If, for example, the public's demand for M2 balances should be damped by moves among depository institutions to lower deposit rates (in response to earlier declines in market yields and to higher insurance premiums), then velocity might tend to be stronger than otherwise would be the case and less M2 growth would be required to support a given rate of GNP increase. If, on the other hand, institutions were to become more aggressive in bidding for loanable funds in the retail deposit market, and thus the public began to shift its portfolio back in favor of M2 assets, then velocity could weaken and faster M2 growth might be required. The Committee expects that the current annual growth range will permit it to deal with such velocity-altering disturbances in money supply and demand while it fosters financial conditions conducive to moderate economic growth and further progress toward price stability.

The 1 to 5 percent target range for M3 adopted in February took into account an expected continued contraction in the thrift industry and associated redirection of credit flows away from depository institutions. The assets of thrift institutions are expected to shrink further in the second half of 1991, in large part because of closures by the RTC. Issuance of large time deposits by branches and agencies of foreign banks has moderated, but domestic banks may have a greater appetite for funds during the second half as sound lending opportunities increase with the projected improvement in the economy.

Even though growth of the aggregate debt of domestic nonfinancial sectors at midyear was at the lower end of its current 4½ to 8½ percent monitoring range, the Committee anticipates that the debt measure will end the year well within that range. Stronger private credit demands are expected to arise as the economy grows, and federal borrowing will increase to finance stepped-up RTC activity. However, debt growth is likely to continue to be damped by the shift in attitudes about leveraging.

In setting provisional ranges for 1992, the Committee chose to carry forward the 1991 ranges for the monetary aggregates and for debt. Recognizing that the ranges had been reduced significantly over the past few years, the Committee at this time believes that expansion of money and debt in 1992 within the current ranges probably would be consistent with consolidating and extending

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the gains toward lower inflation that have been made to date, and at the same time would provide sufficient liquidity to support a sustainable expansion of economic activity. The ranges will, of course, be reevaluated next February in light of intervening economic and financial events. The Committee will want to update its assessment of the underlying tendencies in the economy as well as in the relations between money and debt expansion and economic performance. Although the initial indications of money and credit ranges that are given in July always are tentative, flexibility seems all the more warranted in the current circumstances, with the economy apparently at a cyclical turning point and the financial system being buffeted by fundamental change.

Economic Projections for 1991 and 1992

The target ranges for the monetary aggregates and debt have been selected with the objective of supporting a sound economic expansion accompanied by declining inflation—a pattern the Board members and Reserve Bank presidents generally expect to prevail over the coming year and a half. Most forecast that real GNP will grow ¾ to 1 percent over the four quarters of 1991; given the decline during the first quarter, this central tendency range for 1991 as a whole implies an appreciable pickup in activity over the remainder of the year. The projections of growth in real GNP over the four quarters of 1992 have a central tendency of 2¼ to 3 percent.

In appraising the near-term outlook, the FOMC participants have placed considerable weight on the apparent absence of inventory overhangs in most sectors. Accordingly, the recent firming of aggregate final demand is expected to bring a halt soon to the inventory drawdowns that persisted into the second quarter. The resulting swing in the pace of inventory investment is expected to boost domestic production considerably over the rest of 1991. As typically occurs in the initial stage of a recovery, much of this rise in output is expected to reflect gains in the productivity of existing workers, rather than a marked pickup in employment. Thus, the Board members and the Bank presidents project only modest progress in reducing unemployment over the second half of the year; the projected central tendency for the civilian jobless rate in the fourth quarter is 6¾ to 7 percent.

The pace of expansion may moderate somewhat in 1992 as the initial impetus from the inventory swing subsides and gains in production track the growth in final demand more closely. The advance in real GNP expected for 1992, though subdued relative to that during the early part of most previous expansions, is anticipated to reduce the margin of slack in the economy over the year. The central tendency of the civilian unemployment rate projected for the fourth quarter of 1992 is 6¼ to 6½ percent, roughly ½ percentage point below the level expected for the fourth quarter of this year.

Several factors lie behind the expectation of a relatively mild upswing in economic activity. In real estate markets, the persistent overhang of vacant space for many types of buildings, along with continued caution on the part of lenders, will likely limit the amount of new construction. In addition, fiscal policy will remain moderately restrictive because of the federal budget agreement reached last fall and efforts by state and local units to correct serious imbalances in their budgets; although this fiscal restraint ultimately will strengthen the U.S. economy by boosting domestic saving and investment, its near-term effect will be to hold down aggregate demand. Further, with the personal saving rate

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already at a low level and some households saddled with heavy debt burdens, consumer spending is projected to grow at a relatively slow pace. Finally, the appreciation of the dollar this year has offset some of the previous declines in relative prices of U.S. goods in international markets, thus limiting the contribution that can be expected from the external sector.

By adopting policies intended to put the economy on a path of moderate, sustainable growth, the Board members and Reserve Bank presidents believe that it will be possible to achieve meaningful progress in reducing inflation over the remainder of this year and into 1992. The central tendency of the projected rise in the total consumer price index is 3¼ to 3¾ percent over the four quarters of 1991 and 3 to 4 percent over 1992, well below the 6¼ percent rise recorded over the four quarters of 1990. In each of the prior three years, 1987–89, the CPI rose about 4½ percent.

The common midpoint of the forecast ranges for CPI increases in 1991 and 1992, 3½ percent, masks the downtrend in core inflation anticipated over the next year and a half. In particular, most of the slowing of inflation observed thus far this year has reflected the sharp drop in energy prices and a move toward smaller increases in food prices; excluding food and energy, the deceleration in the CPI so far has been relatively small. However, with the tempering of labor-cost increases now under way and the reduced pressure on plant utilization, core inflation is expected to recede significantly in coming quarters. As these declines become widely perceived, expectations of inflation should moderate, reinforcing the tendencies toward deceleration. By reducing and ultimately eliminating the distortion to resource al-

Economic Projections for 1991 and 1992

Item	FOMC members and other FRB presidents		Administration
	Range	Central tendency	
	1991		
Percent change, fourth quarter to fourth quarter[1]			
Nominal GNP	3¾–5¾	4½–5¼	5.3
Real GNP	½–1½	¾–1	.9
Consumer price index[2]	3–4½	3¼–3¾	4.3
Average level, fourth quarter (percent)			
Unemployment rate[3]	6½–7	6¾–7	6.6
	1992		
Percent change, fourth quarter to fourth quarter[1]			
Nominal GNP	4–6¾	5½–6½	7.5
Real GNP	2–3½	2¼–3	3.6
Consumer price index[2]	2½–4¼	3–4	3.9
Average level, fourth quarter (percent)			
Uunemployment rate[3]	6–6¾	6¼–6½	6.5

1. From average for fourth quarter of preceding year to average for fourth quarter of year indicated.

2. FOMC projections are for all urban consumers (CPI–U); Administration projection is for urban wage earners and clerical workers (CPI–W).

3. FOMC projections are for civilian labor force; Administration projection is for total labor force, including armed forces residing in the United States.

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location stemming from ongoing, generalized price increases, a monetary policy aimed at achieving price stability over time will enhance the economy's potential for growth and thereby will raise standards of living.

The Administration's economic projections for 1991, presented in the budget, differ from the projections of Federal Reserve policymakers mainly with respect to expectations for the consumer price index. The Administration forecast, at 4.3 percent, is above the central tendency projected by the Federal Reserve; however, recent statements by Administration officials suggest that this number will be lowered in the midsession update of the budget. The Administration is somewhat more optimistic than the FOMC participants about prospects for real GNP growth in 1992; in addition, the Administration anticipates an increase in consumer prices next year near the upper end of the central tendency forecast by the Federal Reserve policymakers. This combination of output and inflation places the Administration's forecast of nominal GNP growth for 1992 somewhat above the range of projections by the FOMC participants. Given the obvious limitations on anyone's ability to forecast the economic future, these differences certainly cannot be said to be large—and the forecasts do have the important common feature of pointing to a relatively moderate recovery, with inflation remaining below the average pace of the past few years. And, in light of the uncertainties attending the behavior of the velocities of money and credit in the current period of flux in patterns of intermediation, there appears to be no necessary inconsistency between the Administration's economic forecast and the FOMC's ranges for money and debt for 1991 and 1992. The FOMC, of course, will be reviewing the prospects for the economy, along with those for velocity, when it reconsiders the 1992 target ranges next February.

Performance of the Economy during the First Half of 1991

Economic activity contracted appreciably this past fall and winter. Although the economy had been sluggish during the first half of 1990, real gross national product registered a further increase in the third quarter, and a substantial downturn in activity began only after the jump in oil prices that followed Iraq's invasion of Kuwait. With consumer and business confidence badly shaken and real income depressed by the higher oil prices, employment and production declined markedly starting in October; real GNP fell at a 1.6 percent annual rate in the fourth quarter. The civilian unemployment rate, which had held around the relatively low level of 5¼ percent during the first half of 1990, rose steadily over the second half, to just over 6 percent at year-end.

The downward momentum in activity carried into the early part of 1991. Industrial production decreased through the first quarter, and the shrinkage of private-sector payrolls continued through April as firms moved aggressively to reduce inventories and trim labor costs in response to the weakening of final demand. However, much of the negative impetus to activity was reversed by the cumulative drop in oil prices that occurred between October and February and by the boost in confidence that accompanied the swift and successful conclusion of the Persian Gulf war. These events, combined with a considerable easing of monetary policy, set the stage for a recovery, and a few sectors of the economy actually hit bottom quite early in the year. Notably, construction of single-family homes,

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which in past recessions turned up before the economy as a whole, reached its low point in January, as did real consumer spending and real personal income.

Recently, further evidence has emerged to indicate that economic activity, in the aggregate, stabilized or began to move up during the second quarter of 1991. Much of this evidence is to be found in developments in the labor market. Initial claims for unemployment insurance—an indicator of the pace of job loss—have fallen from their high level in March; employment on nonfarm payrolls edged up, on balance, over May and June after ten months of decline; and the length of the average workweek increased noticeably in May and June. In addition, industrial production advanced in April, May, and June, with the gains being propelled initially by increased output of motor vehicles and parts. Although these indicators are subject to revision and thus should be read with considerable caution, the weight of the available evidence points in the direction of economic recovery.

The magnitude and length of the recent recession still are not known with certainty, but the decline in real GNP appears to have been considerably smaller than the average decline during the previous post–World War II recessions; for the industrial sector alone, production dropped 5 percent between the peak in September 1990 and the low point in March 1991, compared with an average falloff of nearly 10 percent during previous recessions. The recent contraction also seems to have been relatively short by historical standards. Aggregate job losses, however, were close to the average in previous recessions, suggesting that firms cut payrolls vigorously in light of the fairly shallow drop in real activity. The resulting rise in the unemployment rate, though, was damped relative to that during earlier contractions, as unusually slow growth of the labor force held down the number of job seekers; the unemployment rate in June of this year, 7 percent, was about ¾ percentage point below the average jobless rate at the end of previous recessions.

Consumer price inflation, which exceeded 6 percent last year, slowed to a 2¾ percent annual rate over the first five months of 1991. Consumer energy prices fell sharply early this year after soaring during the second half of 1990. In addition, the rate of increase in food prices has retreated this year from the pace registered during the preceding three years.

Apart from food and energy, price increases were large early in the year but have been more moderate in recent months. In January and February, prices were boosted by hikes in federal excise taxes and postal rates and by the passthrough of the energy price increases in 1990 to a wide range of goods and services. With no further increases in these federal charges and the reversal of energy prices beginning to show through to other items, the CPI excluding food and energy rose much more slowly over the three months ended in May. On balance, over the first five months of 1991, this portion of the CPI increased a bit more than 5 percent at an annual rate, about ½ percentage point below the trend rate of increase as of last summer. In part, the recent headway made on inflation reflects the reduction in labor-cost pressures that accompanied the rise in unemployment. As measured by the employment cost index, compensation per hour increased at an average annual rate of 4¼ percent over the second half of 1990 and the first quarter of this year, compared with the 5¼ percent (annual rate) rise over the first half of 1990.

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The Household Sector

Consumer spending was an area of notable weakness last fall and early this year, largely in response to a substantial decline in real income; purchasing power was cut initially by the jump in oil prices, but it continued to fall even after oil prices were in retreat, reflecting the ongoing declines in employment. Real consumer outlays dropped sharply between September and January; the monthly pattern of spending was distorted to a degree by tax changes that caused some households to shift purchases from early 1991 into late 1990. All told, real consumer spending fell at a 1½ percent annual rate in the first quarter, after a 3½ percent (annual rate) decline in the fourth quarter of 1990. However, in February, real income turned up and consumer confidence rebounded late in the month with the end of the Gulf war; both developments bolstered consumer spending. As a result of the spending gains that began in February, the average level of outlays in April and May stood considerably above the first-quarter average.

Among the major components of consumer spending, outlays for motor vehicles and other durable goods were cut back sharply as the recession unfolded. Indeed, between the third quarter of 1990 and the first quarter of this year, real consumer outlays for motor vehicles fell at a 23 percent annual rate; the resulting level of such outlays in the first quarter was the lowest recorded since 1984. Substantial cuts also were made in purchases of nondurable goods. In contrast, consumer outlays for services trended up at a pace only slightly below that registered during the first three quarters of 1990. Since the January trough in total consumer outlays, purchases of both durable and nondurable goods have turned up. In particular, as of May, real consumer purchases of motor vehicles had risen about 8 percent from the depressed January level; separate data on unit sales of new cars and light trucks suggest that further gains were registered in June.

During late 1990 and early this year, total consumer outlays fell more sharply than they had in most previous postwar recessions. The steepness of the drop this time mainly reflects the unusual weakness in several components of income out of which the propensity to consume is high. Most important, nominal wages and salaries fell more during this recession than would have been expected given the magnitude of the decline in nominal GNP, as firms moved aggressively to control costs by trimming payrolls. In addition, because the percentage of unemployed persons receiving unemployment insurance benefits declined during the 1980s, total payments to job losers were less than during earlier downturns. The weakness in these components of nominal income was compounded, in real terms, by the spurt in energy prices.

Although consumers cut back spending, they cushioned some of the effect of weak income by reducing their savings. After averaging about 5 percent over the first half of 1990, the personal saving rate dropped to 4.2 percent in the third quarter and remained at that level through the first quarter of this year. The decline in the saving rate occurred despite some deterioration, on net, in wealth positions during the second half of 1990, which reflected the softening of house prices and losses in the stock market. The average level of the saving rate dropped another notch in the spring, to about 3¾ percent. The bounceback in the stock market and the improvement in confidence may have contributed to the decline in saving, but the explanation also could involve the reduction in personal interest income associated with

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the lowering of short-term interest rates between last fall and this spring. Historically, consumer spending has been rather insensitive to movements in interest income, so that a decline in such income causes the saving rate to fall in the short run. That said, the saving rate is now at the lowest level since late 1987, and it would not be surprising if, in the near term, gains in consumer spending lagged increases in income as households worked to rebuild net worth.

The recession placed some strains on household finances, as indicated by the increase in delinquency rates for all types of consumer loans during the first quarter. By far the sharpest rise was for credit card debt; in fact, the first-quarter delinquency rate was close to the highest on record. This jump partly reflects the relaxation of credit standards by major card issuers in recent years; at the same time, relatively low risk borrowers who have access to home equity lines of credit evidently have reduced their reliance on credit cards. Because of the resulting deterioration in the quality of the pool of credit card users, the rise in delinquencies for this type of debt probably overstates the degree of stress in the household sector as a whole. For other types of consumer loans, the first-quarter delinquency rates were not out of line with those typically seen during recessions, despite the currently high level of debt relative to disposable income. Apparently, the rise in asset values during the 1980s left most households with sufficient wherewithal to cover the expanded level of debt. Thus, although the recession has weakened the financial position of the household sector, the situation does not appear worse than that at the end of other downturns.

Residential construction activity, which had been trending lower since 1986, slumped further in the second half of 1990. However, the market for single-family homes bottomed out in January of this year and has staged a mild recovery since then, spurred by a firming of demand. Several factors account for the pickup in demand, including the decline in home prices to more affordable levels in a number of markets, improved prospects for employment and income, and some reduction in mortgage rates from those prevailing in the middle of last year. Recent survey results show a more favorable attitude toward homebuying among consumers than at any other time since 1988. Reflecting this shift in sentiment, sales of existing homes have risen substantially from their low in January. Although sales of new homes have been less impressive, the higher level prevailing since February has reduced considerably the inventory of unsold new homes relative to sales; in response, home builders have boosted production to satisfy consumer demand. Despite continued lender caution about granting land-acquisition and construction loans, the quantity of financing available appears sufficient, on balance, to support a further recovery in this sector.

In contrast, the market for multifamily housing has continued to weaken this year. Starts in May were at the lowest monthly level since the 1950s. Moreover, even with the greatly reduced pace of new construction in recent years, the vacancy rate for multifamily units has remained exceptionally high. Given current conditions in the market, both lenders and potential investors recognize that the number of viable projects is quite limited.

The Business Sector

During the latter part of 1990 and the first quarter of this year, the business sector experienced considerable stress. Demand for business output was depressed both by the loss of domestic

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purchasing power and by the enormous uncertainties created by the situation in the Persian Gulf. In response to the slump in demand, industrial production turned downward last October; it continued to fall through March. In most industries, the combination of plummeting sales and rising energy prices caused profit margins, which were already slim, to shrink further during the second half of 1990. In the first quarter of 1991, before-tax profits from current operations of U.S. corporations edged down from the low fourth-quarter level.

An unusual feature of the recent recession was the speed with which producers cut output to avoid a buildup of inventories. The promptness of this adjustment likely reflected a combination of factors. The downturn in final demand was widely anticipated, and some producers cut output preemptively rather than risk being saddled with excessive stocks. In addition, improved systems for monitoring and controlling inventories, which have been installed in recent years, enabled firms to react quickly to signs of slowing demand. Further, the relatively heavy debt burdens in the corporate sector created substantial financial pressures for many firms and focused attention on the need to cut costs.

Accordingly, inventories were run off at a rapid clip beginning late last summer. Automakers slashed production and inventories particularly aggressively; domestic output of motor vehicles in the first quarter of 1991 was nearly 30 percent below that in the third quarter of 1990. The resulting drawdown of inventories at auto dealers accounted for fully one-half of the total liquidation of nonfarm stocks during the fourth quarter and the first quarter. Despite production cutbacks by the automakers and other producers, the inventory-to-sales ratio for total manufacturing and trade moved up through January. However, by May, the ratio had retraced most of the run-up that began with the onset of the recession, reflecting the continued liquidation of stocks and an upturn in sales.

Inventories in most industries appear now to be reasonably well aligned with sales, and output has begun to rise with the expansion of final demand. After reaching a trough in March, industrial production expanded over the next three months at an annual rate of more than 7 percent; although stronger output of motor vehicles and parts accounted for most of the increase early in the second quarter, the gains in recent months have been more widespread. Orders for a range of manufactured goods firmed in April and May, pointing to a further pickup in production during the summer.

Business spending for fixed investment was flat in real terms during the fourth quarter of last year and dropped sharply during the first quarter of this year. Several factors worked to reduce outlays, including the easing of pressures on capacity, the diminished level of cash flow, and the general atmosphere of uncertainty related to events in the Persian Gulf. Real spending for equipment plunged during the first quarter; measured in percentage terms, the decline was the sharpest quarterly falloff recorded in nearly eleven years. Reflecting the difficulties in the manufacturing sector, real spending for industrial equipment dropped at an annual rate of more than 20 percent, after smaller declines during the preceding five quarters. Real business outlays for motor vehicles were cut at nearly a 35 percent annual rate in the first quarter, sinking to the lowest level since mid-1983. Purchases of computers and other information-processing equipment also were scaled back during the first quarter, and outlays for aircraft edged down,

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after jumping 60 percent over the preceding year.

The pace of nonresidential construction fell substantially during the fourth quarter of 1990 and the first quarter of 1991. The decline was broad-based, with the steepest contraction for office and other commercial buildings. Activity in this sector actually peaked in 1985 and has trended lower since then in response to persistently high vacancy rates and the removal of important tax benefits. In the industrial sector, the rate of plant construction has been damped by the emergence of substantial excess capacity in a number of major industries. Petroleum drilling activity, which moved up a bit late last year, retreated during the first quarter with the price declines for crude oil and natural gas; data on drilling rigs in use indicate a further weakening of activity during the second quarter.

Business spending for new equipment typically does not turn up until several months after the end of a recession, and the lag for construction outlays is often substantially longer. As yet, there is little sign of a rebound in spending for either equipment or nonresidential structures. Nonetheless, shipments of industrial equipment and other nondefense capital goods—a coincident indicator of equipment spending—have stabilized in recent months. Similarly, although vacancy rates for commercial buildings remain high, the steepest declines in total nonresidential construction activity may be over; in April and May, the average level of activity was about unchanged from the first-quarter average, and the downtrend in forward-looking indicators, such as construction contracts and permits, has slowed considerably.

The Government Sector

The federal budget deficit over the first eight months of fiscal year 1991 was $175 billion, compared with a $151 billion deficit during the same part of fiscal year 1990. The deficit during the current fiscal year has been boosted considerably by the slowdown in economic activity, and this cyclical increase has masked the fiscal restraint imposed by last autumn's budget agreement. On the revenue side, federal tax receipts have been held down by the anemic growth of nominal income since last fall; indeed, personal income tax payments so far this fiscal year are little changed from the payments made during the same period a year earlier. The slowdown in activity also has raised the deficit by increasing outlays for income-support programs such as unemployment insurance, food stamps, and Medicaid. These effects of the contraction have been offset, to some degree, by the easing of short-term interest rates, which has restrained the growth of interest payments on the federal debt.

Although the deficit has increased during the current fiscal year, the increase has been far smaller than that projected roughly six months ago. At that time, the Administration and the Congressional Budget Office both estimated that the deficit for fiscal year 1991 would top $300 billion. Two developments have caused the 1991 deficit to be lower than was expected, though neither one indicates any fundamental improvement in the budget situation. First, cash contributions from our allies in Operation Desert Storm have exceeded the outlays made to date for U.S. involvement in the Persian Gulf. The contributions not yet spent will be used to pay for the replacement of munitions into fiscal 1992 and beyond. Second, federal outlays related to deposit insurance were well below expectations during the first quarter, mainly reflecting the slow pace at which insolvent thrift institutions were resolved. The activities

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of the RTC during that period apparently were hindered, in part, by a lack of funding; legislation providing additional funding was enacted in late March, and the RTC has scheduled more rapid resolutions over the rest of the year.

Federal purchases of goods and services, the part of federal spending that is included directly in GNP, rose 5¼ percent in real terms over the four quarters of 1990. This increase reflected the fourth-quarter rise in defense purchases to support operations in the Persian Gulf, as well as increases over the year in such nondefense programs as law enforcement, space exploration, and health research. In the first quarter of 1991, real defense purchases moved above the already high fourth-quarter level, while nondefense purchases fell somewhat on net, pushed down by sales of oil from the Strategic Petroleum Reserve. Over the rest of 1991, fiscal policy likely will be a restraining influence on the economy because of the spending limits and tax increases mandated by last fall's budget agreement.

The fiscal position of state and local governments has remained extremely weak in recent quarters. The deficit in operating and capital accounts (that is, the deficit excluding social insurance funds) stood above $40 billion at an annual rate in both the fourth quarter of 1990 and the first quarter of 1991, after holding at a $30 billion rate for a year. The recent increase in the state and local deficit reflects, for the most part, a cyclical shortfall in tax receipts. However, this cyclical effect overlays structural imbalances that have been growing for some time. Since mid-1986, when the sector's accounts (excluding social insurance) were roughly in balance, outlays have risen from about 13½ percent of nominal GNP to 14½ percent while revenues have held fairly steady relative to GNP. The rise in the spending share reflects an expansion of services largely related to rapid growth in public school enrollments, prison populations, and Medicaid expenses.

During the past year, state and local governments moved to address their mounting fiscal difficulties. Many governments trimmed outlays relative to earlier trends. Between the first quarter of 1990 and the first quarter of 1991, real purchases by state and local governments rose only about 1 percent, well below the 3½ percent annual rate of increase averaged over 1985–89. Moreover, last year several states instituted broad-based hikes in personal income and sales taxes. Looking ahead, state budgets for fiscal year 1992—which began on July 1 for all but four states—generally mandate significant further cost-cutting from earlier plans. On balance, these budgets point to a weak picture for real state and local purchases over the current calendar year. Supplementing this restraint on spending, many new budgets include a second wave of major tax increases.

The External Sector

Over the first half of 1991, the foreign exchange value of the dollar appreciated about 15 percent, on balance, in terms of the currencies of the other Group of Ten (G-10) countries. The net appreciation over this period reversed about two-thirds of the decline in the dollar that had occurred between the middle of 1989 and the end of 1990.

In early January, the dollar was boosted by investors seeking a safe haven against the backdrop of growing tensions in the Persian Gulf. However, once the Allied bombing campaign commenced and was perceived as going well, part of the safe-haven demand for dollars evaporated, and the currency resumed its earlier decline. Between mid-January and early February, the dollar

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fell about 4 percent against the currencies of the other G-10 countries. During this period, U.S. monetary authorities joined with foreign central banks to support the dollar. Subsequently, the dollar surged through the end of March, largely reflecting the quick end of the war and the resulting expectation of an early rebound in the U.S. economy. The sharp run-up prompted official sales of dollars during March and April, mainly by European authorities. After dropping back a bit, the value of the dollar rose again in June on the accumulation of evidence suggesting that the U.S. recession had ended.

On a bilateral basis, the dollar this year has appreciated about 20 percent against the German mark and by similar amounts against the European currencies associated with the mark. The weakness of these currencies partly reflects economic difficulties in Germany and the spillover effects of the turmoil in the Soviet Union and Yugoslavia. In contrast, the dollar has appreciated much less against the currencies of most of our other major trading partners. So far this year, the dollar has risen less than 5 percent, on balance, against the Japanese yen and has changed even less against the currencies of Canada, Korea, Singapore, and Taiwan.

The overall strengthening of the dollar this year has acted to restrain prices for non-oil imports. Over the first quarter of 1991, these prices rose at a 2½ percent annual rate, less than half the rate of increase between June and December of 1990; non-oil import prices then fell during April and May, more than reversing the entire first-quarter rise. The price of imported oil, which surged between August and October of last year, has since retraced most of the rise induced by the Iraqi invasion of Kuwait. Taken together, these two developments have contributed significantly to the restraint on domestic inflation.

Real merchandise imports declined in the first quarter to a level about 5 percent below that in the third quarter of 1990, with the drop largely reflecting the weakness in domestic demand. Import volumes fell in the first quarter for a wide range of non-oil products, including consumer goods, motor vehicles, and industrial supplies. Preliminary data for April show some increase in non-oil imports, a pattern that is likely to continue with the apparent firming of domestic activity. The quantity of oil imports—which plunged after the spurt in oil prices last summer and remained relatively low early this year—has moved back up in recent months, reflecting efforts to rebuild U.S. petroleum inventories.

Merchandise exports continued to move higher through the spring, a factor that clearly tempered the output loss in manufacturing after the oil shock last year. In real terms, merchandise exports rose at a 10 percent annual rate between the third quarter of 1990 and the first quarter of this year, led by increased sales of computers, other capital goods, and industrial materials. Preliminary data indicate that merchandise exports rose again in April. The competitive position of U.S. companies has benefited, at least until quite recently, from the substantial drop in the dollar over 1990 and the latter part of 1989. However, recessions in the economies of some of our major trading partners, especially Canada and the United Kingdom, have offset part of the stimulus to U.S. exports provided by the rapid economic growth in such countries as Germany, Japan, and Mexico.

The merchandise trade deficit narrowed to $74 billion (at an annual rate) in the first quarter of 1991, compared with $111 billion in the fourth quarter of

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1990; the first-quarter deficit was the smallest since mid-1983. The current account actually recorded a $41 billion (annual rate) surplus in the first quarter, a sharp improvement over the $94 billion deficit in the fourth quarter of 1990. Most of this improvement reflected unilateral transfers associated with Operation Desert Storm: The fourth-quarter deficit was boosted by a grant from the U.S. government to Egypt for the purpose of repaying outstanding loans, while cash payments to the United States from our coalition partners surged in the first quarter. Excluding these cash contributions and the special grant to Egypt, the current account moved from a deficit of $83 billion in the fourth quarter to a deficit of $50 billion in the first quarter.

A small net capital inflow was recorded in the first quarter of 1991, as an increase in foreign official holdings of reserve assets in the United States more than offset a net outflow of private capital. Within the private-sector accounts, there was a substantial capital outflow in the first quarter associated with U.S. direct investment abroad, the bulk of which was in the countries of the European Community; at the same time, capital inflows related to foreign direct investment in the United States fell to a low level. Increasingly, multinational firms have raised funds in the United States to finance direct investment here and elsewhere, taking advantage of the low U.S. interest rates relative to those in other industrial nations. With regard to other private transactions, banks reported a small net capital inflow in the first quarter, and net purchases of U.S. securities by private foreigners about matched U.S. net purchases of foreign securities.

The net capital inflow during the first quarter, when combined with the surplus on current account, implies a large negative statistical discrepancy in the international accounts. Nearly as large a discrepancy in the opposite direction was registered in the fourth quarter of last year. These wide swings in the statistical discrepancy, along with the huge size of the discrepancy for 1990 as a whole, cast doubt on the accuracy of both the capital account and current account data used in the U.S. international accounts and highlight the need to improve these data.

Labor Markets

Labor demand appears to have stabilized after contracting sharply during the latter part of 1990 and the early part of this year. Employment on private nonfarm payrolls peaked last June, edged lower through September, and then fell substantially in each month from October through April. However, the most recent data show that payrolls expanded slightly on balance over May and June, and survey results suggest that firms intend to increase employment further in the third quarter.

The cumulative decline in private nonfarm employment through April was slightly more than 1½ million jobs, roughly a 1.7 percent drop. Although that percentage decline is close to the average in the other recessions after World War II, three industries had abnormally large job losses: construction; retail and wholesale trade; and finance, insurance, and real estate. The steep decline in construction employment likely reflected the unusually sharp falloff in office and other commercial construction, which compounded the normal cyclical contraction in residential building. In the trade sector, employment was depressed by the sizable decline in consumer spending and the high degree of financial distress among retailers, some of whom were burdened with heavy debt-servicing costs as a result of lever-

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aged buyouts. Employment in finance, insurance, and real estate—which continued to rise during past recessions—edged lower this time, reflecting the shakeout in the financial sector and spillovers from the slump in real estate markets. In contrast, the decline in manufacturing payrolls was somewhat smaller than in previous contractions, largely because the drop in industrial production was relatively shallow. Employment in the services industries continued to trend up during late 1990 and early 1991, as it had in previous recessions, supported entirely by gains in health services.

Although the size of the drop in private nonfarm payroll employment was similar to that in previous contractions, the decline in real GNP during the current episode was relatively small. This contrast confirms the widespread impression that firms shed workers to an unusual degree during the recent downturn. At the same time, the rise in the civilian unemployment rate from 5.5 percent in July 1990 to 7 percent this June was not particularly large relative to the decline in real GNP. Apparently, an unusual proportion of people who lost jobs subsequently dropped out of the labor force and thus were no longer counted as unemployed. In addition, the muted rise in unemployment and labor-force size during recent quarters may be part of a longer-term deceleration in the rate at which women—especially younger women—have entered the labor market. For this latter group, there has been a shift toward additional school attendance and toward staying at home to care for young children. By reducing the number of new job seekers at a time when jobs were quite hard to find, this shift held down the rate of unemployment.

A variety of indicators suggest that labor demand has stabilized in recent months. Perhaps the earliest signal of this improvement was provided by the data on initial claims, which peaked at a weekly rate of 535,000 in March and then dropped back to about 470,000 in April; the pace of weekly claims has since moved considerably lower. Employment on private nonfarm payrolls rose in May, the first increase since the middle of 1990. Although part of this gain was reversed in June, firms continued to lengthen the average workweek of their employees. This pattern of cautious hiring combined with an extension of the workweek is common in the early stage of a recovery; given the expenses associated with hiring and firing, such a strategy is a natural response to uncertainty about the strength and duration of the pickup in demand. A separate measure of employment, derived from a survey of households, also suggests that labor demand has stabilized; the number of persons reporting themselves as employed was about flat, on balance, over the second quarter, after falling sharply over the three preceding quarters. Although the civilian unemployment rate did continue to inch up over the second quarter, this increase is not too surprising, as the jobless rate often increases during the first several months of a recovery. With the brightening of employment prospects, job seekers enter the labor force at an increasing rate, raising unemployment until hiring accelerates enough to outstrip the growth in labor supply.

The slack opened up in labor markets since last summer has helped damp the rate of increase in labor costs, which had trended higher between the end of 1987 and the middle of 1990. As indicated by the employment cost index (ECI), increases in compensation per hour for private industry workers accelerated from 3¼ percent during 1987 to about a 5¼ percent annual rate during

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the first half of 1990; this measure of labor costs covers both wages and payments for worker benefits. The most recent ECI data show that compensation costs rose at an average annual rate of 4¼ percent over the second half of 1990 and the first quarter of 1991, a full percentage point below the peak rate recorded early last year. Although this slowing of labor-cost inflation was apparent in both wages and benefits, the latter component of compensation decelerated the most sharply, reflecting declines in nonproduction bonuses and pension contributions per hour of work. However, employer costs for insurance, mainly for health insurance premiums, continued to rise at close to double-digit rates.

Output per hour in the nonfarm business sector was essentially flat, on balance, over the year ended in the first quarter of 1991, after declining during 1989 and the early part of 1990. This pattern differed somewhat from the usual cyclical experience. Typically, productivity continues to rise until shortly before the business-cycle peak, then turns down and falls sharply through the early part of the ensuing recession. Productivity during this episode declined well before the cyclical peak last summer, as output growth slowed, and firms continued to hire at a relatively rapid pace. However, as demand softened at the peak, firms began to trim payrolls, and this pruning continued in an aggressive fashion through the recession; as a result, output per hour was better maintained during the 1990–91 contraction than during previous downturns. In manufacturing, where competitive pressures have been particularly intense, the process of cutting payrolls began well before the onset of recession, and this early action allowed productivity gains to remain robust over the year leading up to the contraction. Although productivity in manufacturing turned down during the recession, the continued cutting of factory jobs kept the drop in output per hour relatively small by historical standards.

Price Developments

Inflation pressures have eased somewhat this year. Most of last year's spike in energy prices has been retraced, and the rate of increase in food prices has slowed. In addition, the margin of slack in labor and product markets that emerged during the recession is placing downward pressure on price increases for other goods and services; this trend toward slower "core" inflation, however, was obscured early in the year by a number of price increases that either were one-time events or have since been reversed.

The Iraqi invasion of Kuwait last August precipitated a sharp rise in oil prices that carried through to early October. At that point, the posted price of West Texas Intermediate oil, the benchmark for U.S. crude prices, reached nearly $40 per barrel, more than double the $16 price prevailing just three months earlier. Then, between October and February, virtually all of this price spike unwound, chiefly as a result of two developments. Saudi Arabia and other oil producers boosted output to offset the embargo on Iraq and Kuwait, and the Allied forces demonstrated that they could prevent significant disruptions to supply. In addition, prices were damped by the slowdown in economic activity in the United States and other industrial nations. After the end of hostilities in February, OPEC sought to bolster prices by trimming production. This effort proved to be largely successful: The posted price of West Texas Intermediate firmed to $20 per barrel in April and has changed little on balance since then.

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Energy prices for consumers have followed the movements in world oil prices since last summer. The CPI for energy peaked in November 1990 at a level 15 percent above that in July and then fell sharply through the first quarter of this year. By April, the decline in crude oil prices had been fully passed through to energy prices at the retail level. In May, consumer energy prices edged back up, mainly reflecting price increases for gasoline, the largest component of the CPI for energy. Gasoline demand this spring apparently was stronger than refiners had expected, and inventories fell to exceptionally low levels. Along with the tight inventory situation, retail gasoline prices may have been boosted by the mandatory switch to cleaner—and more expensive—gasoline before the summer driving season. However, as of early June, gasoline inventories had moved back into the normal seasonal range, and survey data suggest that pump prices softened during the second half of June and into early July.

Increases in consumer food prices this year have slowed from the 5¼ to 5½ percent range that prevailed over the preceding three years. During the first five months of 1991, the CPI for food rose at only a 3¼ percent annual rate, held down in large part by price declines for dairy products and by roughly stable prices on balance for meat, poultry, and eggs. Following the typical pattern in agricultural cycles, prices for these livestock products have been damped by an expansion of supply that was itself spurred by the relatively high prices of recent years. In addition, price increases have been muted for many foods for which labor and other nonfarm inputs represent a large share of total cost. For example, the prices of food consumed away from home rose at a 3¼ percent annual rate over the first five months of 1991, down from the 4½ percent increases over 1989 and 1990. The deceleration in food prices this year would have been somewhat greater but for a series of adverse weather developments that have raised prices for fresh fruits and vegetables; given the short production cycles for many of these products, the recent price increases should be reversed, at least in part, in coming months.

The consumer price index for items other than food and energy rose sharply during January and February, but the jumps in those months reflected a number of one-time or transitory increases. Higher federal excise taxes on cigarettes and alcoholic beverages went into effect, raising consumer prices for both items; these tax hikes supplemented the increases in sales and excise taxes that a number of states have imposed over the past year. Postal rates also were raised 16 percent in February. Apparel prices climbed at double-digit annual rates in both January and February, mainly because of the earlier-than-usual introduction of spring clothing lines, which was not anticipated by the seasonal adjustment factors used by the Bureau of Labor Statistics. More generally, the spurt in oil prices last fall spilled over through early 1991 to prices for a wide range of non-energy goods and services; this pass-through occurred via higher shipping costs and price hikes for petroleum-based components. However, each of these factors boosting inflation proved to be short-lived. After the large increases in January and February, the CPI excluding food and energy rose at just a 2¼ percent annual rate between February and May. Apparel prices declined over this period, and airfares—which are quite sensitive to changes in oil prices—fell 10 percent (not an annual rate).

The uneven pace of inflation this year has tended to obscure trends in the gen-

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eral level of retail prices. Nonetheless, there is little doubt that the underlying pace of inflation has moderated since last year. The twelve-month change in the CPI excluding food and energy—which held around 4½ percent throughout 1988, 1989, and the early part of 1990—moved up to about 5½ percent in August 1990. By May of this year, the twelve-month change in this index had fallen back to 5.1 percent. This figure slightly overstates the trend rate of inflation because it includes the increases in federal excise taxes and postal rates earlier this year; in addition, the pass-through of lower energy prices to non-energy items probably was not complete as of May. Adjusting for both these factors would put the twelve-month change in the CPI excluding food and energy a bit below 5 percent.

Price developments at earlier stages of processing have been favorable this year, reflecting the easing of capacity pressures and price declines for petrochemical products. The producer price index for finished goods excluding food and energy rose at a 3¼ percent annual rate over the first six months of 1991, a bit below the pace in 1990. Prices for intermediate materials excluding food and energy fell about 1½ percent at an annual rate between December and June. Spot prices of raw industrial commodities plunged late last year with the downturn in economic activity, and these prices moved down somewhat further on balance over the first half of 1991.

Monetary and Financial Developments during the First Half of 1991

The progressive easing of money market conditions initiated last fall as the economy weakened continued through much of the first half of 1991. Since the end of last year, open market operations, in combination with two cuts of ½ percentage point in the discount rate, have reduced the federal funds rate from 7 percent to 5¾ percent—the lowest level in well over a decade. These moves followed a number of easings in the final months of 1990, including a ½ point reduction in the discount rate in December, that already had brought the federal funds rate down about 1 percentage point. As a consequence of these and earlier actions, the federal funds rate has declined 4 percentage points from its most recent peak in the spring of 1989.

The policy easings this year were undertaken to foster a turnaround in the economy and to help ensure a satisfactory expansion. They were prompted by evidence that the economy was declining further and that inflationary pressures were abating; early in the year, continuing weakness in the monetary aggregates and further restraint on credit availability, especially at banks, also were important indications of the need for additional policy easing. Policy actions led to a strengthening of money growth over the first half from the slow pace of earlier quarters, and both M2 and M3 in June were in the middle portions of their annual target ranges. The debt aggregate, by contrast, expanded at the lower end of its monitoring range throughout the first half, held down by sluggish spending and also by a cautious attitude toward additional debt by both borrowers and lenders. As the monetary aggregates accelerated and signs accumulated that the economy was bottoming out, the pace of policy easings slowed, and the last such move was made at the end of April.

Despite the drop in short-term interest rates, long-term rates were mixed, on balance, over the first half of the year. In the wake of the rapid conclusion of the

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Gulf war, expectations became widespread that there would be a strengthening in aggregate demand, and this tended to push yields on Treasury bonds a little higher and contributed to an increase in the foreign exchange value of the dollar. With the brighter outlook for the economy, however, the risk entailed in holding private obligations was seen as considerably reduced, and yields on corporate bonds fell and stock prices rose. However, substantial loan losses continued to afflict many financial intermediaries, and these institutions maintained cautious attitudes toward extending new loans; the caution was reflected in wide spreads of lending rates over borrowing rates and more stringent nonprice terms on credit.

Implementation of Monetary Policy

The Federal Reserve adjusted policy in three separate steps during the first quarter of the year, extending the series of moves initiated during the final months of 1990. Amid signs of continuing steep declines in economic activity and abating inflation pressures, the Federal Reserve eased reserve provision through open market operations in January and again in early March, leading to a decline in the federal funds rate of a quarter point each time, and reduced the discount rate ½ percentage point on February 1, resulting in a similar-sized decline in the federal funds rate.[1] The monetary aggregates were very weak in January, and while strengthening considerably in February and early March, remained on a moderate growth track, especially taking into consideration the lack of expansion late in 1990.

Other short-term rates generally fell about a percentage point over this period. The commercial bank prime loan rate was reduced ½ percentage point in early January in lagged response to earlier declines in short-term rates. The drop apparently had been delayed as banks attempted to hold down loan growth as 1990 drew to a close, bolstering their capital positions in response to market concerns and the initial phase-in of risk-based capital requirements. The prime rate was reduced again after the cut in the discount rate in early February.

Longer-term rates also fell, on balance, over the first two months of the year, under the influence of monetary easings and prospects for lower inflation, especially when it became clear that the Gulf war would not interrupt oil supplies. Initial success in the Persian Gulf also led briefly to weakness of the dollar in foreign exchange markets, as safe-haven demands that had been boosting its value since late 1990, in the face of a substantial easing of U.S. monetary policy, evaporated.

In March, however, long-term market rates began to firm, reflecting the rebound in consumer confidence and ini-

1. The federal funds rate came under some upward pressure during much of January, as reduced levels of required reserve balances at Federal Reserve Banks complicated commercial banks' reserve management. Required reserves were low partly because of the effects of the cut in reserve requirements on nonpersonal deposits in December and partly because of seasonal variations. For some banks, balances held in accounts at Reserve Banks threatened to fall below prudent clearing levels. To avoid overnight overdrafts, banks markedly raised holdings of excess reserves and borrowed sporadically at the discount window. But with maintained balances still low relative to clearing needs, the volatility of the federal funds rate increased. As banks became more accustomed to operating with lower levels of required reserves and as these reserves subsequently rose for seasonal reasons, reserve management problems eased, and the volatility of the federal funds rate diminished. The upward pressures on the funds rate in January did not show through to other short-term rates.

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tial indications of a turnaround in the housing market, which were seen as pointing to a somewhat shorter and milder recession than many had previously feared. Rate increases on private instruments were muted, though, as risk premiums began to shrink in response to brightening prospects for a recovery. These gains extended even to below-investment-grade bonds, and growing optimism was reflected as well in a strong stock market in February and into March. The debt and equity instruments of banks generally outperformed broader indexes over this period, as the market apparently expected banks' earnings to be bolstered by lower short-term interest rates and the deterioration in the quality of their loan portfolios to be limited as the anticipated economic recovery materialized. Better prospects for a U.S. economic recovery about coincided with a turn toward more pessimism about the economic outlook abroad. As a result, the exchange value of the dollar reversed, and the dollar began to appreciate sharply.

Growth of Money and Debt
Percent

Period	M1	M2	M3	Debt of domestic non-financial sector
Annually, fourth quarter to fourth quarter[1]				
1980	7.4	8.9	9.5	9.4
1981	5.4 (2.5[2])	9.3	12.3	10.1
1982	8.8	9.1	9.9	9.1
1983	10.4	12.2	9.8	11.1
1984	5.4	8.0	10.7	14.2
1985	12.0	8.7	7.6	13.1
1986	15.5	9.2	9.0	13.2
1987	6.3	4.3	5.8	9.7
1988	4.2	5.2	6.3	9.2
1989	.6	4.7	3.6	7.7
1990	4.2	3.8	1.7	6.7
Semiannually (annual rate)[3]				
1991:1	6.7	4.0	2.9	4.5[e]
Quarterly (annual rate)[4]				
1991:1	5.9	3.4	4.0	4.8
2	7.4	4.6	1.8	4.2[e]

1. From average for fourth quarter of preceding year to average for fourth quarter of year indicated.
2. Adjusted for shift to NOW accounts in 1981.
3. From average for fourth quarter of 1990 to average for second quarter of 1991.
4. From average for preceding quarter to average for quarter indicated.
e Partially estimated.

In the wake of the successful Gulf war and in view of initial signs that the System's earlier easing actions had begun to take hold, the FOMC concluded at its meeting in late March that the risks to the economy had become more evenly balanced. Accordingly, the Committee decided to end the formal tilt toward ease that it had adopted in mid-1990, when slowing money growth and tightening credit availability aroused concerns that financial conditions might be placing greater-than-anticipated restraint on economic activity. Under the previous instructions, the FOMC's directive to the domestic trading desk at the Federal Reserve Bank of New York had stipulated that possible adjustments to reserve pressures between Committee meetings would be more responsive to unanticipated signs of economic weakness and abating price pressures than to unexpected evidence of strength. The directive issued at the March meeting restored symmetry to these instructions concerning intermeeting adjustments.

Interest rates generally declined during April, mainly at the short end, reflecting market participants' disappointment that the response to earlier monetary easings and to the rebound in consumer confidence they had expected had yet to show through in measures of economic activity. At the same time, with evidence also continuing to point to a further abatement of inflation, particularly as reflected in wage behavior, the Federal Reserve at the end of April reduced the discount rate another ½ per-

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centage point, allowing about half that amount to show through to money market rates. As was the case in February, this action was followed by a ½ percentage point decline in the bank prime rate. Despite further monetary ease, the dollar continued to rally on foreign exchange markets, in part boosted by political developments abroad, particularly in the Soviet Union, and potential economic difficulties in Germany.

Market interest rates were little changed until early June, when they rose in response to the release of data on employment and retail sales for May that strongly suggested the trough of the recession had been reached, or at least was close at hand. The ensuing rise in interest rates was particularly sharp at the long end of the Treasury market. As signs of the recovery grew more distinct and interest rates firmed, the dollar strengthened further, and by June it had retraced all its declines of late 1990 and early 1991. On balance, Treasury bond yields rose almost ¼ percentage point over the first half of 1991, while yields on investment-grade corporates were down close to ½ percentage point.

Monetary and Credit Flows

Despite the continuing weakness in economic activity, expansion of the monetary aggregates in the first half of 1991 picked up from the lackluster pace of late 1990, and M2 and M3 grew at annual rates of 3¾ and 2¼ percent respectively, from the fourth quarter of last year through June. M2 growth increased as policy actions reduced short-term market interest rates relative to returns that could be earned on assets in this aggregate (a decline in the "opportunity cost" of holding M2). As a consequence, expansion of M2 exceeded the growth of nominal GNP. However, the growth in M2 (and decline in its velocity) was smaller than would have been expected on the basis of past relationships with income, interest rates, and opportunity costs. This shortfall of M2 growth from historical patterns followed an even greater discrepancy in 1990.

The tepid response of M2 to declines in interest rates may partly reflect reduced funding needs at depositories associated with weak credit growth. As discussed below, commercial bank credit expanded sluggishly over the first half of 1991, and thrift institution balance sheets continued to contract. In these circumstances, depositories may well have been less aggressive in supplying retail deposits; although rates on these deposits do not appear on the surface to have fallen unusually rapidly, institutions may have acted in other ways to reduce the cost of funds, including adjusting advertising and marketing strategies. On the demand side, growth in M2 appears to have been held down early in the year by the public's concerns about depository institutions; purchases of Treasury securities through noncompetitive tenders were especially heavy in January. As the turnaround in the economy seemed in prospect, bank access to both deposit and capital markets improved greatly. Later, in the second quarter, a slowdown in M2 growth appeared to be partly related to the developing configuration of returns on assets. Maturing small time deposits could be rolled over only at much lower rates at the same time the steep upward slope of the yield curve seemed to offer an opportunity to preserve high yields by moving into capital market instruments. For example, expansion of stock and bond mutual funds was quite strong over the second quarter. In addition, with returns on M2 assets falling steeply relative to rates charged on loans, households had a greater incentive to finance spending by holding down the accumu-

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lation of M2 assets rather than by taking on new debt.

The decline in market interest rates also promoted a marked shift in the composition of M2 toward its liquid household deposit components—other checkable deposits, money market deposit accounts, and savings deposits. As is typically the case, offering rates on these deposits adjusted very slowly to the drop in market rates. As their opportunity costs declined, these deposits accelerated, expanding at double-digit rates over the first half. Small time deposits, by contrast, contracted over the period as some of the proceeds of maturing instruments evidently were shifted into liquid components of M2 and depositors hesitated to commit currently generated savings at available time deposit rates. The strength in other checkable deposits contributed to a strong first-half advance in M1. In the first quarter, this aggregate also was boosted by a surge in currency stemming from rising demand abroad, particularly the Middle East. Reflecting the strength in currency and in other checkable deposits, the monetary base expanded over the first half at an 8½ percent annual rate, more than twice the pace of M2.

Growth of M3 over the first half of 1991 was concentrated in the early months of the year, when it received a considerable boost from heavy issuance of large time deposits by U.S. branches and agencies of foreign banks. The issuance of these "Yankee CDs" resulted from the reduction in December of the reserve requirement on nonpersonal time deposits and net Eurocurrency deposits from 3 percent to zero. Previously, branches and agencies had been able to borrow a limited volume of funds from their head offices without becoming subject to reserve requirements. With Yankee CDs apparently an inherently cheaper source of funds, institutions that had been able to fund additional asset expansion through reserve-free borrowing from their head offices began to pay down these advances with funds raised in the CD market. Some foreign banks also tapped the CD market to advance funds to affiliates abroad and to pay down other nondeposit liabilities. Domestic banks and thrift institutions, in contrast, ran off large time deposits in the first quarter as core deposit inflows were more than adequate to fund asset growth. The strength of M3 in the first quarter also reflected strong growth of money market mutual funds. The relative attractiveness of these funds tends to rise when market rates are falling, as fund owners receive returns based on average portfolio yields, which decline only as fund holdings mature and must be replaced with lower-yielding instruments.

M3 was about flat between March and June. Shifts of foreign bank liabilities toward large time deposits slowed, large time deposits at domestic depositories ran off more rapidly with a contraction of their credit, and money funds decelerated as their yields came into line with market rates.

Bank credit expanded very slowly during the first half of 1991 and was concentrated in acquisitions of securities, particularly Treasury and agency securities. As in 1990, the recent strength in acquisitions of these securities is due in part to their favorable treatment under risk-based capital requirements. Mainly, however, it reflects the impact on loan growth of weaker spending by potential borrowers and continued lending restraint by banks. A substantial proportion of bank lending officers, citing heightened uncertainties about the economy and, in many cases, weak capital positions, reported implementing still more restrictive lending policies in a Federal Reserve survey

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conducted early in 1991. Evidence of tightening continued into May, although the percentage of surveyed banks that reported additional tightening declined, perhaps in part because of the more favorable market environment that had developed from earlier in the year and that had allowed banks to issue large volumes of debt and equity.

The asset-quality problems that dogged banks in 1990 continued to crop up in the first half of 1991. Available data on delinquency rates show further increases in the first quarter, for both commercial real estate and other business credits and also for consumer loans. At midyear, when a number of large banks announced surprisingly large loan losses and depressed profits, some of the gains that banks had made in debt and equity markets were reversed.

The contraction in depository credit was not fully reflected in the growth of total debt of nonfinancial sectors. As occurred last year, credit advanced through securities markets and by other intermediaries met an unusually high proportion of credit needs. Banks themselves continued to sell consumer loans and mortgages into securities markets to hold down asset growth and to bolster capital ratios; through these sales, the cost and availability of funds to households has been largely insulated from the possible effects of bank restraint on credit. In addition, businesses turned to long-term securities markets to meet credit needs and to restructure balance sheets, reducing their reliance on banks as well.

Overall, the debt of domestic nonfinancial sectors increased at about a 4½ percent annual rate over the first half of 1991. This was likely a bit above the rate of expansion of nominal GNP, though by considerably less than on average over the previous decade, as both borrowers and lenders apparently have been adopting more cautious attitudes toward additional debt. Businesses, for example, stepped up new equity issuance and greatly reduced the retirement of existing equity in corporate restructurings. These activities, together with the decline in financing needs associated with falling inventories and fixed investment, held down growth of business sector debt to a 2 percent annual rate in the first half. With some consumers also attempting to reduce high debt loads, growth of consumer credit was weak as well. Lower mortgage rates and stronger home sales helped maintain growth of residential mortgages. States and municipalities, facing continuing downgrades and the need to cut back expenditures, put fairly limited net demands on the credit markets in the first half of this year. Federal government debt growth in the first quarter was held down by the slow pace of RTC activity and the receipt of contributions from foreign governments of payments related to the Gulf war; government debt issuance picked up sharply in the second quarter, however. ■

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Part 2

Records, Operations, and Organization

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Record of Policy Actions of the Board of Governors

Regulation D (Reserve Requirements of Depository Institutions)

April 5, 1991—Amendments

The Board approved certain technical amendments to Regulation D, effective April 24, 1991.

Votes for this action: Messrs. Greenspan, Angell, Kelley, LaWare, and Mullins.[1]

The changes approved for Regulation D include a simpler definition of "savings deposit," amendments to the provisions governing reserve deficiencies, and several clarifications, corrections, and conforming changes.

November 21, 1991—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, Angell, Kelley, and LaWare. Absent and not voting: Mr. Mullins.[1]

Under the Monetary Control Act of 1980, depository institutions, Edge Act corporations 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 at 12 percent of balances above that level. The act directs the Board to adjust annually the amount subject to the lower reserve requirement to reflect changes in transaction balances nationwide; by the beginning of 1991, that amount was $41.1 million. Recent increases in transaction balances warranted an increase of $1.1 million. The Board therefore amended Regulation D to increase to $42.2 million the amount of transaction balances to which the lower reserve requirement applies.

The Garn–St Germain Depository Institutions Act of 1982 established a zero percent reserve requirement on the first $2 million of an institution's reservable liabilities. The act also provides for annual adjustments to that exemption based on deposit growth nationwide; by the beginning of 1991, that amount had been increased to $3.4 million. Recent growth in deposits warranted an increase to $3.6 million in the amount of deposits subject to a zero percent reserve requirement, and the Board amended Regulation D accordingly.

The amendments are effective with the reserve computation period beginning December 24, 1991, for institutions that report weekly; and December 17, 1991, for institutions that report quarterly.

1. Throughout this chapter, note 1 indicates that two vacancies existed on the Board when the action was taken.

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

September 4, 1991—Amendments

The Board amended Regulations G and T, effective October 11, 1991, to allow clearing agencies to accept deposits of margin securities in satisfaction of margin obligations.

Votes for these actions: Messrs. Greenspan, Mullins, Angell, Kelley, and LaWare.[1]

The amendments to Regulations G and T exclude from the limitations of the margin rules any margin security deposited with clearing agencies regulated by the Commodity Futures Trading Commission (CFTC) or the Securities and Exchange Commission (SEC), provided that those deposits are made in connection with (1) the issuance, guarantee, or clearance of any security, including options on a security, certificates of deposit, securities index, or foreign currency; or (2) the guarantee of contracts for the purchase or sale of a commodity for future delivery or options on such contracts. These amendments eliminate the need for clearing agencies to register or be regulated under the Board's regulations if those agencies comply with the rules of the CFTC or the SEC.

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

September 4, 1991—Amendments and Interpretations

The Board amended Regulations G and U, effective October 11, 1991, to permit transfers between lenders of purpose loans secured by margin stock under certain conditions.

The Board issued an interpretation, effective October 11, 1991, of the applicability of the single-credit rule and of the restrictions on withdrawal of collateral to the purchase of loan participations by lenders with other outstanding purpose credit to the same borrower.

Votes for these actions: Messrs. Greenspan, Mullins, Angell, Kelley, and LaWare.[1]

The amendments permit banks and lenders subject to Regulation G to transfer purpose loans secured by margin stock on the same basis as transfers between two banks or two lenders subject to the same regulation. The amendments also describe the terms under which the transfer of a loan that is in compliance with the Board's margin regulations would be permitted. The interpretation describes the circumstances under which lenders or banks that acquire a loan by transfer (for example, through the purchase of a loan participation) would not be required, under the single-credit rule, to aggregate that loan with other purpose credit from the same borrower.

Regulation H (Membership of State Banking Institutions in the Federal Reserve System) *and* **Regulation K** (International Banking Operations)

October 23, 1991—Interpretations

The Board issued an interpretation of Regulation H, effective November 25, 1991, to require that state member banks obtain Board approval before engaging in certain commodity swaps and other commodity- or equity-linked transactions. The Board also issued a similar interpretation concerning commodity swaps under Regulation K applicable to

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the overseas activities of bank holding companies and subsidiaries of Edge Act corporations.

Votes for this action: Messrs. Greenspan, Mullins, Angell, Kelley, and LaWare.[1]

Recently, banking organizations have shown increased interest in engaging in commodity-linked transactions; that is, transactions in which a portion of the return is linked to the price of a particular commodity, equity security, or an index of commodity or equity prices. The Board's interpretations indicate that engaging in such activities generally would constitute a change in the general character of a bank's business. The interpretations require that state member banks seeking to begin or to continue engaging in these activities obtain the Board's approval. The Board's approval is not required, however, if the transactions are linked to commodities that banks are permitted to hold directly, if the bank engages in the transactions on a perfectly matched basis, or if only the interest portion of the contract is linked to a commodity.

It was expected that the approval process would be simple. It was intended primarily so that the Board could ensure that only well-capitalized institutions, with experienced management, sound operating procedures, and adequate controls could engage in commodity- or equity-linked transactions.

Regulation H (Membership of State Banking Institutions in the Federal Reserve System) *and* **Regulation Y** (Bank Holding Companies and Change in Bank Control)

August 21, 1991—Amendments

The Board approved amendments to Regulations H and Y, effective November 8, 1991, to implement modifications, clarifications, and technical revisions to the risk-based capital guidelines.

Votes for this action: Messrs. Greenspan, Mullins, Angell, Kelley, and LaWare.[1]

The modifications to the guidelines concerned the treatment of certain assets sold with recourse, the redemption of perpetual preferred stock, the treatment of supervisory goodwill in the definition of capital, and the treatment of claims on certain central banks.

Regulation K (International Banking Operations)

March 27, 1991—Revision

The Board revised Regulation K to permit U.S. banking organizations to expand the scope of their international activities.

Votes for this action: Messrs. Greenspan, Kelley, LaWare, and Mullins. Votes against this action: Mr. Angell.[1]

Besides making technical and clarifying changes, the Board also revised Regulation K to (1) expand the authority of institutions to underwrite and deal in equity securities abroad, (2) increase the dollar limits under which U.S. banking organizations may make investments abroad without first notifying the Board, (3) clarify the portfolio investment authority under which U.S. organizations may make limited equity investments in any type of company abroad, (4) permit Edge Act corporations to provide domestic banking services to foreign persons and governments, (5) permit U.S. banking organizations to engage in futures commission merchant activities and insurance underwriting, (6) change the conditions under which organizations may make debt-for-equity swaps,

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(7) authorize exemptions from the standards, on a case-by-case basis, for qualifying foreign banking organizations, and (8) require Edge Act corporations to maintain a risk-based capital level of at least 10 percent.

Governor Angell dissented from this action because he thought that revisions to Regulation K should be part of a more general effort to reform the U.S. banking system. He believed that competitive equity would be achieved only when all banking organizations in the United States operated under U.S. banking laws and not as branches of foreign companies, and when U.S. banks operated abroad through a separate entity isolated from the protection of the U.S. safety net.

The revisions were effective May 27, 1991, except for certain provisions dealing with investment procedures and requirements abroad, which were effective immediately.

Regulation P (Minimum Security Devices and Procedures for Federal Reserve Banks and State Member Banks)

March 6, 1991—Revision

The Board revised Regulation P, effective May 1, 1991, to simplify and update it.

Votes for this action: Ms. Seger and Messrs. Angell, LaWare, and Mullins. Absent and not voting: Messrs. Greenspan and Kelley.[2]

The Board revised Regulation P as part of its ongoing effort to improve its regulations. The revisions update and simplify the rules, eliminate obsolete references and technical requirements, and delete references to reports no longer required.

Regulation BB (Community Reinvestment Act)

April 22, 1991—Amendments

The Board amended Regulation BB, effective July 11, 1991, to adopt final rules regarding public access to Community Reinvestment Act (CRA) ratings.

Votes for this action: Messrs. Greenspan, Angell, Kelley, LaWare, and Mullins.[1]

Provisions of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 amended the CRA to provide for written evaluations of an institution's record of meeting the credit needs of the community it serves and to require that those evaluations include findings and conclusions for each of the assessment factors specified for measuring CRA performance. The act requires that supervisory agencies replace the current five-tiered numerical rating system with a four-tiered descriptive system for assessing CRA performance. It also requires public disclosure of both the written evaluation and the rating assigned for any CRA examination begun after July 1, 1990. In addition, the written evaluations must contain the institution's rating and a description of the basis for the rating.

Last year, the Board, along with the other supervisory agencies, proposed a temporary rule to implement these requirements, effective July 1, 1990. Subsequently, the Board adopted the rule in final form with only minor modifications.

2. Throughout this chapter, note 2 indicates that one vacancy existed on the Board when the action was taken.

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Regulation CC (Availability of Funds and Collection of Checks)

February 19, 1991—Amendments

The Board adopted final amendments to Regulation CC to extend the availability schedule for deposits at nonproprietary automated teller machines (ATMs) for a two-year period.

Votes for these actions: Mr. Greenspan, Ms. Seger, and Messrs. Angell, Kelley, LaWare, and Mullins.[2]

The Board amended Regulation CC to conform the regulation to amendments made to the Expedited Funds Availability Act. The amendments extended for two years the availability schedules for deposits at nonproprietary ATMs. The amendments to the act were signed into law on November 28, 1990, with a retroactive effective date of September 1, 1990. The Board adopted these conforming changes to Regulation CC on an interim basis on December 5, 1990, and requested comment on the interim rule pending adoption of a final rule.

The amendments provide that, from September 1, 1990, through November 27, 1992, an institution may treat all deposits made by its customers at a nonproprietary ATM as if the deposits were nonlocal checks under the permanent schedule (provide funds availability not later than the fifth business day after the banking day of deposit). Effective November 28, 1992, deposits of cash, "next-day" checks, and local checks at a nonproprietary ATM must be made available by the second business day after the banking day of deposit, and nonlocal checks deposited at a nonproprietary ATM must be made available by the fifth business day after the banking day of deposit.

In December 1991 the Congress adopted an amendment to the act to make the special treatment of deposits at nonproprietary ATMs permanent (section 227 of the Federal Deposit Insurance Corporation Improvement Act of 1991, enacted December 19, 1991). It was expected that in early 1992 the Board would propose for comment conforming amendments to Regulation CC and revisions to its commentary.

Other Actions

In January the Board issued for public comment a proposed amendment to Regulation CC to provide for same-day settlement for checks presented by private-sector presenting banks. Under the proposal, if specified conditions are met, paying banks would be required to settle for checks presented by private-sector presenting banks on the day of presentment without the imposition of presentment fees. The proposal provided for an 8:00 a.m. (local time of the paying bank) presentment deadline for same-day settlement for checks presented by private-sector presenting banks. The presenting bank must deliver the checks to a location, designated by the paying bank, in the same check processing region as that designated by the routing number encoded on the check. In March the Board also requested comment on proposed services that the Federal Reserve Banks could offer in a same-day settlement environment. No final action was taken on these proposals in 1991.

In September the Board issued its final report to the Congress on the Expedited Funds Availability Act and Regulation CC. The report summarized actions and activities of the Federal Reserve that have been taken since the Board's March 1990 report. It summarized Board actions affecting Regulation

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CC, described Federal Reserve initiatives to improve the check collection and return system, and highlighted available data on compliance by banks with the act and Regulation CC. The report also included legislative recommendations to reduce bank risks of check fraud resulting from provisions of the act and to facilitate compliance with the act's requirements.

Policy Statements and Other Actions

November 21, 1991—Supervisory Policy on Securities Activities

The Board, along with the other member agencies on the Federal Financial Institutions Examination Council, issued a supervisory policy statement, effective February 10, 1992, regarding inappropriate securities activities by depository institutions.

Votes for this action: Messrs. Greenspan, Angell, Kelley, and LaWare. Absent and not voting: Mr. Mullins.[1]

The policy statement revises a statement adopted in 1988 by the Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency. The new statement provides depository institutions with guidance in three broad areas: (1) procedures to be used in selecting a securities dealer, (2) trading activities and sales practices that are unsuitable when conducted in an investment portfolio, and (3) certain mortgage securities with high risk that are not suitable investments for most institutions. In addition, the revised policy statement suggests several tests to help institutions identify those mortgage-backed securities with high risk.

Rules Regarding Delegation of Authority

February 21, 1991—Amendment

The Board amended its Delegation Rules, effective February 28, 1991, to allow certain System officials to approve certain types of mergers.

Votes for this action: Mr. Greenspan, Ms. Seger, and Messrs. Angell, Kelley, and LaWare. Absent and not voting: Mr. Mullins.[2]

The Board revised its rules to delegate to the Reserve Banks and to the Staff Director of the Division of Banking Supervision and Regulation, in consultation with the General Counsel, authority to approve the merger of a savings association owned by a bank holding company with a bank owned by the same holding company, under the conditions specified in the Oakar amendment to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

1991 Discount Rates

During 1991 the Board approved five reductions in the basic discount rate; these actions lowered the rate from 6½ percent at the start of the year to 3½ percent by year-end. None of the Federal Reserve Banks requested an increase in the basic rate during the year. The Board approved numerous changes, including increases and decreases, in the flexible rate on extended credit; that rate is adjusted on the basis of a market-related formula.

The reasons for the Board's decisions are reviewed below. The decisions were made in the context of the policy actions of the Federal Open Market Committee (FOMC) and the related economic and financial developments that are covered

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in more detail elsewhere in this REPORT. A listing of the Board's actions on the basic discount rate during 1991, including the votes on those actions, follows this review.

Actions on the Basic Discount Rate

The Board approved two reductions in the basic rate during the first four months of 1991, maintained existing rates during the months that followed, and approved three further reductions in the period from mid-September to year-end.

January–April: Basic Rate Reduced

In the early months of the year, the economy remained in a downswing that had begun during the summer of 1990. Monetary policy had been eased substantially in the final months of 1990, and the Board had approved a reduction in the basic discount rate from 7 percent to 6½ percent on December 18. The reduction had served in part to realign the basic rate with market interest rates, which had declined considerably.

During January 1991 the Board deferred action on requests by six of the twelve Federal Reserve Banks to lower the discount rate, but on February 1 the Board approved a ½ percentage point reduction to a level of 6 percent. The decision was made in light of indications of further softening in economic activity, continuing sluggish growth in money and credit, and evidence that inflationary pressures were abating, including weakness in commodity prices.

In the weeks that followed, a variety of developments appeared to have established the basis for a recovery in economic activity; those developments included the cumulative decline in oil prices since their October 1990 highs, the considerable easing in monetary policy over previous months, and especially the boost to confidence associated with the rapid and successful completion of the Persian Gulf war. Consumer spending and demand for single-family homes strengthened.

Nonetheless, while an upturn in economic activity was widely viewed as a reasonable expectation, indications of weakness persisted in the economy. Moreover, by April, growth in the broader monetary aggregates clearly had slowed. Against this background, an increasing number of Federal Reserve Banks proposed reductions of ½ percentage point in the basic discount rate, and on April 30 the Board approved such a decrease to a level of 5½ percent. The action was intended in part to realign the discount rate with short-term market interest rates, which had declined considerably further since the reduction in the discount rate on February 1.

May to August: No Changes

From late spring to midsummer, signs of a moderate recovery in business activity multiplied. Consumer spending registered sizable gains, and expenditures on residential construction continued to rise. Data for industrial output and labor markets indicated that production was being stepped-up to meet emerging demands. Until late in this period, no Federal Reserve Bank proposed any change in the discount rate.

September to December: Further Reductions

As the summer progressed, however, the recovery appeared to lose momentum. The growth of money and credit weakened markedly during the summer months, and the cumulative expansion

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of M2 and M3 dropped to the lowerends of the annual ranges set by the FOMC. In light of concerns about the ongoing strength of the recovery and given further indications that inflationary pressures were abating, the FOMC had eased reserve conditions slightly during August. During the latter half of August and early September, an increasing number of Federal Reserve Banks submitted requests to lower the discount rate, and on September 13 the Board approved actions by seven Banks to reduce the rate from 5½ percent to 5 percent.

Subsequently, the incoming information provided increasing evidence that the expansion in overall economic activity had stalled amid widespread indications of depressed business and consumer confidence. On November 6, against the background of continued weak expansion in the money and credit aggregates and diminishing inflationary pressures, the Board approved a further ½ percentage point reduction in the discount rate. This action followed a decision by the FOMC to ease reserve conditions somewhat further and served in part to realign the discount rate with other short-term market rates.

The FOMC implemented further easing actions during December through open market operations, and the discount rate was reduced by a full percentage point on December 20, to a level of 3½ percent. These easing actions were taken on the basis of cumulating evidence, notably monetary and credit conditions as well as current economic conditions, that pointed to receding inflationary pressures. The actions, together with the ongoing effects of earlier easing moves, were seen as likely to have a positive effect on financial markets and as possibly supplying adequate monetary stimulus to promote a resumption of sustainable economic growth.

Structure of Discount Rates

The basic discount rate is the rate charged on loans to depository institutions for short-term adjustment credit and for credit extended under the seasonal program; under the latter program, loans 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. The interest rate charged on seasonal credit was scheduled to be replaced by a flexible, market-related rate starting January 9, 1992.

A flexible rate may also be charged on extended-credit loans (for other than seasonal purposes) to depository institutions that are under sustained liquidity pressure and are not able to obtain funds on reasonable terms from other sources. The flexible rate is somewhat higher than the market rates to which it is linked and is always at least 50 basis points above the basic discount rate. The rate is adjusted periodically, subject to Board approval. The first thirty days of borrowing on extended credit may be at the basic rate, but further borrowings ordinarily are charged the flexible rate. Exceptionally large adjustment-credit loans that arise from computer breakdowns or other operating problems that clearly are not beyond the reasonable control of the borrowing institution are assessed the highest rate applicable to any credit extended to depository institutions; under the current structure, that rate is the flexible rate on extended, nonseasonal credit.

At the end of 1991 the structure of discount rates was as follows: a basic rate of 3½ percent for short-term adjustment credit and for credit under the seasonal program, and a flexible rate of 4.85 percent. During 1991 the flexible

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rate ranged from a high of 7.65 percent to a low of 4.85 percent.

Board Votes

Under the provisions of the Federal Reserve Act, the boards of directors of the Federal Reserve Banks are required to establish rates on loans to depository institutions at least every fourteen days and to submit such rates to the Board of Governors for review and determination. Federal Reserve Bank actions on the discount rate include requests to renew the formula for calculating the flexible rate on extended credit. The votes of the Board of Governors listed below involved changes in the basic discount rate. Votes relating to the reestablishment of existing rates or for the updating of market-related rates under the extended credit program are not shown. Except as indicated in the listing below, all votes taken during 1991 were unanimous.

Votes on the Basic Discount Rate

February 1. Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Richmond, Chicago, Kansas City, and Dallas to reduce the basic discount rate ½ percentage point, to 6 percent.

> Votes for this action: Mr. Greenspan, Ms. Seger, and Messrs. Kelley, LaWare, and Mullins. Votes against this action: None.[2]

The Board subsequently approved similar actions taken by the directors of the Federal Reserve Banks of Cleveland, Minneapolis, and San Francisco, also effective February 1; and St. Louis and Atlanta, effective February 4.

April 30. Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Atlanta, Chicago, and Dallas to reduce the basic discount rate to 5½ percent.

> Votes for this action: Messrs. Greenspan, Kelley, LaWare, and Mullins. Vote against this action: Mr. Angell.[1]

Mr. Angell dissented because he was concerned that a reduction in the basic discount rate under current conditions could have adverse repercussions on long-term interest rates and thus on interest-sensitive sectors of the economy.

The Board subsequently approved similar actions taken by the directors of the Federal Reserve Banks of Philadelphia, Richmond, Minneapolis, Kansas City, and San Francisco, also effective April 30; St. Louis, effective May 1; and Cleveland, effective May 2.

September 13. Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, Philadelphia, Cleveland, Atlanta, Chicago, Minneapolis, and Dallas to reduce the basic discount rate to 5 percent.

> Votes for this action: Messrs. Greenspan, Mullins, Angell, and LaWare. Votes against this action: None.[1]

The Board subsequently approved similar actions taken by the directors of the Federal Reserve Banks of New York, Richmond, Kansas City, and San Francisco, also effective September 13; and St. Louis, effective September 17.

November 6. Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Atlanta, Chicago, and Minneapolis to reduce the basic discount rate to 4½ percent.

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Votes for this action: Messrs. Greenspan, Mullins, Kelley, and LaWare. Vote against this action: Mr. Angell.[1]

Mr. Angell dissented because of his concern about the effect of the easing action on inflation expectations and consequently on long-term interest rates. In his view monetary policy needed to be implemented in a way that was not perceived as a shift from a focus on price-level stability to a focus on short-term economic growth.

The Board subsequently approved similar actions taken by the directors of the Federal Reserve Banks of Richmond, Kansas City, Dallas, and San Francisco, also effective November 6; and St. Louis, effective November 7.

December 19. Effective December 20 the Board approved actions taken by the directors of the Federal Reserve Banks of New York and Chicago to reduce the basic discount rate to 3½ percent.

Votes for this action: Messrs. Greenspan, Mullins, Kelley, LaWare, and Lindsey and Ms. Phillips. Vote against this action: Mr. Angell.

Mr. Angell dissented because he believed that a steady policy course was desirable after an extended period of interest rate declines. He did not rule out the potential need for some easing later if warranted by the incoming information on the economy and a reversal of the recent pickup in monetary growth.

The Board subsequently approved actions taken by the directors of the Federal Reserve Banks of Boston, Philadelphia, Cleveland, Richmond, Atlanta, Kansas City, Dallas, and San Francisco, also effective December 20; Minneapolis, effective December 23; and St. Louis, effective, December 24. ■

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Record of Policy Actions of the Federal Open Market Committee

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

The pages that follow contain entries relating to the policy actions at the meetings of the Federal Open Market Committee held during the calendar year 1991, 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 decision.

During 1991 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 sets of instruction 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 policy instruments are shown below in the form in which they were in effect at the beginning of 1991. 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, 1991

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

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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 $8.0 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;[1]

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

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

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

3. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York (a) for System Open Market Account, to sell U.S. Government securities to such foreign and international accounts on the bases set forth in paragraph 1(a) under agreements providing for the resale by such accounts of those securities within 15 calendar days on terms comparable to those available on such transactions in the market; and (b) for New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph 1(c), repurchase agreements in U.S. Government and agency securities, and to

1. At its meeting on Dec. 18, 1990, the Committee approved a temporary increase, to $14 billion, in the limit on changes between Committee meetings in System Account holdings of U.S. government and federal agency securities. The limit reverted to its regular level of $8 billion at the close of business on Feb. 6, 1991.

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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, 1991[2]

The information reviewed at this meeting suggests appreciable weakening in economic activity. Total nonfarm payroll employment fell sharply further in November, reflecting widespread job losses that were especially pronounced in manufacturing and construction; the civilian unemployment rate rose to 5.9 percent. Industrial output declined markedly in October and November, in part because of sizable cutbacks in the production of motor vehicles. Retail sales were weak in real terms in October and November; real disposable income has been reduced not only by a decrease in total hours worked but also by the effects of higher energy prices. Advance indicators of business capital spending point to considerable softening in investment in coming months. Residential construction has declined substantially further in recent months. The nominal U.S. merchandise trade deficit widened in October from its average rate in the third quarter as non-oil imports rose more sharply than exports. Increases in consumer prices moderated in November largely as a result of a softening in oil prices. The latest data on labor costs suggest some improvement from earlier trends.

Most interest rates have fallen appreciably since the Committee meeting on November 13. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose slightly on balance over the intermeeting period.

M2 was about unchanged on balance over October and November after several months of relatively limited expansion, while M3 declined slightly in both months. From the fourth quarter of 1989 through November, expansion of M2 was estimated to be in the lower half of the Committee's range for the year and growth of M3 near the lower end of its range. Expansion of total domestic nonfinancial debt appears to have been near the midpoint of its monitoring range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, 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 July reaffirmed the range it had established in February for M2 growth of 3 to 7 percent, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The Committee in July also retained the monitoring range of 5 to 9 percent for the year that it had set for growth of total domestic nonfinancial debt. With regard to M3, the Committee recognized that the ongoing restructuring of thrift depository institutions had depressed its growth relative to spending and total credit more than anticipated. Taking account of the unexpectedly strong M3 velocity, the Committee decided in July to reduce the 1990 range to 1 to 5 percent. For 1991, the Committee agreed on provisional ranges for monetary growth, measured from the fourth quarter of 1990 to the fourth quarter of 1991, of 2½ to 6½ percent for M2 and 1 to 5 percent for M3. The Committee tentatively set the associated monitoring range for growth of total domestic nonfinancial debt at 4½ to 8½ percent for 1991. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to decrease slightly the existing degree of pressure on reserve positions, taking account of a possible change in the discount rate. Depending upon progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint might or somewhat lesser reserve restraint would 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 4 and 1 percent, respectively.

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2. Adopted by the Committee at its meeting on Dec. 18, 1990.

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Authorization for Foreign Currency Operations

In Effect January 1, 1991

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 $25.0 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

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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, 1991

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;

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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 5–6, 1991

1. Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity had weakened further. A persisting low level of consumer confidence, related partly to the uncertainties surrounding the Persian Gulf situation, and reduced real disposable incomes continued to depress consumer demand; and business investment spending, especially for structures, remained in a downtrend. With businesses attempting to maintain tight control over inventories as demand weakened, industrial production and nonfarm payroll employment had declined sharply. Broad measures of prices indicated some moderation of inflation toward the end of 1990, largely as a result of lower energy prices. The latest data suggested some deceleration in wages and overall labor costs.

Total nonfarm payroll employment fell sharply in January, and a larger drop than previously reported was now indicated for December. The contraction in employment in January was especially heavy in the construction sector, only partly reflecting unseasonably wet weather in some sections of the country, and widespread job losses were registered in manufacturing, notably in durable goods. The civilian unemployment rate edged higher in January to 6.2 percent.

Industrial output declined markedly in the fourth quarter, and partial data suggested a further drop for January. A sizable portion of the reduction reflected cutbacks in the production of motor vehicles, but output also was down in most other industries. Declines in production were especially large for computers, construction supplies, and a wide range of non-auto consumer durables. Capacity utilization in manufacturing continued to fall in December; in most industries, operating rates were down substantially from their recent peaks and from their longer-run averages.

Partly reflecting lackluster sales during the holiday season, consumer spending in real terms was soft in the fourth quarter. Outlays for goods were considerably below the levels seen earlier in the year, and while spending for services rose further, the fourth-quarter gain was well below that recorded in previous quarters. Total private housing starts declined substantially further in the fourth quarter; sales of new homes remained weak through year-end, and home prices continued to slip.

Shipments of nondefense capital goods were about unchanged in the fourth quarter. Aircraft purchases remained at the robust third-quarter level, while business outlays for motor vehicles dropped sharply after a third-quarter spike in fleet sales. Outside the transportation sector, equipment spending advanced appreciably, mainly reflecting strong increases in spending for computers. New orders for business equipment pointed to a softening in spending for such goods in coming months. Available data indicated that nonresidential construction activity fell sharply in the fourth quarter. In a period of weak sales, total manufacturing and trade inventories, measured on a constant-cost basis, increased a little further on balance over October and November, and the ratio of stocks to sales rose only slightly, reflecting strong efforts by businesses to keep inventories in line with sales.

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In the October–November period, strong exports cushioned to some extent the drop in production and output in the United States; nonagricultural exports were up substantially over the third-quarter average, with substantial increases recorded in all major trade categories except aircraft and computers. Despite the strength in exports, the nominal U.S. merchandise trade deficit for the two months combined was at a higher rate than in the third quarter because of rising oil prices, which brought a sharp increase in the value of oil imports. Growth in most major foreign industrial countries appeared to have slowed somewhat in the fourth quarter. In many of these countries, lower oil prices late in the year had brought some moderation in consumer price inflation.

In December, a sizable decline in producer prices of finished goods more than offset the November rise, as prices of both food and energy products moved sharply lower. For other finished goods, producer prices increased in the fourth quarter at about the moderate pace evident in the three previous quarters. Lower oil prices and a slowing in food price increases also damped the rise in consumer prices in December. Excluding the food and energy components, consumer inflation was a little lower on balance in November and December than in earlier months of 1990. Total compensation costs of private industry workers rose more slowly in the fourth quarter and also increased a bit less for the year than in 1989.

At its meeting on December 18, the Committee adopted a directive that called for an initial slight reduction in the degree of pressure on reserve positions and for giving particular weight to potential developments that might require some further easing later in the intermeeting period. To reflect the tilt toward further easing, the directive indicated that, subsequent to the initial move, somewhat lesser reserve restraint would be acceptable, or slightly greater reserve restraint might be acceptable, during the intermeeting period depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The Committee also noted that open market operations might need to take account of a possible reduction in the discount rate early in the intermeeting period. The contemplated reserve conditions were expected to be consistent with expansion of M2 and M3 over the period from November through March at annual rates of about 4 and 1 percent respectively.

Immediately after the Committee meeting, the Board of Governors approved a reduction in the discount rate from 7 to 6½ percent; afterwards, open market operations were directed at allowing part of this decline to show through to short-term interest rates more generally. Another easing step was taken in early January in response to weak money growth and considerable softness in the economy. Subsequently, on February 1, the Board approved a further reduction in the discount rate to 6 percent; this action was taken in response to indications that economic activity was slackening further, growth in money and credit continued sluggish, and inflation pressures were abating. In this instance, open market operations permitted the full reduction in the discount rate to be reflected in money market rates. Adjustment plus seasonal borrowing fluctuated widely over the intermeeting period; borrowing was well above expected levels during much of the period as banks adapted to the phase-out of the reserve requirement on nonpersonal time deposits and net Euro-

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currency liabilities; the phase-out reduced required reserve balances to levels that at times proved to be insufficient for the clearing needs of many banks.

The federal funds rate averaged around 7¼ percent just before the December meeting. Late in the intermeeting period, after the two cuts in the discount rate and the monetary easing through open market operations, the federal funds rate averaged a little above 6¼ percent. Over the intermeeting period, however, the funds rate was unusually volatile; key factors behind this volatility included the phase-out of the nontransaction reserve requirement, balance-sheet adjustments undertaken near year-end, and some reserve projection misses near the ends of maintenance periods. Other short-term interest rates also fell considerably over the intermeeting period; private money market rates declined more than Treasury bill rates, reflecting a reduction in the pronounced risk premiums that had been built into private short-term rates ahead of year-end. Yields in longer-term markets were unchanged to down slightly, and broad indexes of stock prices rose appreciably on balance over the period.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies advanced in the early part of the intermeeting period as market participants sought a safe haven for their funds in the face of diminishing prospects for a peaceful settlement in the Persian Gulf region. The dollar also was buoyed, especially against the German mark, by market perceptions that political conditions were deteriorating in the Soviet Union. The early successes of the Allied forces in the Gulf war brought a reduction in safe-haven demands, and the dollar began to decline in the latter half of January. After an increase in the German Bundesbank's official lending rates and the reduction the next day in the Federal Reserve's discount rate, the dollar dropped sharply. On balance, the dollar was down somewhat over the intermeeting period.

Growth of M2 remained sluggish in December and January, running at a pace below the path expected by the Committee; expansion of M3 picked up in January from the very slow pace of previous months. The continuing weakness in M2 despite an appreciable narrowing in opportunity costs appeared to reflect in part heightened concerns about the financial condition of many depository institutions in the wake of the closing of privately insured banks and credit unions in Rhode Island and the failure of the Bank of New England. For the year 1990, M2 and M3 grew at rates in the lower portions of the Committee's ranges. Expansion of total domestic nonfinancial debt appeared to have been near the midpoint of its monitoring range for the year.

The staff projection prepared for this meeting, which was assembled against the background of the outbreak of hostilities in the Persian Gulf region, pointed to some further decline in economic activity in the near term. The length and intensity of the war was a matter of conjecture, but the projection was based on the assumption that the war would end within the next few months and would have little further effect on world oil supplies and the level of oil prices. The projection also assumed that constraints on the supply of credit would persist to some degree through the rest of the year. In the near term, concerns emanating from the war, reduced credit availability, and financial fragility were expected to continue to damp consumer and business confidence and, by depressing private domestic demand, to push manufacturing activity still lower. Subsequently, economic growth was ex-

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pected to resume in association with the support provided by further gains in exports, the stimulative effects of sharp declines in oil prices and short-term interest rates, and some improvement in consumer and business sentiment as the war drew to a close. Increases in business orders and sales could be expected to bring a prompt pickup in production, given lean inventories, and with some lag a rise in business spending for investment goods other than commercial structures; severe problems of excess supply were expected to inhibit any recovery in commercial construction for an extended period. With oil prices lower and some added slack expected in resource utilization, the staff projected a slowing in the pace of increases in prices and labor costs in coming quarters.

In the Committee's review of economic developments, members commented that the outbreak of war in the Persian Gulf region had heightened the already substantial uncertainties bearing on the outlook for the economy. A relatively mild recession followed by a moderate upturn in economic activity was still regarded as a reasonable expectation, assuming that the war would not be prolonged and that oil prices would remain at substantially reduced levels. However, the risks clearly were on the downside, and a very sluggish recovery or indeed a deep and relatively long recession could not be ruled out. Business and consumer confidence, a critical factor underlying the economic outlook, already was quite negative and was subject to further erosion stemming from financial strains and credit constraints in the domestic economy as well as from unpredictable developments in the Middle East. On the positive side, members saw growing indications of some moderation in underlying inflation pressures; and in light of the increasing slack in labor and capital markets and the slower growth of money over a period of years, they believed that considerable progress in reducing inflation was likely to be made in the year ahead.

In conformance with the practice at meetings when the Committee establishes its long-run ranges for growth of the money and debt aggregates, the Committee members and the Federal Reserve Bank presidents not currently serving as members had prepared projections of economic activity, the unemployment rate, and inflation for the year 1991. For the period from the fourth quarter of 1990 to the fourth quarter of 1991, the forecasts for growth of real GNP had a central tendency of ¾ percent to 1½ percent. These forecasts assumed an upturn in economic activity later in the year and subsequent expansion at a pace that was consistent with continued progress toward price stability. Estimates of the civilian rate of unemployment in the fourth quarter of 1991 were concentrated in a range of 6½ percent to 7 percent. On the assumption that oil prices would remain near their recent levels and in the context of reduced pressures on resources, all of the members expected a sizable decline in the rate of inflation from the pace in 1990; as measured by the consumer price index, the central tendency of their projections was in a range of 3¼ percent to 4 percent for the year, compared with an actual rise of 6¼ percent in 1990. Forecasts of growth in nominal GNP had a central tendency of 3¾ percent to 5¼ percent.

In their comments about the prospects for business activity, the members gave considerable attention to the uncertainties and concerns that were exerting a depressing effect on business and consumer confidence. The rapidly evolving situation in the Middle East undoubtedly was contributing an element of caution to spending plans, but the problems

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of many financial institutions and the financial difficulties of heavily indebted business firms and individuals were adding to the generally somber economic climate. Not only had financial problems affected attitudes, but constraints on the availability of credit to many borrowers with limited or no access to alternative sources of financing were having a retarding effect on business activity and could limit the vigor of the expected expansion. Many financial problems were the legacy of financial excesses of the past decade, notably those associated with the financing of speculative real estate ventures and highly leveraged restructurings of business firms. While some progress was being made in addressing such problems, a good deal of time undoubtedly would be needed before many troubled lending institutions again became important suppliers of new credit and before many business firms were able to access credit sufficient to support increases in spending. Such financial difficulties were likely to have continuing effects on business and consumer attitudes and to constrain business activity to some extent even if there were a relatively prompt end to the hostilities in the Middle East. Nonetheless, members pointed to a number of promising developments bearing on the prospects for the economy, notably the substantial declines that had occurred in interest rates, including key long-term rates, the sharp drop in oil prices, and the improved competitive position of U.S. businesses in world markets stemming from the depreciation of the dollar. Members also noted that despite the generally negative sentiment in the business community and among many consumers, the performance of the stock market, including the shares of banking organizations, had been surprisingly strong; while such a development had to be interpreted with caution in terms of its implications for future business activity, it suggested that many investors viewed the economic outlook with some degree of optimism.

Turning to current and prospective developments in different parts of the country and sectors of the economy, members reported further indications of some softening in business conditions in several regions, including areas where business activity previously had been relatively well maintained in comparison with national trends. Much of the weakness tended to be concentrated in manufacturing, primarily the production of motor vehicles and associated inputs and of other durable goods, and in construction. At the same time, however, there were indications that business conditions were no longer deteriorating in some areas and might indeed be improving somewhat with attendant gains in local business confidence. The outbreak of war seemed to be having little effect thus far on overall domestic manufacturing activity, though some firms were reported to have increased their production of defense-related goods.

The prospects for consumer spending remained the key uncertainty in the outlook for overall economic activity. It was unclear at this point how consumers would respond to unfolding developments in the Middle East. There were widespread reports that retail sales had dropped sharply after the outbreak of hostilities in mid-January, but that development seemed to represent at least in part a temporary reaction associated with the diversion of attention to the reporting of military events. Indeed, there were indications or at least expectations among businessmen that consumer behavior would return to a more normal pattern, though perhaps tending to the weak side, in the period ahead. For the present, however, consumer sentiment clearly remained depressed, and

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many anxious consumers seemed unwilling, or at least reluctant, to make discretionary purchases. As a consequence business contacts, such as those in the motor vehicles industry, remained concerned about the outlook for sales at least for the nearer term. Over time, the end of hostilities in the Middle East would improve consumer confidence, and the drop in oil prices, if sustained, would have a positive effect on consumer purchasing power.

A significant rebound in consumer spending was likely to be followed fairly promptly by increased production of consumer goods, given generally lean business inventories, and with some lag by greater output of producer equipment. At the same time, construction activity would probably remain depressed in light of the high vacancy rates in existing commercial structures across the country and the weakness in residential real estate markets in many areas. Construction expenditures by state and local governments also appeared likely to be restrained, given the financial problems of many of these governments, but members noted that some major public works projects had been financed or were under way in a few areas.

Members continued to anticipate further expansion in exports stemming importantly from the nation's improved competitive position associated with the substantial decline in the foreign exchange value of the dollar. Views differed to some extent, however, with regard to the strength and potential contribution of the export sector to domestic economic activity. Some members stressed that relatively depressed economic conditions in a number of major foreign industrial nations were likely to limit U.S. exports to those countries. Moreover, developments in the Middle East already had curbed foreign sales of some domestic goods, notably agricultural products. At the same time, many manufacturing firms continued to report receptive export markets, and production for such markets was helping to offset weakness in domestic demand. However, a substantial further decline in the foreign exchange value of the dollar would not be a welcome development; such a decline, should it occur, might well foster higher domestic bond yields and could give rise to protectionist reactions abroad to the detriment of further gains in U.S. exports.

With regard to the outlook for inflation, the members saw favorable prospects for considerable progress in the year ahead. There were growing indications that the core rate of inflation would trend down. Currently available statistics might not yet be fully capturing the extent of the underlying improvement in inflation, though it already was clear that some downward adjustment was occurring in the crucial area of wages. With regard to future prospects, several members stressed that the slowing in monetary growth over a period of years was likely to be reflected increasingly in lower inflation. The slack in labor and capital resources probably would have a restraining effect on underlying inflation pressures over the next several quarters. Evidence of such a development included indications of strong competition in markets for a wide range of products and reports of adjustments in the pricing policies of many business firms. The members recognized that the effects of earlier declines in the dollar on the prices of imported goods and competing domestic products would tend to maintain some upward pressure on the overall price level for a time; however, they assumed for the purpose of their forecasts that there would not be any further change in the value of the dollar of a magnitude that would affect domestic

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prices over the projection horizon and that oil prices would remain near recent lower levels.

Against the background of the members' views on 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 reviewed the ranges for growth of the monetary and debt aggregates in 1991 that it had established on a tentative basis in July 1990. The tentative ranges included expansion of 2½ percent to 6½ percent for M2 and 1 percent to 5 percent for M3, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt had been set provisionally at 4½ percent to 8½ percent for 1991. The ranges for M2 and nonfinancial debt involved reductions of ½ percentage point from those that were reaffirmed in July for the year 1990; the M3 range for 1990 had been lowered by 1½ percentage points in July and no further reduction had been made in the tentative M3 range for 1991.

In the Committee's discussion of the ranges for 1991, which mainly focused on M2, most of the members indicated a preference for affirming the ranges that had been established on a tentative basis in July. Insofar as could be judged under present circumstances, the tentative ranges offered in this view the best prospects of balancing and accommodating the Committee's objectives of a prompt recovery in business activity and continuing progress toward reducing inflation. Many of the members conceded that in light of the current uncertainties surrounding the relationship between money growth and economic performance, somewhat higher or somewhat lower ranges also were defensible. For example, it was unclear to what extent the relatively slow growth of M2 in relation to that of nominal income, allowing for the effects of movements in interest rates, would persist during the year ahead; a return to a more normal pattern in this relationship would have a substantial effect on the rate of M2 growth that was consistent with a satisfactory economic performance. The Committee needed to be prepared to revise those ranges at midyear as interim economic or financial developments might warrant. Members also noted the risk that market participants might misinterpret the implications of any changes in the ranges for the conduct of monetary policy during the year. Increasing the ranges could raise questions about the System's commitment to its anti-inflationary goals, while lowering them, especially in the context of already weak money growth, could lead to concerns about the System's objective of fostering an upturn in business activity. Moreover, a reduction in the M2 range might have to be reversed later if the behavior of money resumed a more normal pattern in relation to income; such a reversal would interrupt the Committee's practice of gradually reducing its growth ranges and could have adverse repercussions on the credibility of the System's anti-inflationary policy. Accordingly, most of the members concluded that the tentative range for M2, which already incorporated a reduction from 1990, represented an appropriately balanced approach, based on current expectations with regard to the behavior of velocity, to promoting the Committee's objectives.

Expressing a differing opinion, two members indicated that they preferred a somewhat higher range for M2, in part to provide a better signal of the System's determination to cushion the recession and foster a quick recovery in business activity. The midpoint of the higher range would call for some

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make-up of the shortfall in M2 growth from the midpoints of the ranges established for this aggregate in recent years. Moreover, growth of M2 at or near the bottom of the tentative range would pose an unacceptable risk of inadequate monetary stimulus that could fail to cushion possible further deterioration in the economy. On the other hand, a preference was expressed for a somewhat lower range to underline the System's commitment to price stability. The midpoint of such a range would not imply a change from the average growth of recent years, and the upper end would trigger a prompter policy response should the recovery be stronger than anticipated with potential inflationary implications.

With regard to M3, all of the members favored adoption of the tentative range that had been set provisionally in July. While that range was unchanged from that for 1990, as revised at midyear, it incorporated a substantial reduction from the M3 ranges of previous years. The members anticipated that growth of M3 would remain below that of M2 as a consequence of the continuing restructuring of thrift depository institutions this year and the likelihood of restrained growth in bank credit. However, the effect on overall credit growth seemed likely to be attenuated by the continuing rechanneling of credit extensions through financial markets or lenders other than depository institutions. In the circumstances, a relatively low range for M3 was expected to prove consistent with the Committee's goals for the economy.

All of the members found acceptable the monitoring range of 4½ percent to 8½ percent that the Committee had established on a provisional basis for growth of total domestic nonfinancial debt in 1991. That range, which represented a further step in a series of annual reductions, took into account the prospect that federal borrowing was likely to be robust in 1991, owing in part to borrowing associated with outlays by the Resolution Trust Corporation but more generally to the likely weakness of federal revenues in a year of relatively sluggish economic activity. On the other hand, growth in borrowing by domestic nonfederal sectors was expected to moderate. Demands for credit would be held down by limited expansion in domestic spending and the increased caution on the part of both businesses and households in taking on debt, while the terms and conditions set by many suppliers of credit would remain tight.

At the conclusion of the Committee's discussion, all but one of the members indicated that they favored or could accept the ranges for 1991 that the Committee had established on a tentative basis at its meeting in July 1990. 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, in light of the behavior of the aggregates and ongoing economic and financial developments. The Committee approved the following paragraph for inclusion in the domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote a resumption of sustainable growth in output, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 2½ to 6½ percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt was set at 4½ to 8½ percent for the year. With regard to M3, the Committee anticipated that the ongoing restructuring of thrift depository institutions would continue to depress its growth relative to spending and total credit. The behavior of

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the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Keehn, Kelley, LaWare, Mullins, Parry, and Ms. Seger. Vote against this action: Mr. Forrestal.

Mr. Forrestal dissented because he wanted to retain the 1990 range of 3 to 7 percent for M2 growth in 1991. He was concerned that monetary growth in 1990 was the lowest since monetary targeting began. Moreover, in the current recessionary environment, the 3 to 7 percent range with its somewhat higher minimum growth rate would provide a better basis for conveying and implementing the Committee's goals of fostering a prompt upturn in economic activity and subsequent expansion at a sustained and acceptable pace. In addition, the midpoint of this range appeared to be consistent with continued progress toward price stability.

In the Committee's discussion of policy for the intermeeting period ahead, all of the members endorsed a proposal to maintain unchanged conditions in reserve markets, at least initially, following this meeting. In reaching their decision, members took into account the considerable easing of monetary policy that had been implemented in a series of steps over the course of recent months, including the reduction in the discount rate and related decrease in money market interest rates within the last few days. The System's policy actions, in the context of a weakening economy and moderating cost pressures, had induced a considerable decline in interest rates, but sufficient time had not yet elapsed for the effects of the lower rates to be felt in the economy or indeed to any measurable extent in the growth of the monetary aggregates. A number of members also commented on the possibility that further easing so soon after the recent policy moves could result in undesirable downward pressure on the dollar in foreign exchange markets. In these circumstances, while views differed with regard to the potential need for further easing moves, the members agreed that for now it was desirable to pause and assess the course of the economy and the effects of past policy actions.

As they had at other recent meetings, many of the members expressed concern about the very sluggish expansion of M2 and M3 over the past several months. This weakness in monetary growth in turn appeared to be associated with the current constraints on the availability of credit from depository institutions and the shortfalls in aggregate spending and income. According to a staff analysis prepared for this meeting, a steady policy course was likely to be consistent with some acceleration in monetary growth over the first quarter because earlier declines in market interest rates had reduced the opportunity costs of holding deposit accounts, and the staff assumed some strengthening of aggregate spending over the balance of the quarter. The incomplete data available thus far for the latter part of January tended to support this staff analysis. The members recognized that the short-run behavior of these monetary measures needed to be interpreted with caution and that easing reserve conditions too much would incur the risk of stimulating a sharp rebound in monetary growth and in inflationary pressures once the economic recovery had gathered some momentum. Nonetheless, several members emphasized the desirability of giving relatively high priority to achieving satisfactory rates of growth in

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reserves and money, especially under prevailing economic and financial conditions.

In the course of the Committee's consideration of possible intermeeting adjustments to the degree of reserve pressure, most of the members expressed a preference for continuing to tilt the directive toward possible easing during the weeks ahead. In this view, the downside risks to the economy and the potential for inadequate monetary growth made it likely that any intermeeting adjustment would be in the direction of easier reserve conditions. Several members also noted that the Committee needed to place a high premium on avoiding any tendency for the weakness in the economy to cumulate because they were more concerned about the severe consequences of a potentially deep and prolonged recession than those of a sharp rebound in the economy, especially given current financial strains and fragilities in the economy. Accordingly, the Committee should be willing to ease in response to evidence of additional weakness in the economy and abatement of inflationary pressures; the need for further easing might be signaled in part by a continuing shortfall in monetary growth. In following such a policy, however, a number of members stressed that the Committee would need to be prepared to tighten policy promptly down the road in the event that inflationary pressures should threaten to re-emerge. A few members, while acknowledging the potential need for some easing, preferred not to bias the directive in either direction. In this view, there were considerable risks of overreacting to indications of a weakening economy, particularly since conditions for a recovery in economic activity already appeared to be in place and weak data for the period at the start of the Persian Gulf war might well reflect what would prove to be a short-lived development.

At the conclusion of the Committee's discussion, all of the members indicated that they favored a directive that called for maintaining the existing degree of pressure on reserve positions. They also noted their preference or acceptance of a directive that gave special weight to potential developments that might require some easing during the intermeeting period. Accordingly, the Committee decided that slightly greater reserve restraint might be acceptable during the intermeeting period or somewhat lesser reserve restraint would be acceptable depending on progress toward price stability, 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 at this meeting were expected to be consistent with some pickup in the growth of M2 and M3 to annual rates of around 3½ percent to 4 percent over the three-month period from December to March.

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 further weakening in economic activity. Total nonfarm payroll employment fell sharply further in December and January, reflecting widespread job losses that were especially pronounced in manufacturing and construction; the civilian unemployment rate rose to 6.2 percent in January. Industrial output declined markedly in the fourth quarter, in part because of sizable cutbacks in the production of motor vehicles, and partial data suggest a further drop in January. Consumer spending has remained soft. Advance indicators of business capital spending point to considerable weakness in investment in coming months. Residential construction has declined substantially further in recent months. The nominal U.S. merchandise trade

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deficit narrowed in November, as the value of imports declined more than that of exports; the average deficit for October and November exceeded that for the third quarter. Increases in consumer prices moderated and producer prices changed little in November and December, largely as a result of a softening in energy prices. The latest data suggest some further deceleration in wages and overall labor costs.

Short-term interest rates have fallen considerably since the Committee meeting on December 18, while rates in longer-term markets are unchanged to down slightly. The Board of Governors approved a reduction in the discount rate from 7 to 6½ percent on December 18 and a further reduction to 6 percent on February 1. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has declined somewhat on balance over the intermeeting period.

Growth of M2 remained sluggish in December and January; expansion of M3 picked up in January from the very slow pace of recent months. For the year 1990, M2 and M3 expanded at rates in the lower portions of the Committee's ranges for the year. Expansion of total domestic nonfinancial debt appears to have been near the midpoint of its monitoring range for the year.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote a resumption of sustainable growth in output, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 2½ to 6½ percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt was set at 4½ to 8½ percent for the year. With regard to M3, the Committee anticipated that the ongoing restructuring of thrift depository institutions would continue to depress its growth relative to spending and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Depending upon progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint might or somewhat lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of both M2 and M3 over the period from December through March at annual rates of about 3½ to 4 percent.

Votes for the paragraph on short-run policy implementation: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Keehn, Kelley, LaWare, Mullins, Parry, and Ms. Seger. Votes against this action: None.

2. Agreement to "Warehouse" Foreign Currencies

At its meeting on March 27, 1990, the Committee approved an increase, if requested by the Treasury, from $10 billion to $15 billion in the amount of eligible foreign currencies that the System would be prepared to "warehouse" for the Treasury and the Exchange Stabilization Fund (ESF). The purpose of the warehousing facility is to supplement the resources of the Treasury and the ESF for financing their purchases of foreign currencies. System holdings of foreign currencies under the facility had risen to $9.0 billion, based on acquisition costs, in March 1990, but subsequent ESF repayments had reduced the total to $4.5 billion by November 1, 1990.

At this meeting, the Committee decided to reduce the limit to $10.0 billion. Such a limit would provide an adequate cushion of unused capacity and thus maintain operational flexibility to respond on short notice to unanticipated developments.

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

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Meeting Held on March 26, 1991

Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity had weakened further in the opening months of the year. Production cutbacks were evident in a wide range of industries, and private payrolls had fallen markedly, especially in the goods-producing sector. On the positive side, consumer confidence had rebounded sharply since the cease-fire in the Persian Gulf, retail sales and housing starts had strengthened recently, and exports had continued to expand. Broad measures of prices had slowed or contracted in January and February, but excluding energy and food prices, increases in those measures were higher than in previous months. Wage increases had moderated over the past several months.

Total nonfarm payroll employment fell sharply further in February. The decline was widespread across industries but was particularly pronounced in the durable goods segment of manufacturing. Construction employment edged up in February after a steep drop in January, when the weather was unusually adverse. The only major industry to post a notable job increase was health services. The civilian unemployment rate rose to 6.5 percent in February.

Industrial output declined markedly again in February, with cutbacks evident in a wide range of industries. Production of motor vehicles and parts slackened after being about unchanged on balance over the previous two months; output of other final products continued to fall in February, with the exception of computer equipment, which advanced for a second month. Capacity utilization in most major industries fell further in February; in manufacturing, operating rates were substantially below their 1989 highs.

Shipments of nondefense capital goods increased in February, boosted by a sizable advance in shipments of aircraft and parts; categories other than aircraft were down. New orders for business equipment suggested that spending on such goods would change little in coming months. Nonresidential construction put-in-place edged up in January from a downward-revised level for December but remained below its weak average for the fourth quarter. Available data on contracts, permits, and office vacancy rates pointed to considerable softness in nonresidential construction activity in coming months. Manufacturing and trade inventories rose considerably in January after little net change in the fourth quarter. With shipments and sales down sharply around the turn of the year, the ratio of inventories to sales in manufacturing and trade continued to rise in January.

After declining considerably in previous months, retail sales turned up in February. Sales at general merchandise, apparel, and furniture outlets jumped in February after posting sizable declines over the preceding few months, and purchases of automobiles and light trucks picked up from the very low sales pace in January. Consumer sentiment appeared to have rebounded sharply in early March from the low levels reached after Iraq's invasion of Kuwait. In February, housing starts more than retraced a sharp January decline but were still at a low level; in particular, multifamily construction activity remained very weak. Available data and anecdotal reports indicated that lower home prices and mortgage rates were stimulating some consumer interest in purchasing homes.

The nominal U.S. merchandise trade deficit increased slightly from Decem-

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ber to January but was considerably below its average rate in the fourth quarter. The value of exports picked up in January from the strong fourth-quarter level; the value of imports declined considerably, mostly reflecting a drop in the price of imported oil. Among the major foreign industrial countries, economic activity in the fourth quarter of 1990 expanded more slowly in Germany and Japan, though there had been some tentative indications of a pickup in growth early this year in both countries. By contrast, some weakening in activity apparently had occurred in several other major industrial countries.

Among major components of broad measures of inflation for January and February, food prices rose more slowly or declined on balance and energy prices fell substantially further; however, prices of items other than food and energy rose more rapidly than in preceding months. At the producer level, this pickup reflected in part large increases in prices of motor vehicles. At the consumer level, increases in federal excise taxes on some items and an unusual bunching of price increases at the beginning of the year had boosted prices of nonfood, non-energy goods and services; as a result, the percent change in these prices over the twelve months ended in February was considerably above that for the previous twelve months. Average hourly earnings of production or supervisory workers were little changed over January and February; for the twelve months ended in February, these earnings had increased at a slower pace than in the comparable year-earlier period.

At its meeting on February 5–6, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions but for giving special weight to potential developments that might require some easing during the intermeeting period. To reflect the tilt toward easing, the directive indicated that somewhat lesser reserve restraint would be acceptable in the intermeeting period, or slightly greater reserve restraint might be acceptable, depending upon progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The contemplated reserve conditions were expected to be consistent with growth of both M2 and M3 at annual rates of around 3½ to 4 percent over the period from December through March.

After the Committee meeting, open market operations initially were directed at maintaining the existing degree of pressure on reserve positions; subsequently, in early March, in response to information suggesting that economic activity had continued to decline through February, pressures on reserve positions were eased slightly. Adjustment plus seasonal borrowing tended to run at appreciably higher levels than expected over the intermeeting period; this seemed to reflect in part a greater willingness of banks to seek discount-window credit when conditions tightened in the federal funds market. In the early part of the intermeeting period, federal funds averaged a bit above 6¼ percent, but by the time of the March meeting the rate had dropped to about 6 percent. The federal funds rate was less volatile around its average level; this evidently reflected not only the change in attitudes toward use of the window but also the greater experience of banks in operating under the lower reserve requirement ratios put in place late last year and the rebound of required reserve balances from their seasonal low in February.

Other short-term interest rates had declined slightly since the Committee

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meeting on February 5–6; Treasury bill rates dropped by less than rates on private instruments. In longer-term markets, rates on Treasury bonds had risen appreciably while rates on high-grade bonds had changed little and those on lower-rated debt had fallen substantially. The narrowing in spreads of private over Treasury rates appeared to stem primarily from investor assessments of improved prospects for a recovery in U.S. economic activity and in business earnings and thus for reduced strains on borrowers. Stock prices moved up considerably on balance over the intermeeting period.

The trade-weighted value of the dollar in terms of the other G-10 currencies increased very sharply over the intermeeting period. In addition to optimism over the prospects for the U.S. economy in the aftermath of the Persian Gulf war, there was a growing perception by market participants that economic activity in the major trade partners of the United States was growing more slowly or declining and that in consequence interest rate spreads were likely to move in favor of dollar assets. Political difficulties in the Soviet Union also appeared to affect the German mark adversely.

At least partly in response to earlier declines in interest rates, growth of M2 and M3 strengthened substantially in February, and partial data suggested appreciable further growth in March. Such growth, which was faster than the Committee had anticipated, brought M2 up to the middle portion of its annual range and put M3 near the upper end of its range. Most of the acceleration in M2 reflected rapid expansion in its liquid retail deposit instruments. Offering rates on these accounts had responded in typically sluggish fashion to declines in market interest rates in recent months, and the opportunity costs associated with holding such deposits had narrowed accordingly. The strength in M3 reflected not only the faster growth of M2 but also in part the efforts of some depository institutions, in the wake of the elimination of the reserve requirement on nontransaction accounts, to replace federal funds and Eurodollar borrowings with funds raised through domestic issuance of large certificates of deposit.

The staff projection prepared for this meeting pointed to a turnaround in the economy in coming months. While further declines in activity were likely in the very near term, the rebound in business and consumer confidence following the declaration of a cease-fire in the Persian Gulf, the positive effects of lower oil prices on household purchasing power and of earlier declines in interest rates on housing demand, and the additional gains expected in exports were likely to foster an upturn in the economy before very long. Subsequently, increases in business orders and sales could lead to a further pickup in production, given generally lean inventories and, with some lag, to a rise in business spending for investment goods. On the other hand, the reduced availability of credit and the effects of the overhang of commercial structures on commercial construction activity, along with a moderately restrictive fiscal policy, were expected to continue to exert some restraint on domestic demand. Against the background of lower oil prices and some added slack in resource utilization, the staff projected a slowing in the pace of increases in prices and labor costs in coming quarters.

In the Committee's discussion of the economic outlook, members saw improving prospects for a recovery in business activity some time in the months ahead, especially in light of the sharp rebound in consumer and business sentiment since the cease-fire in the Persian

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Gulf war. A variety of financial indicators, including the performance of the stock and bond markets and the foreign exchange markets, along with faster monetary growth suggested both that an upturn in economic activity was widely expected and that liquidity had been made available to support it. Thus far, however, the surge in consumer confidence was not accompanied by appreciable evidence of stronger economic activity, though the February data in two key areas, retail sales and housing starts, were positive after a period of substantial weakness. In the view of many members, the anticipated upswing in economic activity might be relatively sluggish, at least in the early stages of the recovery. Consumers and businesses probably would remain relatively cautious in the context of continuing concerns about employment opportunities as well as heavy debt burdens and tight constraints on credit availability; in addition, confidence was vulnerable to further difficulties in the financial sector. Indeed, there was some risk that the recession could deepen considerably further, but on balance the conditions seemed to be in place for a turnaround in coming months. With regard to the outlook for inflation, members expressed disappointment about the lack of progress in reducing its underlying rate; however, they remained optimistic that reduced pressures in markets for output as well as for key inputs, indications of some moderation in wage increases, a firmer dollar, and weaker commodity prices all pointed to some subsidence in inflation over coming quarters. The slower average rate of money growth over the course of recent years suggested a monetary policy that had for some time been consistent with a gradual diminution in inflation.

In their reports on developments around the country, members noted that their contacts indicated a sharp rebound in business sentiment since the last Committee meeting, mirroring the marked increase of consumer confidence as the Persian Gulf war drew to a successful close. The effects of this change in attitudes by both producers and consumers were not yet evident in many statistical measures of economic activity, except perhaps in the housing sector and retail sales. Across the nation, regional economic activity remained uneven; it was still declining in some areas, albeit with increasing signs that it might be stabilizing, and appeared to have bottomed out or strengthened a little in other parts of the country. Manufacturing activity in particular remained depressed in many areas, notably those that were dominated by the production of motor vehicles and related parts. Members commented that many businesses, especially in the construction industry, were continuing to report difficulties in obtaining financing, but both loan demand and the availability of financing showed signs of improvement in some areas.

In their review of developments in key sectors of the economy, members emphasized that the timing and strength of the recovery would depend importantly on how quickly and to what extent the rebound in consumer confidence was translated into increased consumer spending. The performance of the consumer durables sector, notably autos, was a key element in the outlook; while expenditures on durable goods did not appear to have strengthened thus far, developments that might help to stimulate such spending included greater capital gains realized from sales of existing homes and more demand for household durables stemming from a possible pickup in the construction of new homes. Members also reported that automobile dealers had become more

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optimistic in many areas. However, many members believed that consumer expenditures were likely to be restrained by a combination of negative factors that included concerns about job security and debt burdens. Moreover, the fiscal problems of state and local governments were tending to erode consumer confidence in some parts of the country, and associated fiscal restraint measures would limit the growth in disposable incomes in those areas.

With regard to the outlook for business investment spending, stronger consumer expenditures in coming months should induce more business spending for inventories and, with some lag, for new equipment, especially in light of the recent improvement in business confidence. On the negative side, if a recovery in consumer spending failed to materialize, the upturn in business confidence might well reverse. Such a development could foster a sharp drop in business capital appropriations that in turn would deepen and extend the recession. With regard to construction activity, members commented that problems of overcapacity were likely to limit new nonresidential construction for an extended period in many areas. On the other hand, signs of renewed buyer interest in housing were widespread, and indeed developments in this sector of the economy were seen by some members as the most encouraging indication of a prospective economic recovery. Some concern was expressed regarding the possibility that persisting constraints on the availability of financing to homebuilders might continue to inhibit homebuilding activity, but given the expected strengthening in the overall economy and the already improving capital positions of many banking institutions, a degree of optimism seemed warranted that such financing might become more readily obtainable in the months ahead.

In the view of many members, the external sector of the economy was likely to make only a small contribution to the domestic expansion in coming quarters. While continuing growth in exports was helping to offset some of the weakness in manufacturing, some members referred to the possibility that further expansion in world demand for U.S. exports might be curtailed by slower growth abroad related to political uncertainties and economic developments in several nations; a partial offset was the potential for large reconstruction expenditures by Kuwait. The recent appreciation of the dollar also would tend to inhibit net exports over time.

Turning to the outlook for inflation, a number of members emphasized that recent increases in producer and consumer prices, excluding their food and energy components, were a disturbing development even though transitory factors helped to account for much of those increases. Concerns about inflation seemed to be echoed in financial markets, judging from the recent rise in long-term interest rates. At the same time, however, increases in labor compensation had continued to trend down, with relatively high unemployment levels contributing to much reduced pressures on wages in many local areas. In circumstances characterized by strong competitive conditions in most industries and thus widespread pressures on prices and profit margins, many business firms continued to seek ways to limit their labor costs. In this connection, members observed that efforts to hold down employment levels were likely to result in some further increases in unemployment even after a recovery got under way. The appreciation of the dollar in recent months would tend with some lag to moderate inflation pressures over coming quarters. On balance, the members remained optimistic about the

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prospects for appreciable reductions in the core rate of inflation, given their expectations of some continuing slack in resource use and of monetary expansion at a pace within the Committee's ranges for the year.

In the Committee's discussion of policy for the intermeeting period ahead, all of the members supported a proposal to maintain an unchanged degree of pressure on reserve positions. The System's policy actions over the course of recent months, including two reductions in the discount rate, represented substantial easing on a cumulative basis and most probably had positioned monetary policy to contribute to a satisfactory recovery in business activity. Changing economic and financial conditions could, of course, lead to a reassessment, but for now a steady policy course seemed indicated as the stimulative effects of earlier policy actions, the drop in oil prices, and the rebound in confidence worked their way through the economy. Some members observed that the most likely direction of the next policy move was not clear at this point and that caution was needed before any action was taken. Prevailing uncertainties suggesting that further easing could not be ruled out included the possibility that consumer spending would not strengthen materially and that business capital spending would continue to weaken. However, if the economy was indeed near its recession trough, additional easing would not be necessary and such a move might add to inflationary pressures later. On the other hand, while a firming of policy clearly would be premature at this point, a number of members commented that the Committee should be alert to the potential need to tighten reserve conditions promptly if emerging economic and financial conditions, including the behavior of the monetary aggregates, threatened progress toward price stability.

Many of the members commented that in current economic and financial circumstances the strengthening in M2 growth in February and March was a welcome development following an extended period of limited expansion. The faster growth tended to support expectations of a near-term recovery in economic activity. It also might be indicative of some rebound of public confidence in depository institutions. The growth of M2 for the year to date was near the middle of the Committee's annual range, but if the most recent rate of M2 growth was to continue for some time, this might signal the need to tighten reserve conditions to forestall a potential intensification of inflationary pressures. However, according to a staff analysis prepared for this meeting, monetary growth was likely to moderate somewhat over the second quarter as the effects of earlier declines in market interest rates on opportunity costs and desired money holdings tended to dissipate. On the assumption of an unchanged degree of pressure on reserve positions, the staff projected the cumulative expansion of M2 to be only slightly above the midpoint of the Committee's range at midyear.

Members expressed a range of views regarding possible intermeeting adjustments to the degree of reserve pressures, but a majority preferred—and all could accept—a directive that did not contain a bias toward tightening or easing. A symmetric directive represented a change from previous directives that had been tilted toward easing since mid-1990, and it was consistent with an assessment that the risks to the economy had shifted in recent weeks and were now more evenly balanced. Further declines in economic activity would not be surprising—nor should they necessarily

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be seen as calling for additional ease, given the lags in policy effects. Under current circumstances, policy adjustments should be made only in the event of particularly conclusive evidence, which might include a significant deviation in monetary growth from current expectations, that the recession might be deeper or the rebound less robust than anticipated. Other members expressed a preference for retaining a directive that was biased toward possible easing. Some of these members believed that, despite the improved prospects for a recovery, there were still marked risks of a prolonged recession and of a weak upturn, and in these circumstances the Committee should react relatively promptly to indications that the economy was not moving toward a turnaround. One member expressed a slight preference for biasing the directive toward restraint. In this view, the possibility of a continuing or even a deepening recession could not be ruled out, but the greater risks were in the direction of too much ease and of persisting or increasing inflation; consequently, the directive should envision any easing as a remote prospect.

At this meeting, the interaction between changes in the discount rate, as approved by the Board of Governors, and open market operations, as implemented under the current operating procedures and directives of the Committee, also was discussed. The principal issue related to the extent to which changes in the discount rate should show through to the federal funds rate that would be expected in the implementation of open market operations. In recent years, changes in the discount rate usually had been allowed to pass through automatically to the federal funds rate; there had been some exceptions involving instances where only partial pass-throughs had been permitted and where the change in the discount rate had been intended to conform the latter to movements that had already occurred in the federal funds rate. In general, however, both rates had tended to move together over time, and appropriately so, as adjustments to both policy instruments are made in the context of the same economic and financial developments. Members agreed that in general the existing practice should be continued, but that consultation among members of the Committee would be particularly appropriate in circumstances in which changes in the discount rate perhaps should not be permitted to show through entirely to market rates, or in which their showing through would result in quite sizable changes in money market rates in the period between meetings.

At the conclusion of the Committee's discussion, all of the members indicated that they favored a directive that called for maintaining the existing degree of pressure on reserve positions. The members also noted that they preferred or could accept a directive that did not include a presumption about the likely direction of any intermeeting adjustments in policy. Accordingly, the Committee decided that somewhat greater reserve restraint or somewhat lesser reserve restraint might be acceptable during the period ahead depending on progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated at this meeting were expected to be consistent with some reduction in the growth of M2 and M3 from their recent pace to annual rates of around 5½ and 3½ percent respectively over the three-month period from March through June.

At the conclusion of the meeting, the following domestic policy directive was

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issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that economic activity weakened further in the opening months of 1991. In February, total nonfarm payroll employment fell sharply further, especially in manufacturing, and the civilian unemployment rate rose to 6.5 percent. Industrial output also declined markedly again in February, with cutbacks evident in a wide range of industries. Advance indicators point to further weakness in business fixed investment in coming months, notably in nonresidential construction. On the other hand, after declining considerably in previous months, retail sales turned up in February; consumer sentiment appears to have rebounded sharply in recent weeks. Housing starts jumped in February, retracing a sizable decline in January but remaining at a low level. The nominal U.S. merchandise trade deficit increased somewhat in January but was considerably below its average rate in the fourth quarter. Energy prices fell substantially further in January and February, but prices of other consumer goods and services rose more rapidly than in preceding months. Wage increases have moderated in recent months.

Short-term interest rates have declined slightly since the Committee meeting on February 5–6. In longer-term markets, rates on Treasury bonds have risen appreciably, owing at least in part to heightened expectations of a recovery in U.S. economic activity. Risk premiums on corporate debt instruments have declined, and stock prices have moved up considerably on balance. The trade-weighted value of the dollar in terms of the other G-10 currencies increased very sharply over the intermeeting period.

Growth of M2 and M3 strengthened substantially in February, reflecting rapid expansion in liquid retail deposits; partial data suggest appreciable further growth in March.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote a resumption of sustainable growth in output, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at its meeting in February established ranges for growth of M2 and M3 of 2½ to 6½ percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt was set at 4½ to 8½ percent for the year. With regard to M3, the Committee anticipated that the ongoing restructuring of thrift depository institutions would continue to depress its growth relative to spending and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Depending upon progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint or somewhat 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 March through June at annual rates of about 5½ and 3½ percent, respectively.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Keehn, Kelley, LaWare, Mullins, and Parry. Votes against this action: None.

Meeting Held on May 14, 1991

Domestic Policy Directive

The economic information reviewed at this meeting was mixed, but on balance it suggested that business activity might be in the process of stabilizing after declining in the fourth and first quarters. Retail sales were little changed in April, and housing markets apparently strengthened in many areas; however, business fixed investment remained weak, and some liquidation of inventories seemed to be continuing. Production held steady in April. Nonfarm payroll employment continued to decline

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but by much less than in previous months. Broad measures of prices and wages pointed to moderating inflation pressures, although a number of special factors tended to obscure underlying inflation trends.

Total nonfarm payroll employment fell further in April, but the reduction was substantially less than the declines in the latter part of 1990 and the early months of 1991. The job losses included much smaller decreases in manufacturing and construction; employment in wholesale and retail trade also continued to slide, and the loss more than offset a further gain at service establishments. The civilian unemployment rate declined somewhat in April to 6.6 percent.

After dropping sharply from October through March, industrial production was about unchanged in April. An upturn in the production of motor vehicles provided an important boost to industrial activity, and output of other consumer durable goods also edged up. These gains offset further declines in the production of consumer nondurable goods and business equipment. Industrial materials, while displaying a mixed pattern, continued to decline as a group. Capacity utilization rates generally fell further in April, and operating rates for most industry groups were at their lowest point in the current recession.

Real business fixed investment fell sharply in the first quarter, with outlays for both equipment and structures decreasing substantially. The plunge in expenditures for equipment included large declines in spending for computers, motor vehicles, and many types of industrial equipment; in contrast, outlays for aircraft were markedly higher. Recent data on orders received by domestic manufacturers pointed to additional cutbacks in spending for most types of equipment. The sizable reduction in first-quarter expenditures for nonresidential structures followed an even larger decline in the fourth quarter. Forward-looking indicators of nonresidential construction suggested continuing weakness. Nonfarm business inventories fell substantially further in the first quarter, largely as a result of continuing liquidation of stocks of motor vehicles. In March, housing starts lost part of their sharp February gain. However, more recent anecdotal reports and surveys of homebuilders suggested that reduced mortgage rates were continuing to stimulate consumer interest in purchasing homes.

Retail sales, which had risen substantially in February after sizable declines in previous months, were now indicated to have increased somewhat further in March and to have changed little in April. The improvement in retail sales was led by the durable goods category. Unit sales of motor vehicles rose in March but subsequently softened again in April. After rebounding earlier, consumer sentiment was reported to have declined slightly in April.

Producer and consumer prices changed little in March and April, partly because of some additional reduction in energy prices. Excluding their food and energy components, both producer and consumer prices were up considerably less in the latest two months than in previous months. Apparently reflecting an increase in the minimum wage, average hourly earnings rose at a faster rate in April than in earlier months of the year. In the first quarter, hourly compensation as measured by the employment cost index was boosted by special factors that included an increase in the wage bases for social security and medicare taxes.

The nominal U.S. merchandise trade deficit narrowed in February, and for January–February combined the deficit

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was considerably below its average rate in the fourth quarter. The improvement reflected a significant decline in the average price of oil imports, a lower volume of non-oil imports, and further expansion in the quantity of exports. In the first quarter, economic activity appeared to have continued to grow at a sluggish pace in the major foreign industrial nations as a group.

At its meeting on March 26, 1991, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that contained no presumption regarding the likely direction of possible intermeeting adjustments. Accordingly, the directive indicated that somewhat more or somewhat less pressure on reserve positions might be appropriate during the intermeeting period depending on progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The contemplated reserve conditions were expected to be consistent with some reduction in the growth of M2 and M3 from accelerated rates in previous months to annual rates of about 5½ and 3½ percent respectively over the three-month period from March through June.

For much of the period after the Committee meeting, open market operations were directed toward maintaining the existing degree of pressure on reserve positions. On April 30, in response to indications of continuing weakness in the economy and in the context of abating inflation pressures, the discount rate was reduced from 6 to 5½ percent and part of this decline was allowed to show through to the federal funds rate. Adjustment plus seasonal borrowing averaged a bit above $150 million over the intermeeting period, close to expected levels. During this period, two technical increases were made to assumed levels of borrowing to reflect a normal upswing in seasonal credit. Federal funds traded at an average rate just below 6 percent until late April; the rate was under downward pressure at times from market expectations of some further easing in monetary policy and from unanticipated reserve surpluses. After the announcement of the reduction in the discount rate on April 30, federal funds traded in a range around 5¾ percent.

Most short-term interest rates declined somewhat more than the federal funds rate over the intermeeting period, apparently reflecting reactions to indications of continued weakness in the economy as well as the easing in reserve conditions. Banks reduced their prime rate from 9 to 8½ percent in early May after the easing of monetary policy. In long-term debt markets, yields on Treasury bonds were little changed on balance over the period as market participants appeared to focus increasingly on the prospects for very large Treasury financing needs. In private-sector bond markets, rates edged lower and risk premia fell further after declining sharply in February and March. Major stock price indexes retreated from record levels reached during April but still rose on balance over the period. Prices of bank debt and equities outpaced the broader indexes, in part because bank earnings for the first quarter were not as poor as many investors had feared.

In foreign exchange markets, the dollar tended to weaken in reaction to the easing of U.S. monetary policy in late April and the release of data that failed to confirm market expectations of a quick recovery in U.S. economic activity after the end of the Persian Gulf war. However, some decline in short-term interest rates abroad and reactions to political developments in Germany and the

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Soviet Union limited the downward pressure on the dollar. On balance, the dollar was little changed over the period in terms of the other G-10 currencies, and at the time of this meeting it was at a level well above its lows of mid-February.

After accelerating to a relatively rapid pace in February and March, growth of M2 slowed appreciably in April. The slowing was somewhat greater than had been anticipated and appeared to be related in part to a relatively small buildup in household deposit balances associated with a falloff in income tax payments. The expansion of M3, which already had moderated in March, stalled in April. Apart from the effect of reduced M2 growth, M3 was influenced by a runoff of large time deposits associated with contracting credit at depository institutions. For the year through April, M2 expanded at a rate close to the midpoint of the Committee's annual range; M3 grew at a pace in the upper half of the Committee's range, as the elimination of reserve requirements on nontransaction accounts induced some foreign banks to shift funding into the U.S. CD market.

The staff projection prepared for this meeting suggested that a recovery in economic activity was imminent and would be fully under way by the summer months; the expansion was projected to continue through 1992. In the context of moderate growth in consumer spending, the recovery would be stimulated by an upturn in homebuilding and a swing in coming months from decumulation to accumulation of inventories. Capital expenditures were expected to strengthen over time as sales trends improved. On balance, however, the projection pointed to a recovery that was less robust than most of those experienced in previous postwar cycles. Among the factors that would tend to inhibit the recovery were the effect of unoccupied nonresidential structures on construction activity, the absence of further significant impetus from net exports, and the prospect of some continued constraint on the availability of credit. Federal fiscal policy was expected to remain moderately restrictive, and efforts by states and localities to cope with budgetary imbalances also promised to exert some restraint on domestic demand. Against the background of some persisting slack in labor and product markets, the staff anticipated that the underlying rate of inflation would trend down in coming quarters.

In the Committee's discussion of the economic situation and outlook, members commented that current business indicators continued to provide mixed signals of the prospects for the economy but that a variety of developments appeared to have laid the groundwork for a recovery. Indeed, in the view of a number of members, the economy might well be close to its recession trough. Consumer spending, while disappointing to many business firms, appeared to have been better maintained in recent months than earlier reports had suggested, and demand for housing clearly had picked up across the nation. Overall spending had exceeded production by a considerable margin since the fall of 1990, and at some point the liquidation of inventories would end and a pickup in production would be needed to satisfy ongoing demand. On the financial side, the stock market remained strong; households and business firms were making progress in rebuilding their balance sheets; and the overall condition of the banking system appeared to be improving despite the continuing difficulties of a number of individual institutions. Negative factors included indications of relatively depressed business sentiment; business capital spending

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remained weak and members were concerned that additional retrenchment in business expenditures could develop, possibly induced by further disappointment over the level of consumer spending, that would deepen and prolong the recession. Consumer confidence had receded after its surge at the end of the Persian Gulf war. Consumer and business attitudes were seen as a critical factor bearing on the prospective performance of the economy.

Despite the uncertainties, the members generally viewed a business recovery in the months ahead as a reasonable expectation. At the same time, while acknowledging the unpredictability of the economy's momentum once the recovery got under way, many questioned the potential strength of the anticipated expansion. Their assessment of current conditions did not point to major sources of stimulus to the economy, aside perhaps from residential housing. Some members also observed that the rebuilding of balance sheets, to the extent that it continued, might temper the initial strength of the recovery though it would have obviously favorable implications for the sustainability of the recovery over time. With regard to inflation trends, members commented that on the whole recent price and wage developments were encouraging and provided a firmer basis than earlier for projections of appreciable progress in reducing the core rate of inflation over the next several quarters.

Reports from around the country indicated that business conditions were still uneven. Economic activity appeared to have weakened somewhat further in some regions over the course of recent months but had changed little or shown modest gains in other parts of the nation. Relatively weak economic conditions had limited the tax revenues of numerous state and local governments, including many major cities, and the imposition or the prospect of higher taxes along with efforts to cut services were having an unsettling influence on business and consumer confidence in many areas. More generally, fiscal developments, including trends in federal spending, were expected to have a retarding effect on the nation's economy over the balance of the year and in 1992.

Many of the members observed that the consumer sector might well remain relatively sluggish in the months ahead as consumer expenditures continued to be restrained by lagging growth in disposable incomes and by concerns about employment prospects, debt burdens, and the health of a number of financial institutions. With regard to the prospects for business capital spending, members continued to anticipate that significant strengthening would lag an improvement in consumer spending. In this connection, some commented that unless tangible evidence of stronger consumer spending began to emerge fairly soon, already gloomy business attitudes would be shaken further and could lead to an additional cutback in business capital expenditures. For now, the weakness in investment spending appeared to reflect in large measure a stretching out of major capital projects rather than widespread cancellations. The large issuance of new equity and long-term debt by business firms was being used at this point mainly to shore up balance sheets rather than to finance capital expenditures, but these activities implied that business firms would be in an improved position to finance more investment spending later in response to a pickup in the demand for their products and an ongoing need to modernize production facilities for competitive reasons. In any event, commercial construction activity was likely to remain depressed for an extended period until a severe over-

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capacity in office space and other facilities in many parts of the country could be worked down.

Several members commented that a turnaround in inventory investment could play a significant role, as it had historically, in helping to generate a business recovery. The members recognized that a good deal of uncertainty typically surrounded the outlook for inventories, and it seemed especially difficult to anticipate inventory behavior in the context of still evolving business policies aimed at much tighter inventory controls. Nonetheless, the general liquidation of inventories was not likely to persist, and its termination would at the minimum remove a major retarding influence on economic activity, should appreciable rebuilding of inventories fail to materialize in the near term. Indeed, the reduction in auto dealer inventories since late 1990 already had caused production schedules in the motor vehicles industry to be raised substantially for the second quarter despite still lagging sales. A question obviously remained regarding the prospective strength of the buildup in business inventories once there were relatively firm indications of a recovery in final demand from recession levels. In one view, a pickup in inventory investment was likely to be a key source of expansion in the economy. A differing view suggested a relatively limited role for inventories in buttressing an expansion in light of the now widespread business practice of tighter inventory management.

Housing construction also was cited as a sector of the economy that might make a significant contribution to a rebound in economic activity. Reports from around the country already indicated a marked revival in buyer interest, abetted by reduced mortgage rates and lower home prices in many areas. Those developments had greatly enhanced the affordability of houses. The availability of financing to many home builders remained subject to some uncertainty, but while lending institutions would probably apply stricter credit standards than in earlier years, the improving financial condition of these lenders should induce them in the context of strengthening housing markets generally to provide the financing that would be needed to translate increased home sales into more home construction.

With regard to the outlook for inflation, members indicated that they were encouraged by recent price and wage developments. Some observed that greater progress had been made in recent months than they had anticipated earlier, and many commented that more progress in reducing the core rate of inflation was a likely prospect over the next several quarters. In this connection, members reported that competitive pressures remained strong and that many business firms found it difficult to sustain price increases. Moreover, the prices paid by business firms for raw materials had tended to hold in a narrow range, and many business contacts indicated that they did not anticipate much change in such prices during the months ahead. More generally, the members continued to express confidence that the ongoing effects of earlier monetary policy actions and reduced monetary growth over an extended period, together with the slack that had emerged in labor and product markets, would result over time in a lasting downward adjustment in the core rate of inflation. In addition, the appreciation of the dollar in foreign exchange markets would tend with some lag to exert a favorable restraining effect on prices. A number of members cautioned, however, that a significant reduction in the core rate of inflation was not yet assured, and some observed that the failure of long-term

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bond yields to adjust more fully to recessionary economic conditions and to the substantial cumulative decline in short-term interest rates over the course of recent quarters might well be indicative of continued and still considerable inflationary expectations on the part of the public.

In the Committee's discussion of a desirable policy for the intermeeting period ahead, all of the members indicated their support of a proposal to maintain an unchanged degree of pressure on reserve positions. Most also preferred to retain the current instruction in the directive that did not bias possible intermeeting adjustments toward ease or toward restraint. Monetary policy appeared to be properly positioned at this point to help implement the Committee's objectives in that it reflected an appropriate balancing of the risks of an overly stimulative policy that would threaten progress against inflation versus the risks of a deepening recession or an overly delayed recovery. A number of members commented that some further deterioration in economic activity could not be ruled out, and some emphasized that the costs of a substantial shortfall in economic activity from current projections would be much greater than those of a markedly faster expansion than the members currently expected, since present levels of slack in labor and other resource use would tend to limit the price consequences of a period of robust economic growth. However, the System's earlier easing actions, including the most recent reduction in the discount rate in late April and some associated easing in reserve conditions, had provided a good deal of insurance against cumulative further weakening in business activity. Moreover, the System's commitment to the goal of reducing inflation argued for a cautious approach to any further easing at a time when the economy might be close to its recession trough. Steady progress against inflation would foster lower interest rates in long-term debt markets and would thus provide an added degree of stimulus to the economy; conversely, a resurgence in inflation would probably induce a backup in long-term interest rates, including mortgage rates, with adverse implications for housing markets and the economy. Against this background, the members concluded that a desirable policy was to take no action at this time but to monitor carefully the ongoing effects of the System's earlier easing moves.

In the course of the Committee's discussion, a number of members underscored the desirability of achieving monetary growth within the Committee's ranges for the year. According to a staff analysis prepared for this meeting, both M2 and M3 were likely to strengthen over the balance of the current quarter after showing little or no growth in April. For the quarter as a whole, expansion of both monetary aggregates was expected to be below the rates projected at the time of the March meeting, but their cumulative growth through midyear would still be in the middle portions of their respective annual ranges. The members recognized that the economy was subject to events beyond the Committee's control, but an appropriate rate of monetary expansion at this stage would support the view that policy was positioned to help prevent substantial further weakening in business activity on the one hand while guarding against disappointing inflation results later on the other. Subnormal monetary growth might be an indication that monetary policy was still too tight, perhaps because of the reluctance of depository institutions and other lenders to extend credit. In that regard, it might be especially useful in this period to scruti-

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nize the asset side of bank balance sheets, notably the behavior of various categories of loans, and other data on debt trends in relation to typical cyclical behavior for possible clues regarding both the strength of credit demands and business activity and changes in lending practices and conditions.

Turning to possible adjustments to the degree of reserve pressure during the intermeeting period, all of the members supported or could accept a symmetrical directive in light of their current assessments of the prospects for the economy and the behavior of the monetary aggregates. Some members emphasized that the marked uncertainties in the current economic situation underscored the need for a great deal of vigilance in appraising ongoing economic developments. Some indicated a slight preference for a directive that was tilted toward possible easing. These members believed that the risks in the economy remained at least marginally tilted toward a weaker than projected economic performance and that any policy adjustments in the intermeeting period were likely to be in the direction of some easing. Should the incoming data suggest a substantial shortfall from expectations, monetary policy in this view should be adjusted promptly toward ease. In the view of a majority of the members, however, a symmetrical directive was warranted because the risks to the economy were reasonably well balanced at this point. While incoming data on business activity might remain relatively weak over the near term, a change in policy probably would not be called for so long as such data did not suggest a further cumulative decline in economic activity but tended to confirm already available anecdotal information and current Committee expectations.

At the conclusion of the Committee's discussion, all of the members indicated that they favored a directive that called for maintaining the existing degree of pressure on reserve positions. The members also noted that they preferred or could accept a directive that did not include a presumption about the likely direction of any intermeeting adjustments in policy. Accordingly, the Committee decided that somewhat greater reserve restraint or somewhat lesser reserve restraint might be acceptable during the period ahead depending on progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated at this meeting were expected to be consistent with growth of M2 and M3 at annual rates of around 4 and 2 percent respectively over the three-month period from March through June.

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 provides mixed signals regarding the course of economic activity, which had weakened appreciably further earlier in the year. Following sharp decreases in previous months, total nonfarm payroll employment fell somewhat further in April; the civilian unemployment rate edged down to 6.6 percent. Industrial output changed little in April after declining markedly in earlier months. Retail sales were about unchanged in April and are now indicated to have risen somewhat in March. Advance indicators continue to point to weakness in business fixed investment in coming months. Housing starts were down in March, partly offsetting a sizable advance in February, but sales of new and existing homes continued to rise. The nominal U.S. merchandise trade deficit declined in February and its January–February rate was considerably below the average rate in the fourth quarter. Producer and consumer prices were little changed over March and April, partly reflecting further reductions in energy prices.

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Short-term interest rates have declined since the Committee meeting on March 26, while bond yields have changed little. The Board of Governors approved a reduction in the discount rate from 6 to 5½ percent on April 30. The trade-weighted value of the dollar in terms of the other G-10 currencies showed little change on balance over the intermeeting period.

Growth of M2 and M3 weakened in April; for the year thus far, expansion of M2 has been at the midpoint of the Committee's range, while growth of M3 has been in the upper half of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote a resumption of sustainable growth in output, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at its meeting in February established ranges for growth of M2 and M3 of 2½ to 6½ percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt was set at 4½ to 8½ percent for the year. With regard to M3, the Committee anticipated that the ongoing restructuring of thrift depository institutions would continue to depress its growth relative to spending and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Depending upon progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint or somewhat 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 March through June at annual rates of about 4 and 2 percent, respectively.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Keehn, Kelley, LaWare, Mullins, and Parry. Votes against this action: None.

Meeting Held on July 2–3, 1991

Domestic Policy Directive

The information reviewed at this meeting suggested that an upturn in economic activity had begun in recent months. Sizable gains in consumer spending and small increases in expenditures on residential construction appeared to be fueling a moderate rise in domestic final demand. Although inventories were still being liquidated, data for industrial production and labor markets indicated that output was being stepped up to meet that demand. Excluding food and energy items, increases in consumer prices had been small in recent months.

Total nonfarm payroll employment edged up in May, following nearly a year of uninterrupted declines, and the average workweek posted a sizable gain. The turnaround in employment was fairly broad-based. In manufacturing, recalls of workers in the motor vehicles industry more than accounted for the overall increase, but most other manufacturing industries registered either small job gains or greatly moderated job losses. Employment also turned up in the construction sector and in private service-producing industries. The unemployment rate rose to 6.9 percent in May but, averaged over April and May, the unemployment rate was little changed from its March level.

Industrial production rose in April and May, after declining sharply earlier in the year; the limited product data available for June pointed toward another gain. Perhaps reflecting the pickup in housing starts in recent months, production of construction supplies turned up in April and May. Further advances in assemblies of motor vehicles contributed to a slight rise in manufacturing

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output over the two months; in spite of the overall increase in activity, though, the operating rate in manufacturing edged lower in May and remained well below its level of a year earlier.

Real personal consumption expenditures rebounded in May from an April decline; over the March-to-May period, the rise in outlays outpaced gains in personal income. In May, a sizable increase in spending for durable goods reflected stronger outlays for motor vehicles and higher expenditures for most major categories of nondurable goods. Excluding outlays for electricity associated with unusually warm weather, spending for services increased only modestly in May. Continuing a pattern of gradual recovery recorded in earlier months, housing starts rose over April and May. In these two months, single-family starts strengthened further but, with apartment vacancy rates continuing high, multifamily construction remained quite weak.

After declining in the first quarter of the year, shipments of nondefense capital goods increased in both April and May. The turnaround resulted mostly from larger shipments of aircraft; shipments of other types of business equipment increased slightly over the two months. Recent data on orders pointed to some firming in the demand for business equipment. Near-record vacancy rates for office buildings and above-average vacancy rates for industrial buildings suggested continuing weakness in nonresidential construction, although a small increase was recorded in April. The pace of liquidation of manufacturing and trade inventories slowed in April from the very rapid March rate, largely reflecting a slower rate of reduction in stocks at auto dealers. In May, manufacturing inventories fell appreciably further, with drawdowns occurring in most durable and nondurable categories. For most industries, the sharp inventory corrections of recent months along with a pickup in sales have reduced inventory-to-sales ratios substantially.

In April, the preliminary nominal U.S. merchandise trade deficit widened slightly from the revised March level; however, the April deficit was somewhat smaller than the average for the first quarter, which itself had registered a sizable decrease. The value of both exports and imports rose in April. For exports, the increase occurred primarily in capital goods and automotive products, but gains also were indicated for a broad range of industrial supplies. Increases in the value of imports were spread among capital and consumer goods and non-oil industrial supplies. Recent indicators of economic activity in the major foreign industrial countries had been mixed; on balance, growth seemed to have been sluggish in the second quarter, while inflation in most of these countries appeared to be stable or declining.

Nonfood, nonenergy consumer prices increased over the March through May period at a substantially slower pace than over the first two months of the year. Part of the slowdown in recent months reflected an unwinding of large price increases that had occurred in certain components of the index early in the year. In May, producer prices of finished goods firmed somewhat, largely reflecting an upturn in energy prices. Although average hourly earnings of production or nonsupervisory workers rose at a faster rate in April and May than in the first quarter of the year, the increase in earnings over the twelve months ending in May slowed somewhat. For the twelve months ending in March, growth in total employer costs for compensation of private industry workers had

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slowed from the comparable year-earlier period.

At its meeting on May 14, 1991, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that did not contain any presumption about the likely direction of possible intermeeting adjustments. Accordingly, the directive indicated that somewhat more or somewhat less pressure on reserve positions might be appropriate during the intermeeting period depending on progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The contemplated reserve conditions were expected to be consistent with growth of M2 and M3 at annual rates of around 4 and 2 percent respectively over the three-month period from March through June.

Open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions. The federal funds rate remained near 5¾ percent, while adjustment plus seasonal borrowing tended to average a little above assumed levels because of somewhat greater usage of adjustment credit. Several technical changes were made to assumed levels of borrowing to reflect expected increases in the demand for seasonal credit during the spring crop planting season. Against a backdrop of accumulating evidence that the economy was beginning to recover and related expectations that no further easing of monetary policy was likely in the near term, many interest rates rose slightly during the intermeeting period, while most major stock price indexes edged higher on balance.

The trade-weighted value of the dollar in terms of the other G-10 currencies increased substantially on net over the intermeeting period, partly in response to news suggesting that the U.S. economy was turning upward. The dollar rose strongly against the mark and other European currencies, which also were affected by political developments in Europe.

Growth of M2 rebounded in May from its tax-related weakness in April but slowed again in June. Over the three months ending with June, the expansion of M2 fell somewhat short of Committee expectations. Inflows to the liquid retail deposit components of M2 were strong in the latest two months, but small time deposits declined at an accelerating rate; depositors evidently responded to less attractive offering rates on time deposits by shifting some funds not only into liquid money stock components but also into bond and stock mutual funds and other capital market investments not included in this aggregate. M3 fell slightly in June and had grown little since February, reflecting continued shrinkage of the thrift industry and the weakness in bank loan demand and therefore in overall bank funding needs. For the year thus far, expansion of M2 and M3 had been in the middle portion of the Committee's ranges.

The staff projection prepared for this meeting suggested that economic activity was beginning to recover from the recession and that moderate growth in final demand accompanied by a shift in business inventories from substantial liquidation to modest accumulation would lead to considerable growth over the second half of the year. The stimulus from the inventory swing was projected to diminish next year and the expansion to slow gradually to a pace consistent with continuing moderate growth in final demand. On balance, the early and subsequent phases of the recovery were

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projected to be relatively slow by past cyclical standards, reflecting the limited impetus that could be expected from some key sectors of the economy, such as nonresidential construction where activity would be depressed by high vacancy rates. In addition, fiscal policy, including the budgetary stance of state and local governments, was projected to remain fairly restrictive. Against the background of continuing, albeit decreasing, slack in labor and product markets, the core rate of inflation was expected to decline considerably over the period through the end of 1992.

In the Committee's review of current and prospective economic developments, the members generally agreed that a recovery very likely was under way, that final demand would grow moderately for some time, and that an end to inventory reductions would provide an impetus to production over coming quarters. A number of factors were expected to damp the expansion, notably the budget policies of governments at all levels and continuing weakness in nonresidental construction. There also were puzzling aspects to the current situation and attendant risks to the outlook: Commodity prices had failed to firm in their usual pattern in the early stages of a recovery; on the financial side, money and credit growth had remained modest, and conditions were still fragile in many respects. However, it was noted that sources of strength in an economic expansion often have been difficult to anticipate near a cycle trough. Moreover, while the expansion was expected to be slower than the average for postwar business cycles, the recession had been relatively shallow, and a moderate expansion was more likely to be sustained for a considerable period ahead, in large measure because it would be consistent with containing inflation pressures.

The members projected that the underlying rate of inflation would decline in coming quarters—despite quite limited progress thus far this year—in light of some continuing slack in demands on production resources and efforts by businesses to contain costs. A number stressed that the moderate monetary growth over recent years suggested that monetary policy had been positioned to foster a reduction in inflation, and they anticipated that the beneficial effects of this policy would show through over the projection period.

In keeping with the practice at meetings when the Committee considers its long-run ranges for the money and debt aggregates, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members provided specific projections of the growth in real and nominal GNP, the rate of unemployment, and the rate of inflation for 1991 and 1992. These projections took account of the monetary growth ranges that the Committee reaffirmed for 1991 and established on a tentative basis for 1992 at this meeting; these ranges are expected to be consistent with the Committee's goal of promoting a sustained expansion in the economy, fostered by further progress toward price stability. Forecasts of nominal GNP converged on growth rates of 4½ to 5¼ percent for 1991 and 5½ to 6½ percent for 1992. With regard to the rate of expansion in real GNP, the projections had a central tendency of ¾ to 1 percent for 1991 as a whole, implying a sizable rebound over the balance of the year; for the year 1992, the central tendency of the projections was 2¼ to 3 percent. While the civilian unemployment rate was not projected to fall much over the balance of the year, the expansion was expected to result in a decline to a somewhat lower range of 6¼ to 6½ percent by the fourth quarter of

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1992. With regard to the rate of inflation as measured by the consumer price index, the projections had a central tendency of 3¼ to 3¾ percent for 1991 and 3 to 4 percent for 1992; because declines in energy prices had damped the rise of consumer prices substantially thus far in 1991, the similarity of the ranges for the two years masked expectations of a pronounced decline in the core rate of inflation.

In the course of the Committee's discussion, members reported that business conditions remained uneven across the country, depending on the mix of local industries, but overall economic activity now appeared to be expanding at a modest pace in a number of regions and to have stabilized following earlier declines in several other parts of the nation. However, in some areas, notably portions of the Northeast, business activity appeared to be weakening further. Business sentiment remained cautious on the whole, but many contacts were expressing greater confidence in the outlook for the economy and their own industries, at least looking ahead to 1992. Agriculture was a source of strength in many parts of the country, although drought conditions in some areas and excessive rains in others had given rise to some concerns.

As has tended to occur in the early stages of previous cyclical recoveries, the swing in business inventories from substantial liquidation toward accumulation was likely to play a leading role in bolstering the expansion during the next two or three quarters. The members acknowledged that inventory developments were difficult to project, and views differed to some extent regarding the strength of the impetus that might be forthcoming from this source over the next few quarters. In any event, the available data tended to confirm reports from business contacts regarding the absence of excessive stocks in most sectors of the economy and parts of the country. In these circumstances, the firming in final sales that appeared to be under way was likely to result in a cessation of inventory liquidation over the nearer term and to induce an actual buildup at some point later. It was suggested that this process already had begun and might indeed be somewhat ahead of earlier expectations.

While the swing in inventories was likely to provide a substantial boost to economic activity over the next few quarters, some members questioned the potential strength of ongoing factors promoting expansion once the adjustment in inventories had largely run its course. Growth in consumer spending might well remain relatively restrained. The saving rate already was low, and the willingness or ability of many consumers to incur debt to finance increased spending would tend to be inhibited by existing debt burdens and perhaps also by the loss of tax deductibility on consumer loan interest. In addition, widespread publicity about the fragility of some financial institutions and continuing concerns about employment prospects might damp consumer sentiment, and the absence of a strong rebound in residential construction would tend to moderate the growth in spending on consumer durables. On the positive side, the favorable effects on disposable income of the earlier decline in oil prices was being supplemented by a resumption of appreciable growth in personal income as final sales and production improved.

With regard to the outlook for business fixed investment, contacts around the nation suggested that business executives remained cautious about making capital spending commitments. Nonetheless, the recent pickup in new orders for business equipment and a more

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mixed pattern in nonresidential building contract awards and permits were promising developments that tended to reduce earlier concerns about a possible cumulative weakening in business investment. Among the components of this key sector of the economy, nonresidential construction activity was expected to remain depressed, probably for an extended period in many localities, because of the substantial overhang of vacant office space and other commercial facilities. Some members noted, however, that nonresidential construction was improving in some areas, in part as a result of public works projects. Despite the likelihood of persisting weakness in nonresidential construction, overall business fixed investment was expected to strengthen to a limited extent once the recovery in economic activity was more firmly established.

The outlook for residential construction was viewed as somewhat more promising. Home sales appeared to be on a distinct uptrend, notwithstanding the temporary reversal in new home sales in May, and residential construction was picking up in many areas as housing backlogs were worked lower. Members commented, however, that the upswing in such construction might be relatively subdued by past cyclical standards, reflecting fairly high vacancy rates and the failure of mortgage rates to decline as much as they had in previous recession periods. Continuing constraints on the availability of loans for land acquisition and construction might also be a factor tending to inhibit construction activity, at least currently.

With regard to the financial setting of the economy more generally, members noted that the distress being experienced by some financial intermediaries was a key source of concern and downside risk for the economy. One could not rule out a major deterioration in public confidence in one or more types of lenders, which could seriously disrupt their ability or willingness to supply credit. However, that risk was likely to lessen over time. The rebuilding of balance sheets, including those of commercial banks, was a promising development, and the strength of the stock market along with lower risk premia on debt obligations pointed to an improving financial climate. Borrowers with direct access to capital markets were finding abundant credit at lower spreads. Many depository institutions apparently were continuing to pursue very cautious lending policies, though the shift toward even more stringent terms on loans seemed to have abated. Overall, debt growth appeared to be quite sluggish, with much of the weakness concentrated at depository institutions; this probably was contributing to the relatively damped expansion of the monetary aggregates around the cycle trough. The relationship between borrowing and spending seemed to be adjusting in ways that were not entirely understood, but the behavior of both debt and money were cautionary signs that needed to be monitored carefully.

A number of members commented that in comparison with prior cyclical experience the budget policies of all levels of government were likely to be relatively restrictive over the projection horizon. At the federal level, despite burgeoning borrowing requirements in the near term, cutbacks in defense spending and other efforts to curb expenditures under the budget agreement of 1990 and to maintain that control under procedures put in place by the agreement, appeared to have helped put federal spending for goods and services on a downward path. At the state and local level, severe budgetary problems were being addressed in many areas by increased taxes and restraints on spend-

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ing. These efforts to control governmental spending were likely to be an important factor contributing to a subdued expansion in nonresidential construction.

Turning to the outlook for inflation, the members remained optimistic that substantial progress could be made in reducing its underlying rate over the projection horizon. Some expressed disappointment that, while a number of special factors had been involved, the deceleration in consumer prices had been very limited this year, excluding the effects of a sharp drop in energy prices and slower increases in food prices. Nonetheless, the members generally believed that if the recovery tended to unfold as they were projecting, pressures on production resources would remain subdued and efforts to contain labor and other business costs would continue, especially in the context of very competitive markets for most products. Additionally, the appreciation of the dollar this year could be expected to exert a damping effect on inflation. As a trend toward lower inflation became more pronounced and widely perceived, the disinflationary forces in the economy would be reinforced by a moderation of inflationary expectations. An integral part of these developments, which several members emphasized, was the role of restrained monetary expansion over an extended period in curbing underlying inflation pressures.

Against the background of the Committee's views regarding prospective economic developments 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 set in February for 1991, and it established on a tentative basis ranges for growth in those measures in 1992. The current ranges included growth of 2½ to 6½ percent for M2 and 1 to 5 percent for M3 for the period from the fourth quarter of 1990 to the fourth quarter of 1991. A monitoring range of 4½ to 8½ percent had been set for growth in total domestic nonfinancial debt in 1991.

In the course of the Committee's deliberations, all of the members agreed that the ranges established for this year remained appropriate. The members noted that both M2 and M3 were in the middle portions of their ranges. With regard to developments affecting M2, growth of nominal income had weakened over the first half of the year, but demands for M2 balances had been bolstered by declines in market interest rates that had brought a narrowing of the opportunity costs associated with holding deposits. On balance, growth of this aggregate thus far in 1991 had fallen short of what might have been expected on the basis of historical relationships with nominal income and interest rates. The reasons for the shortfalls were not fully understood, but the continuing redirection of credit flows away from depository institutions and toward market channels as well as apparent investor preferences for the higher yields offered by longer-term investments appeared to be contributing factors. The projected pickup in nominal GNP growth in the second half of the year would by itself tend to boost the growth of M2 somewhat, but increases in velocity also were quite possible. Any strengthening of M2 probably would be limited by some widening of opportunity costs associated with a further decline in offering rates on liquid deposits in lagged response to earlier declines in market rates. Moreover, the likely persistence of a steep yield curve could lead depositors to continue to place some maturing time deposits in long-term market

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instruments that had more attractive yields, such as bond mutual funds. Considerable uncertainty continued to surround the demand for money and the behavior of velocity. However, in the judgment of the Committee, it now seemed that growth within the current range would indicate that policy was positioned to foster a sustainable economic expansion, and that the 4-percentage-point range provided adequate leeway for any adjustments that might be needed in the event the economy or monetary velocity were to diverge substantially from their expected paths.

Through the remainder of 1991, M3 growth also could be expected to be boosted by the strengthening of the recovery, which was likely to stimulate some pickup in bank credit extensions. However, a faster pace of resolutions by the Resolution Trust Corporation (RTC) would tend to depress thrift credit—by placing more thrift assets under government control or in the hands of private nondepository institutions—and issuance of large time deposits by branches and agencies of foreign banks could be expected to slow from the pace earlier in the year as more of the adjustment to the change in relative borrowing costs caused by the reduction in reserve requirements late last year was completed.

The members took note of a number of factors that had tended to depress the growth of domestic nonfinancial debt, which had been growing at the low end of the Committee's monitoring range. The latter included the slower pace of economic activity, more cautious attitudes on the part of borrowers toward taking on debt and lenders toward extending it, and a sharply lower pace of net equity retirements. Looking ahead, the members anticipated that, with the pickup in the economy, nonfinancial debt would expand more rapidly in the second half of the year. While slowing debt growth had a number of positive aspects for the long-run stability of the financial markets and the economy, a tendency for debt to drop below its current range might indicate that supply or demand conditions were inconsistent with a satisfactory economic expansion.

At the conclusion of this discussion, the Committee voted to approve the following broad policy statement and to reaffirm the 1991 ranges that it had established in February for growth of M2, M3, and nonfinancial debt:

> The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at this meeting the ranges it had established in February for growth of M2 and M3 of 2½ to 6½ percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 4½ to 8½ percent for the year.

> Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Keehn, Kelley, LaWare, Mullins, and Parry. Votes against this action: None.

In the Committee's discussion of the ranges for 1992, most of the members supported a proposal to extend the 1991 ranges provisionally to next year. Insofar as developments bearing on economic and financial conditions in 1992 could be anticipated at this point, these members believed that monetary growth within the current ranges would be consistent with sustainable economic expansion in the context of continuing progress toward price stability. The upper bounds of those ranges provided desirable leeway for policy to resist any tendency for the recovery to falter while the lower ends allowed ample room for

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policy to counter stronger-than-expected inflationary pressures.

Several members favored a reduction in the M2 range for next year. Such a move would continue the trend of moving the range downward until it was consistent with price stability. Recent developments suggested that conditions were favorable for making substantial progress toward lower inflation, and these members emphasized that it was important for the Committee not only to take advantage of this opportunity but to signal its determination in this regard. The resulting improvement in the credibility of the Committee's anti-inflationary policy and the related favorable effects on inflationary expectations would reduce the transitional costs of achieving price stability.

Those in favor of retaining the current range for M2 commented that the range had been reduced substantially in recent years and that its midpoint already was close to a rate consistent with price stability over time, presuming no unanticipated trend in the velocity of M2 and some upward bias in measured inflation. For 1992, some members were concerned that, absent a significant increase in the velocity of M2, satisfactory nominal GNP growth—within the central tendency of the members' forecasts—already implied expansion of M2 in the upper part of a 2½ to 6½ percent range. A lower range might not provide sufficient flexibility to deal with an unanticipated shortfall in aggregate demand or disturbances to still-fragile financial markets. Uncertainties about the behavior of velocity at a time when an important restructuring of financial flows appeared to be in process, especially with regard to the role of depository institutions, also argued for simply carrying over the existing range. There would be an opportunity to review the range next February, when evidence would be in hand about velocity in the second half of the year and some of the uncertainties about the strength of the recovery would be diminished. At that time, careful consideration would need to be given to reducing the range, if conditions implied that such an action was appropriate in furthering and underscoring the System's goal of reducing inflation over time.

At the conclusion of this discussion, with two members dissenting, the Committee approved provisional ranges for 1992 that were unchanged from those for 1991, and it voted to incorporate the following statement regarding the 1992 ranges in its domestic policy directive:

> For 1992, on a tentative basis, the Committee agreed to use the same ranges as in 1991 for growth in each of the monetary aggregates and debt, measured from the fourth quarter of 1991 to the fourth quarter of 1992. With regard to M3, the Committee anticipated that the ongoing restructuring of thrift depository institutions would continue to depress the growth of this aggregate relative to spending and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

Votes for this action: Messrs. Greenspan, Corrigan, Forrestal, Keehn, Kelley, LaWare, Mullins, and Parry. Votes against this action: Messrs. Angell and Black.

Messrs. Angell and Black dissented because they preferred to reduce the M2 range for 1992 by ½ percentage point. They pointed out that the lower range would be centered on the average growth of M2 in recent years and would provide a timely signal of the Committee's continuing commitment to price stability, thereby reinforcing and extending the progress in curbing inflation anticipated over the next several quarters. They believed that the resulting

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decline in inflationary expectations would lower the transitional costs of achieving price stability and, by favorably affecting long-term interest rates, would help sustain the expansion in economic activity.

In the Committee's discussion of policy for the intermeeting period ahead, all of the members were in favor of maintaining an unchanged degree of pressure on reserve positions. They believed that at this juncture an unchanged policy course offered the greatest promise of reconciling the Committee's goals of sustaining the nascent business recovery while also fostering further progress against inflation. There were obvious areas of uncertainty and vulnerability in the current economic and financial situation, but developments were unlikely to require an immediate adjustment in reserve market conditions. For now, monetary policy appeared to be on an appropriate course.

The members devoted some attention during this discussion to the relatively sluggish growth of M2 and M3 in recent months. Some commented that the behavior of the broader aggregates might imply that monetary policy had not been eased sufficiently in recent months and therefore might not provide adequate support to sustain the expansion. It was noted, however, that apart from the usual uncertainties about the relationship of M2 and M3 to growth and spending in the short run, the expansion of M1 and especially of reserves and the monetary base had been fairly robust since early spring. Moreover, many borrowers were meeting their financing needs through market sources. In this situation, the members generally concluded that the behavior of M2 and M3, which on a cumulative basis were still in the middle portions of the Committee's ranges for the year, did not call for any policy adjustments at this point. Nonetheless, continuing weak growth might require a review of this conclusion. A staff projection prepared for this meeting indicated that, with reserve market conditions unchanged, somewhat faster growth in the broader aggregates was likely to emerge in the months ahead, induced by greater money demands in the context of a strengthening economy.

With regard to possible adjustments to the degree of reserve pressure during the intermeeting period ahead, nearly all the members expressed a preference for a directive that did not bias prospective operations toward tightening or easing but made an intermeeting adjustment, if any, equally likely in either direction depending on economic and financial developments and the behavior of the monetary aggregates. One member preferred a directive that was tilted toward possible tightening; in this view, a prompt response to any tendency for inflationary conditions to re-emerge would have a favorable effect on inflationary expectations and long-term debt markets and might avert the need for a more substantial policy adjustment later. Other members agreed on the desirability of a prompt adjustment to inflationary developments, but they did not see a special need to anticipate such an adjustment in the period ahead.

At the conclusion of the Committee's discussion, all of the members indicated that they favored a directive that called for maintaining the existing degree of pressure on reserve positions. The members also noted that they preferred or could accept a directive that did not include a presumption about the likely direction of any intermeeting adjustments in policy. Accordingly, the Committee decided that somewhat greater reserve restraint or somewhat lesser reserve restraint might be acceptable during the period ahead depending on progress toward price stability, trends in

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economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated at this meeting were expected to be consistent with some increase in the growth of M2 and M3 to annual rates of around 5½ and 3 percent respectively over the three-month period from June through September.

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 begun to recover from the recent recession. The unemployment rate rose to 6.9 percent in May, but total nonfarm payroll employment edged up and the average workweek posted a sizable gain. Manufacturing output has risen in recent months, led by appreciable increases in assemblies of motor vehicles. Consumer spending has been bolstered in part by an upturn in personal income. An increase in orders points to a firming in demand for business equipment, but nonresidential construction remains weak. Housing starts rose over April and May. The nominal U.S. merchandise trade deficit in April was somewhat below the average rate in the first quarter. Increases in consumer prices have been small in recent months.

Most interest rates have risen slightly since the Committee meeting on May 14. The trade-weighted value of the dollar in terms of the other G-10 currencies increased substantially on balance over the intermeeting period.

M2 grew at a moderate pace over May and June, while M3 changed little. For the year thus far, expansion of M2 and M3 has been in the middle portion of the Committee's ranges.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at this meeting the ranges it had established in February for growth of M2 and M3 of 2½ to 6½ percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 4½ to 8½ percent for the year. For 1992, on a tentative basis, the Committee agreed to use the same ranges as in 1991 for growth in each of the monetary aggregates and debt, measured from the fourth quarter of 1991 to the fourth quarter of 1992. With regard to M3, the Committee anticipated that the ongoing restructuring of thrift depository institutions would continue to depress the growth of this aggregate relative to spending and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Depending upon progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint or somewhat 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 June through September at annual rates of about 5½ and 3 percent, respectively.

Votes for the paragraph on short-run policy implementation: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Keehn, Kelley, LaWare, Mullins, and Parry. Votes against this action: None.

Meeting Held on August 20, 1991

The information reviewed at this meeting was mixed, but it suggested on balance that economic activity was expanding at a moderate pace. Some strengthening in consumption expenditures, notably for motor vehicles, and in single-family residential investment was providing much of the impetus for the

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recovery. On the other hand, business fixed investment was still weak, and the runoff of business inventories was showing few signs of abating. On the supply side, production had strengthened, particularly in manufacturing and housing, but labor demand remained soft overall. Increases in consumer prices had been small in recent months, while the pace of labor cost increases did not appear to have slowed further.

Total nonfarm payroll employment edged down in July, but substantial upward revisions to data for May and June left the July level above that for April. Job gains were recorded in manufacturing, retail trade, and health services in July, but employment in construction and various financial service industries continued to contract. Despite the lower employment level and a sharp decline in the average workweek, the unemployment rate fell slightly to 6.8 percent in July apparently owing to a net exit of jobless workers from the labor force.

Led by another rise in the production of motor vehicles, industrial production rose appreciably further in July, although the rate of increase was a little less than the average pace in the second quarter. Over the period from April through July, production retraced nearly half of the decline that had occurred between September of last year and March. Total industrial capacity utilization rose for a fourth consecutive month in July, but the overall operating rate was still well below its longer-run average.

Retail sales rose in July, and previously reported increases for May and June were revised upward. Gains at automotive dealers remained strong, and sales at general merchandise, apparel, and furniture outlets in July more than retraced a sharp June decline. Housing starts continued to trend higher in July. As had been the case thus far in the upturn, most of the July increase occurred in single-family units; multifamily starts edged up but remained near the thirty-year low recorded in May. Sales of both new and existing homes strengthened further in June.

Business fixed investment declined again in the second quarter as outlays for producers durable equipment fell modestly, and forward-looking indicators pointed to sluggishness in spending for equipment over the near term. Reflecting in part the damping effect on office construction of high vacancy rates and falling property values for existing buildings, the decline in nonresidential construction continued in the second quarter, and data on construction permits and contracts suggested that this sector likely would remain weak for an extended period. Inventory liquidation by manufacturers and non-auto trade establishments continued through the second quarter, although the pace slowed in June from the sharp declines of April and May. The ratio of stocks to sales at these establishments was about unchanged.

The nominal U.S. merchandise trade deficit narrowed somewhat in June from the downward revised May value and was somewhat below its rate for the first quarter. For the second quarter, there was substantial growth in the value of exports, primarily resulting from strength in machinery, commercial aircraft, and automotive products. The value of imports edged up as increases in foods and selected capital goods were not quite offset by declines in oil and automotive products. Economic activity in the major foreign industrial countries continued to present a mixed picture. Tentative signs of more rapid growth emerged in the second quarter in some European countries, but the pace of economic activity appeared to have eased in

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Japan and Germany from robust rates in the first quarter.

Declines in the prices of food and energy in June and July damped the rise in consumer prices and lowered producer prices of finished goods. Excluding food and energy items, consumer prices rose over the twelve months ended in July at a slightly slower rate than in the preceding twelve months. At the producer level, prices of nonfood, non-energy items continued to increase in July at the very slow second-quarter pace. Total compensation per hour for private industry workers accelerated a bit in the second quarter, reflecting the effects of a sharp increase in the cost of benefits and the upward adjustment of the minimum wage in April.

At its meeting on July 2–3, 1991, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any intermeeting adjustments to policy. Accordingly, the Committee decided that somewhat greater or somewhat lesser reserve restraint might be acceptable during the intermeeting period ahead depending on progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated at this meeting were expected to be consistent with some increase in the growth of M2 and M3 to annual rates of around 5½ and 3 percent respectively over the three-month period from June through September.

Open market operations during the intermeeting period initially were directed toward maintaining the existing degree of pressure on reserve positions. Subsequently, in early August, reserve pressures were eased slightly; this action was taken against a backdrop of indications that price pressures were abating and the recovery was proving to be sluggish at a time of persisting weakness in the broad monetary aggregates. Over the course of the period, two technical increases were made to expected levels of adjustment plus seasonal borrowing to reflect the run-up in seasonal borrowing that usually occurs at this time of the year. In the three reserve maintenance periods completed since the July meeting, adjustment plus seasonal borrowing tended to run at appreciably higher levels than expected, owing in part to difficulties in estimating nonborrowed reserve needs near the ends of reserve maintenance periods. The federal funds rate averaged around 5¾ percent in the early part of the intermeeting period, but following the action to ease reserve conditions, the rate averaged about 5½ percent.

Other market interest rates declined appreciably over the intermeeting period in response to downward revisions in market expectations about the pace of the recovery and price pressures, the easing of reserve conditions, and especially for short-term Treasury securities, the uncertain outcome of the coup attempt in the Soviet Union that had begun a few days before the meeting. Despite the uncertainty surrounding the status of the recovery, interest rates on private instruments fell as much as Treasury yields, and most major indexes of stock market prices advanced considerably. Expectations of a slower recovery and an easier monetary policy in the United States contributed to a decline on balance in the trade-weighted value of the dollar in terms of the other G-10 currencies over the intermeeting period. Late in the period, the coup attempt in the Soviet Union triggered a sharp rise in the dollar against many European currencies.

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The broad monetary aggregates were quite weak in July. After several months of sluggish growth, M2 contracted as expansion in transaction deposits slowed and retail time deposits continued to run off at a rapid rate. M3 fell further in July as declines in M2 were augmented by further runoffs of large time deposits. The reasons for the weaker-than-expected growth of the broader aggregates were not entirely understood; however, it appeared that the underlying weakness in credit growth at depository institutions combined with shifts of funds out of the broader aggregates by depositors reaching for higher yields were contributing to the reduced growth. For the year through July, M2 and M3 had expanded at rates near the lower ends of the Committee's ranges.

The staff projection prepared for this meeting indicated that the economy was continuing to recover from the recent recession, although somewhat slower growth than previously anticipated was now projected for the second half of the year. The projection still pointed to moderate expansion in final demand over the next several quarters, with economic activity later this year and in the first part of 1992 given added impetus by a cyclical swing from substantial liquidation to modest accumulation in business inventories. The stimulus from the swing in inventories was expected to diminish during the first part of next year, but business capital expenditures were projected to pick up as the recovery continued. Real purchases of goods and services by the federal government were projected to trend downward, and budgetary problems were expected to restrain spending by state and local governments. On balance, the expansion in economic activity was projected to be relatively moderate in comparison with past cyclical experience. Persisting though diminishing slack in the economy was expected to induce a further moderation in cost pressures and an appreciable decline in the core rate of inflation over the period through 1992.

In the Committee's discussion of current and prospective economic and financial conditions, the members generally agreed that the recovery was continuing, although recent economic data and the general tenor of the anecdotal information suggested an uneven performance in different sectors of the economy and parts of the country. While sustained expansion at a moderate pace was still viewed as a reasonable expectation, many members now believed that the risks were tilted toward the downside. These risks stemmed to an important extent from the financial side of the economy: life insurance companies as well as banks had become quite cautious lenders, and the very weak recent data on both money and credit added to concerns about financial developments. In addition, consumer surveys and business contacts suggested some erosion in the confidence that had built up amid the initial signs of an economic turnaround after the end of the Persian Gulf war. Some members commented, however, that the prospective sources and potential strength of the expansion were always difficult to discern at this stage of the recovery, and a stronger-than-projected expansion could not be ruled out. With regard to the outlook for inflation, members continued to anticipate a reduction in its core rate over coming quarters, especially following an extended period of restrained monetary growth. However, several expressed disappointment regarding the recent behavior of labor costs and commented that progress toward lower inflation might be more limited, at least in the quarters immediately ahead, than they had expected earlier.

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Recent events in the Soviet Union had introduced a new element of uncertainty in the economic outlook. The outcome of the coup attempt was uncertain but, should it succeed, early market reactions suggested the possibility of some adverse consequences for the U.S. economy stemming in part from a further deterioration in business and consumer confidence, an increase in the price of oil and the value of the dollar, and perhaps higher long-term interest rates.

The financial sector of the domestic economy continued to be seen as a potential source of developments that could hold the expansion below the forecast. Financing from a number of institutional lenders had been curtailed for some time and did not yet show signs of becoming more readily available; indeed, mounting difficulties for some life insurance companies could reduce further the willingness of these lenders to extend credit. Members also commented that the continuing publicity given to the weakened condition of many financial institutions along with widespread reports of financial scandals tended to erode confidence. Several observed that the weakness of the monetary aggregates, while not closely correlated with short-run economic performance, was nonetheless a matter of increasing concern to the extent that it implied unusual constraints on the availability of credit and possibly a faltering economic expansion. On the positive side, the financial condition of banking institutions appeared to be continuing to stabilize or improve. Indeed, while banks had raised their credit standards, bank financing was widely reported to be readily available to creditworthy borrowers, at least outside the real estate sector, though bank lending continued to lag because of weak credit demand associated in part with inventory liquidation and because many business firms were taking advantage of their direct access to financial markets. In the absence of further deterioration in lender confidence, the availability of loans from financial intermediaries could be expected to increase over time and appeared likely to be adequate to finance a moderate recovery. Nonetheless, the risks seemed to be skewed toward the possibility of further difficulties damping credit supplies and impeding economic growth.

In the course of their discussion, members commented on continuing indications of mixed business conditions in different parts of the country. They noted that economic activity appeared to have deteriorated at least marginally in several regions, though the available evidence pointed on the whole to growth in the overall economy. Members referred to the contrast between gloomier business attitudes and the improvement that was occurring in some sectors of the economy, notably industrial production and housing. Business executives seemed disappointed by a much less vigorous rebound in demand than they had anticipated with the end of the Persian Gulf war. In the circumstances, they remained very cautious in managing their inventories and reluctant to undertake major investment projects.

Available information suggested that inventories had declined somewhat further in recent months. As at previous meetings, members anticipated that with inventories at much reduced levels, the pickup in final demand would at some point stimulate a turnaround in inventory investment that would in turn provide an important fillip to the expansion. Thus far, however, the evidence did not indicate a cumulative expansionary process involving stepped-up inventory demand that generated growth in production, incomes, and spending and in

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turn stimulated further demand for inventories. Some members commented that the relative weakness in commodity prices was further evidence that a self-reinforcing process of that kind had not yet emerged in the current cyclical recovery. There was little reason to conclude, however, that a dynamic process of that sort, which in the early stages of past cyclical recoveries had tended to provide the major thrust to the expansion, would fail to materialize in the quarters ahead.

During their discussion, members commented that retail sales appeared to be improving at least a little in many parts of the country but remained quite sluggish elsewhere. An important but geographically uneven source of strength was the sale of motor vehicles, though contacts in the auto industry suggested some disappointment over the sales performance of many new models. In general, consumers remained concerned about financial developments, relatively heavy debt burdens, and uncertainty about employment prospects. While further growth in consumer spending was a likely development, various factors tending to inhibit consumer confidence and an already low saving rate pointed to relatively limited expansion in such spending over the quarters ahead.

Members did not see business capital spending as an important source of stimulus to the economy over the next few quarters. There were continuing reports of marked weakness in commercial construction activity, reflecting the persistence of high vacancy rates in many parts of the country that were likely to hold back new building for an extended period. Nonetheless, overall nonresidential construction appeared to have bottomed out in some areas and indeed to have edged up in others, buttressed by expenditures on public works projects by a number of state and local governments. Current spending for business equipment was less depressed though also indicative of considerable caution on the part of businessmen in the context of disappointing profits and uncertain demand for their products. While a pickup in equipment spending could be expected to occur with some lag during the course of the cyclical upswing, overall capital spending was likely to grow at a relatively subdued pace unless final demand turned out to be much stronger than the members currently expected and induced a major turnaround in business sentiment.

The outlook for residential construction remained more promising. Spurred by reduced mortgage rates, sales of homes continued on a moderate uptrend in most areas and, indeed, represented a bright spot in some otherwise depressed regions such as New England. While the construction of new housing was still being damped by relatively high vacancy rates and the difficulties encountered by some builders in obtaining financing, modest strengthening in homebuilding was occurring in many parts of the country. The recent decline in long-term interest rates was cited as a further favorable factor for housing construction activity.

Turning to the outlook for the nation's trade balance, members commented that export demand had continued to grow and several expressed optimism regarding the prospects for further growth, including the outlook for expanding markets in Latin America. The trade balance would be influenced to an important extent by the value of the dollar in foreign exchange markets; the latter was subject to considerable uncertainty, especially in connection with the events that were under way in the Soviet Union. Those events had raised questions about trade develop-

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ments, notably the potential for reduced world oil supplies and lower foreign demand for U.S. goods, especially agricultural products. The members also recognized that the domestic economic expansion would have a damping effect on the trade balance by stimulating growth in imports.

The members anticipated that federal government purchases of goods and services would be curtailed in line with last year's budget agreement. They noted that the recent developments in the Soviet Union had raised new uncertainties about the size of cutbacks in defense spending, which had been projected to account for all the reduction in real federal expenditures. With regard to the state and local governments, there continued to be widespread reports of current or expected spending cuts and higher taxes to counter budgetary shortfalls. On balance, overall government spending and tax policies appeared likely to exert a somewhat negative influence on the economic expansion.

Given a projection of some persisting slack in labor and product markets and following an extended period of relatively restrained monetary growth, the members continued to anticipate appreciable progress toward lower inflation over the period through 1992. Competitive pressures, including competition from foreign producers, remained strong in markets for many products, and the decline in consumer inflation over the course of recent months was likely to have a favorable effect on inflationary expectations. On the negative side, the recent lack of progress in bringing down the rate of increase in labor costs was a worrisome development. While some of the upward pressures on such costs appeared to reflect special factors such as the second-quarter rise in the minimum wage, a major underlying cause was the continuing surge in the cost of benefits, especially medical insurance. In this situation, several members observed that they now anticipated less progress toward a lower core rate of inflation over the next several quarters.

Against the background of a broad consensus that a moderately paced recovery with ebbing inflation probably was under way, all of the members indicated that they preferred or could accept a proposal to maintain an unchanged degree of pressure on reserve positions. In addition, a majority expressed a preference for an asymmetric directive that was tilted toward possible easing during the weeks ahead. Those favoring such asymmetry felt that the risks to the expansion were largely on the side of a weaker-than-projected economy, and they believed that the Federal Reserve should react promptly to any signs that the expansion was less robust than desired or that monetary conditions might be inconsistent with sustained growth. However, they believed that an immediate easing move would be premature because the most recent economic information, although mixed, still suggested a moderate rate of economic expansion and also because of the questions that were raised about how to interpret the behavior of the monetary aggregates. Some members marginally favored an immediate move toward ease because of the weakness in the broader monetary aggregates and a sense that such a move might bolster confidence and better ensure a satisfactory recovery in the months ahead. Nonetheless, they found acceptable an initially unchanged policy that was coupled with an instruction calling for policy implementation to be especially alert to developments that might require some easing during the intermeeting period. Other members viewed the risks to the expansion as more evenly balanced or questioned the extent to which further easing in the

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near term might stimulate monetary growth or result in lower long-term interest rates. Accordingly, they felt that retaining the current symmetric directive was a preferable option. They were concerned about the risk of responding to what might prove to be short-lived fluctuations in the economic data and anecdotal information bearing on the performance of the economy. In particular, the persistence of inflationary cost pressures made it advisable to pause in order to assess the implications of the information that would become available over the next few weeks, including data on the behavior of the monetary aggregates. Nonetheless, given prevailing uncertainties, these members could accept a directive that was biased toward possible easing in the weeks ahead.

In the course of the Committee's discussion, members devoted considerable attention to the behavior of the monetary aggregates. While the cumulative growth of M2 and M3 for the year to date was still within the Committee's ranges—though near the bottom of those ranges—the weakness in recent months, including declines in both aggregates in July, was seen by many members as a disturbing development. The members acknowledged that it was difficult to disentangle the various reasons for the unexpected shortfall in monetary growth and thus the implications for the thrust of monetary policy. In the context of essentially unchanged or even declining interest rates, there appeared to be little import for the economy and monetary policy to the extent that the shortfall reflected shifts of funds out of the broader aggregates and into nonmonetary investment instruments that provided higher interest returns, thereby bypassing depository institutions but tending to have little effect on the overall availability of credit. Of potentially greater concern and significance for policy was the evidence that some of the weakness of the monetary aggregates stemmed from unusual constraints on the amount of credit provided by depository institutions and implied restraint on the overall supply of credit. The weak growth in credit extended by depository institutions reflected, of course, an uncertain combination of anemic demand by creditworthy borrowers and supply constraints by lending institutions. The behavior of M2 and M3 also might be indicative of even weaker nominal spending than was currently recognized and hence a monetary policy stance that was too tight under such circumstances. According to a staff analysis prepared for this meeting, growth in both measures could be expected to pick up a little over the months ahead, assuming steady reserve conditions. The persistence in some degree of recent relationships between movements in short-term interest rates, income, and monetary growth would imply slower monetary expansion than might otherwise be expected.

In these circumstances, many members indicated that continued weakness in M2 and M3 would be a matter of increasing concern, especially given questions about the strength of the economic recovery. Some favored a proposal to give greater emphasis in the directive to the behavior of the monetary aggregates in guiding possible intermeeting adjustments in policy, at least for the period ahead. However, a majority preferred to retain the current directive wording. In support of this view, some commented that in recent years the broader aggregates have been unreliable indicators of the path of the economy over the quarters immediately ahead and thus imperfect guides for short-run policy adjustments. Some observed that growth in M1 and total

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reserves had held up fairly well on balance over the past several months and that the behavior of those measures might be more indicative of the underlying thrust of monetary policy than that of the broader aggregates on which the Committee had tended to focus. Giving the monetary aggregates more prominence in the directive could provide a misleading indication of the adjustments that would be made to reserve conditions in response to the behavior of the aggregates, including aberrant fluctuations, thereby misconstruing the views of many members.

At the conclusion of the Committee's discussion, all of the members indicated that they could vote for a directive that called for maintaining the existing degree of pressure on reserve positions. All also indicated that they preferred or could accept a directive that included a bias toward possible easing during the intermeeting period. Accordingly, the Committee decided that somewhat greater reserve restraint might be acceptable or somewhat lesser reserve restraint would be acceptable during the period ahead depending on progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated at this meeting were expected to be consistent with a resumption in the growth of M2 and M3 during the weeks ahead, but in light of the declines in these aggregates since June, the Committee now anticipated that M2 would be little changed and M3 would be down at an annual rate of about 1 percent in the period from June through September.

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 has been mixed, but it suggests on balance that economic activity is expanding at a moderate pace. The unemployment rate fell slightly to 6.8 percent in July, but total nonfarm payroll employment edged down and the average workweek posted a sharp decline. Industrial production rose appreciably further in July. Consumer spending has increased considerably in recent months, led by sizable gains in expenditures for motor vehicles. New orders for nondefense capital goods point to little change in spending for business equipment over the near term, and nonresidential construction remains weak. Housing starts rose further in June and July. The nominal U.S. merchandise trade deficit declined in June, and its average for the second quarter was somewhat below the rate in the first quarter. Increases in consumer prices have been small in recent months.

Over the intermeeting period prior to August 19, market interest rates declined appreciably and the trade-weighted value of the dollar in terms of the other G-10 currencies depreciated somewhat. Subsequently, in the wake of events in the Soviet Union, Treasury bill rates fell somewhat further and the dollar rebounded sharply against many European currencies.

M2 contracted in July after several months of slow growth and M3 fell further. For the year through July, expansion of M2 and M3 has been near the lower ends of the Committee's ranges.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February for growth of M2 and M3 of 2½ to 6½ percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 4½ to 8½ percent for the year. For 1992, on a tentative basis, the Committee agreed in July to use the same ranges as in 1991 for growth in each of the monetary aggregates and debt, measured from the fourth quarter of 1991 to the fourth quarter of 1992. With regard to M3, the Committee anticipated that the ongoing restructuring of thrift depository institutions would continue to depress the growth of this aggregate relative to spending

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and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Depending upon progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint might or somewhat lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with a resumption of growth of M2 and M3 in the weeks ahead; but in view of the declines already posted since June, the Committee anticipates that M2 would be little changed and M3 would be down at an annual rate of about 1 percent over the period from June through September.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Keehn, Kelley, LaWare, Mullins, and Parry. Votes against this action: None.

Meeting Held on October 1, 1991

Domestic Policy Directive

The information reviewed at this meeting suggested on balance that the economy was continuing to recover from the recession but that its performance was uneven across sectors. Consumer spending was rising, especially for durable goods, but businesses remained cautious about investing in plant, equipment, or inventories. On the production side, the advance in manufacturing activity continued, although the recovery in housing construction appeared to have lost some of the momentum evident through the spring, and little growth was occurring in much of the service-producing sector. The pickup in production had been reflected primarily in a sizable rise in aggregate hours worked rather than in the number of jobs. Increases in prices appeared to be on a gradual downtrend.

In August, total nonfarm payroll employment retraced part of a July decline and on balance was little changed since March. Manufacturing employment registered widespread gains in August, and the factory workweek rose to its highest level in nearly a year. In the private service-producing sector, new hires in health and business services displayed appreciable strength, but the rest of this sector, particularly wholesale and retail trade, remained weak. Jobs in construction continued to decline, and employment reductions occurred in state and local governments for a second straight month. The civilian unemployment rate was 6.8 percent in both July and August.

Industrial production posted a moderate further rise in August after several months of sizable gains. Assemblies of motor vehicles slowed in August when a number of plants were closed temporarily for model changeovers, but output of other consumer durables continued to increase and that of consumer nondurables rebounded. Production of business equipment remained weak and on balance had changed little since spring after dropping sharply in late 1990 and early 1991. Total industrial capacity utilization edged up in August; over the course of recent months it had retraced only a small part of the decline that occurred between mid-1990 and March 1991. Operating rates in manufacturing had recovered to a somewhat greater extent, reflecting in part the rebound in motor-vehicle assemblies.

Retail sales fell in August, mostly because of a decline in sales of motor vehicles. For July and August together, nonautomotive retail sales were up considerably on balance. After increasing appreciably since January, housing starts

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rose only slightly further in July and August. The number of permits for construction of single-family homes declined in August and was unchanged from the second-quarter level. In the multifamily sector, construction activity remained near its thirty-year low. Sales of new homes were down in July, while sales of existing homes fell in both July and August.

Shipments of nondefense capital goods, measured in nominal terms, were down on balance over July and August. Taking into account the substantial recent declines in the prices of computing equipment, however, real outlays for business equipment apparently rose on balance over the two months as reduced spending on industrial equipment was more than offset by increased investment in computers and, to a lesser extent, transportation equipment. Recent data on orders and shipments of nondefense capital goods pointed to a further small rise in real outlays for business equipment. The value of nonresidential construction put in place in July was substantially below the second-quarter level, reflecting the continuing decline in office, other commercial, and hotel construction. Available information on new contracts suggested a continuing downtrend in nonresidential construction.

The nominal U.S. merchandise trade deficit widened substantially in July to a rate considerably above its average in the second quarter. In July, the value of imports rose sharply from a low second-quarter average; the rise was concentrated in consumer goods, automobiles, and computers. The value of exports changed little in July from a second-quarter level that was high compared with other recent quarters; the improvement in exports in recent months had been the result of the strong performance of capital goods. The pattern of economic activity in the major foreign industrial countries continued to be mixed. In western Germany and Japan, growth fell sharply in the second quarter and apparently remained slow in the third quarter, while economic activity picked up in some other industrial countries in the second quarter.

Producer prices of finished goods were unchanged over July and August after declining on balance in earlier months of the year. Further reductions in food prices in August, notably prices of fresh fruits and vegetables, offset a rebound in the prices of finished energy goods. Excluding food and energy, the increase in producer prices of finished goods in the twelve months ended in August was little different from the rise over the previous twelve months. At the consumer level, increases in prices were small in July and August because of declines in the prices of food and energy items. Although nonfood, non-energy consumer prices had risen somewhat faster in recent months, the twelve-month change in this index had continued to edge down.

At its meeting on August 20, 1991, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that also provided for giving special weight to potential developments that might require some further easing during the intermeeting period. Accordingly, the Committee decided that somewhat greater reserve restraint might be acceptable or somewhat lesser reserve restraint would be acceptable during the intermeeting period depending on progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated at the August meeting were expected to be consistent with a

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resumption in the growth of M2 and M3 over the balance of the third quarter. However, in view of the declines in these aggregates that had taken place since June, the Committee anticipated that, over the three-month period from June through September, M2 would be little changed and M3 would be down at an annual rate of about 1 percent.

Open market operations during the intermeeting period were directed initially toward maintaining the existing pressures on reserve positions. Subsequently, on September 13, the discount rate was lowered by ½ percentage point to 5 percent and part of this decline was allowed to show through to the federal funds rate. Two technical decreases to expected levels of adjustment plus seasonal borrowing were made during the intermeeting period to reflect the abatement of seasonal credit needs. Early in the period, adjustment plus seasonal borrowing averaged nearly $400 million. Later, in part because of the decline in seasonal funding needs, the volume of borrowing slipped below $350 million. The federal funds rate averaged around 5½ percent during the first part of the intermeeting period, but after the discount rate was reduced, the federal funds rate edged down to a little above 5¼ percent.

In the period immediately after the August 20 meeting, most other market interest rates rose slightly, reflecting in part the absence of an anticipated easing of monetary policy and data indicating that the expansion might be more robust than expected. Treasury bill rates also were boosted by an unwinding of the flight to quality and liquidity that had been prompted by the attempted coup in the Soviet Union. In subsequent weeks, market rates declined as incoming nonfinancial and monetary indicators were seen by market participants as portending a sluggish expansion, reduced inflation, and an associated easing of monetary policy. The average commitment rate on fixed-rate mortgages reached its lowest level since 1977, and the prime rate was reduced by ½ percentage point to 8 percent after the easing of monetary policy in mid-September. The trade-weighted value of the dollar in terms of the other G-10 currencies fell sharply over the intermeeting period; much of the drop retraced the previous run-up associated with the attempted coup in the Soviet Union that began shortly before the August meeting.

After contracting in July, M2 was about unchanged in August and September. M3 declined further in July and August and apparently changed little in September. Both aggregates were somewhat weaker than anticipated at the time of the August meeting. For the year thus far, expansion of M2 and M3 had been at the lower ends of the Committee's ranges.

The staff projection prepared for this meeting pointed to a sustained recovery in economic activity; however, because of persisting weaknesses in some sectors of the economy the pace of the expansion was projected to remain subdued compared with past cyclical experience and the risks of a different outcome seemed to be mostly on the downside. Consumer spending was expected to continue to provide much of the impetus to the expansion, but a swing from inventory liquidation to modest accumulation was projected to supply an additional boost to economic growth during the quarters immediately ahead. As the stimulus from the swing in inventories began to wane during the course of 1992, spending for business equipment was projected to strengthen to some extent. Housing construction also would provide some stimulus over the projection horizon. Further declines in the construction of commercial struc-

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tures were expected to inhibit the economic expansion. Additionally, real purchases of goods and services by the federal government were assumed to be on a mildly declining trend, and spending by many state and local governments was expected to be constrained by severe budgetary problems. The persisting slack in labor and product markets, while diminishing over time, was projected to restrain the rise in labor costs and to foster some slowing in the underlying trend of inflation.

In the Committee's review of prevailing and prospective economic developments, members observed that the mixed nature of the recent economic information and the uneven economic conditions in different parts of the country made it particularly difficult to assess the overall state of the economy. They generally concluded that, on balance, the evidence was consistent with a continuing though still sluggish recovery in economic activity and that the prospects remained favorable for a sustained expansion at a moderate pace over the next several quarters. Many commented, however, that the risks to the expansion appeared to be tilted at least marginally to the downside. Those risks were felt to stem especially from a variety of financial strains in the economy, and several members also indicated that they were uneasy about the potential implications of the ongoing weakness in broad measures of money and credit. With regard to the outlook for inflation, many of the members expressed confidence that the relatively moderate rate of expansion in economic activity that they anticipated was likely to be associated with appreciable progress in reducing the core rate of inflation over the next several quarters.

In the course of the Committee's discussion, members commented that the anecdotal reports on economic conditions and on business and consumer sentiment continued to have a generally negative tone that did not appear to be fully consistent with the available economic statistics. To a degree, business attitudes seemed to reflect perceptions of little momentum in business activity and related concerns about the outlook for profits. On the positive side, business conditions in some areas were contributing to some optimism, at least among business managers whose activities tended to be limited to local markets, and the performance of the stock market continued to provide evidence of confidence on the part of many investors.

Turning to the outlook for key sectors of the economy, members noted that despite reports of quite weak retail sales in some parts of the country, real consumer outlays had been trending upward on an overall basis since the early part of the year, and in the absence of a new adverse shock to consumer confidence, consumers were likely to continue to provide important support to the overall economic expansion. However, the extent of that support might remain somewhat limited because consumer sentiment was still cautious amid concerns about employment opportunities and personal debt burdens. In the circumstances, retailers in many areas anticipated relatively sluggish sales during the upcoming holiday season. In the context of an already low saving rate, the outlook for retail sales would continue to hinge on growth in disposable incomes and the latter in turn would tend to be constrained by the moderate growth that was anticipated in overall economic activity.

The members continued to anticipate that a turnaround from inventory liquidation to at least modest accumulation would stimulate the economy in the quarters ahead. Available data and anec-

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dotal reports suggested that overall nonfarm business inventories had continued to decline through July and probably over the third quarter as a whole. With stocks now at generally low levels, a pickup in final demands, including expected further growth in exports, was likely to foster some tendency to rebuild inventories. Looking further ahead, some concern was expressed that, once the expected swing in inventories began to abate next year in line with the usual cyclical pattern, other sources of economic stimulus might not materialize to the extent needed to support continued economic growth at an adequate pace. On the other hand, some members observed that both the economic statistics and reports from business contacts were consistent with some pickup in business spending for equipment, which could well strengthen further as the recovery matured.

Residential construction also seemed likely to provide some ongoing stimulus to the expansion. While this sector appeared to have lost some momentum during the summer months, declines in mortgage interest rates along with anticipated moderate growth in overall economic activity and incomes pointed to a gradual uptrend in housing construction. The prospective strength of housing activity was viewed as likely to be tempered, however, by continuing weakness in the multifamily market; the latter was adversely affected by high vacancy rates in many local areas and over time by a slower pace of family formations.

Among the negative developments that could be expected to limit the strength of the overall economic expansion was the outlook for commercial construction. Indeed, the overbuilt condition of commercial space in major markets around the country portended an extended period of weak activity in this sector of the economy. There were, nonetheless, anecdotal reports that sale prices of commercial real estate might be stabilizing in some areas and that new and renewal lease prices were no longer declining in some markets and indeed might have begun to edge up. The government sector also was seen as likely to exert some restraint on the overall expansion. Federal government spending for goods and services appeared to have swung into a gradual downtrend associated with cutbacks in defense spending. At the same time, the budgetary difficulties affecting many state and local governments were likely to continue to constrain the overall growth in state and local government spending.

Many of the members referred to the potential impact of financial conditions on the outlook for economic activity. In some important respects, financial developments could be viewed as favorable. Financial markets were receptive to new financing activity as evidenced by the large volumes of stock and bond issuance. Moreover, the balance sheets of many financial institutions were improving; banks, for example, were making considerable efforts to increase their capital, work out problem loans, and rationalize their operations. On the other hand, the balance sheets of many business firms like those of a significant portion of households were burdened by heavy debt loads. Furthermore, many contacts referred to the continuing problems of small and medium-size businesses in securing financing to carry on or expand their operations. In this regard, it was difficult to assess the extent to which the weakness in loan extensions through financial intermediaries reflected unwarranted constraints on credit supplies as opposed to a lack of demand from qualified borrowers. Reports from several parts of the country tended to suggest that, while to some

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extent credit standards had been tightened further this year, lenders remained willing to provide financing to creditworthy borrowers. On balance, while the members differed in their appraisals of the severity and possible implications of the financing problems of borrowers without access to financial markets, they agreed on the need for careful monitoring of the availability of adequate credit to support a sustained economic recovery.

The members continued to view the outlook for inflation as favorable. The moderate rate of economic expansion anticipated over the forecast horizon was expected to be associated with enough slack in productive resources to accommodate further downward adjustments in the underlying rate of inflation. Competition from foreign producers was likely to remain substantial in many domestic markets. Indeed, overall competitive pressures and resistance to price increases were strong in key markets and provided a promising setting for progress toward price stability. From a different perspective, a number of members observed that the lagging growth in money, at least as measured by M2 and M3, had favorable implications for prices over the longer run. In particular, it was suggested that the restrained growth in money over recent years would tend to foster lower inflation while providing liquidity sufficient to sustain a moderate rate of economic expansion.

In the Committee's discussion of policy for the intermeeting period, all of the members indicated that they were in favor of maintaining an unchanged degree of pressure on reserve positions. While the economy was subject to an unusual array of problems and related uncertainties, the members generally felt that monetary policy was on the right course under currently prevailing and immediately forseeable economic and financial circumstances. In particular, insofar as could be judged at this point, the present policy stance provided an appropriate balance between the risks of a faltering economic expansion and the risks of little or no progress toward price stability. The easing steps in recent months and the associated declines in interest rates, including mortgage rates, appeared to have supplied more monetary stimulus than had yet shown through to the economy. Several members commented, however, that the Committee needed to remain particularly alert to indications of renewed weakening in business activity, especially given the current financial fragilities in the economy and the likely difficulty of reviving the economy in the event of another downturn. Other members gave somewhat more weight to the need to avoid over-stimulating the economy; a failure to take advantage of the apparent momentum toward lower inflation would have seriously adverse consequences on longer-term debt markets and the outlook for sustained economic growth. The members agreed that a steady policy course was desirable for now while the Committee assessed the economy's responses to its earlier easing actions.

In the course of the Committee's discussion, the members expressed varying degrees of concern about the continuing weakness in the broader monetary aggregates and overall credit growth. It was clear that a significant restructuring of household and business balance sheets was occurring that partly involved adjustments to the unusually rapid buildup of debt during the 1980s and that such restructuring was being reflected in the behavior of the broader monetary aggregates. Resolutions of insolvent thrift institutions, which in recent months had resumed in volume,

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also were acting to depress M2 as well as M3. In addition, the more liquid components of the monetary aggregates were growing relatively strongly. Under these circumstances, slow growth in broader money and credit did not necessarily indicate that monetary policy was being too restrictive by damping the expansion of incomes or curtailing demands for goods and services. Moreover, a staff analysis prepared for this meeting indicated that some recovery in the growth of these aggregates could be expected over the balance of 1991, assuming an unchanged degree of pressure in reserve markets. Nonetheless, many of the members felt that the behavior of M2 and M3, whose growth for the year to date was at the bottom of the Committee's ranges, needed to be monitored with special care and, at least in one view, that some further easing measures might be desirable in the near term to improve the prospects that monetary expansion for the year would be within the Committee's ranges.

Turning to possible adjustments to the degree of reserve pressure during the intermeeting period, a majority of the members indicated a preference for a directive that was biased at least marginally toward easing. Such a bias was called for in this view by the downside risks in the economy, though a number of these members also felt that there should be no strong presumption that any easing would be undertaken during the intermeeting period ahead. The other members indicated that they could support an asymmetric directive toward ease though they preferred a symmetric intermeeting instruction, especially in the context of the further stimulus that could be expected to result over time from the earlier monetary easing actions.

At the conclusion of the Committee's discussion, all of the members indicated that they favored a directive that called for maintaining the existing degree of pressure on reserve positions. They also noted their preference or acceptance of a directive that included a slight bias toward possible easing during the intermeeting period. Accordingly, the Committee decided that slightly greater reserve restraint might be acceptable during the intermeeting period or slightly lesser reserve restraint would be acceptable depending on progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. 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 1½ percent respectively over the three-month period from September through December.

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 has been mixed, but it suggests on balance that economic activity has been expanding at a moderate pace. Total nonfarm payroll employment changed little over July and August, and the civilian unemployment rate was 6.8 percent in both months. Employment in manufacturing continued to advance in August, and industrial production posted a further rise after several months of sizable gains. Consumer spending increased considerably on balance in July and August. Recent data on orders and shipments of nondefense capital goods point to a small increase in real outlays for business equipment, but nonresidential construction has remained weak. Housing starts rose only slightly further in July and August after increasing appreciably on balance since January. The nominal U.S. merchandise trade deficit widened substantially in July and was considerably above its average rate in the second quarter. Increases in consumer prices have been small in recent

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months, owing to declines in food and energy prices.

Most interest rates have declined further since the Committee meeting on August 20. The Board of Governors approved a reduction in the discount rate from 5½ to 5 percent on September 13. The trade-weighted value of the dollar in terms of the other G-10 currencies fell sharply over the intermeeting period; much of the drop retraced the previous run-up associated with the attempted coup in the Soviet Union that began shortly before the August Committee meeting.

After contracting in July, M2 was about unchanged in August and September. M3 declined further in July and August and is indicated to have changed little in September. For the year thus far, expansion of M2 and M3 has been at the lower end of the Committee's ranges.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February for growth of M2 and M3 of 2½ to 6½ percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 4½ to 8½ percent for the year. For 1992, on a tentative basis, the Committee agreed in July to use the same ranges as in 1991 for growth in each of the monetary aggregates and debt, measured from the fourth quarter of 1991 to the fourth quarter of 1992. With regard to M3, the Committee anticipated that the ongoing restructuring of thrift depository institutions would continue to depress the growth of this aggregate relative to spending and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Depending upon progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint might or slightly lesser reserve restraint would 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 3 and 1½ percent, respectively.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Keehn, Kelley, LaWare, Mullins, and Parry. Votes against this action: None.

Meeting Held on November 5, 1991

1. Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity had turned sluggish after registering considerable gains around midyear. Consumer spending for goods had been lackluster recently, and businesses remained cautious about investing in increased production capacity or inventories. Industrial production had flattened out, nonresidential construction had moved sharply lower, and housing construction had lost much of its forward momentum. Price inflation evidently remained on a gradual downtrend.

After falling sharply in the first half of the year, total nonfarm payroll employment rose slightly in the third quarter and was unchanged in October. Sizable job gains in the services sector, notably in health and business services, were offset by losses elsewhere. Manufacturing employment declined further; durable goods industries bore all of the loss. Job cutbacks in construction and retail trade were larger in October than they had been in recent months. Also, the small September increase in average weekly hours worked by production or nonsupervisory workers was reversed in October. The civilian unemployment rate edged back up to 6.8 percent.

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Industrial production was little changed over August and September after sizable gains in earlier months; available data indicated that production would remain flat in October. Sluggishness had been evident in most components of the index since July; abstracting from the output of motor vehicles and parts, which had been subject to wide swings, the production of consumer goods and construction supplies had been rising much less rapidly since midyear while the output of business equipment had not expanded much since reaching its low last March. Total industrial capacity utilization edged lower in September.

Real personal consumption expenditures advanced considerably further in the third quarter, partly reflecting a sharp rise in purchases of motor vehicles. However, outlays for non-auto goods weakened in August and September, and partial data for October suggested a slowing in sales of motor vehicles in that month. In addition, indicators of consumer confidence, which had remained at subdued levels since the end of the war in the Persian Gulf, had deteriorated significantly in October. Housing starts declined in September after rising substantially on balance in earlier months of this year. Sales of both new and existing houses had dropped recently despite lower mortgage rates and favorable price developments.

Shipments of nondefense capital goods rose for a second straight month in September. For the third quarter as a whole, real business spending for computers, aircraft, and motor vehicles registered a sizable gain while outlays for industrial machinery fell further. Recent data on orders pointed to some further moderate expansion in business spending for equipment in the near term. Nonresidential construction continued to contract at a rapid rate as outlays for all major types of structures, but particularly for commercial buildings, fell sharply. Available information on new contracts and commitments suggested that the rate of decline for non-office construction activity might slow in coming months.

The pace of inventory liquidation by businesses slowed in July and August from the substantial second-quarter rate. Ratios of inventories to sales edged down at manufacturing and non-auto retail firms. In September, stocks held by manufacturers increased.

The nominal U.S. merchandise trade deficit widened appreciably in August. For the July–August period, the trade deficit was significantly larger than its average rate in the second quarter, reflecting a strong expansion in the value of imports and a small reduction in the value of exports. The increase in imports was entirely in consumer goods and automotive products; other major trade categories registered small declines. Part of the drop in exports resulted from a partial reversal of a sharp second-quarter increase in exports of aircraft and parts. Indicators of economic activity in the major foreign industrial countries suggested continued weak growth on balance in the third quarter. The rate of growth in western Germany and Japan was considerably slower in the second and third quarters than earlier in the year, although capacity utilization rates remained high in both countries. In some other major countries, economic activity was slowly and unevenly recovering from a period of recession.

Producer prices of finished goods were little changed in September; a firming of prices of finished energy goods was offset by lower food prices. For finished goods other than food and energy, producer prices had advanced thus far in 1991 at a pace appreciably

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below that for 1990. At the consumer level, the September rise in prices was larger than the increases in the prior few months. Excluding food and energy items, consumer prices advanced in September at the same elevated rate as in the previous three months; however, for 1991 to date, nonfood, non-energy consumer prices had increased at a slightly slower pace than in 1990. Total hourly compensation for private industry workers rose at a somewhat slower rate in the third quarter than in the first half of the year. For the year to date, wage increases had slowed appreciably, but benefit costs had continued their rapid rise.

At its meeting on October 1, 1991, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and for giving special weight to potential developments that might require some easing during the intermeeting period. Accordingly, the directive indicated that slightly greater reserve restraint might be acceptable or slightly lesser reserve restraint would be acceptable during the intermeeting period depending on progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated at this meeting were expected to be consistent with a resumption in the growth of both M2 and M3; these aggregates were expected to expand at annual rates of around 3 percent and 1½ percent respectively over the three-month period from September through December.

Over most of the intermeeting period, open market operations were directed toward maintaining the existing degree of pressure on reserve positions. At the end of October, however, a slight easing of reserve conditions was implemented; this action was taken in response to signs of a weaker-than-expected economic recovery and flagging consumer and business confidence. Just before the intermeeting period, adjustment plus seasonal borrowing had averaged around $340 million. During the period, several technical decreases were made to expected levels of adjustment plus seasonal borrowing to reflect the usual autumn pattern of ebbing seasonal credit needs. By the end of the intermeeting period, following the slackening of seasonal funding needs and the easing of reserve conditions, the volume of borrowing had declined to around $125 million. The federal funds rate remained near 5¼ percent during most of the intermeeting period but slipped to about 5 percent after the easing of reserve conditions.

Over the early weeks of the intermeeting period, other short-term interest rates declined somewhat as market participants interpreted incoming data as indicating a sluggish economy. At the same time, long-term rates moved considerably higher in response to the release of disappointing statistics on consumer prices and concerns stemming from discussions of possible measures of fiscal stimulus that would increase the federal deficit and borrowing needs. Subsequently, short-term rates fell further and long-term rates retraced a portion of their rise as markets reacted to information suggesting additional economic weakness and reduced pressure on labor costs, and to actual as well as prospective further easing of monetary policy. The prime rate remained unchanged at 8 percent over the period, but primary-market yields on mortgages fell to their lowest levels since 1977. Most stock price indexes were slightly higher on balance.

The trade-weighted value of the dollar in terms of the other G-10 currencies

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fluctuated in a fairly narrow range over the intermeeting period but declined slightly on balance. The dollar was generally higher over the first half of the period but then weakened in response to growing evidence of a sluggish U.S. economy and consequent market anticipation of an easing of U.S. monetary policy. The dollar was up a little against the mark, in large part reflecting concerns that the Soviet Union might default on its foreign debt, much of which is owed to or guaranteed by the German government. The yen was strong on balance, in part because of continuing indications of growing Japanese trade surpluses.

M2 expanded slowly in October after shrinking on balance over the previous three months. The turnaround was consistent with the Committee's expectations for the fourth quarter and reflected in part the rapid growth in the liquid-deposit components of this monetary aggregate. As the Committee also had expected, the pickup in M2 showed through to M3, which posted its first monthly increase since May. For the year through October, expansion of both M2 and M3 was estimated to have been at the lower ends of the Committee's annual growth ranges.

The staff projection prepared for this meeting pointed to a continuing recovery in economic activity, but recent reports on business and consumer confidence combined with other information had led to an appreciable markdown in the projected rate of expansion for the current quarter and to a lesser markdown for the first quarter of 1992. Economic growth was projected to pick up by the spring of next year, but as in earlier staff forecasts, it was expected to remain subdued in comparison with past cyclical experience and the risks of a different outcome continued to be seen as predominantly on the downside. Increases in the construction of single-family housing and in business spending for equipment, along with a shift from inventory liquidation to limited accumulation, were expected to give impetus to the expansion during 1992. As in earlier forecasts, real federal government purchases were projected to fall somewhat next year, with defense expenditures more than accounting for the decline, and fiscal adjustments at the state and local levels and a continuing decline in commercial construction were expected to be persisting sources of restraint on aggregate demand. Significant though diminishing slack in labor and product markets was projected to induce a further decline in the underlying rate of inflation over the next several quarters.

In the Committee's discussion of current and prospective economic developments, the members commented on widespread indications of deteriorating business and consumer confidence and on evidence that the recovery in business activity had weakened since early summer. Nonetheless, despite quite negative anecdotal reports from many parts of the country, the members generally concluded that the available economic data appeared consistent with continuing, albeit sluggish, expansion in overall economic activity. Views differed to some extent with regard to the risks to a continuing recovery. A number of members expressed concern about the potential for some further softening, especially in light of the vulnerability of the expansion stemming from the troubled condition of many financial institutions and the heavy debt burdens of numerous business firms and individual households; other members saw the risks as more evenly balanced and perhaps even tilted marginally to the upside. While the performance of the economy was likely to remain relatively lackluster over the nearer term and the risks of a

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downturn would be greatest during the next quarter or two, many of the members judged a resumption of growth next year at a pace broadly in line with the staff forecast to be a reasonable expectation. In this regard, some noted that much of the stimulus from the easing in monetary policy over the course of recent months had not yet been felt in the economy. Many of the members emphasized that the prospects for appreciable progress toward price stability were quite favorable, though some expressed reservations about the extent of the progress that could be expected over the forecast horizon.

Several members referred to the continuing adjustments by financial institutions and many business firms to the financial excesses of the past decade and the greater-than-expected downward pressure that these adjustments appeared to be exerting on the expansion. The efforts to reduce debt exposure and rebuild equity positions were necessitated by the effects on balance sheets of the contraction in the value of a variety of assets, notably in the structurally troubled sectors of the economy such as commercial real estate, and the failure of other assets to appreciate as expected. The rebuilding of balance sheets augured well for the future financial health and stability of the economy, but members commented that an extended period would be required before that process could be completed. In the interim, the retrenchment that was involved implied reduced propensities to spend and constrained growth in business activity. One facet of the adjustment process was greater caution on the part of institutional lenders. Many business borrowers continued to complain about the difficulty of obtaining credit, while institutional lenders stressed the lack of demand from qualified borrowers.

In the course of the Committee's review of business developments in different regions, members continued to report uneven conditions ranging from modest growth to some further decline in regional activity, but business and consumer sentiment was described as almost universally negative. It was unclear to what extent the drop in confidence reflected the disappointing pace of the economic recovery so far or was a harbinger of further weakening in economic activity. Members commented that surveys of consumer confidence had to be viewed with caution because they had tended in the past to be coincident rather than leading indicators of economic activity. More generally, bearish sentiment, though perhaps more muted, had not been an unusual occurrence in the early stages of past business recoveries.

While the potential sources of economic stimulus were subject to uncertainty and recent developments heightened concerns that the rate of economic expansion would remain below a desirable pace for an extended period, the members generally anticipated that improvement in key areas of the economy, notably certain interest-sensitive sectors and business inventories, eventually would provide the impetus needed to promote at least moderate growth in overall business activity. In the critical area of consumer demand, members observed that consumer caution reflected not only concerns about employment prospects and, in the case of many households, relatively heavy debt burdens, but also appeared to stem from actual or perceived declines in the market value of residences. Consumer expenditures on services were continuing to grow, though at a relatively slow pace, but spending on goods had edged lower over the course of recent months and many retailers reported that they

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expected very weak sales during the approaching holiday season. With regard to the longer-term outlook for consumer expenditures, some pickup in interest-sensitive spending for durable goods was seen as a likely prospect that would have feedback effects on the demand for inventories and production.

According to available data and reports from around the country, inventories generally appeared to be near acceptable levels, and members continued to anticipate that a further swing from inventory liquidation to modest accumulation would provide some stimulus to the economy over the year ahead. The members recognized that a number of developments argued against a typical surge in inventory investment during the recovery, including the now widespread practice of "just-in-time" inventory management. Nonetheless, despite sluggish demand, the pace of inventory liquidation appeared to have slowed in the third quarter, and there were scattered reports of efforts by some manufacturers to increase their inventories.

The construction of new housing also appeared likely to play a positive, though possibly limited, role in helping to sustain the recovery. Recent indicators of home sales and housing starts were disappointing, but the demand for new single-family homes would respond over time to the declines that had occurred in mortgage interest rates. Some of that demand might be postponed, however, until borrowers were persuaded that interest rates had bottomed out. On the negative side, commercial construction activity would probably remain depressed for an extended period as excess capacity in many parts of the country gradually was absorbed. With regard to business spending for new equipment, real outlays were indicated to have risen, especially for computers, and this sector could be expected to provide ongoing strength, especially once the expansion was well under way.

In their comments concerning the outlook for inflation, members observed that many of the recent statistical indicators and especially the anecdotal evidence from around the country provided the basis for considerable optimism that progress was being made toward price stability. Developments on the financial side, including low levels of business and consumer borrowing and an extended period of limited monetary growth, reinforced expectations of an ongoing movement toward stable prices. Members also noted that the information on wages was consistent with a downtrend in labor costs despite still substantial upward pressures on employee benefit costs. Some members cautioned, however, that an appreciable inflationary risk remained in the economy. While inflationary expectations might well be waning, as evidenced in part by the behavior of equity markets, the level of long-term interest rates suggested that inflation concerns had not disappeared.

In the Committee's discussion of an appropriate policy for the intermeeting period ahead, a majority of the members indicated that they could support a proposal to ease reserve conditions slightly at this time and to bias the directive toward possible further easing later in the intermeeting period. The members recognized that monetary policy had been eased considerably over the course of recent months, including a decision to reduce reserve pressures at the end of October, and that all of the stimulus from the earlier actions had not yet been felt in the economy. Nonetheless, in the view of many members further modest easing was desirable at this point to provide some added insurance against the downside risks in the economy. Such

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a policy move would help counter the deterioration in business and consumer confidence, and it might also encourage some decline in longer-term interest rates. Under current economic and financial conditions, this easing would pose negligible risks of deflecting inflation from its downward path. Continuing weakness in the monetary aggregates reinforced the need for easier reserve conditions.

There was considerable discussion regarding the possible advantages of a somewhat stronger move at this juncture. A ½ percentage point reduction of the discount rate was pending at several Federal Reserve Banks, but the Board of Governors had not yet made a decision with regard to those proposals. It was noted during this discussion that the Federal Reserve had tended to implement its easing of monetary policy since the spring of 1989 through a series of small policy actions. That approach generally appeared to have been appropriate, but a number of members expressed concern that further small moves would lack the visibility that was needed in present circumstances. If reserve pressures were to be reduced only modestly, this action should be accompanied in the view of many members by Board approval of the pending discount rate proposals to signal clearly that monetary policy was moving against the weakening tendencies in the economy. An accompanying reduction in the discount rate also was seen as providing further encouragement to a drop in the prime rate.

Other members expressed reservations about the need for substantial easing, and two indicated that they could not support any easing through open market operations at this time. Some questioned whether monetary policy actions could have a constructive influence on business and consumer confidence under prevailing circumstances. Indeed, appreciable further easing, or any easing, would incur too much risk of reviving inflationary concerns with adverse consequences for longer-term debt markets. While none of these members wanted to rule out the potential need to ease monetary policy significantly further, they preferred to pause and wait for additional evidence before such action was taken, especially given the further stimulus that could be anticipated from previous easing moves. Concern also was expressed that the Committee might not recognize the need to reverse its course and tighten policy on a timely basis should inflationary pressures tend to revive later.

Members noted that the expansion of M2 appeared to have resumed in October, though at a pace that kept the aggregate only at the bottom of the Committee's range for the year. According to an analysis prepared by the staff for this meeting, M2 was likely to continue to expand slowly over the balance of the year, despite the effects of earlier policy easing actions, and for the year as a whole M2 growth was expected to average close to the lower end of the Committee's range. Some members commented that an easing in reserve conditions would not only improve slightly the odds that M2 growth would end the year within the Committee's range but would also help to put M2 on a desirable growth path by early next year. While the relationship between money growth and economic activity was subject to substantial uncertainty in the short run, they saw a marked advantage, in terms of the continuity of monetary policy and its credibility, for the Committee to more aggressively foster growth of M2 within the annual range.

With regard to possible adjustments to the degree of reserve pressure during the intermeeting period, most of the

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members who favored some immediate easing of reserve conditions also supported a directive that remained biased toward further easing. However, some also indicated that if the Board were to approve the pending proposals to reduce the discount rate, the intermeeting instruction should then be viewed as symmetrical.

The members discussed at some length the appropriate timing of the Committee's easing action. Starting that afternoon and continuing over the next two days, the Treasury would be conducting its quarterly auctions of notes and bonds. In view of this, an immediate policy move would come as a surprise to many participants in financial markets, although such a move shortly after the auctions was widely anticipated. An immediate move, even in the easing direction, could have an adverse effect on some Treasury market participants, with potentially unsettling consequences for current and future Treasury financings. The members agreed that in general it was preferable to avoid policy moves during Treasury refundings, but most felt that the contemplated easing move should not be delayed for any significant period. They concluded that, on balance, it would be less misleading to take action immediately rather than to wait until the Treasury auctions were completed later in the week. It was noted in this connection that a prompt easing of reserve conditions, and any accompanying Board action to approve a lower discount rate, would become known to outside observers after the auction of the shorter-term Treasury note but before the auctions of the intermediate- and long-term Treasury issues.

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 for an immediate slight easing in the degree of pressure on reserve positions. These members also noted their acceptance of a directive that included a bias toward possible easing during the intermeeting period. Accordingly, the Committee decided that slightly greater reserve restraint might be acceptable during the intermeeting period or slightly lesser reserve restraint would be acceptable depending on progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. 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 1 percent respectively over the three-month period from September through December.

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 portrays a sluggish economy and a marked deterioration in business and consumer confidence. Total nonfarm payroll employment was unchanged in October after rising slightly over the third quarter, and the civilian unemployment rate edged back up to 6.8 percent. Industrial production has been flat in recent months. Consumer spending increased considerably through the summer, in part because of a sizable rise in expenditures on motor vehicles; sales of motor vehicles slowed in October, however. Real outlays for business equipment—especially for computers—have been rising, but nonresidential construction has continued to decline. Housing starts and home sales have weakened recently. The nominal U.S. merchandise trade deficit in July–August was significantly above its average rate in the second quarter. Wage and price increases have continued to trend downward.

Short-term interest rates have declined somewhat further since the Committee meeting on October 1, while bond yields are

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about unchanged to slightly higher on balance. The trade-weighted value of the dollar in terms of the other G-10 currencies declined on balance over the intermeeting period.

Expansion in M2 and M3 resumed in October, albeit at a slow pace. For the year through October, expansion of both M2 and M3 is estimated to have been at the lower ends of the Committee's ranges.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February for growth of M2 and M3 of 2½ to 6½ percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 4½ to 8½ percent for the year. For 1992, on a tentative basis, the Committee agreed in July to use the same ranges as in 1991 for growth in each of the monetary aggregates and debt, measured from the fourth quarter of 1991 to the fourth quarter of 1992. With regard to M3, the Committee anticipated that the ongoing restructuring of thrift depository institutions would continue to depress the growth of this aggregate relative to spending and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to decrease somewhat the existing degree of pressure on reserve positions. Depending upon progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint might or slightly lesser reserve restraint would 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 3 and 1 percent, respectively.

Votes for this action: Messrs. Greenspan, Corrigan, Black, Forrestal, Keehn, LaWare, Mullins, and Parry. Votes against this action: Messrs. Angell and Kelley.

Mr. Angell dissented because he was concerned about the impact of further easing on inflation expectations and consequently on long-term interest rates. In his view, the prospect for a robust and long-lasting recovery is dependent on the completion of adjustments in business pricing practices, household savings, and balance sheets more generally. Monetary policy actions that are perceived as a shift from a focus on price-level stability to one on short-term economic growth may well abort the needed adjustments. In his view, credible price-level targeting would provide assurance, particularly given the somewhat precarious short-term business outlook, that monetary policy would act to counter either deflation or inflation. The consequence would be to foster a considerable downward thrust in long-term interest rates and to set the stage for sustained expansion.

Mr. Kelley dissented because he believed that a steady policy course was appropriate, at least for now, in the context of the ongoing stimulus that could be anticipated from the System's earlier easing actions. In his view, the outlook for continuing expansion in economic activity remained favorable, and he saw considerable risks in further easing at this time. In particular, he was concerned that a policy easing move would stimulate inflation expectations with adverse implications for long-term interest rates and the performance of interest-sensitive sectors of the economy. Further, he did not believe that many of the factors that are importantly inhibiting economic expansion could be constructively addressed by a more accommodative position. He also feared that the dollar would come under downward pressure in foreign exchange markets

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with only slight benefits for exports but added inflation pressures in the domestic economy.

2. Authorization for Domestic Open Market Operations

The Committee approved a temporary increase of $2 billion, to a level of $10 billion, in the limit on changes between Committee meetings in System Account holdings of U.S. government and federal agency securities. The increase amended paragraph 1(a) of the Authorization for Domestic Open Market Operations and was effective for the intermeeting period ending with the close of business on December 17, 1991.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Keehn, Kelley, LaWare, Mullins, and Parry. Votes against this action: None.

The Manager for Domestic Operations advised the Committee that the current leeway of $8 billion for changes in System Account holdings might not be sufficient to accommodate the potentially large need to add reserves over the intermeeting period ahead to meet an anticipated seasonal bulge in currency in circulation and required reserves.

Meeting Held on December 17, 1991

Domestic Policy Directive

The information reviewed at this meeting indicated that the economy was sluggish and that business and consumer confidence remained depressed. Spending for housing and business equipment had been rising, but consumption expenditures had softened, commercial construction activity was still declining, and government spending at all levels was being restrained by budgetary imbalances. Recently, industrial production had fallen, and payroll employment had dropped sharply. Wage and price increases had continued to trend downward.

Total nonfarm payroll employment fell sharply in November after rising somewhat in the third quarter and changing little in October. Declines in employment were widespread: The number of manufacturing jobs decreased in November for a third straight month, and further job losses were reported in construction and in wholesale and retail trade. However, the average weekly hours worked by production or nonsupervisory workers in the private nonfarm sector edged up in November, and the civilian unemployment rate remained at 6.8 percent.

Industrial production fell appreciably in November after changing little in the previous three months. A portion of the November decline reflected a sizable drop in the output of motor vehicles and parts. In addition, however, the production of non-auto consumer goods slackened, and the output of business equipment other than motor vehicles remained near its low of last March; the latter reflected in part the persisting effects of a strike at a major producer of industrial equipment. As in most earlier months of the year, the production of defense and space products declined. With industrial output down in November, total industrial capacity utilization decreased, and declines in operating rates were widespread across industries.

Real consumer spending had been soft on balance in recent months, reflecting sluggish growth in disposable incomes, weak labor-market conditions, and depressed consumer confidence. Nominal retail sales expanded somewhat in November from a downward revised level for October. The Novem-

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ber increase reflected a rebound in sales of nondurable goods other than food and a rise in sales at automotive dealers; sales of durable goods other than autos were about unchanged. Housing starts fell in November, retracing part of a substantial advance in October; on average, starts were appreciably higher in October and November than in the third quarter. Despite low mortgage interest rates and steady house prices, sales of single-family homes in October remained well below their spring levels.

After changing little over the third quarter, shipments of nondefense capital goods registered a sharp rise in October, reflecting a bulge in outlays for computing equipment; shipments of most other types of business equipment remained sluggish. Recent data on orders suggested little growth in aggregate outlays for business equipment over the near term. Nonresidential construction, notably of office and other commercial structures, continued to shrink in October. The vacancy rate for office buildings was still very high, and this along with available information on contracts and commitments suggested that nonresidential construction activity would remain weak for an extended period.

Business inventories turned up sharply in September after many months of liquidation. At the retail level, inventories rose further in October, with nearly half of the buildup occurring at auto dealers. The additional rise in stocks coupled with declines in sales led to higher inventory-to-sales ratios at many types of retail establishments. Aggregated over all retail establishments other than auto dealers, the ratio of inventories to sales in October was close to the peak posted in early 1991. By contrast, in manufacturing, stocks changed little in October, and the ratio of stocks to sales decreased and nearly reached its low of August 1990. Wholesale inventories were up slightly in October after a sizable decline in the previous month; the inventory-to-sales ratio remained in the narrow range that had prevailed in recent months.

The nominal U.S. merchandise trade deficit widened slightly further in September. For the third quarter, the deficit was somewhat above its average rate over the first half of 1991 but well below its rate in 1990. The value of exports in the third quarter remained close to the record high reached in the second quarter while the value of imports increased appreciably, with most of the rise reflecting larger imports of automotive products and consumer goods. The increase in imports of consumer goods appeared to have contributed to the substantial buildup in retail inventories in the United States, particularly in the month of September. The available data on economic activity in the major foreign industrial countries provided further evidence of relatively weak growth on balance in these countries in the third quarter and gave few indications of a revival in the fourth quarter. The trend toward reduced inflation had continued in most of the industrial countries.

Producer prices of finished goods advanced in November at about the slow pace recorded since midyear; over this period, declines in food prices roughly offset increases in energy prices. At the consumer level, food and energy prices jumped in November, but the increase in the prices of nonfood, non-energy items was about the same as that registered since midyear and considerably below the 1990 pace. Average hourly earnings of production or nonsupervisory workers in the October–November period increased at about the reduced third-quarter rate; over the past twelve months, average hourly earnings had risen more slowly than in the previous twelve-month period.

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At its meeting on November 5, 1991, the Committee adopted a directive that called for an immediate slight easing in the degree of pressure on reserve positions and that provided for giving special weight to potential developments that might require some additional easing during the intermeeting period. Accordingly, the directive indicated that slightly greater reserve restraint might be acceptable during the intermeeting period or slightly lesser reserve restraint would be acceptable depending on progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated under this directive were expected to be consistent with growth of M2 and M3 at annual rates of around 3 percent and 1 percent respectively over the three-month period from September through December.

Immediately following the November meeting, open market operations were directed toward a slight easing of conditions in reserve markets; this step was taken in conjunction with the reduction in the discount rate from 5 to 4½ percent approved by the Board of Governors on November 6. In early December, as economic indicators continued to point to a faltering recovery and growth of the broad monetary aggregates remained sluggish, an additional slight easing of reserve conditions was carried out. Several technical reductions were made during the intermeeting period to expected levels of adjustment plus seasonal borrowing to reflect the declining usage of seasonal credit during the autumn. For most of the intermeeting interval, adjustment plus seasonal borrowing tended to run a little below expected levels, averaging slightly more than $100 million over the three complete reserve maintenance periods. The federal funds rate averaged around 4¾ percent over most of the period but softened to around 4½ percent after the second easing action.

Other short-term interest rates declined more than the federal funds rate as market participants reacted to actual and anticipated further easing steps amid growing evidence that the economic recovery had stalled. Expectations of more subdued economic activity contributed to declines in yields on longer-term instruments as well. Yields on intermediate maturity securities dropped almost as much as short-term rates while rates on mortgages, corporate bonds, and long-term Treasuries fell by less. The prime rate was reduced by ½ percentage point to 7½ percent early in the intermeeting period. Broad stock price indexes were down slightly.

The trade-weighted value of the dollar in terms of the other G-10 currencies declined further on balance over the intermeeting period. During most of the period, signs of weakness in the U.S. economy and the easings of U.S. monetary policy had a depressing effect on the value of the dollar. The dollar's depreciation was primarily against the mark and other European currencies; the mark was supported by reports of further increases in wage and price inflation in Germany and associated expectations that German monetary policy would be tightened. The dollar declined less against the Japanese yen as evidence accumulated that the Japanese economy was slowing further and some easing was implemented in Japanese monetary policy.

Expansion in M2 picked up in November from a slow pace in October. At least in part this reflected the cumulative effect of earlier declines in short-term market interest rates in lowering the opportunity costs of holding liquid deposits. The somewhat faster expan-

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sion of M2 was consistent with the Committee's expectations for M2 growth in the fourth quarter. The more rapid growth of M2 showed through to a limited extent to M3. For the year through November, expansion of both M2 and M3 was estimated to have been at the lower ends of the Committee's annual ranges.

The staff projection prepared for this meeting pointed to a recovery in economic activity. However, a variety of incoming information, notably indications of a depressed state of confidence, weaker than expected consumer spending, and sluggish industrial production suggested a pause in the recovery that might extend into early 1992. By the spring, the cumulative effects of declines in interest rates in recent months would contribute to a resumption of economic growth at a moderate rate, with the risks of a stronger or weaker trajectory for the economy being viewed as about in balance. Increases in residential construction, somewhat larger consumption expenditures, and some pickup in business equipment spending were projected to provide the underpinnings for the resumption of growth. As in earlier forecasts, the continuing downtrend in commercial construction and ongoing adjustments in state and local government spending in response to budget imbalances were expected to have a retarding effect on aggregate demand. At the federal level, projected declines in defense outlays, which would be only partially offset by higher nondefense spending, also would be a source of restraint, at least in the absence of new fiscal initiatives. The substantial though diminishing slack expected in labor and product markets in coming quarters was projected to induce further declines in the underlying rate of inflation.

In the Committee's discussion of current and prospective economic developments, the members focused on an evident pause in the business recovery and its interaction with very gloomy business and consumer sentiment. A number of factors that had been expected to damp the expansion—including the retrenchment associated with the rebuilding of balance sheets by heavily indebted businesses and consumers and the efforts of many firms to improve efficiency by streamlining operations and reducing employment—had in fact proved to be stronger and more persistent than anticipated. The timing of a renewed expansion in business activity was uncertain, and a number of members commented that the economy might well remain quite sluggish over the months immediately ahead. Nonetheless, considerable progress in business and financial restructuring activities was in train, and the latter, together with the stimulus that could be expected from the lagged effects of earlier monetary policy easing actions, was likely to lead to a moderate pickup in the economy later in 1992. With regard to the outlook for inflation, many members observed that the statistical and anecdotal evidence pointed to faster progress toward price stability than they had anticipated earlier.

As they had at earlier meetings, the members gave considerable emphasis to current business and consumer sentiment, which they judged to be much more negative than under similar business and employment conditions in the past. The underlying reasons were difficult to ascertain but probably reflected a variety of developments, including widespread disappointment over the pace of the economic recovery, related consumer concerns about employment opportunities, and fears associated with heavy debt burdens and the weakened financial condition of many business and financial institutions. The size of the

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federal budget deficit was adding to those concerns, and the budgetary problems of many state and local governments were seen as likely to result in higher taxes and spending cutbacks. On the positive side, while the efforts to rebuild balance sheets and to restructure business activities were likely to continue to exert restraining effects on the economy, such developments had favorable implications for the financial health and the competitive strength of the economy over the longer run. Members noted in this connection that a record volume of equity issues was helping to reduce balance sheet leverage and that proceeds from large offerings of debt securities were being used to a considerable extent to pay down short-term liabilities. The sizable decline in interest rates over the course of recent months was easing the debt service burdens of many borrowers, and in a few geographic areas banking institutions were reported to be making funds more readily available. The stock market continued to display appreciable strength, reflecting the drop in interest rates and suggesting investor confidence in the longer-run outlook for the economy. Some members also cited the indications of reviving growth in the broader monetary aggregates as an encouraging if still tentative development.

Turning to developments in key sectors of the economy, the members commented that it was still too early to get a firm indication regarding holiday spending by consumers, though retailers in some parts of the country reported that sales were somewhat better than they had projected. Nonetheless, consumers remained quite cautious nationwide, and some members commented that consumer spending for durable goods might well continue sluggish over the months ahead, especially in a context of widespread consumer concerns about employment prospects, debt burdens, and softness in real estate prices. Some members also observed that the saving rate was already on the low side and that the risks of a rise in that rate could not be ruled out in the environment that was likely to prevail during the months ahead.

The members did not discern signs of significant strengthening in business expenditures for equipment over the nearer term, though the output of capital goods appeared to be on a slowly rising trend in at least one major capital-producing region. Nonresidential construction activity remained very weak in most parts of the country, and high vacancy rates suggested little prospect for improvement in the commercial building sector for an extended period. On the other hand, significant improvement in housing construction was reported in some parts of the country, and housing activity appeared to be holding up reasonably well on a nationwide basis. The declines that had occurred in interest rates would tend over time to stimulate housing and other interest-sensitive sectors of the economy. The outlook for U.S. exports was tempered by more sluggish business conditions in several key countries than had been expected earlier, but exports would be supported by the depreciation in the foreign exchange value of the dollar since mid-1991.

Businesses continued to pursue cautious inventory investment policies. Contacts in most parts of the country described current inventories as lean, and many retailers were prepared to accept reduced sales rather than to add to their inventories under prevailing conditions, although some buildup had occurred in recent months in association with weak demands. While rising inventories were not likely to make a major contribution to the anticipated recovery,

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any significant firming in final demands probably would be reflected fairly promptly in increased production.

With regard to the outlook for the government sectors, members commented that the massive size of current federal budget deficits greatly limited any flexibility in providing some stimulus through fiscal policy actions. It was noted in this connection that any legislation that was seen as significantly increasing the size of the federal deficits over the longer run could have adverse repercussions on long-term interest rates and business and consumer confidence. Some members also referred to the negative effects on confidence and spending stemming from the budgetary difficulties of numerous state and local governments; at least in some areas, however, capital expenditures by such government entities were being accelerated by lower interest and other costs.

The members were encouraged by evidence that inflationary pressures appeared to be subsiding at a faster pace than they had anticipated earlier. Anecdotal reports suggested very competitive conditions in producer and retail markets and favorable wage patterns. Employee benefit costs were still rising rapidly, notably medical costs, but members cited some examples of promising efforts on the part of medical providers to curb the escalation in their costs. It was suggested that the behavior of commodity prices over the past year was consistent with an outlook for stable producer prices. The members saw little risk of worsening inflationary pressures over the forecast horizon even if the pace of the recovery proved to be somewhat more vigorous than they currently expected; however, some stressed that it was important for monetary policy to sustain the downtrend in inflation over an even longer horizon.

In the Committee's discussion of policy for the period ahead, most of the members indicated that they favored or could accept a directive that called for no immediate change in the degree of pressure on reserve positions but that carried an especially strong presumption that some easing in reserve conditions would be implemented unless improvement in the economy became evident fairly promptly or there was significant evidence of a pickup in M2 growth in the period immediately ahead. Separately, the Board of Governors would need to decide how the discount rate should be structured in order to get the maximum benefits from any easing, given the current state of business and consumer confidence.

The policy discussion focused on the need to foster a sustained, noninflationary recovery. Such an environment would promote continuing balance sheet adjustments and business restructurings that would over time enhance the financial soundness and competitive strength of the economy. For now, however, these activities were having restraining effects on the economy, and there were as yet no clear indications that the recovery was resuming. While the risks of a substantial weakening in the economy were perhaps small, such a development would have severe consequences for the economy and financial institutions. In these circumstances, many of the members believed that some further easing of reserve conditions likely would be called for, especially if indications of some strengthening in the economy or in the growth of the monetary aggregates should fail to materialize in the near future. A number of members also commented that against the background of better-than-expected progress toward price stability, a stalled recovery, and slow monetary growth, the inflation risks of further easing were minimal.

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Some members indicated that they saw an advantage in making a more substantial policy move at some point in the period ahead rather than additional limited easing actions of the sort that had been implemented in recent years. In this view, a larger and more visible policy action, which generally was not anticipated in financial markets, would have greater effectiveness in part because it would be more likely to bolster confidence. The level of interest rates and money growth that would be expected to ensue from such an action, against the background of the substantial easing that had already been implemented, should be sufficient to foster expansion and promote the view that further easing would not be needed.

Other members, while not disagreeing that further easing might be desirable, nonetheless expressed reservations about the urgency to ease in the near term and especially the need for a sizable move. These members emphasized that a substantial amount of easing had been implemented over the past several months and that to a considerable extent the effects of such easing had not yet shown through in the economy. A number of these members also expressed the view that monetary policy could do little to offset the restraining effects of the balance sheet adjustments and business restructuring activities that were currently under way. Moreover, a resurgence of inflation pressures as the recovery gathered strength could not be ruled out, and too much easing in the period immediately ahead might have to be reversed later with unsettling consequences.

According to a staff analysis prepared for this meeting, M2 and M3 were likely to continue to grow at a restrained pace over the months ahead in light of sluggish expansion in nominal income and very limited loan growth. A decision to implement somewhat easier reserve conditions would stimulate slightly faster monetary expansion in the early months of next year, though the broader aggregates would probably remain appreciably below the midpoints of the tentative ranges that the Committee had established for 1992. The members observed that to an important extent the weakness of the monetary aggregates appeared to be related to developments that involved some reduction in the intermediary role of depository institutions and might not have adverse implications for the overall availability of financing in the economy. Some members suggested that a number of indicators, including the behavior of commodity prices, the slope of the yield curve, and trends in the growth of reserves and narrow measures of money, pointed to an adequate availability of liquidity in the economy. Nonetheless, several members expressed concern about the continuing lagging growth in the broad measures of money, and they felt that consideration should be given to an easing of reserve conditions if incoming data were to suggest that the recent pickup was not being sustained.

In the course of the Committee's discussion, the members reviewed a proposal to amend the wording of the statement in the operational paragraph of the directive that related to possible intermeeting adjustments to the degree of reserve pressures. While several members expressed a slight preference for retaining the current statement, which contained an ordering of the factors considered by the Committee in guiding intermeeting policy adjustments, and a few preferred to delete the listing of factors altogether from the sentence, all of the members indicated that they could support a proposed alternative. That alternative would make clearer the Committee's focus on its long-term goals by

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inserting a reference to those goals at the beginning of the sentence and would refer in a more general way to the immediate economic, financial, and monetary developments that might prompt an intermeeting adjustment. This new wording implied less focus in the directive itself on the ranking of the factors, but the understandings reached at meetings regarding their relative importance would continue to be explained fully in the policy record. The members agreed that the revised statement should be reviewed every year or more often if warranted by changing economic or financial conditions.

At the conclusion of the Committee's discussion, all but one of the members indicated that they favored or could accept a directive that would call initially for maintaining the existing degree of pressure on reserve positions. The members also noted their preference or acceptance of a directive that included a marked bias toward easing during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint might be acceptable or somewhat lesser reserve restraint would be acceptable during the intermeeting period. 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 1½ percent respectively over the four-month period from November through March.

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 continues to portray a sluggish economy and a depressed state of business and consumer confidence. Total nonfarm payroll employment fell sharply in November; however, the average workweek in the private nonfarm sector edged up and the civilian unemployment rate remained at 6.8 percent. Industrial production fell in November, partly reflecting a sizable drop in motor vehicle assemblies. Consumer spending has been soft on balance in recent months. Real outlays for business equipment appear to be rising slowly, and nonresidential construction has continued to decline. Housing starts were appreciably higher on average in October and November than in the third quarter. The nominal U.S. merchandise trade deficit widened slightly further in September; the deficit in the third quarter was substantially larger than in the second quarter. Wage and price increases have continued to trend downward.

Interest rates have declined appreciably since the Committee meeting on November 5. The Board of Governors approved a reduction in the discount rate from 5 to 4½ percent on November 6. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined further over the intermeeting period; the dollar depreciated primarily against the mark and other European currencies.

Expansion in M2 and M3 edged up in November from a slow pace in October; the slightly faster growth reflected a strengthening in the most liquid components of the aggregates. For the year through November, expansion of both M2 and M3 is estimated to have been at the lower ends of the Committee's ranges.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February for growth of M2 and M3 of 2½ to 6½ percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 4½ to 8½ percent for the year. For 1992, on a tentative basis, the Committee agreed in July to use the same ranges as in 1991 for growth in each of the monetary aggregates and debt, measured from the fourth quarter

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of 1991 to the fourth quarter of 1992. With regard to M3, the Committee anticipated that the ongoing restructuring of thrift depository institutions would continue to depress the growth of this aggregate relative to spending and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint might or somewhat lesser reserve restraint would 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 1½ percent, respectively.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Keehn, Kelley, Lindsey, Mullins, Parry, and Ms. Phillips. Vote against this action: Mr. LaWare.

Mr. LaWare dissented because he did not favor the inclusion in the directive of a strong presumption that monetary policy would be eased further during the intermeeting period. While future developments might call for further easing, he preferred not to prejudge that need but to wait and assess the effects of the considerable easing actions undertaken earlier. In his view, the main barrier to a satisfactory economic performance was a crisis in confidence that was not likely to be alleviated by further incremental easing. In present circumstances, a steady policy could provide a firm signal that the downward drift in interest rates associated with a long series of small easing actions had come to an end. This signal might well prove to be beneficial to the economy as interest-sensitive decisions to spend no longer were postponed in anticipation of still lower interest rates. He recognized that lower interest rates could alleviate heavy debt service burdens, but he was concerned about the effects of a further decline in interest rates on the value of the dollar in foreign exchange markets.

At a telephone conference on December 20, 1991, the Committee discussed the approval by the Board of Governors of a 1 percentage point reduction in the discount rate, effective that day, and the implications of that action for the implementation of the Committee's policy with regard to the degree of pressure to be sought in reserve markets. It was noted during this discussion that the limited data received since the Committee's meeting on December 17 continued to point to a very sluggish economy. In keeping with the Committee's decision at its recent meeting, it was deemed appropriate to direct open market operations toward allowing part of the reduction in the discount rate to be reflected in the federal funds rate. Members commented that the substantial cut in the discount rate and the accompanying adjustment in open market operations were likely to have a favorable effect on financial markets and the behavior of the monetary aggregates and in conjunction with the ongoing effects of earlier easing actions would provide the financial basis for a resumption of sustainable economic growth. In light of the substantial size of these actions, it would be appropriate to view the directive as symmetrical with regard to any further changes in policy over the remainder of the intermeeting period. ∎

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Consumer and Community Affairs

The Community Reinvestment Act, the Home Mortgage Disclosure Act, and discrimination in mortgage lending were a major focus of activity in the Division of Consumer and Community Affairs during 1991. Responding to heightened interest in the effect of interstate banking and bank consolidation on local communities, the Board held public meetings on two bank holding company applications. Together with other agencies, the Board collected and processed a voluminous amount of HMDA data, which were made available to the public in October. The data renewed concerns about disparities in the rate of loan approvals among different racial groups and raised perceptions of unlawful discrimination in mortgage lending. In response to a resolution from the Federal Reserve's Consumer Advisory Council, the Board explored whether testing was a feasible enforcement tool in detecting mortgage credit discrimination.

This chapter presents the Board's efforts to promote fair lending and compliance with the CRA. It also presents the Board's implementation in 1991 of new statutory protections for consumers; reports on the examination of institutions for compliance with consumer laws—by the Federal Reserve and other regulatory agencies—and on the System's handling of consumer complaints; discusses the community affairs program of the Board and Reserve Banks; details the activities of the Board's Consumer Advisory Council; and reports on congressional testimony on consumer affairs issues.

Regulatory Matters

The Board amended Regulation C (Home Mortgage Disclosure) to require institutions to use 1990 census tract numbers, beginning in 1992, in reporting data about their mortgage lending activity. The Board made a comprehensive review of Regulation E (Electronic Fund Transfers), and studied whether the Electronic Fund Transfer Act should apply to electronic systems used by government agencies to deliver benefits.

The Board revised the commentary to Regulation Z (Truth in Lending) to address issues such as renewals of home equity lines of credit and credit card substitution. The Board proposed amendments to Regulation Z that would require the lender to disclose payment examples for each payment option offered to consumers, as well as the exact amount of any "teaser" or discounted interest rate. The amendments also would allow banks to include a demand provision in home equity loans to executive officers.

The Board amended Regulation CC (Expedited Funds Availability) to allow banks to hold deposits made at nonproprietary ATMs for up to five business days, in keeping with the underlying statute. The statutory rule, adopted for a temporary period ending November 27, 1992, was made permanent by the Congress at year-end.

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Regulation C (Home Mortgage Disclosure)

Revisions to Regulation C that took effect in 1990 expanded the information that lenders collect about loans for home purchase or home improvement. During 1991 the Board, the other banking agencies, and the Department of Housing and Urban Development implemented a new system for processing the HMDA data submitted by more than 9,600 institutions. Regulation C generally applies to mortgage lenders located in metropolitan areas and with assets of more than $10 million.

In the past, HMDA reports have focused on the geographic distribution of mortgage loans. Lenders prepared public disclosures that reported data by the type of loan and the census-tract location of the home for loans that they made or purchased. Amendments in 1990 expanded the data collected to include the race or national origin, sex, and income of applicants and, for loans that the lender sells, the type of purchaser. Lenders now also report loan applications that do not result in a loan. These data will help the Board and the other regulatory agencies monitor the compliance of lenders with the laws on fair lending and community reinvestment.

The new HMDA reporting system calls for lenders to provide information about each application or loan instead of aggregating the data by census tract. The lenders send the data to their respective supervisory agencies—the Federal Reserve, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, or the Department of Housing and Urban Development. The Federal Financial Institutions Examination Council (FFIEC) compiles the data and prepares HMDA disclosure statements for covered lenders.

In 1991, the FFIEC collected and tabulated the data for 1990 (almost 6.6 million records) and prepared more than 24,000 individual reports. The reports consist of a series of tables and total more than 1.2 million pages of data. The tables, as many as thirty-one for each metropolitan area in which a lender has offices, display information about loans purchased and about the disposition of loan applications, all by type of loan and geographic location of the property. For loans sold, the tables show the type of secondary market purchaser. The tables also give summaries for six categories of loan applications, showing the disposition of applications by characteristics of the applicant (annual income, race or national origin, and sex) and by characteristics of the neighborhood in which the property related to the loan application is located (median family income and percentage of the population that belongs to a minority group).

HMDA disclosure statements are available to the public from the lender. The FFIEC also prepares aggregate reports that show the overall home lending picture among all reporting lenders in each of the nation's 341 metropolitan areas; these reports, and copies of the individual reports, are available at a data depository in each metropolitan area.

In addition, the FFIEC provides edited raw data on magnetic tape, giving community groups, researchers, and others access to a larger body of data for analysis of lending patterns than was possible under the old system. Because of the massive volume of the HMDA data, however, analysis can be complicated and time-consuming. In September the Board hosted a meeting with community representatives to identify ways in which the data might be com-

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piled and loaded onto diskettes to make its use on personal computers feasible for local groups. In October the Board and the other HMDA agencies took part in a forum organized to explore the feasibility of making the data available through alternative automated means.

The expanded HMDA reports for 1990 became public in October 1991. They received considerable attention from the news media because of substantial differences in the dispositions of loan applications when applicants were categorized by race and income. In particular, the data revealed that the percentage of rejected home loan applications was much larger for black and Hispanic applicants than for white and Asian applicants. The data raised concerns about access to home mortgage credit among minority applicants and about unlawful discrimination in the lending process. They also raised questions about the performance of lenders in meeting their obligations under the Community Reinvestment Act.

The HMDA data are subject to an important limitation, however: They do not include the wide range of financial factors—about the applicants and the properties they seek to purchase—that lenders consider in evaluating loan applications. For example, the HMDA data do not contain information about applicants' debt and asset levels, employment experience, or credit history. Thus, it is not possible to determine from the HMDA data alone whether individual institutions or groups of lenders are discriminating unlawfully against minority applicants.

Because the agencies have access to application files and institutions' lending standards, they can largely overcome this limitation in examining lenders' actions. With the expanded data, the agencies will be able to evaluate more thoroughly lenders' compliance not just with fair lending laws but also with community reinvestment obligations. To facilitate statistical analyses, the agencies are developing computer-based systems that will help them identify specific groups of applicants for whom the application-disposition rates are significantly different from those of other groups. They can thereby target specific files for in-depth review.

In November the Board published changes to Regulation C that become applicable in January 1992. The major change requires financial institutions to use 1990 census tract numbers, rather than the 1980 numbers, to identify and report property locations. In many communities demographics have changed dramatically since the time of the 1980 census, and use of the 1990 census tracts will make the HMDA data more accurate and useful. The Board also amended Regulation C to make clear that institutions are subject to civil money penalties for violations of HMDA reporting requirements. Changes to the reporting instructions emphasized that institutions are expected to submit their HMDA data in automated format (unless they report only a small number of transactions) to improve the accuracy and timeliness of reports.

An article in the November 1991 *Federal Reserve Bulletin* described analytical studies based on the geographic data available under the old reporting system, and it presented preliminary numbers drawn from nationwide aggregates of the 1990 data while sounding some cautions about the limitations of the data.[1] The article discussed potential uses of the expanded data, with a focus on the supervisory agencies, and took

1. See Glenn B. Canner and Dolores S. Smith, "Home Mortgage Disclosure Act: Expanded Data on Residential Lending," *Federal Reserve Bulletin*, vol. 77 (November 1991), pp. 859–84.

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a look at an area newly covered by HMDA—sales of home loans to the secondary mortgage market.

Regulation E (Electronic Fund Transfers)

The Board began a comprehensive review of Regulation E, with major emphasis on the law's applicability to electronic systems used by government agencies for delivery of benefits.

Regulation E, which implements the Electronic Fund Transfer Act, established rights and responsibilities for consumers and providers of electronic transfer services. Among the consumer rights are the right to disclosure of terms and conditions, to receipts and periodic statements, to error resolution within specified periods, and to limits on the consumer's liability for unauthorized transfers. The statute's coverage extends to any entity that provides EFT services to consumers, not just traditional financial institutions such as banks.

The comprehensive review is in keeping with Federal Reserve policy that calls for a periodic look at Board regulations. It has centered on identification of substantive changes needed because of technological and other developments. A rewriting of the official staff commentary is also under way.

The Board's consideration of the applicability of Regulation E to systems for electronic delivery of government benefits arises from a statutory mandate. In the event that EFT services are offered by nonfinancial institutions, the statute directs the Board to ensure that rights and responsibilities created by the act are made applicable to these services. Accordingly, during 1991 the Board examined whether Regulation E ought to apply to government agencies' use of electronic benefit transfer (EBT) as an alternative to paper-based delivery. EBT offers opportunities for improving delivery to recipients, maximizing efficiency of operations, and over time, minimizing costs for all parties.

To date, the Board has refrained from covering EBT in Regulation E so as not to impede pilot programs being tested by federal and state agencies. This result has been achieved by narrowly defining what constitutes an "asset account" for purposes of coverage.

In prescribing rules, the Board is directed by the statute to consider their effect on the availability of EFT services to different groups of consumers, particularly low-income consumers. The Board also must take into account costs and benefits to all parties and demonstrate, to the extent practicable, that the protection accorded consumers outweighs the costs of compliance imposed on consumers and on the providers of the EFT services.

Bringing EBT under the regulation raises questions about who must comply and how exactly to apply the rules. Some existing rules would be easy to apply to EBT; others raise significant policy questions and operational problems, especially in regard to who bears liability for unauthorized use. An article in the April 1991 *Federal Reserve Bulletin* gave an overview of the developing interest in EBT programs among various parties, described some of the pilot programs carried out by federal and state agencies, and discussed regulatory and other issues raised by the implementation of EBT programs.[2]

To ensure adequate attention to the potential effects of Regulation E on EBT

2. John C. Wood and Dolores S. Smith, "Electronic Transfer of Government Benefits," *Federal Reserve Bulletin*, vol. 77 (April 1991), pp. 203–17.

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systems, the Board during 1991 continued to consult with federal and state agencies, financial institutions, the retail food industry and other private-sector participants in EBT systems, the Federal Reserve's Consumer Advisory Council, and consumer advocacy groups. The Federal Reserve joined in discussions with a task force assembled to facilitate the exchange of information between the private and public sectors, and it has maintained close liaison with the Department of the Treasury, which is coordinating efforts among federal agencies in promoting EBT programs.

Any regulatory proposal that results from the review of Regulation E and EBT programs will be published for comment, and members of the public will have the opportunity to give their views.

Regulation Z (Truth in Lending)

In December the Board proposed amendments to Regulation Z on home equity lines of credit. One of the proposals resolves a conflict between the home equity rules and regulations on loans to bank executive officers. A demand provision in loans to executive officers is currently required by the Federal Reserve Act and Regulation O (Loans to Executive Officers), but a demand provision is generally prohibited by the home equity rules of Regulation Z. To resolve the conflict, the Board proposed a limited exception in Regulation Z for transactions involving bank officers.

The balance of the proposed changes respond to issues raised in a lawsuit filed by Consumers Union in 1989 that contested existing rules. The amendments would require lenders to disclose the specific "teaser" or discounted annual percentage rate of interest and to give payment examples for each payment option offered to consumers.[3]

Regulation CC (Expedited Funds Availability)

In February the Board published revisions that conformed Regulation CC to amendments to the Expedited Funds Availability Act (EFAA). The revisions continued—for a period extending from September 1, 1990 through November 27, 1992—the hold schedule for deposits made at nonproprietary automated teller machines (ATMs); the schedule allows banks to hold such deposits for five business days. The Federal Deposit Insurance Corporation Improvement Act of 1991, enacted in December, amends the EFAA by making the Board's temporary rule permanent. The new law also allows banks to extend holds, on an exception basis, on checks that normally require next-day availability and allows one-time notices of exception holds in certain cases. [In early 1992 the Board proposed revisions to Regulation CC to implement these changes.]

Interpretations

In 1991 the Board continued to offer legal interpretations and guidance on Regulation B (Equal Credit Opportunity), Regulation E (Electronic Fund Transfers), and Regulation Z (Truth in Lending) through official staff commentaries. These commentaries, intended to help financial institutions and others apply the regulations to specific situations,

3. The U.S. District Court for the District of Columbia ruled in favor of the Board (No. 89–3008, filed Nov. 1, 1989). On appeal by the plaintiff (No. 90–5156, D.C. Circuit, filed May 2, 1990), the court decided in favor of the Board on four issues and remanded two other issues to the Board for further consideration; the December amendments were in response to this action.

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are updated periodically to address significant questions that arise.

In April the Board revised the commentary to Regulation Z. The revisions addressed a variety of issues such as renewals of home equity lines of credit, credit card substitution, and disclosures for renewable balloon-payment mortgages. In the same month, the Board revised the commentary to Regulation B to clarify the Board's long-standing position that a notice of adverse action need not be provided in instances when a creditor terminates an account or takes other action because of a current delinquency or default on the account.

In December the Board proposed another revision to the commentary on Regulation B. The proposal addresses the relationship between Regulations B and C with regard to data collection on mortgage loan applications received by creditors through brokers or others. It makes clear that loan brokers or other persons do not violate Regulation B (which limits questions about the applicant's race, national origin, and sex) if they collect the information for a creditor that is required to comply with the Home Mortgage Disclosure Act.

Home Mortgage Brochure

In March the Board revised an existing consumer pamphlet, renaming it "Home Mortgages: Understanding the Process and Your Right to Fair Lending." The brochure describes how to shop for a mortgage and what to expect in the application process; it also describes some of the laws that protect home mortgage borrowers—in particular, those laws that prohibit discrimination based on such factors as race or national origin. The brochure explains that creditors cannot take certain personal characteristics into account when considering a mortgage application and provides sources for consumers to contact if they suspect discriminatory practices.

Community Affairs

During 1991, the availability to the public of financial institutions' CRA evaluations and ratings stimulated an increase in requests for information about the Community Reinvestment Act from banks and from neighborhood, housing, small business, and civil rights groups throughout the country. Especially notable was increased interest among officials of local and state governments and development agencies about the CRA and about bank involvement in local community development programs. Community Affairs staff members at the Board and at the Reserve Banks also responded to a large number of requests for information about HMDA and banks' mortgage lending patterns after the release of the expanded HMDA data in October.

Community Affairs educational programs continued their strong focus on bank and bank holding company participation in community development financing for low- and moderate-income housing, small and minority businesses, and community revitalization projects. The Board's Community Affairs staff developed two related publications on community development corporations (CDCs) and investments. *Community Development Investments* describes the Federal Reserve's policies and guidelines governing approval of bank holding company CDCs and other community development equity investment activities. A companion piece, *Directory: Bank Holding Company Community Development Investments*, profiles existing CDCs and investments authorized by the Board.

The number of Community Affairs newsletters published by the Reserve

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Banks grew in 1991 with publication by the Atlanta Reserve Bank of *Partners in Community and Economic Development.* This newsletter highlights CRA-related issues and community development finance partnerships among banks, community organizations, government agencies, and others. It brings to nine the number of Reserve Bank newsletters that address community development. During 1991, these newsletters reached more than 37,300 financial institutions, community organizations, local government officials, and others interested in bank involvement in community development and reinvestment efforts.

The Philadelphia Reserve Bank published *Resources for Revitalization,* a directory of selected government and other public–private programs that financial institutions can use to finance affordable housing, small businesses, and economic development. The New York and Atlanta Reserve Banks created computerized databases with information on community groups, governments, small businesses, and other organizations interested in banking, community development, and CRA-related issues.

To help educate both the public and the banking community about CRA and community development lending, Reserve Banks sponsored 124 Community Affairs conferences and seminars during 1991. In addition, Community Affairs staff members from the Board and the Reserve Banks made more than 315 speeches and presentations at conferences, seminars, and meetings of banking, community, and other organizations on community development, CRA, and related topics.

Reserve Banks developed special programs on rural development issues. The Kansas City Reserve Bank, in cooperation with state bankers associations throughout its District, conducted more than fifty seminars focused largely on CRA and public–private partnership programs that banks can use in financing community development projects in smaller communities. The Chicago Reserve Bank intensified its outreach and education program for rural areas.

During 1991, bank interest in multibank approaches to the financing of community development increased significantly. Community Affairs staff members at the Atlanta and San Francisco Reserve Banks devoted resources to assisting bankers, local governments, and others in structuring multilender consortiums.

A key part of the Community Affairs program during 1991 was CRA and community development training for Federal Reserve consumer compliance examiners. A session on advanced CRA examination techniques became a permanent part of the Board's training curriculum. Community Affairs staff members from the Board and from the Reserve Banks helped familiarize System commercial examiners with the key concepts of community development lending and the objectives of the CRA.

FFIEC Activities

The Federal Financial Institutions Examination Council (FFIEC) is an interagency body that prescribes uniform principles, standards, and report forms for the examination of financial institutions by the federal supervisory agencies. Membership consists of the Board, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

In November the FFIEC approved a policy statement concerning the Fair-

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Credit Reporting Act (FCRA) that addressed prescreening by financial institutions. Credit bureaus often compile lists of consumers who meet the specific credit-granting criteria provided by an institution, and institutions use these prescreened lists to solicit consumers for credit products. The FFIEC policy statement noted that prescreening is permissible under the FCRA if the institution follows certain rules. Prescreening may be conducted if the institution makes a firm offer of credit to each consumer who meets the prescreening criteria. An institution may withdraw such an offer only if a significant change, such as foreclosure or filing for bankruptcy, happens between the prescreen and the consumer's acceptance of the offer.

In December the FFIEC approved a policy statement that encourages financial institutions to analyze the geographic distribution of their lending patterns as a part of their CRA planning process. The FFIEC emphasized that these analyses should be reviewed by the board of directors and appropriate levels of management in setting an institution's CRA programs and its lending policies.

Compliance with Consumer Regulations

Data received 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 Expedited Funds Availability Act declined slightly from 1990 levels and that compliance with the Equal Credit Opportunity Act and the Electronic Fund Transfer Act remained essentially unchanged. This section summarizes these compliance data for the reporting period from July 1, 1990, to June 30, 1991.[4]

Truth in Lending Act (Regulation Z)

The data from the Board, the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) show that, on average, 42 percent of examined institutions were in full compliance with Regulation Z, down slightly from 44 percent in 1990.[5] The FDIC and the NCUA showed increases in compliance, while the Board, the OCC, and the OTS reported declines. Some agencies were able to provide the frequency of violations (the Board, the NCUA, the OCC, and the OTS); these agencies indicated that of the financial institutions examined that were not in full compliance, 53 percent had between one and five violations (the lowest frequency-category), up from 51 percent in 1990.

The most frequent violations of Regulation Z observed by the five regulatory agencies were the failure to disclose accurately the finance charge, the annual percentage rate, and the number, amounts, and timing of payments scheduled to repay the obligation; the failure to provide consumers with notice of their right to rescind certain transac-

4. The federal agencies that regulate financial institutions do not use the same method to compile compliance data. However, the data reported to the Board support the general conclusions presented here.

5. The percentage of institutions in full compliance with the regulations included in this report is calculated using a straight average of the percentage of institutions in compliance as reported by the five financial regulatory agencies. The figures reported for previous years were calculated using a weighted average.

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tions; and the failure to provide Truth in Lending disclosures that accurately reflected the terms of the legal obligation.

The Board, the FDIC, and the OTS each issued one cease and desist order involving violations of Regulation Z. The OTS also assessed civil money penalties against two savings associations. The OCC issued notice of charges to two banks for violations of Regulation Z. One bank reimbursed customers and the other has appealed to the U.S. Court of Appeals. Under the Interagency Enforcement Policy on Regulation Z, a total of 379 institutions supervised by the Board, the FDIC, the OCC, and the OTS refunded to customers about $5.7 million on 26,796 accounts in 1991 compared with roughly $4.5 million on 52,344 accounts in 1990.

The Federal Trade Commission (FTC) continued its Truth in Lending enforcement program and obtained relief in three cases involving understated annual percentage rates (APRs). The FTC accepted for public comment two consent agreements addressing understated credit costs including APRs. The FTC also issued an order involving a nationwide mortgage lender that disclosed understated APRs for its adjustable-rate mortgages.

Educating consumers and businesses about their rights and responsibilities continued to be an integral part of the FTC's enforcement activities. In this effort, the FTC released a publication on fraudulent automobile financing practices and is developing a publication on reverse mortgages.

The Department of Transportation reported a satisfactory level of compliance with Regulation Z by foreign and domestic carriers. Consumer inquiries that were investigated resulted in no formal enforcement proceedings for violations.

The Farm Credit Administration (FCA) reported that violations had increased more than 31 percent from the 1990 reporting period. As a result of examinations and enforcement activities, the FCA took formal enforcement actions against four institutions for violations of Regulation Z or Regulation B or both. These institutions are now in substantial compliance with the regulations.

The Packers and Stockyards Administration of the Department of Agriculture received no complaints and initiated no enforcement actions. Individuals and firms regulated by the Administration are believed to be in substantial compliance.

Consumer Leasing (Regulation M)

The five financial regulatory agencies reported substantial compliance with Regulation M, which implements the consumer leasing provisions of the Truth in Lending Act. More than 99 percent of examined institutions were found to be in full compliance with the regulation. The violations that were noted by the agencies involved the failure to provide disclosures clearly, conspicuously, in a meaningful sequence, and in accordance with the regulation.

Equal Credit Opportunity Act (Regulation B)

The five financial regulatory agencies reported that compliance with Regulation B remained similar to levels in 1990. In the 1991 reporting period, 58 percent of examined institutions were in compliance with the ECOA compared with 57 percent for 1990. The four agencies that were able to provide the frequency of violations (the Board, the NCUA, the OCC, and the OTS) reported that of the institutions examined that were not in full compliance, 73 percent

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had between one and five violations, a rate similar to that for 1990. The most frequent violations involved the failure to take the following actions:

- Notify the applicant of the action taken within thirty days of the date that the creditor receives a completed application
- Provide a written notice of adverse action that contains a statement of the action taken, the name and address of the creditor, the ECOA notice, and the name and address of the federal agency that enforces compliance
- Provide the specific reasons for adverse action
- Follow the prescribed form of the ECOA notice
- Request information, for monitoring purposes, about race or national origin, sex, marital status, and age on credit applications for the purchase or refinancing of a primary dwelling.

The Board and the FDIC each issued one cease and desist order that addressed violations of Regulation B.

The FTC obtained consent judgments before litigation in two cases involving practices in violation of the ECOA. One other case previously filed in federal court was resolved by a consent judgment. Litigation continues in another case previously filed.

The FCA reported a satisfactory level of compliance with the ECOA. As a result of examinations and enforcement activities, the FCA took formal enforcement actions against four institutions for violations of Regulation Z or Regulation B or both. These institutions are now in substantial compliance. The total number of ECOA violations decreased 14 percent from 1990 levels. The other agencies that enforce the ECOA—the Department of Transportation, the Interstate Commerce Commission, the Small Business Administration, the Packers and Stockyards Administration of the Department of Agriculture, and the Securities and Exchange Commission—reported substantial compliance among the entities they supervise.

Electronic Fund Transfer Act (Regulation E)

The five financial regulatory agencies found that, at 84 percent, the level of compliance with Regulation E remained similar to that in 1990. The following five rules were the most frequently violated provisions of Regulation E:

- Provide, in a timely manner, a written statement outlining the terms and conditions of the EFT service
- Provide a summary of consumers' liability for unauthorized EFTs
- Provide a statement for each monthly cycle in which an EFT occurred or at least a quarterly statement if no transfer occurred
- Provide a periodic notice of the procedures for resolving alleged errors
- Investigate and resolve alleged errors promptly.

A cease and desist order issued by the FDIC covered violations of Regulation E in addition to violations of Regulations B and Z.

The Federal Trade Commission reported ongoing litigation with one telemarketing company that allegedly failed to obtain written authorization from consumers for preauthorized transfers.

Expedited Funds Availability Act (Regulation CC)

The five financial regulatory agencies reported that the level of compliance with Regulation CC declined from 76 percent in the 1990 reporting period to 73 percent. The four agencies that were able to provide the frequency of violations (the Board, the NCUA, the

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OCC, and the OTS) reported that of the institutions examined that were not in full compliance, 76 percent had between one and five violations. The five most frequent violations of Regulation CC were the failure to

• Provide next-day availability for required items

• Provide a specific disclosure of the availability policy followed by the institution in most cases

• Adequately train employees and provide procedures to ensure compliance

• Post the availability policy at locations where employees accept deposits

• Provide the deposit availability notice on preprinted deposit slips.

A cease and desist order issued by the Board covered violations of Regulation CC in addition to violations of Regulations B and Z.

Community Reinvestment Act (Regulation BB)

The Community Reinvestment Act (CRA) requires the Board to encourage financial institutions under its jurisdiction to help meet the credit needs of their entire communities, including low- and moderate-income neighborhoods, in a manner consistent with safe and sound banking practices. The Board assesses the CRA performance of state member banks during regular compliance examinations and takes the CRA record into account, along with other factors, when acting on applications from state member banks and bank holding companies.

The Federal Reserve System maintains a three-faceted program for enforcing and fostering better bank performance under the CRA:

• Examination of institutions to assess compliance

• Dissemination of information on community development techniques to bankers and the public through Community Affairs offices at the Reserve Banks

• CRA analyses of the records of banks and bank holding companies submitting an application for expansion or reorganization.

Federal Reserve examiners review performance in fair lending, community revitalization, and other relevant areas to assess CRA compliance. During the 1991 reporting period, they examined 651 state member banks for compliance with the consumer laws, including those that address fair lending, and examined 637 state member banks for compliance with the CRA. When appropriate, examiners suggested ways to improve CRA performance.

The 1991 reporting period is the first that includes information on public CRA ratings. Sixty-three banks received an outstanding rating for meeting community credit needs, 516 received a satisfactory rating, 52 received a rating of "needs to improve," and 6 received a rating of "substantial noncompliance." In June the Board amended Regulation BB to clarify that state member banks may respond to their CRA evaluations and place their responses in the public file but are not required to do so. In December the Board announced that, in keeping with an FFIEC recommendation, it will publish weekly the CRA examination ratings of state member banks.

During calendar year 1991, adverse CRA ratings were at issue in thirty-one bank and bank holding company applications received by the Federal Reserve System, down from forty-two in both 1990 and 1989. The number of applications that generated protests because of CRA performance declined from twenty-seven in 1990 to twenty-four in 1991. Three of the protested applications—the request of Mitsui Taiyo Kobe Bank to convert a trust com-

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pany into a bank, NCNB Corporation's acquisition of C&S/Sovran Corporation, and the merger of Chemical Banking Corporation with Manufacturers Hanover Corporation—involved numerous protests. In the Mitsui case, the Board held a public hearing at which about 20 individuals and groups testified; the application was later withdrawn. The Board received more than 150 comments regarding the NCNB and C&S/Sovran application, and it held public meetings in four cities—Atlanta, Dallas, Richmond, and Charlotte—at which more than 100 witnesses testified; the Board approved the application in December. The Board approved the Chemical–Manufacturers application in November.

In October the Board considered a 1990 application by First Interstate BancSystem of Montana, Inc., to merge with Commerce BancShares of Wyoming, Inc. The application was protested by a community organization. The Board denied the application based solely on deficiencies in the CRA record of a subsidiary of First Interstate.

At year-end, eighteen protested applications had been approved and six applications were pending.

Economic Effects of the Electronic Fund Transfer Act

In accordance with statutory requirements, the Board monitors the effect of the Electronic Fund Transfer Act on the compliance costs and consumer benefits from EFT services. In 1991, there were no new requirements or changes in the regulation that altered the economic effect of the act.

The act covers a large number of accounts and financial institutions. In 1991, about three-fourths of all households in the United States had one or more EFT features on accounts at financial institutions. About two-thirds of all depository institutions offered EFT services and were covered by the act. The economic effect of the act increased in 1991 as a result of continued growth in the availability and use of EFT services.

Automated teller machines are the most widely used EFT service in the United States. Most of the nation's banks and thrift institutions offer ATM services to consumers, and more than half of all households currently have access cards for ATMs. The availability of ATM services has been enhanced by the development of shared networks. Virtually all ATM terminals in operation today are part of one or more shared networks. The monthly number of ATM transactions increased about 13 percent, from 474.9 million in 1990 to 534.9 million in 1991. Over the same period, the number of installed ATMs rose about 3 percent.

Point-of-sale (POS) systems account for a small fraction of all EFT transactions, but their use grew rapidly in 1991: POS volume rose 23 percent, to 19.5 million transactions per month; and the number of POS terminals rose 28 percent, to 77,700. Direct deposit is another widely used EFT service. More than 40 percent of all U.S. households receive direct deposit of funds into their accounts. Direct deposit is particularly widespread in the public sector, with about half of social security payments and two-thirds of federal salary and retirement payments made by direct deposit. Although direct deposit is less common in the private sector, it has grown substantially in recent years.

The benefits to consumers from the Electronic Fund Transfer Act are difficult to measure because they cannot be isolated from consumer protections that would have been provided in the absence of regulation. The available evidence provides no indication of serious

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consumer problems with electronic transactions. One source of information on potential problems is the Board's Consumer Complaint Control System. In 1991, sixty-nine of the complaints processed involved electronic transactions. The Federal Reserve System forwarded thirty-six complaints that did not involve state member banks to other agencies for resolution. Of the remaining thirty-three complaints, none involved a violation of the act or regulation.

The Board also obtains information about potential problems from consumer surveys. The University of Michigan's December 1990 Survey of Consumer Attitudes contained several Board-sponsored questions about consumer experience with EFT. The survey results suggest that EFT problems are relatively infrequent and that the vast majority of problems that do occur are resolved satisfactorily. Of the households that had accounts with EFT features, 7.5 percent reported experiencing EFT errors in the previous twelve months. This percentage is about the same as that reported in surveys from 1981 and 1983. In 1990, 88.0 percent of those experiencing problems complained to the institution about the error, and 87.8 percent of the complainants reported that the error was resolved to their satisfaction.

The incremental costs associated with the EFTA are also difficult to quantify, again because the industry practices that would have evolved in the absence of statutory requirements are unknown. Cost estimates from 1981 suggested that the ongoing compliance cost of an electronic transaction was not high enough to compromise the cost advantage of such transactions over check-based transactions. Since that time, few changes have been made in the regulation, and an increase in transaction volume has allowed financial institutions to exploit economies of scale in compliance costs. Thus, the regulation is not likely to have any greater effect on EFT costs now than it had in 1981.

Utility of the New HMDA Data

The new data available under the Home Mortgage Disclosure Act, beginning with the year 1990, offer expanded opportunities for analysis of lending patterns in metropolitan areas. The new data enhance the regulatory agencies' ability to assess lender performance in a number of ways.

Before 1990, data required by the Home Mortgage Disclosure Act revealed only the geographic distribution of residential lending by institutions covered by the act. These data could be used to help evaluate the extent to which reporting institutions were serving the housing needs of their local communities. The usefulness of the data was limited, however, providing little information about the demand for credit arising from different geographic areas or about the demand faced by individual lenders.

The expanded disclosures, mandated by statutory amendments enacted in 1989, now include the disposition of applications—approved, denied, withdrawn, or files closed for incompleteness—and the number and dollar amount of loan applications. These data provide specific information on credit demand among individual lenders and groups of creditors serving different neighborhoods. The information substantially enhances the ability to evaluate the residential lending activities of covered institutions, including the conventional and FHA lending of independent mortgage companies.

The expanded disclosures also will help the supervisory agencies to better assess the CRA performance of the institutions they regulate. The agencies can examine an institution's record to deter-

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mine how its lending performance compares with the record of other lenders serving the same locality. If peer lenders report a significantly greater number of applications and home mortgages, the comparison may suggest that the institution needs to focus greater attention on determining and meeting community credit needs, by reexamining its marketing and outreach programs and the mix of its loan products. Alternatively, if peer lenders also receive few applications for home loans, weak demand in the locality might explain the lack of lending activity. A general lack of applications may also indicate, however, that outreach efforts and marketing among all lenders are ineffective or inadequate to reach the community.

The new HMDA data also can be used to assess whether a lender has established a reasonable CRA community delineation. Although many factors affect a lender's choice of the primary service area it seeks to serve, analyses of HMDA data can help determine whether the distribution of home loan applications received by a lender is consistent with this geographic delineation. If most of a lender's applications for home purchase loans come from outside its service area, examiners may question why it is not receiving more applications from its delineated community and whether the existing delineation is reasonable. The lender might need to reconsider and perhaps revise the boundaries of the area it seeks to serve.

The added data now disclosed about loan applicants—their race or ethnic origin, sex, and income—provides an opportunity for insight into the provision of home purchase and home improvement loans to certain categories of consumers. The agencies that supervise depository institutions will use this information, together with data on the disposition of applications, in assessing the fairness of the mortgage lending process. HUD also will use the data to assess methodologies for targeting and conducting fair lending investigations under the Fair Housing Amendments Act of 1988. The HMDA data alone will not suffice for determining whether a lender is discriminating unlawfully against minority mortgage applicants, principally because the data do not include the wide range of financial factors that lenders consider in evaluating loan applications. Because the agencies have access to application files and institutions' lending standards, however, they can overcome most of the limitations when examining lenders' actions.

The data will be useful to financial institutions in developing strategies and programs to respond to the credit needs of the various segments of their communities. Such analyses were not fully possible before the 1990 HMDA data became available.

The 1989 amendments to HMDA also require lenders to report the type of secondary market purchaser for home loans that they sell during the year. The legislative history suggests that the Congress sought the new information to help identify any secondary market requirements that may have a discriminatory effect on protected groups. The HMDA data provide an opportunity for the first time to profile, for loans covered by HMDA, the characteristics of both the borrowers whose loans are purchased by secondary market entities and the neighborhoods in which they reside. In addition, the information permits an assessment of the distribution of home purchase and securitization activity of secondary market institutions. In its oversight capacity, HUD plans to make use of the 1990 data to assess the adequacy of secondary market allocations for central areas of cities and for low- and moderate-income households.

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Some uses of the HMDA data will build on information available from other sources. For example, HUD plans to enter into research contracts that will assess the allocation of FHA and conventional lending to a sample of metropolitan areas. This lending data will be combined with recent information on loan defaults linked to census tract attributes to provide a more complete description on the volume and characteristics of areas served by FHA and conventional lending.

Complaints about State Member Banks

The Federal Reserve investigates complaints against state member banks, and the Board forwards to appropriate enforcement agencies those that involve other creditors or businesses. In 1991 the Board implemented an on-line system for tracking consumer complaints and inquiries.

In 1991, the Federal Reserve received 2,398 complaints: 1,912 by mail, 471 by telephone, and 15 in person. The Federal Reserve investigated and resolved the 891 that were against state member banks (see accompanying table). The Board also received 282 written inquiries concerning consumer credit laws and banking practices. In responding to these complaints and inquiries, staff members of the Board and of the Reserve Banks gave specific explanations of laws, regulations, and banking practices and provided relevant printed materials.

A second table summarizes the nature and resolution of the 891 complaints against state member banks. About 55 percent involved loan functions, 7 percent alleged discrimination on a prohibited basis, and 48 percent concerned credit denial on nonprohibited bases (such as length of residency) and other unregulated lending practices (such as the disclosure of the amount of appraisal fees). About 29 percent involved disputes concerning interest on deposits and general practices involving deposit accounts.

Unregulated Practices

In 1991 the Board continued to monitor, under section 18(f) of the Federal Trade Commission Act, complaints about

Consumer Complaints Received by the Federal Reserve System, by Subject, 1991

Subject	State member banks	Other lenders	Total
Regulation B (Equal Credit Opportunity)	59	57	116
Regulation E (Electronic Fund Transfers)	33	36	69
Regulation Q (Interest on Deposits)	18	34	52
Regulation Z (Truth in Lending)	93	259	352
Regulation BB (Community Reinvestment)	1	6	7
Regulation CC (Expedited Funds Availability)	25	53	78
Fair Credit Reporting Act	12	83	95
Fair Debt Collection Practices Act	7	13	20
Fair Housing Act	0	1	1
Flood Disaster Protection Act	1	0	1
Real Estate Settlement Procedures Act	1	5	6
Holder in due course	0	1	1
Unregulated practices [1]	641	959	1,600
Total	**891**	**1,507**	**2,398**

1. Complaints against nonmember institutions were referred to the appropriate regulatory agencies.

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banking practices that are not subject to existing regulations to focus on those that may be unfair or deceptive. Two categories each accounted for 5 percent or less of the 1,600 complaints: denial of credit card applications based on credit history (59) and miscellaneous practices (74). Complaints about credit denials based on credit history indicate that applicants underestimate the importance lenders give to a poor credit history or a lack of borrowing experience when assessing creditworthiness. The miscellaneous complaints covered a wide variety of practices, including a lender's failure to close on a mortgage loan by the agreed settlement date, the amount a bank charged for an appraisal fee, and a bank's refusal to make change for a nondepositor.

Consumer Advisory Council

The Consumer Advisory Council (CAC) met in March, June, and October to advise the Board on its responsibilities under the consumer credit protection laws and on other issues dealing with financial services to consumers. The council's thirty members come from consumer and community-based organizations, financial institutions, academia,

Consumer Complaints Received by the Federal Reserve System, by Function, Institution, and Resolution, 1991

Type of institution and resolution	Total	Function					
		Loans		Deposits	Electronic fund transfers	Trust services	Other
		Discrimination	Other				
Complaints about state member banks, by type							
Insufficient information[1]	34	2	14	9	2	0	7
Information furnished to complainant[2]	120	16	62	25	2	1	14
Bank legally correct							
No accommodation	342	26	172	93	14	10	27
Accommodation made[3]	125	4	65	42	4	2	8
Clerical error							
No correction made	37	1	16	12	2	1	5
Corrected	59	1	23	17	5	1	12
Factual dispute[4]	43	2	13	18	1	3	6
Bank violation, resolved[5]	6	1	2	2	0	0	1
Matter in litigation[6]	9	0	5	2	0	0	2
Customer error	12	2	6	4	0	0	0
Pending, December 31	104	8	49	34	3	0	10
Total, state member banks	891	63	427	258	33	18	92
Percent	100	7	48	29	4	2	10
Complaints about nonmember institutions[7]	1,507	68	834	351	36	11	207
Total	**2,398**	**131**	**1,261**	**609**	**69**	**29**	**299**

1. The staff has been unable, after follow-up correspondence with the consumer, to obtain sufficient information to process the complaint.

2. When it appears that the complainant does not understand the law and that there has been no violation on the part of the bank, the Federal Reserve System explains the law in question and provides the complainant with other pertinent information.

3. The bank appears to be legally correct but has chosen to make an accommodation.

4. Involves a factual dispute not resolvable by the Federal Reserve System or a contractual dispute that can be resolved only by the courts. Consumers wishing to pursue the matter may be advised to seek legal counsel or legal aid or to use small claims court.

5. The Federal Reserve determined that a state member bank violated a law or regulation, and the bank took corrective measures voluntarily or as indicated by the Federal Reserve.

6. Parties are seeking resolution through the courts.

7. Complaints referred to other agencies.

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and state and local government. Council meetings are open to the public.

In 1991 the council considered proposed banking reform, data collected under the Home Mortgage Disclosure Act, issues related to the feasibility of using testers to detect racial discrimination in mortgage lending, and other matters.

In March the council considered the main elements of Treasury Department recommendations for changes in the deposit insurance system and reform of the banking laws. Members supported the idea of better, publicly available information on the financial condition of institutions to help large corporate depositors and sophisticated customers to apply market discipline to encourage safe bank investments. Many believed, however, that it is unrealistic to expect the average consumer to similarly use that information in choosing depository institutions.

Members of the council's committee on depository and delivery systems accepted, with some reluctance, the need for the "too-big-to-fail" doctrine as a way to protect the integrity of the banking system. They indicated, however, that deposit insurance premiums should be adjusted to reflect the actual risks to the insurance funds and that small institutions should not indirectly fund the costs associated with preventing the large ones from failing.

In October 1990 the council had asked the Board for a feasibility study on the possible use of testers to detect unlawful discrimination in mortgage lending. In February 1991 the Board approved the preparation of that study by staff members in the Divisions of Consumer and Community Affairs and of Research and Statistics. The study, presented at the council's June meeting, focused on several areas: ethical concerns expressed by Board members about the testing technique; perceptions about racial discrimination and its costs in social terms; questions about the potential effectiveness of testing in the mortgage lending area; and cost considerations.

The council debated the issues and adopted a resolution recommending that the Board, along with the other banking agencies and the Department of Housing and Urban Development, fund a research project that would define the way testing could be used to investigate unlawful mortgage lending practices.

The Board considered the council's testing recommendation in September and decided not to pursue the program. Its decision, conveyed to the council in October, was based on concerns about the validity of testing in the mortgage credit area, its substantial cost, and the use of deception by the government. The Board emphasized that, although it has chosen not to undertake a testing project, it continues to be concerned about the reported disparities in mortgage lending when applicants are grouped by race. Besides working on more sophisticated examination procedures to detect discrimination, the Board has directed the staff to explore other promising methods to address discrimination issues. The Board also is planning to use nationwide surveys to learn more about consumer experience in seeking mortgage loans, and it is working with the Department of Justice and other agencies in identifying ways to address fair lending concerns.

During the year, the council also considered the following issues:

• The functioning of the new CRA public disclosure process, focusing on public access to the evaluations, the examination process, and the usefulness of information contained in the evaluations

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- Possible effects of electronic benefit transfer programs on recipients of public assistance
- Referral practices among real estate brokers who market and originate mortgage loans for various lenders.

A roundtable discussion among members of the council and Board members, known as the Members Forum, gave council members the opportunity to offer their views on a variety of other topics. During 1991 the council discussed matters such as the level of, and ways to improve, consumer confidence in the banking system and the current availability of commercial and real estate credit in their local markets.

Testimony and Legislative Recommendations

The Board testified on credit card issues and disclosures related to deposit accounts.

Regional Evaluation of Credit Card Holders

The Board testified in April before a House banking subcommittee on the manner in which financial institutions evaluate the creditworthiness of cardholders. The hearing was prompted by a bank credit card issuer's evaluation of customers in a nine-state region in which bankruptcy filings had increased significantly. The bank applied a credit-scoring model to evaluate cardholders who had been delinquent in payments over the previous fourteen months or had exceeded their credit limit. The bank then closed or reduced the credit limit on accounts perceived to pose a risk of loss.

The Board favored a flexible regulatory stance to allow geographic evaluation of credit card portfolios if certain regions show signs of economic distress. The Board noted that although most institutions do not base special reviews on residency, more banks may follow this course of action if pockets of the country continue to decline economically. Such reviews may benefit card issuers but may create hardship for consumers who have their credit reduced or eliminated.

The Equal Credit Opportunity Act, implemented by the Board's Regulation B, prohibits creditors from discriminating against credit applicants or existing customers because of factors such as race, color, religion, sex, or marital status. The law does not prohibit the review of cardholders based on their residency. If a creditor decides not to grant credit to an applicant or reduces credit to a nondelinquent consumer, however, it must notify the consumer and give the reasons. Furthermore, the Fair Credit Reporting Act mandates that if a creditor makes a negative decision based on information contained in a report from a credit bureau, the creditor must so advise the consumer and furnish the name and address of the credit bureau. If information in the report is incorrect, the consumer has the right to an investigation and the correction of any inaccuracies. The bank's practices, on which the hearing focused, included proper notification.

Credit and Charge Card Legislation

In October the Board testified before a House banking subcommittee on proposed amendments to the Truth in Lending Act that would require additional disclosures and would grant substantive rights to consumers when creditors change certain terms. In addition, the Board reported on the credit card industry and gave possible reasons why credit card interest rates have not fallen along with the lenders' cost of funds.

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The Board believes that the existing law provides adequate disclosure to consumers on the costs associated with credit and charge card accounts. The Board acknowledged the value of disclosure but noted that the pending legislation would greatly burden the industry with more compliance costs without meaningful benefit to consumers.

Although the Truth in Lending Act is primarily a disclosure statute, the proposed legislation sought to grant consumers a substantive right to close their accounts and pay off existing balances according to the original terms if the creditor changed certain terms, such as the annual percentage rate. The Board believes that substantive laws of this type remain within the domain of state law.

The Board commented on the credit card industry generally. In recent years, the profitability of credit card operations has been increasing. As profits climb, so does competition—in the form of low or no annual fees, increased credit limits, the addition of special features to the card plans, and the entry of new firms into the market.

The Board noted the concerns of some that credit card interest rates have not tracked the decline of creditors' cost of funds but observed that the interest rate is only one component of credit card pricing. Other components include annual fees, grace periods, and credit limits. When funding costs change, creditors may choose to modify these other components rather than the interest rate. The Board also suggested that creditors may lack the incentive to lower interest rates because many consumers will not change creditors even if they must pay more to maintain their accounts. To obtain a new credit card, a consumer must often incur fees, expend time and effort, and risk a rejection. With these costs and risks in mind, many consumers elect to keep their current cards and pay the higher rates.

Truth in Savings

The Board testified in May before a House banking subcommittee on proposed truth in savings legislation that called for depository institutions to disclose certain information about consumer deposit accounts. The Federal Deposit Insurance Corporation Improvement Act, adopted in December, includes provisions from the earlier proposals. The new law mandates detailed rate and fee information in advertisements and account schedules and requires depository institutions to inform account holders when terms are changed, all of which will allow consumers to more readily compare the costs of deposit accounts. The Board expects to propose rules in early 1992 to implement the law.

Recommendations of Other Agencies

Each year the Board asks those agencies that have enforcement responsibilities under Regulations B, E, M, Z, and CC for recommended changes to the regulations or the underlying statutes. The FDIC has recommended revising Regulation B to require a specific notice informing consumers who were denied credit that they should contact the financial institution rather than the institution's regulatory agency if they have questions. ■

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Litigation

During 1991, the Board of Governors was named in twenty-seven lawsuits, the same number as in 1990. Eleven new lawsuits were filed in 1991, five of which raised questions under the Bank Holding Company Act. As of December 31, 1991, eleven cases were pending, six of which involved questions under the Bank Holding Company Act.

Bank Holding Companies—Antitrust Actions

In *United States v. First Hawaiian, Inc.*, No. 90-00904 (D. Hawaii, filed December 28, 1990), the Department of Justice challenged the acquisition by First Hawaiian, Inc., a Hawaiian bank holding company, of First Interstate of Hawaii, Inc., under the antitrust laws. The Board had approved the transaction on November 30, 1990 (77 *Federal Reserve Bulletin* 52). The case was settled.

In *United States v. Fleet/Norstar Financial Group, Inc.*, No. 91-0219-P (D. Maine, filed July 5, 1991), the Department of Justice challenged the acquisition by Fleet/Norstar Financial Group, a bank holding company, of the New Bank of New England, N.A., and New Connecticut Bank & Trust Company, N.A., under the antitrust laws. The Board had approved the transaction on July 1, 1991 (77 *Federal Reserve Bulletin* 750). The case was settled.

Bank Holding Company Act—Review of Board Actions

In *Synovus Financial Corporation v. Board of Governors*, No. 89-1394 (D.C. Circuit, filed June 21, 1989), petitioner sought review of a Board order dated May 22, 1989, approving the application of SouthTrust Corporation to acquire a national bank in Georgia by relocating an Alabama national bank subsidiary across state lines pursuant to 12 U.S.C. §30 (75 *Federal Reserve Bulletin* 516). On December 20, 1991, the Court of Appeals held that the Board has no authority over interstate relocations and vacated the Board's order.

In *Babcock and Brown Holdings, Inc. v. Board of Governors*, No. 89-70518 (9th Circuit, filed November 22, 1989), petitioners sought review of a Board order dated October 25, 1989, in which the Board requested the Federal Deposit Insurance Corporation to condition deposit insurance for a proposed District of Columbia bank on Board approval of the acquisition of control of the bank by Babcock and Brown Holdings, Inc., a brokerage firm. On April 7, 1991, the court dismissed the case as moot (931 F.2d 59).

In *Kaimowitz v. Board of Governors*, No. 90-3067 (11th Circuit, filed January 23, 1990), petitioner, raising issues under the Community Reinvestment Act, sought review of a Board order dated December 22, 1989, approving an application by First Union Corporation to acquire Florida National Banks (76 *Federal Reserve Bulletin* 83). On August 27, 1991, the Court of Appeals ruled that the petitioner lacked standing to bring the action (940 F.2d 610).

In *Citicorp v. Board of Governors*, No. 90-4124 (2nd Circuit, filed October 4, 1990), petitioner sought review of a Board order requiring Citicorp to terminate certain insurance activities by a nonbank subsidiary of Citicorp's subsid-

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iary bank in Delaware (76 *Federal Reserve Bulletin* 977). On June 10, 1991, the Court of Appeals vacated the Board's order (936 F.2d 66). The petition for certiorari was denied on January 13, 1992 (No. 91–587).

In *First Interstate BancSystem of Montana, Inc. v. Board of Governors*, No. 91–1525 (D.C. Circuit, filed November 1, 1991), petitioner seeks review of a Board order dated October 7, 1991, denying on Community Reinvestment Act grounds petitioner's application under section 3 of the Bank Holding Company Act to merge with Commerce Bancshares of Wyoming, Inc. (77 *Federal Reserve Bulletin* 1007). The case is pending.

Litigation under the Financial Institutions Supervisory Act

In *MCorp v. Board of Governors*, No. 90–913 (U.S. Supreme Court, petition for certiorari filed December 10, 1990), the Board appealed a preliminary injunction entered by the district court enjoining pending and future enforcement actions against a bankrupt bank holding company (101 Bankr. 483, S.D. Texas 1989). On May 15, 1990, the Fifth Circuit Court of Appeals vacated the injunction in part and affirmed it in part (900 F.2d 852). On December 3, 1991, the Supreme Court affirmed the Court of Appeals' vacating of part of the injunction and vacated the remainder of the injunction. A related case, *MCorp v. Board of Governors* (No. CA3–88–2693, N.D. Texas, filed October 28, 1988), has been stayed for the duration of the preliminary injunction entered by the Southern District of Texas in the above case.

In *Burke v. Board of Governors*, No. 90–9505 (10th Circuit, filed February 27, 1990), petitioners sought review of Board orders assessing civil money penalties and issuing orders of prohibition. On July 31, 1991, the Court of Appeals upheld the Board's orders (940 F.2d 1360).

In *Stanley v. Board of Governors*, No. 90–3183 (7th Circuit, filed October 3, 1990), petitioners sought review of a Board order imposing civil money penalties. On August 15, 1991, the Court of Appeals upheld the Board's order (940 F.2d 267).

In *Board of Governors v. Pharaon*, No. 91–CIV–6250 (S.D. New York, filed September 17, 1991), the Board seeks to freeze the assets of an individual pending administrative adjudication of a civil money penalty assessment by the Board. On September 17 the court issued an order temporarily restraining the transfer or disposition of the individual's assets. The order has been extended by agreement.

In *Board of Governors v. Shoaib*, No. CV 91–5152 (C.D. California, filed September 24, 1991), the Board seeks to freeze the assets of an individual pending administrative adjudication of a civil money penalty assessment by the Board. On October 15 the court issued a preliminary injunction restraining the transfer or disposition of the individual's assets.

In *Greenberg v. Board of Governors*, No. 91–4200 (2nd Circuit, filed November 22, 1991), the petitioner seeks review of a Board order dated October 28, 1991, prohibiting former national bank officials from banking. The case is pending.

In two cases filed under seal in the U.S. District Court for the District of Columbia, two institution-affiliated parties of a bank holding company and state member bank applied, pursuant to 12 U.S.C. 1818(f), for a stay of suspension and prohibition orders against them pending completion of the Board's administrative proceedings. On May 10,

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1991, the Court denied plaintiffs' motion for an injunction.

Other Actions

In *White v. Board of Governors*, No. 88–623 (D. Nevada, filed July 29, 1988), the plaintiff alleged discriminatory practices under the Age Discrimination in Employment Act. The case was dismissed on August 30, 1991.

In *Consumers Union of U.S., Inc. v. Board of Governors*, No. 90–5156 (D.C. Circuit, filed May 2, 1990), appellant appealed a district court decision granting summary judgment for the Board in connection with a challenge to various amendments to Regulation Z implementing the Home Equity Loan Consumer Protection Act. On July 12, 1991, the Court of Appeals affirmed the majority of the district court decision upholding the Board's regulation but remanded two issues to the Board for further action (938 F.2d 266).

In *May v. Board of Governors*, No. 90–1316 (D. District of Columbia, filed June 5, 1990), the plaintiff challenged the Board's response to his requests under the Freedom of Information Act and Privacy Act. On July 17, 1990, the district court granted the Board's motion to dismiss, and plaintiff subsequently appealed (No. 90–5235) to the D.C. Circuit. On May 16, 1991, the court granted the Board's motion for summary affirmance and dismissed the appeal (946 F.2d 1565).

In *Kuhns v. Board of Governors*, No. 90–1398 (D.C. Circuit, filed July 30, 1990), petitioner sought review of a Board order denying a request for attorney's fees under the Equal Access to Justice Act on the grounds that the petitioner had failed to provide reliable financial information establishing his eligibility and that the filing against him had been substantially justified. On April 12, 1991, the Court of Appeals affirmed the Board's decision on both grounds (930 F.2d 39).

In *Rutledge v. Board of Governors*, No. 90–7599 (11th Circuit, filed August 21, 1990), appellant appealed a district court grant of summary judgment in favor of the Board in connection with his challenge to Board and Reserve Bank supervisory actions under several tort theories. The Court of Appeals summarily affirmed the lower court on January 17, 1991 (924 F.2d 1065).

In *Sibille v. Federal Reserve Bank of New York, et al.*, No. 90–CIV–5898 (S.D. New York, filed September 12, 1990), plaintiff sought review of a denial of a Freedom of Information Act request. On July 9, 1991, the district court granted the Board's motion to dismiss.

In *State of Illinois v. Board of Governors*, No. 90–C–6863 (N.D. Illinois, filed November 27, 1990), the State of Illinois filed suit to prevent disclosure of state examination reports provided to the Board under a confidentiality agreement. The documents were the subject of a congressional subpoena. On December 28, 1990, the district court preliminarily enjoined disclosure of the reports. The House Banking Committee appealed (Nos. 90–3824, 91-1048) to the U.S. Court of Appeals for the Seventh Circuit. On June 25, 1991, the court dismissed the case as moot (*Harris v. Board of Governors*, 938 F.2d 720).

In *Fields v. Board of Governors*, No. 3:91CV7069 (N.D. Ohio, filed February 5, 1991), the plaintiff appeals the denial of a request for information under the Freedom of Information Act. The case is pending.

In *Hanson v. Greenspan*, No. 91–1599 (District of Columbia, filed June 28, 1991), the plaintiffs sued for return of funds and financial instruments alleg-

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edly owned by plaintiffs. On December 6, 1991, the district court granted motions to dismiss.

In *In re Smouha*, No. 91–B–13569 (Bkr. S.D. New York, filed August 2, 1991), petitioners—the provisional liquidators of BCCI Holdings (Luxembourg), S.A., and affiliated companies—seek relief under the U.S. bankruptcy code ancillary to foreign liquidation proceedings. On August 15, 1991, the bankruptcy court issued a temporary restraining order staying certain judicial and administrative actions, which has been continued by consent.

In *In re Subpoena Served Upon the Board of Governors of the Federal Reserve System*, No. 91–5428 (D.C. Circuit, filed December 27, 1991), the Board appeals from an order of the D.C. District Court (No. 91–320) ordering the Board to produce bank and bank holding company examination reports of the Fleet/Norstar Financial Group that the Board had sought to protect from disclosure on the grounds of the bank examination and deliberative process privileges. The Board had been subpoened to produce these documents in a shareholder derivative and class action suit pending in the U.S. District Court in Rhode Island against the Fleet/Norstar Financial Group. The case is pending. ■

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Legislation Enacted

In 1991 the Congress passed a bill that requires changes in several areas of bank regulation.

Federal Deposit Insurance Corporation Improvements Act of 1991

Public Law 102–242, the Federal Deposit Insurance Corporation Improvements Act of 1991 (FDICIA), was enacted on December 19, 1991. The following discussion briefly summarizes each of the act's five titles and describes in more detail the portions that bear significantly on the Federal Reserve and the institutions it regulates.

Title I

Title I of the act addresses funding of the Bank Insurance Fund and general safety and soundness questions, providing for improvements in the examination and auditing of insured depository institutions and the accounting standards applicable to these institutions. Title I also provides for prompt corrective action concerning any depository institution that fails to meet certain minimum capital standards; it also generally requires the FDIC, as conservator or receiver, to seek the least-cost resolution of failed depository institutions.

Supervisory Reforms

Under title I, insured depository institutions generally must be examined annually by their primary federal regulator. For state-chartered institutions, state examinations may be substituted in alternate years. A depository institution with less than $100 million in assets that is well-capitalized and was given an outstanding rating during its last examination may be examined once every eighteen months if control has not changed within twelve months of the last examination.

Title I also requires an insured depository institution with assets of more than $150 million to have annual, independent audits, including reports on internal controls and compliance with certain regulatory requirements to be specified by the FDIC. For an insured subsidiary of a bank holding company, this requirement may be met by audits at the holding company level if the insured institutions received a CAMEL rating of 1 or 2 in its most recent examination.[1]

Title I removes provisions of the Federal Deposit Insurance Act that allowed banks to become insured institutions upon receiving a national charter or, for state-chartered institutions, upon becoming members of the Federal Reserve System. All depository institutions now must apply directly to the FDIC to receive deposit insurance.

Accounting Reforms

Title I generally requires that the accounting principles applicable to the reports of insured institutions must be uniform and consistent with generally accepted accounting principles (GAAP). The accounting principles may depart from this requirement if federal banking agencies determine that the application

1. CAMEL is the acronym for a consolidated rating gauging a depository institution's level of capital, asset quality, management, earnings, and liquidity.

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of a particular principle results in financial statements and reports that do not accurately reflect the capital of an institution or do not facilitate supervision and prompt corrective action; alternative accounting principles prescribed by the agencies must, however, be no less stringent than GAAP.

Within a year of enactment of the FDICIA, all federal banking agencies must review all existing reporting and regulatory requirements and modify any that do not appropriately reflect capital and facilitate supervision and corrective action. Uniform accounting standards are to be used by the agencies in determining regulatory compliance by institutions. Each agency also must develop reporting requirements for contingent assets and liabilities and must jointly develop methods for supplemental disclosures of market values of assets.

Title I also requires depository institutions to provide additional reporting on the availability of credit to small businesses and farms.

Prompt Regulatory Action

The FDICIA requires the federal banking agencies to address the financial difficulties of insured institutions with prompt corrective action. Title I establishes categories of capitalization, with the specific ratios to be set by the agencies, and requires successively more stringent regulatory actions as an institution's capital deteriorates. Title I also authorizes the appropriate federal banking agency to downgrade the categorization of an institution it believes to be unsafe and unsound or to be engaged in an unsafe or unsound practice.

Title I requires an undercapitalized institution to file with its federal regulator an acceptable capital restoration plan within a brief time after becoming undercapitalized. Any company having control of the undercapitalized institution must provide a limited guarantee that the institution will comply with the plan until it has been adequately capitalized for four consecutive quarters. An undercapitalized institution may not make acquisitions, establish new branches, or engage in new lines of business unless its plan has been accepted and the proposed action is found to be consistent with the plan. In addition to requiring the institution to raise additional capital, the institution's federal banking agency may also restrict transactions with affiliates, interest rates paid, asset growth, acceptance of interbank deposits, or other activities of the institution; the agency may also require changes in the institution's management and require divestitures by the institution or its parent.

If an institution is significantly undercapitalized, or if it is undercapitalized and has not submitted an acceptable capital plan, the appropriate federal banking agency is required to take one or more of the actions referred to above and may impose additional requirements if necessary. Title I also places restrictions on the compensation of such an institution's management.

Critically undercapitalized institutions generally are prohibited from making any investments, acquisitions, sales of assets, payments on subordinated debt, and other actions without the permission of the FDIC. Within ninety days of the date the institution becomes critically undercapitalized, the appropriate federal banking agency must appoint a conservator or receiver or, with the concurrence of the FDIC, require other action to restore capital. If the institution is critically undercapitalized during the calendar quarter beginning 270 days after the date the institution became critically undercapitalized, the agency must appoint a conservator or receiver unless

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the agency, with the concurrence of the FDIC, determines that the institution is in compliance with its capital plan and other requirements.

If either deposit insurance fund suffers a material loss with respect to an insured institution, title I requires that the inspector general of the institution's federal banking agency review the supervision of the institution, report on the cause of the loss, and recommend ways to prevent such losses in the future.

Title I also requires federal banking agencies to prescribe standards for operations, management, asset quality, earnings, stock valuation, and compensation for all insured depository institutions and depository institution holding companies. It also requires institutions and holding companies that do not meet such standards to submit compliance plans to their regulators.

In order to implement the requirements for prompt corrective action, title I significantly expands the grounds on which a conservator or receiver may be appointed. These provisions give the Federal Reserve Board the authority to appoint the FDIC as receiver for a state member bank after consulting with the appropriate state regulator.

Least Cost Resolution

Title I amends the Federal Deposit Insurance Act to require the FDIC to use the least costly method to resolve its insurance obligations with regard to an insured institution. After 1994, title I will prevent the FDIC from taking any action to protect uninsured depositors or creditors if such action will increase costs to the insurance funds. The FDIC may resolve its obligation to a troubled institution without following the least-cost requirement in limited situations in which the Secretary of the Treasury—upon a recommendation of two-thirds of the Federal Reserve Board and two-thirds of the board of the FDIC—determines that the FDIC's compliance with these provisions would result in serious adverse effects on economic conditions or financial stability that would be avoided by the FDIC's use of other resolution methods. The FDIC is required to recover any additional costs incurred through special insurance assessments.

Title I amends the Federal Reserve Act—effective two years after the enactment of the FDICIA—to limit lending by any Federal Reserve Bank to an undercapitalized institution to sixty days out of any one-hundred-twenty-day period. An exception is provided if the head of the appropriate federal banking agency or the Chairman of the Federal Reserve Board certifies that the institution is viable. The Federal Reserve may continue lending for more than sixty days to an undercapitalized institution without such certification, but the Federal Reserve would be required to reimburse the FDIC for any loss in excess of the loss that would have been incurred had the FDIC closed the institution five days after the institution became critically undercapitalized.

In any event, if the Federal Reserve lends to any critically undercapitalized institution for more than a five-day period, the Federal Reserve will be liable to the FDIC for losses over those that would have been incurred if the institution had been closed at the end of the five day period. Title I limits the Federal Reserve's liability to the lesser of the loss that it would have incurred on increases in advances made after the five-day period had the advances been unsecured or the amount of interest received on increases in advances made after the end of the five-day period. The Federal Reserve is also given the authority to examine any depository institution or depository institution affiliate in con-

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nection with lending to the depository institution.

Title II

Title II expands the regulation of foreign bank operations in the United States and addresses several consumer issues, including the Truth in Savings Act, low-cost basic transaction accounts, and affordable housing.

Regulation of Foreign Banks

Title II amends the International Banking Act to strengthen federal supervision, regulation, and examination of foreign bank operations in the United States. Under the International Banking Act, a foreign bank now must obtain the approval of the Federal Reserve Board before establishing a branch or an agency or before acquiring ownership or control of a commercial lending company. To approve such an application by a foreign bank, the Board must determine that the foreign bank engages directly in the business of banking outside of the United States, that it is subject to comprehensive supervision or regulation on a consolidated basis in its home country, and that the foreign bank has provided adequate information to assess the application.

The amendments permit the Board to terminate the activities of a state-chartered branch, agency, or commercial lending subsidiary of a foreign bank if the foreign bank is not subject to comprehensive supervision or regulation in its home country, or if it is being operated in an unsafe and unsound manner. Title II also directs the Board to develop and publish the criteria to be used in evaluating the operations of any foreign bank in the United States that the Board has determined is not subject to comprehensive supervision or regulation.

Title II also limits state-chartered branches and agencies of foreign banks to the same activities and lending limits as those permitted federally chartered branches and agencies, unless the Federal Reserve Board and, for insured branches, the FDIC approve exceptions. Further, the Board is authorized to impose conditions on the approval of federal branches and agencies by the Office of the Comptroller of the Currency (OCC).

Title II strengthens the Board's authority to examine any branch or agency of a foreign bank, any commercial lending company or bank controlled by a foreign bank, and any other office or affiliate of a foreign bank. Title II requires foreign banks to obtain the approval of the Federal Reserve Board before establishing representative offices in the United States. Title II also adds a provision to the Federal Deposit Insurance Act to require any financial institution that has extensions of credit secured by 25 percent or more of any class of shares of an insured depository institution to provide consolidated reports to the insured institution's primary federal regulator. Civil and criminal penalties are established for violations by foreign banks, and specific references to foreign bank operations are added in a number of consumer and related statutory provisions.

Title II requires foreign banks that maintain accounts with balances of less than $100,000 to establish a banking subsidiary and obtain deposit insurance from the FDIC; accounts that were held in an insured branch on the date of FDICIA's enactment are exempted from this requirement.

Title II requires the Board, jointly with the Treasury, to report to the Congress on the regulatory capital standards that apply to foreign banks operating in the United States and to establish guide-

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lines to be used in comparing foreign bank capital to the risk-based capital and leverage requirements for United States banks. The Board is also required to report, jointly with the OCC, the FDIC, and the Attorney General, as to whether foreign banks should be required to conduct banking operations in the United States through subsidiaries rather than branches.

Customer and Consumer Provisions

Within one year of the enactment of the FDICIA, the Federal Financial Institutions Examination Council is required to review all policies and procedures used to enforce compliance with all laws under the jurisdiction of the federal banking agencies and the Treasury and to report to the Congress on revisions that can be made without weakening compliance with, or enforcement of, consumer laws and without endangering the safety and soundness of insured institutions.

Title II amends the Equal Credit Opportunity Act to require federal agencies to refer to the Attorney General cases in which creditors discourage or deny loan applications in violation of the act and to require the reporting of individual instances of suspected mortgage discrimination to the Department of Housing and Urban Development and to the applicant. Lenders are required upon request to provide applicants with copies of appraisals in connection with loans secured by residential real property. Title II also amends the Home Mortgage Disclosure Act to extend its requirements to a broader range of financial institutions.

Title II amends the Expedited Funds Availability Act to permit deposits made at nonproprietary automated teller machines to be treated as nonlocal checks, thereby allowing depository institutions to put a hold on the proceeds of the checks until the fifth business day after deposit. Additional amendments permit longer holds on certain large or redeposited government or depository institution checks.

Title II also requires that a ninety-day advance notice of the closing of any branch of an insured depository institution be provided to the federal regulator and customers of the institution.

Bank Enterprise Act

Title II requires the Board and the FDIC to establish minimum requirements for "lifeline" accounts, which provide basic transaction services. Subject to congressional appropriations, institutions providing such accounts may be able to pay lowered deposit insurance premiums on funds in these accounts. Credits against deposit insurance assessments are also allowed for institutions increasing certain qualifying activities, including lending to low- and moderate-income persons or enterprises in distressed communities, subject to congressional appropriations.

Whistleblower Protections

Title II provides protections for employees of depository institutions and federal banking agencies if they report misconduct at an institution or agency, effective retroactively to January 1, 1987. Employees that believe they had been wrongfully discharged or discriminated against under this provision could file civil actions for damages or reinstatement within two years after enactment of the FDICIA.

Truth in Savings

The Truth in Savings Act (TSA), adopted as subtitle F of title II of the FDICIA, provides for uniform disclosure of the rates of interest payable on deposit accounts and the fees payable on such accounts. All advertisements that refer to a specific interest rate must in-

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clude the annual percentage yield on the account and the period during which the annual percentage yield is in effect, as well as any minimum balances, minimum initial deposit, fees, and early withdrawal penalties. The TSA authorizes the Federal Reserve Board to exempt advertisements made by broadcast, electronic media, or outdoor displays not on the premises of the depository institution if such disclosure would be unnecessarily burdensome. The TSA prohibits references to free or no-cost accounts if minimum balances or limits on transactions are required to avoid fees or if any regular service fee or transaction fee is imposed; the TSA also generally prohibits any depository institution or deposit broker from making any statement that is inaccurate or misleading or that misrepresents a deposit contract.

The TSA requires each depository institution to maintain a schedule of fees, charges, interest rates, and terms and conditions applicable to each type of account offered, as detailed in regulations to be established by the Board. These schedules must be available to any person upon request, to customers before an account is opened, and to holders of automatically renewable time deposits. Notice must be given thirty days in advance of any change in the terms or conditions of an account that may reduce the yield or adversely affect the account holder.

The TSA requires that interest be calculated on the full amount of the principal in an account for each day of the calculation period at the stated rate of interest, and that interest begin to accrue no later than the availability date required by the Expedited Funds Availability Act. Each depository institution is also required to include with each periodic statement a statement of the annual percentage yield earned, the amount of interest earned, the amount of any fees or charges imposed, and the number of days in the reporting period.

The Board is required to promulgate regulations to implement the provisions of the TSA within nine months of enactment of the FDICIA, with such regulations to be effective within six months of final publication. The TSA provides for administrative enforcement by the appropriate federal banking agency and civil liability for violations.

Title III

Title III places limitations on deposit insurance, brokered deposits, real estate lending and lending to insiders, and the activities of FDIC-insured state-chartered banks generally; it also provides penalties for false assessment reports. Title III requires the Board to develop rules to limit the exposure of insured depository institutions to other depository institutions and requires studies on ownership of deposits and on deposit insurance.

Activities

Title III restricts the acceptance of brokered deposits to institutions that are well-capitalized or that are adequately capitalized and have received a waiver from the FDIC. The interest rates on brokered deposits may not be significantly above (1) the rates paid on deposits of comparable maturity in the institution's normal market area or (2) above national rates as determined by the FDIC.

The FDIC is required to establish a system of risk-based deposit insurance premiums, which will account for the risk to the insurance funds posed by the types and concentrations of assets and liabilities of an institution.

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A provision of title III effective one year after enactment of the FDICIA restricts the activities of insured state-chartered banks to those activities that are permissible for national banks; the restriction does not apply if the FDIC determines that the activity poses no risk to the insurance fund and that the state bank is in compliance with applicable capital requirements. Insured state banks generally will be prohibited from engaging in insurance activities that are not permissible for national banks. Insured state banks will also be prohibited from holding any equity investment of a type or in an amount not permitted for a national bank, with limited exceptions, including exceptions for certain subsidiaries and qualified housing projects. State banks are given a period of several years to conform existing investments.

Subsidiaries of insured state banks may engage as principal in activities that are not permissible for a subsidiary of a national bank only if the activity is approved by the FDIC and the parent bank meets applicable capital requirements. Insurance activities that were lawfully provided in a state as of November 21, 1991, may continue within that state. Title insurance and savings bank life insurance activities are grandfathered or permitted for certain insured state banks.

Title III requires the Board and other federal banking agencies to adopt uniform standards for real estate lending and provides that loan evaluation standards should not require loans to be considered nonperforming solely because the proceeds are invested in residential, commercial, or industrial property. The Board and each appropriate federal banking agency are also required to review capital and risk-based capital standards biennially and to discuss the development of comparable standards with members of the supervisory committee of the Bank for International Settlements.

Title III amends the Federal Reserve Act to recodify and strengthen existing law concerning extensions of credit to officers, directors, and principal shareholders. The provision makes applicable to lending to directors the restrictions that currently apply to lending to bank officers. The provision also imposes an aggregate limit on the total extensions of credit to the bank's officers, directors, and principal shareholders and their related interests. The Board is permitted to set a higher aggregate limit for lending by small banks when necessary to prevent the restriction of credit in a community or to permit banks to attract directors. Insiders are prohibited from knowingly receiving, or permitting their related interests to receive, prohibited extensions of credit.

Title III provides the FDIC with the authority to take enforcement action directly against any insured depository institution under certain circumstances. Title III also amends the Federal Reserve Act to add a new section 23, which requires the Board to prescribe standards to limit the exposure of insured depository institutions to the failure of a large depository institution.

Deposit and Pass-through Insurance

Title III modifies the current system of federal deposit insurance to eliminate insurance coverage for certain bank investment contracts held by employee benefit plans that permit penalty-free withdrawals. The FDIC is directed to study the feasibility of tracking deposits of any individual, and the Board is directed to survey the ownership, amounts, and types of deposits held by individuals.

Title III prohibits the FDIC, the Federal Reserve System, and any other agency or instrumentality of the United

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States from making any payment for the benefit of foreign depositors except payments by the FDIC to meet the requirements of least-cost resolution. Federal Reserve Banks may continue to extend credit to member banks under the provisions of the Federal Reserve Act, regardless of whether the bank has foreign deposits.

Title III also provides for a three-tiered system of penalties applicable to insured institutions that make false reports in connection with insurance premium assessments.

Title IV

Title IV concerns payment system risk, FDIC operations and settlement procedures, qualified thrift lenders, emergency loan guarantees, the right to financial privacy; it also mandates several studies and reports.

Reduction of Payment System Risk

To promote efficiency and reduce systemic risk within the banking system and financial markets, title IV validates bilateral netting contracts between certain financial institutions and multilateral netting contracts between members of clearing organizations. Title IV provides that netting contracts between depository institutions, brokers, dealers, and futures commission merchants will be enforceable even in the event of the bankruptcy of one of the parties; the Board is authorized to expand the coverage of this provision to include affiliates of brokers and dealers and other financial institutions.

Miscellaneous Provisions

Title IV permits the FDIC to settle immediately all uninsured and unsecured claims against an institution in receivership by making final payments reflecting the FDIC's average rate of recovery.

The Board, jointly with the FDIC, the National Credit Union Administration, the OCC, and the Office of Thrift Supervision, is required to report to the Congress on the feasibility of payment by the Federal Reserve Banks to the deposit insurance funds of imputed interest on reserve accounts held by insured depository institutions.

Title IV amends the Federal Reserve Act to permit a Federal Reserve Bank, upon an affirmative vote of at least five members of the Federal Reserve Board, to provide secured lending in unusual and exigent circumstances to individuals, partnerships, or corporations without regard to the purpose of the notes used to secure the lending.

Under Title IV, the Board and other appropriate federal banking agencies are required to determine the amount of purchased mortgage servicing rights that may be included in an institution's tangible capital, risk-based capital, and leverage limit.

Each year, the Board must collect and publish information on the availability of credit to small businesses, including farms and minority-owned businesses.

Title V

Title V amends the Federal Deposit Insurance Act to allow a bank that is not part of a bank holding company to merge or consolidate with a savings association or acquire its assets and liabilities without payment of the entrance and exit fees required under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. The amendments also permit a thrift institution to acquire a bank in the same manner. The amendments require the filing of a bank merger application and generally require the Board to review applications for mergers under the same standards applicable to other bank mergers. ■

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Banking Supervision and Regulation

The past year was another difficult one for the U.S. banking system, and it made new demands on the Federal Reserve's bank supervisory and regulatory activities. The continued weakening of commercial real estate markets, in particular, put many banking organizations under increased stress and kept the rate of bank failures high. Real estate problems, sometimes compounded with exposures to heavily indebted borrowers and to developing countries, forced some institutions to report low or negative earnings and to take exceptional measures to rebuild their capital bases. Many institutions also took steps to strengthen loan underwriting standards, which had declined in past years. In large part, these measures were needed to improve the industry's performance and to maintain a sound and responsive banking system. In certain areas, however, they also contributed to a general tightening of credit availability that may have gone beyond a point of sensible balance and produced unnecessarily adverse effects on some creditworthy borrowers.

In response to these developments, the Federal Reserve Board took steps to promote the increased availability of credit. In addition to its monetary policy actions, the Board—often in connection with other federal bank regulatory agencies—issued a series of policy statements intended to clarify its supervisory policies, prevent excessive criticism of weak assets by examiners, and encourage bankers to extend funds to creditworthy borrowers.

These statements did not change the Board's longstanding supervisory policies but rather were aimed at correcting misunderstandings about them on the part of both bankers and bank examiners. In general, the statements emphasized the importance of reviewing loans in a consistent, prudent, and balanced fashion that recognized the borrower's willingness and capacity to repay and the income-producing capacity of the properties. They also emphasized the need for banks to extend credit to sound borrowers and to work with troubled borrowers in resolving problems.

These lending patterns reflect only one dimension of a financial system that is changing rapidly in response to new technology, regulatory initiatives, and market pressures and innovations. The stress and opportunities brought about by these and other events continued to encourage consolidation within the U.S. banking industry. In late 1991, the Board approved the two largest bank combinations in U.S. history. Other significant mergers and acquisitions are pending.

The ongoing administration and continued development of the international risk-based capital standard remained an important element of the Federal Reserve's supervisory process. In the fall, several changes were made to the U.S. standard to bring it into closer conformity with interpretations of the internationally agreed Basle Accord and also to remove certain impediments to the issuance of noncumulative perpetual preferred stock. Throughout the year, staff also worked to develop a framework for incorporating risks arising from interest rate changes, foreign exchange movements, and securities trading activities into the risk-based capital measure. One approach for evaluating interest rate risk was described in the August 1991 *Fed-*

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eral Reserve Bulletin, and work in all of these areas continues on an international basis.[1]

During much of the year, supervisory efforts relating to the July failure of the Luxembourg-based Bank of Credit and Commerce International (BCCI) required close coordination and cooperation with banking authorities worldwide. These efforts also placed significant demands on the Federal Reserve as it sought to minimize losses to U.S. customers and to identify abusive and unauthorized practices of the bank. Also in the international area, the May implementation of final revisions to Regulation K (International Banking Operations) provided a basis for improving the competitiveness of U.S. banks operating abroad.

Problems with BCCI, along with legislative initiatives proposed by the U.S. Treasury to reform the domestic financial system, led to enactment of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). That major legislation expanded the authority of the Federal Reserve to regulate and supervise foreign banks conducting business in the United States and included numerous other provisions that will have significant effects on supervisory and regulatory activities in future years (see the chapter on Legislation Enacted).

Near year-end, William Taylor, the Staff Director of the Division of Banking Supervision and Regulation, resigned to become Chairman of the Federal Deposit Insurance Corporation (FDIC). Subsequently, the Board announced the appointment of Richard Spillenkothen as the new director and the selection of Stephen C. Schemering as deputy director; both have been long-time staff members in the division.

1. James V. Houpt and James A. Embersit, "A Method for Evaluating Interest Rate Risk in U.S. Commercial Banks," *Federal Reserve Bulletin,* vol. 77 (August 1991), pp. 625–37.

Scope of Responsibilities for Supervision and Regulation

The Federal Reserve is the primary federal supervisor and regulator of all U.S. bank holding companies and of state-chartered commercial banks that are members of the Federal Reserve System. In its supervision of the general operations of these organizations, the Federal Reserve primarily seeks to promote their safety and soundness and their compliance with laws and regulations, including the Bank Secrecy Act and consumer and civil rights laws.[2] The Federal Reserve also reviews the following specialized activities of these institutions: electronic data processing, fiduciary activities, government securities dealing and brokering, municipal securities dealing and clearing, and securities underwriting and dealing through section 20 securities subsidiaries.

The Federal Reserve also has responsibility for the supervision of (1) all Edge Act corporations and agreement corporations (organizations chartered by the Federal Reserve to provide all segments of the U.S. economy with a means of financing international trade, espe-

2. The Board's Division of Consumer and Community Affairs has the responsibility of coordinating the Federal Reserve's supervisory activities with regard to the compliance of banking organizations with consumer and civil rights laws. To carry out this responsibility, institutions are examined by specially trained Reserve Bank examiners. The chapter of this REPORT covering consumer and community affairs describes these regulatory responsibilities. Compliance with other statutes and regulations, which is treated in this chapter, is the responsibility of the Board's Division of Banking Supervision and Regulation and the Reserve Banks, whose examiners check for safety and soundness.

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cially exporting), (2) the international operations of state member banks and U.S. bank holding companies, and (3) the operations of foreign banking companies in the United States. In addition, the FDICIA increased the Federal Reserve's authority over branches, agencies, commercial lending subsidiaries, and representative offices of foreign banks in the United States with respect to the establishment, examination, and termination of such offices.

Through its administration of the Bank Holding Company Act, the Bank Merger Act, and the Change in Bank Control Act for bank holding companies and state member banks, the Federal Reserve also exercises important regulatory influence over entry into, and the structure of, the U.S. banking system. The Federal Reserve is also responsible for the regulation of margin requirements on securities transactions. The Federal Reserve coordinates its supervisory activities with other federal and state regulatory agencies and with the bank regulatory agencies of other nations.

Supervision for Safety and Soundness

To ensure the safety and soundness of banking organizations, the Federal Reserve conducts on-site examinations and inspections, off-site surveillance and monitoring, and enforcement and other supervisory actions.

Examinations and Inspections

The on-site review of operations is an integral part of ensuring the safety and soundness of financial institutions. Examinations of state member banks and Edge Act and agreement 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.

State Member Banks

At the end of 1991 there were 982 state member banks, 65 fewer than in 1990. These banks represented about 8 percent of all insured commercial banks and accounted for about 16 percent of their assets.

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 by either a Reserve Bank or, if an alternate examination agreement exists, by a state banking agency. Large or troubled banks must be examined at least annually by a Reserve Bank. Under FDICIA, annual on-site examinations are now required for all depository institutions, except well-capitalized and well-managed institutions with assets of less than $100 million.

Because of the reassignment in 1991 of bank examiners to address other emerging problems in the banking industry, scheduled examinations of 21 healthy, well-managed banks were deferred into the first quarter of 1992. All other state member banks were examined at least once in 1991. Altogether, the Reserve Banks conducted 790 examinations (some of them jointly with state banking departments), and state banking departments conducted 281 independent examinations. Also, under policy guidelines, Reserve Bank officials held 313

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meetings with directors of large state member banks and those that displayed significant weaknesses.

Bank Holding Companies

At year-end 1991, the number of bank holding companies totaled 6,441, 16 more than in 1990. These organizations control about 8,500 commercial banks, which hold approximately 93 percent of the assets of all insured commercial banks in the United States.

Large bank holding companies (generally, those with assets in excess of $150 million) and smaller companies with significant nonbank assets are to be inspected annually under the guidelines for frequency and scope of examinations. Small companies that do not appear to be experiencing problems are inspected on a sample basis, and medium-sized companies that do not appear to be experiencing problems are inspected on a three year cycle.

The inspection focuses on the operations of the parent holding company and its nonbank subsidiaries. In judging the condition of subsidiary banks, Federal Reserve examiners consult the examination reports of the federal and state banking authorities that have primary responsibility for supervision of these banks. In 1991, 2,269 bank holding companies were inspected. Federal Reserve examiners inspected 2,145 of them; state examiners inspected 124. Because certain institutions require more than one inspection per year, the Federal Reserve made a total of 2,254 inspections in 1991, of which 142 were off-site. Because members of the examining staff were assigned to work with other industry problems in 1991, 53 bank holding company inspections were deferred until 1992. During 1991, Reserve Bank officials held 524 meetings with the boards of directors of bank holding companies to discuss supervisory concerns.

Enforcement Actions, Civil Money Penalties, and Significant Criminal Referrals

In 1991 the Federal Reserve Banks recommended, and members of the Board's staff initiated and worked on, 198 formal enforcement cases involving 449 separate actions—such as written agreements, cease and desist orders, removal and prohibition orders, and civil money penalties—dealing with unsafe or unsound practices and violations of law. Of these, 54 cases involving 106 actions were completed by year-end. In addition, the Board and several Reserve Banks undertook the most extensive enforcement-related investigation ever conducted by the Federal Reserve, addressing the activities of BCCI in the United States and other countries. As a result of the investigation, which was continuing at year-end, the Board in 1991 initiated 23 actions, including 6 actions seeking $257 million in civil money penalties.

All final enforcement actions issued by the Board and all written agreements executed by the Reserve Banks in 1991 are available to the public. In addition to formal enforcement actions, the Reserve Banks initiated and worked on 297 informal enforcement actions and completed 235 of them through instruments such as memorandums of understanding with state member banks, bank holding companies, and foreign financial institutions subject to the jurisdiction of the Federal Reserve. In addition to the foregoing, the Board obtained approximately $2.7 million in restitution to, and over $140 million in capital infusions into, state member banks and bank holding companies through informal actions that were taken in lieu of the issu-

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ance of formal enforcement orders or agreements.

In 1991, the Division of Banking Supervision and Regulation forwarded 222 criminal referrals to the Fraud Section of the Criminal Division of the Department of Justice for inclusion in its significant referral tracking system.

Specialized Examinations

The Federal Reserve conducts specialized examinations in the following areas of bank activity: electronic data processing, fiduciary activities, government securities dealing and brokering, municipal securities dealing and clearing, and securities underwriting and dealing through section 20 securities subsidiaries.

Electronic Data Processing

Under the Interagency EDP Examination Program, the Federal Reserve examines the electronic data processing activities of state member banks, Edge Act and agreement corporations, and independent centers that provide EDP services to these institutions. In 1991, Federal Reserve examiners conducted 277 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.

Fiduciary Activities

The Federal Reserve has supervisory responsibility for institutions that hold more than $3.1 trillion of discretionary and nondiscretionary assets in various fiduciary capacities. This group of institutions includes 316 state chartered member banks and trust companies and 80 trust companies and investment advisory companies that are subsidiaries of bank holding companies.

On-site examinations are essential to ensure the safety and soundness of financial institutions that have fiduciary operations. The scope of these examinations includes (1) an evaluation of management, policies, audit procedures, and risk management, (2) an appraisal of the quality of trust assets, (3) an assessment of earnings, (4) a review for conflicts of interest, and (5) a review for compliance with laws, regulations, and general fiduciary principles.

During 1991, Federal Reserve examiners conducted on-site trust examinations of 152 state member banks and state member trust companies and 36 inspections of bank holding company subsidiaries engaged in fiduciary activities. The institutions examined in 1991 held more than $2.2 trillion in fiduciary assets.

Government Securities Dealers and Brokers

The Federal Reserve is responsible for examining the activities of state member banks, and of some foreign banks that are government securities dealers and brokers, for compliance with the Government Securities Act of 1986 and with the Treasury Department's regulations. Forty-four state member banks, three state branches of foreign banks, and one state agency of a foreign bank currently have on file with the Board notices that they are government securities dealers or brokers that are not otherwise exempt from Treasury Department regulations.

Municipal Securities Dealers and Clearing Agencies

The Securities Act Amendments of 1975 made the Board responsible for supervising state member banks and bank holding companies that act as municipal

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securities dealers or as clearing agencies. Registered with the Board are forty-four banks that act as municipal securities dealers and five clearing agencies that act as custodians of securities involved in transactions settled by bookkeeping entries. In 1991 the Federal Reserve examined all five of the clearing agencies and nineteen of the banks that deal in municipal securities.

Securities Subsidiaries of Bank Holding Companies

Section 20 of the Banking Act of 1933, commonly known as the Glass–Steagall Act, prohibits the affiliation of a member bank with a company that is "engaged principally" in underwriting or dealing in securities. The Board in 1987 approved proposals by banking organizations to underwrite and deal on a limited basis in specified classes of bank "ineligible" securities (that is, commercial paper, 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. At that time the Board limited revenues from these newly approved activities to no more than 5 percent of total revenues for each securities subsidiary. This limit was subsequently increased in September 1989 to 10 percent.

In January 1989 the Board approved applications by five U.S. bank holding companies to underwrite and deal in corporate and sovereign debt and equity securities, subject in each case to reviews of managerial and operational infrastructure and other conditions and requirements specified by the Board. Four of these organizations subsequently received authorization to underwrite and deal in corporate and sovereign debt securities, and two also received equity underwriting and dealing authority.

At year-end 1991, thirty-one bank holding companies had section 20 subsidiaries authorized to underwrite and deal in ineligible securities. Of these, seven could underwrite any debt or equity securities; three could underwrite all types of debt securities; and twenty-one could underwrite only the limited types of debt securities approved by the Board in 1987. Specialized inspection procedures have been developed for use in reviewing operations of these securities subsidiaries.

Transfer Agents

Federal Reserve examiners conduct separate reviews of state member banks and bank holding companies that act as transfer agents. Transfer agents countersign and monitor the issuance of securities, register their transfer, and exchange or convert them. During 1991, System examiners reviewed 66 of the 169 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 through a quarterly surveillance program to supplement the Federal Reserve's on-site examinations. This program consists of automated screening systems that identify organizations with poor or deteriorating financial profiles. Banking organizations submit financial statements from which the screening systems compute numerous financial ratios. These ratios are then analyzed to determine whether the organizations have emerging problems that may require the commitment of examiner resources for on-site examinations or other appropriate supervisory responses. The Federal Reserve supplements the quarterly surveillance pro-

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grams with ad hoc screening reports on specific areas of supervisory concern.

To enhance the timeliness and quality of the surveillance processes, the current system is being revised and will include an early-warning model to continually evaluate a banking organization's supervisory rating based on the most current financial information available.

International Activities

The Federal Reserve is responsible for supervising international activities through various vehicles.

Edge Act Corporations and Agreement Corporations

Edge Act 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 Act corporation. In 1991 the Federal Reserve examined all 97 Edge Act and agreement corporations, which held about $29 billion in total assets at year-end.

Foreign-Office Operations of U.S. Banking Organizations

The Federal Reserve examines the international operations of state member banks, Edge Act 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 1991 the Federal Reserve examined eight foreign branches of state member banks and twenty-four subsidiaries of Edge Act corporations and bank holding companies. All of the examinations abroad were conducted with the cooperation of the supervisory authorities of the countries in which the examinations took place; when applicable, they were coordinated with the Office of the Comptroller of the Currency. Also, examiners made five visits to overseas offices to obtain current financial information on their operations and to evaluate their compliance with corrective measures previously required.

U.S. Activities of Foreign Banks

Foreign banks continue to be significant participants in the U.S. banking system. As of year-end 1991, 313 foreign banks operated 529 state-licensed branches and agencies, of which 53 are insured by the Federal Deposit Insurance Corporation. These foreign banks also operated 84 branches and agencies licensed by the Office of the Comptroller of the Currency, of which 9 have FDIC insurance. Foreign banks also directly owned 11 Edge Act corporations and 13 commercial lending companies. In addition, foreign banks held an interest of at least 25 percent in 90 U.S. commercial banks. Altogether, these foreign banks control approximately 24 percent of U.S. banking assets.

The Federal Reserve has broad authority to supervise and regulate foreign banks that engage in banking and related activities in the United States through branches, agencies, commercial lending companies, Edge Act corporations, banks, and certain nonbanking companies. The Federal Reserve conducted or participated with state regulatory authorities in the examination of 123 such offices during the past year.

Before the December 1991 passage of the FDICIA, the Federal Reserve had residual authority to examine all branches, agencies, and commercial lending subsidiaries of foreign banks in the United States. The International

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Banking Act of 1978 instructed the Federal Reserve to use, to the extent possible, the examination reports of other state and federal regulators. The FDICIA amended the International Banking Act and increased the Federal Reserve's authority with respect to these foreign bank operations, including representative offices, in the United States. The Federal Reserve may coordinate the examinations of foreign bank operations with other state and federal regulators. Branches and agencies are now required to be examined at least once during each twelve-month period in an on-site examination. The FDICIA also authorizes the Federal Reserve to terminate the operations of foreign banks in the United States under certain conditions. In addition, the legislation requires Federal Reserve approval to establish foreign bank branches, agencies, commercial lending subsidiaries, and representative offices in the United States.

Supervisory Policy

During 1991 the Federal Reserve undertook several major supervisory and regulatory policy initiatives. These initiatives included increased supervision of problem banking organizations, action on several merger applications involving large regional and multinational banking organizations, and an intensified review of internal supervisory policies relative to alleviating credit availability conditions throughout the nation. The following sections summarize these initiatives and review other activities conducted in 1991 to enhance the Federal Reserve's supervisory programs.

Real Estate Appraisals

The comment period on the Board's amendment to its regulation on appraisal standards for federally related transactions ended on January 25, 1991, with more than 2,800 comment letters being received. For such transactions, the proposed amendment seeks reconsideration of the level above which financial institutions would be required to obtain the services of a licensed or certified appraiser. The Board's existing regulation sets the level at $100,000, and the proposal would lower the threshold to $50,000. Recently, the FDIC and the Office of the Comptroller of the Currency (OCC) announced amendments to their regulations to raise their appraisal threshold from $50,000 to $100,000.

The Board amended its appraisal regulation as a result of a provision in the FDICIA that changed—from July 1, 1991, to December 31, 1992—the effective date for the use of state licensed and certified appraisers in federally related transactions. However, any requirements of state law regarding the use of licensed or certified appraisers remain unaffected by the Board's action.

Risk-Based Capital Standards at Year-End 1991

The risk-based capital standard provides for a two-year phase-in period, which began December 31, 1990. As of that date, banking organizations were expected to maintain total capital equal to at least 7.25 percent of risk-adjusted assets. This minimum standard rises to 8 percent at year-end 1992. The risk-based capital standard was developed in cooperation with the FDIC and OCC and representatives of the other eleven members of the Basle Committee on Banking Regulations and Supervisory Practice.

In October 1991 the Board also issued for public comment a proposal to establish new guidelines for bank holding companies, which would remove the

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limit on the amount of noncumulative perpetual preferred stock a bank holding company may include in its tier 1 capital. The guidelines would continue to limit cumulative perpetual preferred stock to 25 percent of tier 1 capital. The additional flexibility provided by this step may assist bank holding companies to strengthen their capital positions and expand their lending capacity. [The Board approved the proposal in January 1992.]

The Board issued in final form the clarifications, modifications, and technical changes to the risk-based capital guidelines that became effective November 8, 1991. The modifications and technical changes relate to the (1) treatment of certain assets sold with recourse, (2) redemption of perpetual preferred stock, (3) treatment of supervisory goodwill in the definition of capital, and (4) treatment of claims on central banks of countries outside the Organisation for Economic Cooperation and Development. The purpose of these modifications, clarifications, and technical changes is to make the Federal Reserve's risk-based capital framework consistent with recent international interpretations of the risk-based capital accord and with the current proposed treatment of certain items by the other federal banking agencies. In addition, these changes are intended to bring the guidelines into closer conformity with the risks associated with certain transactions and with current Federal Reserve supervisory practices.

The risk-based capital framework of the Basle Accord encourages banking organizations to strengthen their capital positions. The standard offers the advantages of differentiating, in a broad way, among the relative riskiness of banking assets and accounting for off-balance-sheet risks. Because of its acceptance by countries with major international banking centers, the risk-based capital standard helps to create a level playing field for U.S. banking organizations as they compete with banks in other countries.

When the Basle Committee adopted the risk-based capital standards in 1988, it expected that further efforts would be required to incorporate certain noncredit risks into the risk-based framework. In this connection, the Federal Reserve in 1991 participated in various international efforts to strengthen the capital positions of internationally active banking organizations. These efforts include incorporating into the risk-based capital framework a capital charge for risks arising from changes in interest rates (interest rate exposure) and from changes in foreign exchange rates (foreign exchange position risk).

The Federal Reserve has advanced a preliminary proposal for measuring and evaluating interest rate risk in U.S. commercial banks. During the second half of 1991, both Federal Reserve and FDIC examiners conducted field tests of the proposed measurement system in selected banks across the country. Once fully developed and field-tested, the approach under consideration could supplement existing examination procedures and provide an additional off-site monitoring tool for identifying banks with excessive exposures to interest rate changes.

Report on Capital and Reporting Standards

As required by section 1215 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), the Federal Reserve, together with the other federal banking agencies, is required to prepare an annual report to the Congress discussing any differences in their capital and accounting standards for federally insured

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depository institutions. The second annual report was delivered to the Congress on August 9, 1991.

The report indicated that the banking agencies' guidelines relating to the capital treatment of identifiable intangible assets are not entirely uniform. The Federal Reserve is working with other banking agencies to reach agreement on the matter.

The report also indicated that the accounting and reporting requirements applicable to commercial banks are substantially consistent among the three federal banking agencies. However, the federal banking agencies and the Office of Thrift Supervision continue to undertake projects and study ways to reduce differences in reporting standards between commercial banks and savings and loan associations.

Credit Availability

The Federal Reserve, together with other supervisors of depository institutions, has been working to ensure that supervisory policies and examiner practices—and bankers' perceptions of these policies and practices—are not detering lenders from meeting the financial needs of creditworthy borrowers. To that end, the Federal Reserve and other supervisory agencies have introduced a series of initiatives designed to clarify longstanding policies and to make sure that examiners and depository institutions are fully informed of these policies. These efforts, which included the issuance of policy statements on March 1 and November 7 to reiterate and clarify longstanding guidance regarding general lending practices and the evaluation of real estate collateral, were designed to ensure that examiners use prudent and balanced practices and procedures. The agencies sought to offer guidance that was both prudent from a supervisory perspective and consistent with generally accepted accounting principles. In addition, officials of each agency held meetings with their examiners to ensure that they fully understood these policies.

The Federal Reserve also issued guidance for resolving differences that can arise between banks and examiners during an examination. In addition, meetings were held with the senior management of major banking organizations around the country to explain these initiatives. Senior agency officials also participated in several regional meetings, sometimes referred to as "town meetings," involving bankers, businessmen, and members of the Congress.

Environmental Liability

In October the Board issued guidance to examiners regarding the risks to banks and borrowers posed by the liability associated with the clean-up of hazardous substance contamination under the federal "Superfund" statute. The guidance provided an overview of the Superfund statute and identified specific situations in which a bank might find itself liable for hazardous substance contamination. In addition, the statement provided examiner guidance on assessing the adequacy and effectiveness of a bank's policies and procedures to identify and limit hazardous substance liability. The guidance gives specific procedures and precautions for banks to limit their Superfund liability.

Dividend Payments

In 1990 the Board issued amended regulations on the payment of dividends by state member banks, which became

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effective January 1, 1991. The rule simplifies and clarifies the calculation of certain statutory limitations on the payment of dividends. The rule also makes the treatment of loan-loss allowances and provisions for dividend payment purposes consistent with current regulatory reporting standards and generally accepted accounting principles.

Highly Leveraged Transactions

In 1991 the Federal Reserve, together with the other banking regulatory agencies, provided additional interpretive guidance on the definition of highly leveraged transactions (HLT). The guidance clarified the purpose test, clarified the application of the HLT definition to parent companies and their subsidiaries, and broadened the criteria for removing loans from HLT status. It also excluded debtor-in-possession financings from HLT designation and clarified other provisions. However, further questions and comments concerning the HLT definition prompted the agencies to seek additional public comments. The Federal Reserve received more than 260 comments. [In early 1992 the Board decided to phase out the HLT definition by midyear.]

Sale of Uninsured Annuities on Retail Banking Premises

In 1991 the Federal Reserve issued guidelines to examiners for reviewing the sale of uninsured annuities on retail banking premises. This guidance indicated that state member banks and bank holding companies should not market, sell, or issue uninsured annuities, or allow third parties to do so, in a manner that could give purchasers the impression that the annuities are federally insured deposits or that they are obligations of the depository institution.

Staff Training

The training of System staff members 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 1991, the Federal Reserve conducted a variety of schools and seminars, and Federal Reserve staff members participated in several courses offered by or cosponsored with other agencies, as shown in the accompanying table. In 1991, the Federal Reserve trained 1,634 persons in System schools, 875 in FFIEC schools, and 26 in other schools, for a total of 2,535 students, including 116 representatives from foreign banks.

The Federal Reserve System also provided scholarship assistance to the states for training their examiners in Federal Reserve and FFIEC schools. Through this program, 402 state examiners were trained; 196 in Federal Reserve courses, 203 in FFIEC programs, and 3 in other courses.

Federal Financial Institutions Examination Council

The members of the FFIEC approved a policy statement on securities activities mainly to update and revise its 1988 supervisory policy statement on the "Selection of Securities Dealers and Unsuitable Investment Practices."[3] The policy statement addresses the selection of securities dealers, requires depository institutions to establish prudent policies

3. The FFIEC consists of representatives from the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

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and strategies for securities transactions, defines securities trading or sales practices that are viewed by the agencies as being unsuitable when conducted in an investment portfolio, indicates characteristics of loans held for sale or trading, and establishes a framework for identifying certain mortgage derivative products as high-risk mortgage securities that must be held either in a trading account or a held-for-sale account.

The Board, together with the FFIEC, is also reviewing guidance on the allowance for loan and lease losses with a view to developing an interagency policy statement.

The FFIEC is continuing its study on the appropriate regulatory reporting and capital treatments to be applied to recourse arrangements for depository institutions and bank holding companies.

The FFIEC also proposed several changes to the Report of Condition and Income (Call Report), which is filed by all insured commercial banks. The proposed changes fall into four general areas: (1) real estate lending and related exposures, (2) other asset quality information, including highly leveraged transactions, (3) assets held for sale, and (4) sources of other noninterest income and expense. There are also several miscellaneous proposed changes.

The Federal Reserve has continued its support of the appraisal subcommittee of the FFIEC. The subcommittee was established pursuant to title XI of FIRREA to monitor the overall implementation of real estate appraisal reform. During the past year, the subcommittee retained permanent staff to handle its daily affairs. The subcommittee is working with the state appraisal regulatory agencies to implement appraiser license and certification programs. In addition, to promote communications with the states, the subcommittee held a two-day conference for state regulators on the requirements of title XI of FIRREA.

Training Programs for Banking Supervision and Regulation, 1991

Agency and type of training	Number of sessions	
	Total	Regional
Schools or seminars conducted by the Federal Reserve		
Banking I	4	1
Banking II	8	5
Banking III	6	2
Senior forum for current banking and regulatory issues	3	...
Effective writing for banking supervision staff	18	17
Credit analysis	13	12
Abbreviated cash flow seminar	4	3
Bank holding company applications	1	...
Bank holding company inspection	5	4
Conducting meetings with management	13	13
Basic entry-level trust	1	...
Advanced trust	2	...
Consumer compliance	3	...
Seminar for senior supervisors of foreign central banks[1]	1	...
Other agencies conducting courses[2]		
Federal Financial Institutions Examination Council	78	15
Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency	12	...
Federal Bureau of Investigation[3]	4	4

1. Conducted jointly with the World Bank.
2. Open to Federal Reserve employees.
3. Cosponsored by the Federal Reserve, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision, and the Resolution Trust Corporation.

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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. In addition, the Board has established regulations for the interstate banking activities of these foreign banks and for foreign banks that control a U.S. subsidiary commercial bank.

Bank Holding Company Act

By law, a company must obtain the Federal Reserve'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 Federal Reserve's approval before acquiring additional banks or nonbanking companies.

In reviewing an application filed by a bank holding company, the Federal Reserve considers factors including the financial and managerial resources of the applicant, the future prospects of both the applicant and the firm to be acquired, the convenience and needs of the community to be served, the potential public benefits, and the competitive effects of the proposal.

In 1991 the Federal Reserve acted on 1,261 bank holding company and related applications. The Federal Reserve approved 213 proposals to organize bank holding companies and denied 2; approved 37 proposals to merge existing bank holding companies and denied 1; approved 207 bank acquisitions by existing bank holding companies and denied 1; approved 772 requests by exist-

Bank Holding Company Decisions by the Federal Reserve, Domestic Applications, 1991

Proposal	Direct action by the Board of Governors		Action under authority delegated by the Board of Governors: Director of the Division of Banking Supervision and Regulation		Office of the Secretary	Federal Reserve Banks		Total
	Approved	Denied	Approved	Denied	Approved	Approved	Permitted	
Formation of holding company	13	2	0	0	3	197	0	215
Merger of holding company	5	1	0	0	2	30	0	38
Retention of bank	0	0	0	0	0	0	0	0
Acquisition								
Bank	32	1	0	0	11	164	0	208
Nonbank	114	4	45[1]	0	40	489	84	776
Bank service corporation	0	0	0	0	0	0	1	1
Other	2	0	21	0	0	0	0	23
Total	**166**	**8**	**66**	**0**	**56**	**880**	**85**	**1,261**

1. Each of these actions represents the acquisition of a savings association that was subsequently merged into an existing subsidiary of a bank holding company, as permitted by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

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ing companies to acquire nonbank firms engaged in activities closely related to banking and denied 4; and approved 24 other applications. Data on these and related bank holding company decisions are shown in the accompanying table. Included in the totals are applications related to the sale of failed thrift institutions by the Resolution Trust Corporation.

Bank Merger Act

The Bank Merger Act requires that all proposed mergers of insured depository institutions be acted upon by the appropriate federal banking agency. If the institution surviving the merger is a state member bank, the Federal Reserve has primary jurisdiction. Before acting on a proposed merger, the Federal Reserve considers factors relating to the financial and managerial resources of the applicant, the future prospects of the existing and combined institutions, the convenience and needs of the community to be served, and the competitive effects of the proposal. The Federal Reserve must also consider the views of certain other agencies on the competitive factors involved in the transaction.

During 1991 the Federal Reserve approved 90 merger applications. As required by law, each merger is described in this REPORT (in table 16 of the Statistical Tables chapter).

When the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, or the Office of Thrift Supervision has jurisdiction over a merger, the Federal Reserve is asked to comment on the competitive factors to assure comparable enforcement of the antitrust provisions of the act. The Federal Reserve and those agencies have adopted standard terminology for assessing competitive factors in merger cases to assure consistency in administering the act. The Federal Reserve submitted 719 reports on competitive factors to the other Federal banking agencies in 1991.

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 Federal Reserve is responsible for reviewing changes in the control of state member banks and of bank holding companies. In so doing, the Federal Reserve must review the financial condition, competence, experience, and integrity of the acquiring person; consider the effect on the financial condition of the bank or bank holding company to be acquired; and determine the effect on competition in any relevant market.

The appropriate 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 Federal Reserve routinely makes such a determination and verifies information contained in the proposal.

In 1991 the Federal Reserve acted on 183 proposed changes in control of state member banks and bank holding companies. The total number of notices was less than the year before because, in late 1990, the Board amended Regulation Y to reduce the filing requirements for individuals purchasing additional shares of a banking organization.

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Public Notice of Federal Reserve Decisions

An order or announcement effects each decision by the Federal Reserve that involves a bank holding company, bank merger, change in control, or international banking proposal. An order states the decision along with the essential facts of the application and the basis for the decision; an announcement states only the decision. All orders and announcements are released immediately to the public; they are subsequently reported in the Board's weekly H.2 statistical release and in the monthly *Federal Reserve Bulletin*. The H.2 release also contains announcements of applications and notices received, but not yet acted on, by the Federal Reserve.

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 1991, 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 Director of the Board's Division of Banking Supervision and Regulation, and to the Secretary of the Board.

The delegation of responsibility for applications allows staff members to work more efficiently at both the Board and the Reserve Banks by removing routine cases from the Board's agenda. In 1991, delegated authority was involved in 78 percent of the applications.

Board Policy Decisions and Developments in Bank-Related Activities

Having made certain that the proper managerial and operational infrastructures were in place, the Board in 1991 permitted a domestic banking organization and several foreign banking organizations to commence equity underwriting activities under authority originally granted in 1989 and 1990. In mid-1991 the Board permitted a regional bank holding company to acquire an investment banking firm that would continue to engage in a full range of securities activities, including the underwriting of equity securities. During the year the Board also approved other new nonbanking activities for individual bank holding companies.

Action on Nonbanking Activities

In 1991 the Board for the first time approved a proposal by a foreign banking organization to trade for the company's account in futures, options, and options on futures based on U.S. government securities that are permissible investments for national banks and certain money market instruments. The Board also approved several more proposals by domestic bank holding companies to provide asset management services to the Resolution Trust Corporation, the FDIC, and unaffiliated third party investors, for pools of assets assembled from failed or troubled financial institutions.

In early 1991 the Board denied an application by a foreign bank to clear securities options and other financial instruments for the accounts of professional floor traders because the proposal, as structured, involved potential adverse effects that outweighed the potential public benefits.

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Proposals to Engage in New Nonbanking Activities

In 1991 the Board continued to consider several proposals related to nonbanking activities. One proposal involved expanding the list of generally permissible nonbanking activities for bank holding companies to include (1) combined investment advisory and securities brokerage activities, and (2) financial advisory activities. The Board also considered modifying its investment advisory policy statement to ease current limitations on the securities underwriting powers of bank holding companies and to permit certain joint marketing and common management officials. In addition, the Board considered adding higher-residual-value leasing to the list of generally permissible nonbanking activities for bank holding companies.

At year-end, two other rulemakings were under consideration. One was a proposal to rescind an existing rule that permits bank holding companies to establish or acquire indirectly, through their state-chartered bank subsidiaries, nonbank operations subsidiaries engaged in activities that may be conducted by the parent bank. The other rulemaking was a proposal to permit bank holding companies to engage in real estate investment activities within certain limitations.

Applications by State Member Banks

State member banks must obtain the permission of the Federal Reserve to open new domestic branches, to make investments in bank premises that exceed 100 percent of capital stock, and to add to their capital bases 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 notice period may be shortened or eliminated in specific cases.

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 purchases may therefore 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 Federal Reserve may object to stock repurchases by holding companies that fail to meet certain standards, including the Board's capital guidelines. During 1991 the Federal Reserve reviewed 94 proposed stock repurchases by bank holding companies.

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 Act 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 Act corporations and their investments.

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Foreign Branches of Member Banks

Under provisions of the Federal Reserve Act and of Regulation K (International Banking Operations), 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 1991, the Board approved the opening of ten foreign branches.

By the end of 1991, 123 member banks were operating 794 branches in foreign countries and overseas areas of the United States; 92 national banks were operating 674 of these branches, and 31 state member banks were operating the remaining 120 branches.

Edge Act Corporations and Agreement Corporations

Under sections 25 and 25(a) of the Federal Reserve Act, Edge Act corporations and agreement corporations may engage in international banking and foreign financial transactions. These corporations, which are usually subsidiaries of member banks, may (1) 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) make foreign investments that 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 1991 there were ninety-seven Edge Act corporations, which together had forty-four branches. The Board requires each Edge Act corporation that is engaged in banking to maintain a ratio of equity to risk assets of at least 7 percent. In line with the revision of Regulation K, this equity to risk-asset ratio will be replaced with a minimum ratio of qualifying total capital to weighted-risk assets of 10 percent, effective January 1, 1993.

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. Significant investments require advance review by the Board, although pursuant to Regulation K, most foreign investments may be made under general-consent procedures that involve only after-the-fact notification to the Board.

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 Act or agreement corporations, and bankers' banks to invest in export trading companies, subject to certain limitations and after Board review. The purpose of this amendment 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. Although the Board did not approve any new export trading companies in 1991, it has since 1982 acted affirmatively on notifications by forty-seven 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

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laws, rules, and regulations other than those specifically related to bank safety and soundness and the integrity of the banking structure.

Bank Secrecy Act

The proliferation of criminal activity is viewed by many as the result of criminal enterprises having the ability to retain the cash proceeds of their illegal activity. The Currency and Foreign Transactions Reporting Act (the Bank Secrecy Act) was originally proposed as a means of creating and maintaining records of various transactions that otherwise would not be identifiable. The records required by the Bank Secrecy Act provide useful data for aiding in the detection of unlawful activity as well as determining the safety and soundness of financial institutions.

The Federal Reserve has maintained its practice of regularly scheduled Bank Secrecy Act examinations of financial institutions under its supervision. The Federal Reserve also continues to provide quarterly reports to the Department of the Treasury detailing all Bank Secrecy Act violations discovered during the examination process and it provides more specific information of such violations when required by the Treasury Department for their enforcement functions. Additionally, the Federal Reserve has increased its efforts with regard to enforcement actions against financial institutions which result from violations of the Bank Secrecy Act.

The Federal Reserve is still committed to ensuring that all new examiners receive training in the areas of the Bank Secrecy Act and money laundering and that seasoned examiners receive refresher courses in these areas. In addition, the Federal Reserve has participated in numerous programs that provide the financial community with insight into the Federal Reserve's belief in strict compliance with the rules and regulations of the Bank Secrecy Act.

The Systemwide committee established within the Federal Reserve in 1990 to coordinate anti-money-laundering activities has continued to develop innovative programs to assist the law enforcement community and educate the banking community with regard to the Bank Secrecy Act and money laundering issues. The Federal Reserve has also continued to assist law enforcement agencies conducting criminal investigations related to the Bank Secrecy Act and money laundering violations.

During the past year, a Federal Reserve study of the effectiveness and practicability of its current procedures for conducting examinations under the Bank Secrecy Act concluded that the procedures could be more streamlined and more effective. New procedures have been developed and continue to be subjected to considerable testing before their release.

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. 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.

Several regulatory agencies enforce compliance with the securities credit regulations. The Securities and Exchange Commission, the National Asso-

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ciation of Securities Dealers, and the national securities exchanges examine brokers and dealers for compliance with Regulation T. The federal banking agencies examine banks under their respective jurisdictions for compliance with Regulation U. Lenders subject to Regulation G are examined by the Board, the Farm Credit Administration, the National Credit Union Administration, or the Office of Thrift Supervision, according to the jurisdiction involved. At the end of 1991, 593 lenders were registered under Regulation G, and 331 came under the Board's supervision. Of these 331, the Federal Reserve regularly inspects 221 either biennially or triennially, according to the type of credit they extend. During 1991, Federal Reserve examiners inspected 41 lenders for compliance with Regulation G.

In general, Regulations G and U impose credit limits on loans secured by publicly held securities when the purpose of the loan is to purchase or carry those or other publicly held equity securities. Regulation T limits the amount of credit that brokers and dealers may extend when the credit is used to purchase or carry publicly held debt or equity securities. Collateral for such loans at brokers and dealers must be securities in one of the following categories: those traded on national securities exchanges, certain over-the-counter (OTC) stocks that the Board designates as having characteristics similar to those of stocks listed on the national exchanges, or bonds that meet certain requirements.

The Federal Reserve monitors the market activity of all OTC stocks to determine which of them are subject to the Board's margin regulations. The Board publishes the resulting "List of Marginable OTC Stocks" quarterly. In 1991 the OTC list was revised in February, May, August, and November; the November list contained 2,766 stocks.

Pursuant to a 1990 amendment to Regulation T, the Board publishes a list of foreign stocks that are eligible for margin treatment by brokers and dealers on the same basis as domestic margin securities. In 1991 the foreign list was revised in February, May, August, and November; the November list contained 294 stocks.

The Board adopted two sets of amendments in September 1991 to equalize treatment between lenders and between regulations. Amendments to Regulations G and T excluded from the margin regulations the deposit of margin securities with clearing agencies regulated either by the Commodity Futures Trading Commission or the Securities and Exchange Commission. Amendments to Regulations G and U extended the exemption for subsequent transfers of under-margined loans currently found in each of the regulations to loans made by one type of lender that are later transferred to the other type of lender.

The Board also issued an interpretation of the "single-credit" rule in Regulations G and U to indicate that compliance with the withdrawal and substitution provisions for syndicated loans can be met by the lead bank or lender.

Under section 8 of the Securities Exchange Act, a nonmember domestic or foreign bank may lend to brokers or dealers posting registered securities as collateral only if the bank has filed an agreement with the Board that it will comply with all the statutes, rules, and regulations applicable to member banks regarding credit on securities. The Board processed no new agreements in 1991.

In 1991 the Securities Regulation Section of the Board's Division of Banking Supervision and Regulation issued forty-nine interpretations of the margin regulations. Those that presented

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sufficiently important or novel issues were published in the *Securities Credit Transactions Handbook,* which is part of the Federal Reserve Regulatory Service. These interpretations serve as a guide to the margin regulations.

Financial Disclosure by State Member Banks

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. By statute, the Board's financial disclosure rules must be substantially similar to those issued by the Securities and Exchange Commission. At the end of 1991, thirty-seven state member banks, most of which are small or medium-sized, were registered with the Board under the Securities Exchange Act.

Loans to Executive Officers

Under Section 22(g) of the Federal Reserve Act, state member banks 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 this information, beginning with the last quarter of 1990 and continuing through the first three quarters of 1991.

Federal Reserve Membership

At the end of 1991, 4,831 banks were members of the Federal Reserve System, a decrease of 216 from the previous year. Member banks operated 34,874 branches on December 31, 1991, a net increase of 1,569 for the year.

Member banks accounted for 39 percent of all commercial banks in the United States and for 66 percent of all commercial banking offices. ■

Loans by State Member Banks to their Executive Officers, 1990–91

Period	Number	Amount (dollars)	Range of interest rates charged (percent)
October 1–December 31, 1990	793	15,206,000	5.0–18.0
January 1–March 31, 1991	773	14,439,000	5.0–18.0
April 1–June 30, 1991	904	22,646,000	6.5–28.5
July 1–September 30, 1991	771	12,483,000	6.8–18.0

SOURCE. Call Report data for the period.

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Regulatory Simplification

In 1978 the Board of Governors established the Regulatory Improvement Project in the Office of the Secretary to help minimize the burdens imposed by regulation. 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. The purpose of the regulatory simplification function is to ensure that the economic effect of regulation on small business is considered, 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. Board staff members continually review regulations for their adherence to these objectives.

Minimum Security Devices and Procedures

In March, after a period of public comment, the Board completed its review of Regulation P, which implements the Bank Protection Act of 1968. Since its adoption in 1969, the regulation has received only minor revisions, in 1973 and 1981. The Board's revisions simplify and clarify the parts of the regulation that already granted to bank management flexibility in achieving the purposes of the act; eliminate many obsolete or technical requirements, particularly those in Appendix A; and delete reporting requirements no longer specifically mandated by statute.

The revised regulation highlights the security responsibilities of boards of directors and security officers of banks rather than technological aspects of security, which become obsolete and require constant updating. The regulation gives managers flexibility to design security programs that include devices and procedures warranted by individual circumstances so long as the devices and procedures meet minimum requirements of the regulation.

International Banking

In April the Board completed its periodic review of Regulation K, International Banking Operations. The International Banking Act requires that the Board review its regulation of Edge Act corporations at least every five years. During some of the mandated reviews, the Board considers only the aspects of Regulation K that relate to Edge Act corporations; this time the Board included all of Regulation K in its review.

Many provisions of the revised regulation expand the authority of U.S. banks to operate in overseas financial markets without first obtaining Board approval. Among other things, the revisions enlarge existing authority to engage in underwriting and dealing in equity securities outside the United States, increase the dollar limits under which U.S. banking organizations may make investments abroad without advance notice to the Board, and clarify portfolio investment authority under which U.S. banking organizations may make limited equity investments in any type of company outside the United States.

Under the revision, Edge Act corporations can provide domestic banking services to foreign persons and governments; and U.S. banking organizations

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may engage in futures merchant activities and life insurance underwriting as permissible activities abroad. The revision also modifies the authorization for debt-for-equity investments by permitting banking organizations to include a cash component in such investments without first notifying the Board.

Applications by Bank Holding Companies To Conduct Nonbanking Activities

In 1990 the Board proposed for public comment adding three activities to the list of generally permitted activities under Regulation Y for nonbank subsidiaries of certain bank holding companies. The list of permissible activities allows simplified applications by bank holding companies to form or acquire subsidiaries engaging in the listed activities. The three activities proposed for inclusion were (1) leasing through non-full-payout contracts, (2) giving financial advice to financial and nonfinancial institutions and to individuals with high net worth, and (3) giving advice on securities investments in combination with the brokering of such investments. Because of pending legislation on bank products and services, the Board took no action on these regulatory proposals in 1991, but it will re-examine them in 1992 in light of the public comments received. ■

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Federal Reserve Banks

The Federal Reserve Banks are preparing to consolidate their general purpose data processing operations. Currently, each of the twelve Banks maintains a general purpose data processing center; in addition, the System has four backup centers (located in New York, Chicago, Los Angeles, and Culpeper, Virginia). Over the next several years, the data processing functions of the centers will be consolidated at three facilities—the Bank headquarters in Dallas (currently under construction) and Richmond and the New York Bank's East Rutherford, New Jersey, operations center (also under construction). The primary objectives of consolidation are improved reliability, enhanced responsiveness to changing business requirements, increased control of payment system risk in a national banking environment, and greater efficiency.

The decision to use three sites in the consolidation was influenced by anticipated capacity requirements, recovery capabilities, and flexibility in workload management. A key consideration in designing the consolidated environment has been the new nationwide telecommunications network currently being established.

Other Developments in Federal Reserve Services

The Monetary Control Act of 1980 requires the Federal Reserve System to recover all its costs of providing services. In 1991, income from all priced services was $912.5 million and costs were $886.8 million, resulting in net income of $25.6 million and a recovery rate of 102.9 percent. In 1990, the System recovered 103.3 percent of its service costs.[1]

Check Collection

The Federal Reserve's 1991 operating expenses and imputed costs for commercial check collection were $524.0 million (see the second pro forma income statement for priced services at the end of this chapter). Overall, check operations for the year generated $561.3 million in income and a net of $10.6 million in other income and expenses. Income from operations after imputed costs was $37.3 million. The Federal Reserve Banks handled 18.7 billion checks, an increase of 0.8 percent over 1990.

In 1989, the Board approved a pilot program in three Federal Reserve Districts under which the Reserve Banks will accept intermingled deposits of returned and forward-collection checks from depository institutions and in turn may present intermingled cash letters to the institutions. (Normally, these items must be kept separate.) In February 1991, the Director of the Division of Reserve Bank Operations and Payment Systems, acting under delegated authority, approved expansion of the pilot program to additional offices in the three

1. For a detailed breakdown of revenue, cost, and net revenue, see the first pro forma income statement at the end of this chapter. *Revenue* is the sum of income from services and investment income. *Cost* is the sum of production expenses, imputed costs, earnings credits, imputed income taxes, and the targeted return on equity. *Net revenue* is net income less the targeted return on equity.

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Districts. The expansion is making it possible to test specific aspects of exchanging intermingled checks among Federal Reserve offices within the same District. Expansion also has allowed large depository institutions that have affiliates served by several Federal Reserve offices within the same District to participate in a pilot program.

In May the Board revised the criteria for offering a tiered pricing structure for check collection: (1) Tiered pricing may be offered in all collection zones but may be used only when clear cost differences exist between groups of checks within a zone; (2) tiered prices may be used only when they have a potential to provide net savings for a substantial number of depositing institutions or a substantial amount of deposited volume; (3) a blended per-item fee will be offered as an alternative to tiered prices for each deposit category; and (4) Federal Reserve Banks may offer more than two price tiers within a collection zone, provided clear cost differences exist to justify more than two tiers. The Board also modified the process for approving implementation of tiered pricing; the revised process is the same as the process for approving other changes in price and service levels.

In October the Board voted not to approve an August 1990 proposal to introduce a cap on the per-item fees charged to ship checks from one Federal Reserve office to another via the Interdistrict Transportation System (ITS). The Board believed that the proposed pricing structure did not adequately reflect the marginal cost of transporting checks via ITS, and it determined that an alternative structure should not be adopted until a Federal Reserve System study of ITS can be completed and the results evaluated.

The Federal Reserve System continues to study the application of digital image technology to check processing. Use of the technology in such areas as archival systems, return item notification, check truncation, and adjustments may make check collection more efficient. During 1991, high-speed systems and low-speed applications were evaluated.

Automated Clearinghouse

Operating expenses and imputed costs of providing automated clearinghouse (ACH) services in 1991 were $54.1 million; income was $57.4 million. The Federal Reserve Banks processed 1,119 million commercial transactions during the year, an increase of 22.3 percent over 1990.

In June the Board adopted a proposal, issued for comment in December 1990, requiring depository institutions to originate or receive commercial ACH transactions through the Federal Reserve Banks via electronic connections. This practice will enable the Reserve Banks to improve their ACH services significantly by increasing the speed of delivery of ACH payments and reducing the risks associated with ACH payments. Depository institutions must establish these electronic connections by July 1, 1993.

Funds Transfer

Operating expenses and imputed costs of providing funds transfer services in 1991 totaled $73.0 million, and income was $78.2 million. The number of Fedwire funds transfers originated increased 7.0 percent over 1990, to 66.9 million.

In January the Federal Reserve Banks started providing same-day telephone notice of receipt of incoming Fedwire third-party funds transfers (including nonvalue messages related to a transfer of funds) to all depository institutions

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that do not have electronic access to Fedwire. Approved by the Board in September 1990, the service is designed to promote efficiency in the payments mechanism by providing timely information, which in turn permits prompt crediting of funds to beneficiary accounts.

Net Settlement

During 1991, 770,000 net settlement transactions were processed for participants in small-dollar clearing and settlement arrangements, predominantly check clearing arrangements; this volume was approximately the same as that processed in 1990. Net settlement via Fedwire is provided to two large-dollar clearing and settlement arrangements—the Clearing House Interbank Payments System and Participants Trust Company. Transaction volumes, costs, and income arising from the net settlement service are included with figures for the funds transfer service.

In April the Federal Reserve Bank of San Francisco began using a national ACH clearing arrangement to provide net settlement services to depository institutions. The service is the first ACH net settlement arrangement that uses a special settlement account and that is intended to operate nationally. The account is funded by participants in net debit positions using Fedwire transfers, and the funds are then disbursed to participants in net credit positions using Fedwire transfers.

Securities and Fiscal Agency Services

The Federal Reserve provides book-entry securities services for debt issues of the U.S. Treasury and for certain federally sponsored agencies such as the Federal Home Loan Mortgage Corporation and the Student Loan Marketing Association. Book-entry services for federal agency securities, a Federal Reserve priced service, in 1991 incurred costs of $12.3 million and earned income of $11.5 million. The Federal Reserve processed 2.8 million such transfers during the year, a 9.6 percent increase over 1990.

Most Federal Reserve Banks have fully implemented the Regional Delivery System (RDS) for over-the-counter savings bonds. The total number of bonds printed by the Federal Reserve System in 1991, RDS and other, exceeded 37 million.

Definitive Securities Safekeeping and Noncash Collection

The System received $13.8 million in income for definitive securities safekeeping and noncash collection services in 1991; the cost of providing these services was $14.4 million. The average number of definitive securities issues and deposits maintained in safekeeping accounts at the Federal Reserve Banks decreased 30.5 percent in 1991, to 57,039. The number of noncash collection items processed decreased 21.4 percent, to 2.2 million.

With volumes in both services declining, the System is developing a long-range plan for the definitive safekeeping service and will consolidate noncash collection functions at the Cleveland Bank and the Jacksonville Branch of the Atlanta Bank by 1993.

Currency and Coin

In its currency and coin operations, the Federal Reserve continued to focus on effectiveness of controls, efficiency of processing, and maintenance of quality in circulating currency.

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In 1991, income from priced cash services was $15.2 million, and the cost was $14.6 million. Four Federal Reserve Districts provided transportation of cash by armored carrier, and three Districts provided wrapped coin to depository institutions.

The Western Currency Facility of the U.S. Treasury's Bureau of Engraving and Printing began printing currency in April and began shipping currency to Federal Reserve offices in June. In August the Federal Reserve began distributing a new series of $100 note with two new features—a security thread and microprinting—to discourage photocopied counterfeits. Over the next five years, these security features will be incorporated into notes of all denominations except the $1 note.

In September a comprehensive assessment of the quality of U.S. currency was completed. The study revealed that, generally, the quality of currency in circulation is acceptable to consumers.

In October the first delivery of the System's new currency-processing equipment (ISS-3000), manufactured by Giesecke and Devrient, Inc., was received at the Baltimore Branch of the Federal Reserve Bank of Richmond. The new equipment will be installed throughout the Federal Reserve System by 1997.

The Federal Reserve System continued to work with the Department of the Treasury and other agencies to deter counterfeiting and laundering of U.S. currency.

Float

Federal Reserve float decreased to a daily average of $348 million in 1991, compared with $431 million in 1990. The costs of Federal Reserve float associated with priced services are recovered each year.

Examinations

The Board's Division of Reserve Bank Operations and Payment Systems examines the operations of the twelve Federal Reserve Banks and their twenty-five Branches each year, as required by section 21 of the Federal Reserve Act. The findings of the examinations are reported to the management and directors of the respective Banks and to the Board of Governors. Also, to assess conformance with policies established by the Federal Open Market Committee (FOMC), the division annually audits the accounts and holdings of the 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 FOMC. The examination procedures used by the division are reviewed each year by a public accounting firm.

Income and Expenses

The accompanying table summarizes the income, expenses, and distribution of net earnings of the Federal Reserve Banks for 1991 and 1990.

Income was $22,553 million in 1991 and $23,477 million in 1990. Total expenses were $1,539 million ($1,265 million in operating expenses, $164 million in earnings credits granted to depository institutions, and $110 million in assessment for expenditures by the Board of Governors). The cost of currency was $261 million. Income from financial services was $737 million.

The profit and loss account showed a net addition of $496 million, primarily a result of realized and unrealized gains on assets denominated in foreign currencies and gains on the sales of securities from the System Open Market Account portfolio. Dividends paid to member

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Income, Expenses, and Distribution of Net Earnings of Federal Reserve Banks, 1991 and 1990[1]

Millions of dollars

Item	1991	1990
Current income	22,553	23,477
Current expenses	1,429	1,350
Operating expenses[2]	1,265	1,211
Earnings credits granted	164	139
Current net income	21,124	22,127
Net addition to (deduction from) current net income	496	2,201
Cost of unreimbursed services to Treasury	90	102
Assessments by the Board of Governors	371	297
For expenditures of Board	110	104
For cost of currency	261	193
Net income before payments to Treasury	21,158	23,929
Dividends paid	153	141
Payments to Treasury (interest on Federal Reserve notes)	20,778	23,608
Transferred to surplus	228	180

1. Details may not sum to totals because of rounding.
2. Operating expenses include a net periodic credit for pension costs of $83 million in 1991 and $60 million in 1990.

banks, as required by law, totaled $153 million, $12 million more than in 1990. The rise reflects an increase in the capital and surplus of member banks and a consequent increase in the paid-in capital stock of the Federal Reserve Banks.

Payments to the U.S. Treasury in the form of interest on Federal Reserve notes totaled $20,778 million, compared with $23,608 million in 1990. The payments consist of all net income after deduction of dividends and deduction of the amount necessary to bring the surplus of the Banks to the level of capital paid in.

In the Statistical Tables chapter of this report, table 6 details income and expenses of each Federal Reserve Bank for 1991, and table 7 shows a condensed statement for each Bank for 1914–91. A detailed account of the assessments and expenditures of the Board of Governors appears in the next chapter—Board of Governors Financial Statements.

Holdings of Securities and Loans

Average daily holdings of securities and loans during 1991 were $256,929 million, an increase of $19,485 million over 1990 (see accompanying table). From 1990 to 1991, average daily holdings of U.S. government securities increased $20,036 million, and average daily holdings of loans decreased $551 million. Over the same period, the average rate of interest decreased from 8.45 percent to 7.51 percent on holdings of U.S. government securities and from 7.88 percent to 5.74 percent on loans.

Volume of Operations

Table 9, in the Statistical Tables chapter, shows the volume of operations in the principal departments of the Federal Reserve Banks for the years 1988–91.

Federal Reserve Bank Premises

During 1991, the Board of Governors authorized construction of new headquarters buildings for the Federal Reserve Banks of Cleveland and Minneapolis. Construction of the new operations center for the New York Bank and the new headquarters building for the Dallas Bank continued. Renovations of the main lobby of the St. Louis Bank and

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the main auditorium of the New York Bank were completed. Table 8, in the Statistical Tables chapter, shows the costs and book values both of premises owned or occupied by the Federal Reserve Banks and Branches and of real estate acquired for future banking-house purposes.

Securities and Loans of Federal Reserve Banks, 1989–91

Millions of dollars, except as noted

Item and year	Total	U.S. government securities[1]	Loans[2]
Average daily holdings[3]			
1989	233,449	232,312	1,137
1990	237,444	236,523	921
1991	256,929	256,559	370
Earnings			
1989	20,163	20,065	99
1990	20,067	19,995	73
1991	19,283	19,262	21
Average interest rate (percent)			
1989	8.64	8.64	8.70
1990	8.45	8.45	7.88
1991	7.51	7.51	5.74

1. Includes federal agency obligations.
2. Does not include indebtedness assumed by FDIC.
3. Based on holdings at opening of business.

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Pro Forma Balance Sheet for Priced Services, December 31, 1991 and 1990[1]
Millions of dollars

Item	1991		1990	
Short-term assets[2]				
Imputed reserve requirement on clearing balances	453.8		270.4	
Investment in marketable securities	3,328.2		1,982.6	
Receivables	63.4		60.4	
Materials and supplies	5.7		6.2	
Prepaid expenses	13.1		15.4	
Items in process of collection	4,167.4		2,474.1	
Total short-term assets		8,031.7		4,809.1
Long-term assets[3]				
Premises	360.1		319.9	
Furniture and equipment	163.5		158.0	
Leases and leasehold improvements	22.0		18.3	
Prepaid pension costs	97.3		71.1	
Total long-term assets		642.9		567.3
Total assets		**8,674.5**		**5,376.4**
Short-term liabilities				
Clearing balances and balances arising from early credit of uncollected items	4,576.0		2,726.8	
Deferred-availability items	3,373.4		2,000.3	
Short-term debt	82.3		82.0	
Total short-term liabilities		8,031.7		4,809.1
Long-term liabilities				
Obligations under capital leases	1.2		1.2	
Long-term debt	173.1		157.4	
Total long-term liabilities		174.3		158.6
Total liabilities		**8,206.0**		**4,967.7**
Equity		468.6		408.7
Total liabilities and equity[4]		**8,674.5**		**5,376.4**

1. Details may not sum to totals because of rounding.

2. The imputed reserve requirement on clearing balances held at Reserve Banks by depository institutions reflects a treatment comparable to that of compensating balances held at correspondent banks by respondent institutions. The reserve requirement imposed on respondent balances must be held as vault cash or as nonearning balances maintained at a Reserve Bank; thus, a portion of priced services clearing balances held with the Federal Reserve is shown as required reserves on the asset side of the balance sheet. The remainder of clearing balances is assumed to be invested in three-month Treasury bills, shown as investment in marketable securities. Receivables are (1) amounts due the Reserve Banks for priced services and (2) the share of suspense-account and difference-account balances related to priced services. Materials and supplies are the inventory value of short-term assets. Prepaid expenses include salary advances and travel advances for priced-service personnel. Items in process of collection (CIPC) is gross Federal Reserve CIPC stated on a basis comparable to that of a commercial bank. It reflects adjustments for intra-System items that would otherwise be double-counted on a consolidated Federal Reserve balance sheet; adjustments for items associated with nonpriced items, such as those collected for government agencies; and adjustments for items associated with providing fixed availability or credit before items are received and processed. Among the costs to be recovered under the Monetary Control Act is the cost of float, or net CIPC during the period (the difference between gross CIPC and deferred-availability items, which is the portion of gross CIPC that involves a financing cost), valued at the federal funds rate.

3. Long-term assets used solely in priced services, the priced-services portion of long-term assets shared with nonpriced services, and an estimate of the assets of the Board of Governors used in the development of priced services. Effective Jan. 1, 1987, the Reserve Banks implemented Financial Accounting Standards Board Statement No. 87, Employers' Accounting for Pensions. Accordingly, in 1991 the Reserve Banks recognized a credit to expenses of $28.1 million and a corresponding increase in this asset account.

4. Under the matched-book capital structure for assets that are not "self-financing," 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 fifty largest bank holding companies, which are used in the model for the private sector adjustment factor (PSAF). The PSAF consists of the taxes that would have been paid and the return on capital that would have been provided had 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.

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Pro Forma Income Statement for Federal Reserve Priced Services, Calendar Years 1991 and 1990[1]

Millions of dollars

Item	1991		1990	
Income from services provided to depository institutions[2]		737.5		730.2
Operating expenses[3]		611.9		597.1
Income from operations		125.6		133.1
Imputed costs[4]				
Interest on float	19.0		33.2	
Interest on debt	19.4		17.0	
Sales taxes	9.9		8.0	
FDIC insurance	6.3	54.6	5.0	63.2
Income from operations after imputed costs		71.0		70.0
Other income and expenses[5]				
Investment income	175.0		155.5	
Earnings credits	162.3	12.7	139.2	16.3
Income before income taxes		83.7		86.2
Imputed income taxes[6]		25.5		24.0
Net income		**58.1**		**62.3**
MEMO				
Targeted return on equity[7]		32.5		33.6

1. Details may not sum to totals because of rounding.

2. Income for priced services is realized from direct charges to an institution's account or from charges against accumulated earnings credits.

3. Operating expenses include direct, indirect, and other general administrative expenses of the Reserve Banks for priced services and the expenses of staff members of the Board of Governors working directly on the development of priced services, which were $2.0 million in 1991 and $1.7 million in 1990. The credit to expenses under FASB 87 is reflected in operating expenses (see the pro forma balance sheet, note 3).

4. Interest on float is derived from the value of float to be recovered, either explicitly or through per-item fees, during the period. Float costs include costs for checks, book-entry securities, noncash collection, ACH, and funds transfers.

Interest is imputed on debt assumed necessary to finance priced-service assets. The sales taxes and FDIC insurance assessment that the Federal Reserve would have paid had it been a private-sector firm are among the components of the PSAF (see the pro forma balance sheet, note 4).

The following list shows the daily average recovery of float by the Reserve Banks for 1991 in millions of dollars:

Total float	603.2
Unrecovered float	16.6
Float subject to recovery	586.6
Sources of recovery of float	
Income on clearing balances	70.2
As-of adjustments	258.5
Direct charges	102.4
Per-item fees	155.5

Unrecovered float includes float generated by services to government agencies and by other central bank services. Float recovered through income on clearing balances is the result of the increase in investable clearing balances; the increase is produced by a deduction for float for cash items in process of collection, which reduces imputed reserve requirements. The income on clearing balances reduces the float to be recovered through other means. As-of adjustments and direct charges are 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 1991.

5. Investment income is on clearing balances and 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 granted to depository institutions on their clearing balances 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.

6. Calculated at the effective tax rate derived from the PSAF model.

7. The after-tax rate of return on equity that the Federal Reserve would have earned had it been a private business firm, as derived from the PSAF model.

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Pro Forma Income Statement for Federal Reserve Priced Services, by Service, 1991[1]

Millions of dollars

Item	Total	Commercial check collection	Funds transfer and net settlement	Commercial ACH	Definitive safekeeping and noncash collection	Book-entry securities	Cash services
Income from services	737.5	561.3	78.2	57.4	13.8	11.5	15.2
Operating expenses	611.9	481.1	69.3	49.5	13.3	10.2	14.4
Income from operations	125.6	80.2	8.9	7.9	.4	1.3	.8
Imputed costs[2]	54.6	42.9	3.7	4.6	1.1	2.1	.2
Income from operations after imputed costs	71.0	37.3	5.2	3.3	−.7	−.8	.6
Other income and expenses, net[3]	12.7	10.6	.9	.7	.2	.1	.2
Income before income taxes	83.7	47.9	6.1	4.0	−.5	−.7	.8

1. Details may not sum to totals because of rounding. The effect of implementing FASB 87 (see the pro forma balance sheet, note 3) is reported only in the "total" column in this table and has not been allocated to individual priced services. Taxes and the aftertax targeted rate of return on equity, as shown on the overall pro forma income statement, have not been allocated among services because these elements relate to the organization as a whole.

2. Includes interest on float, interest on debt, sales taxes, and the FDIC assessment. Float costs are based on the actual float incurred for each priced service. Other imputed costs are allocated among priced services according to the ratio of operating expenses less shipping expenses for each service to the total expenses for all services less the total shipping expenses for all services.

3. Income on clearing balances and the cost of earnings credits. Because clearing balances relate directly to the Federal Reserve's offering of priced services, the income and cost associated with these balances are allocated to each service based on the ratio of income from each service to total income.

Activity in Federal Reserve Priced Services, Calendar Years 1991, 1990, and 1989[1]

Thousands of items, except as noted

Service	1991	1990	1989	Percent change	
				1991–90	1990–89
Funds transfers	66,921	62,559	60,645	7.0	3.2
Commercial ACH	1,119,073	915,257	740,623	22.3	23.6
Commercial checks	18,742,950	18,594,652	18,014,301	.8	3.2
Securities transfers	2,800	2,555	2,536	9.6	.7
Definitive safekeeping	57	82	110	−30.5	−25.4
Noncash collection	2,243	2,854	3,180	−21.4	−10.3
Cash transportation	338	330	322	2.4	2.5

1. Activity is defined as follows: for wire transfer of funds, the number of basic transactions originated; for ACH, total number of commercial items processed; for commercial checks, total number of commercial checks collected, including both processed and fine-sort items; for securities, number of basic transfers originated on line; for definitive safekeeping, average number of issues or receipts maintained; for noncash collection, number of items on which fees are assessed; and for cash transportation, number of armored-carrier stops.

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Income and Expenses for Locally Priced Federal Reserve Services, by District, 1991[1]
Millions of dollars

District	Total income	Operating expense	Float expense	Total expense	Net income
	Commercial check collection				
Boston	39.9	31.9	1.1	33.0	6.9
New York	72.4	61.2	2.3	63.5	8.9
Philadelphia	28.2	24.9	2.4	27.3	.9
Cleveland	32.2	27.4	1.1	28.5	3.7
Richmond	54.0	46.7	1.6	48.3	5.7
Atlanta	73.3	61.7	1.6	63.3	10.0
Chicago	72.7	60.5	2.3	62.8	9.9
St. Louis	24.6	19.3	1.4	20.7	3.9
Minneapolis	30.7	27.2	.5	27.7	3.0
Kansas City	36.0	30.5	1.2	31.7	4.3
Dallas	38.1	33.6	1.6	35.2	2.9
San Francisco	59.2	56.2	1.5	57.7	1.5
System total	**561.3**	**481.1**	**18.6**	**499.7**	**61.6**
	Definitive safekeeping and noncash collection				
Boston	.7	.7	*	.7	.0
New York	2.4	2.4	*	2.4	.0
Philadelphia	.9	.8	*	.8	.1
Cleveland	1.6	1.3	*	1.3	.3
Richmond	.8	.9	*	.9	-.1
Atlanta	2.4	1.9	*	1.9	.5
Chicago	2.0	2.1	*	2.1	-.1
St. Louis	.7	.5	*	.5	.2
Minneapolis	.2	.3	*	.3	-.1
Kansas City	.9	1.3	*	1.3	-.4
Dallas	1.2	1.1	*	1.1	.1
San Francisco	*	*	*	*	*
System total	**13.8**	**13.3**	**.1**	**13.4**	**.4**
	Cash services				
Boston	*	...	...	*	*
New York	*	...	...	*	*
Philadelphia	1.8	...	...	1.8	.0
Cleveland	1.9	...	...	1.8	.1
Richmond	*	...	...	*	*
Atlanta	*	...	...	*	*
Chicago	.5	...	...	.5	.0
St. Louis	.1	...	...	.1	.0
Minneapolis	3.0	...	...	2.6	.4
Kansas City	.6	...	...	.5	.1
Dallas	*	...	...	*	*
San Francisco	7.2	...	...	6.9	.3
System total	**15.2**	...	...	**14.4**	**.8**

1. Details may not sum to totals because of rounding; also, expenses related to research and development projects are reported at the System level, and therefore the sum of expenses for the twelve Districts may not 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. To reconcile net revenue by priced service shown in this table with that shown in the income statement by service, adjustments must be made for imputed interest on debt, sales taxes, FDIC assessment, Board expenses for priced services, and net income on clearing balances.

*In absolute value, greater than zero and less than $50,000.

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Board of Governors Financial Statements

The financial statements of the Board were audited by Coopers & Lybrand, independent public accountants, for 1991 and 1990.

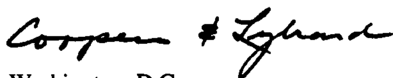
Report of Independent Accountants

To the Board of Governors of the
Federal Reserve System

We have audited the accompanying balance sheets of the Board of Governors of the Federal Reserve System (the Board), as of December 31, 1991 and 1990, and the related statements of revenues and expenses and fund balance and cash flows for the years then ended. 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 in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those 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. An audit also includes 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 our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Board of Governors of the Federal Reserve System as of December 31, 1991 and 1990, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.



Washington, D.C.
February 12, 1992

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BALANCE SHEETS

	As of December 31,	
	1991	1990
ASSETS		
CURRENT ASSETS		
Cash	$ 4,498,138	$ 9,256,285
Accounts receivable	1,227,367	1,146,044
Prepaid expenses and other assets	778,485	827,876
Total current assets	6,503,990	11,230,205
PROPERTY, BUILDINGS AND EQUIPMENT, Net (Note 3)	50,338,953	50,841,923
Total assets	$56,842,943	$62,072,128
LIABILITIES AND FUND BALANCE		
CURRENT LIABILITIES		
Accounts payable	$ 3,609,392	$ 4,208,717
Accrued payroll and related taxes	1,120,332	3,673,252
Accrued annual leave	5,057,365	4,760,513
Unearned revenues and other liabilities	1,257,442	1,042,167
Total current liabilities	11,044,531	13,684,649
COMMITMENTS (Note 5)		
FUND BALANCE	45,798,412	48,387,479
Total liabilities and fund balance	$56,842,943	$62,072,128

The accompanying notes are an integral part of these statements.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF REVENUES AND EXPENSES AND FUND BALANCE

	For the years ended December 31,	
	1991	1990
BOARD OPERATING REVENUES		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures	$109,631,000	$103,752,200
Other revenues (Note 4)	4,520,462	4,217,225
Total operating revenues	114,151,462	107,969,425
BOARD OPERATING EXPENSES		
Salaries	75,056,412	69,562,505
Retirement and insurance contributions	11,590,355	9,529,726
Depreciation and net losses on disposals	5,682,355	5,968,909
Travel	3,542,401	3,466,251
Postage and supplies	3,344,444	3,358,071
Utilities	3,286,946	3,460,224
Contractual services and professional fees	3,113,853	3,048,327
Repairs and maintenance	2,877,050	2,709,196
Software	2,478,238	2,125,800
Printing and binding	2,059,165	2,202,823
Other expenses (Note 4)	3,709,310	2,988,899
Total operating expenses	116,740,529	108,420,731
BOARD OPERATING REVENUES (UNDER) EXPENSES	(2,589,067)	(451,306)
ISSUANCE AND REDEMPTION OF FEDERAL RESERVE NOTES		
Assessments levied on Federal Reserve Banks for currency costs	261,316,379	193,006,998
Expenses for currency printing, issuance, retirement, and shipping	261,316,379	193,006,998
CURRENCY ASSESSMENTS (UNDER) OVER EXPENSES	—	—
TOTAL REVENUES (UNDER) EXPENSES	(2,589,067)	(451,306)
FUND BALANCE, Beginning of year	48,387,479	48,838,785
FUND BALANCE, End of year	$ 45,798,412	$ 48,387,479

The accompanying notes are an integral part of these statements.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF CASH FLOWS

Increase (Decrease) in Cash

	For the years ended December 31,	
	1991	1990
CASH FLOWS FROM OPERATING ACTIVITIES		
Board operating revenues (under) expenses	$(2,589,067)	$ (451,306)
Adjustments to reconcile operating revenues (under) expenses to net cash provided by operating activities:		
Depreciation and net losses on disposals	5,682,355	5,968,909
Increase in accounts receivable, and prepaid expenses and other assets	(31,932)	(210,391)
Increase in accrued annual leave	296,852	422,251
(Decrease) in accounts payable	(599,325)	(652,063)
(Decrease) Increase in payroll payable	(2,552,920)	641,836
Increase in unearned revenue and other liabilities	215,275	139,027
Net cash provided by operating activities	421,238	5,858,263
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from disposals of furniture and equipment	36,156	8,900
Capital expenditures	(5,215,541)	(3,521,903)
Net cash used in investing activities	(5,179,385)	(3,513,003)
NET INCREASE (DECREASE) IN CASH	(4,758,147)	2,345,260
CASH BALANCE, Beginning of year	9,256,285	6,911,025
CASH BALANCE, End of year	$ 4,498,138	$ 9,256,285

The accompanying notes are an integral part of these statements.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOTES TO FINANCIAL STATEMENTS

(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 three to ten years for furniture and equipment and from ten to fifty years for building equipment and structures. Upon the sale or other disposition of a depreciable asset, the cost and related accumulated depreciation are removed from the accounts and any gain or loss is recognized.

(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 before 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 December 31, 1991, actuarial calculations showed that the fair value of the assets of the System's Plan exceeded the projected benefit obligations by 113 percent. Based on these calculations and similar calculations performed for 1990, it was determined that employer funding contributions were not required for the years 1991 and 1990 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 $674,700 in 1991 and $639,600 in 1990.

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 $2,696,800 in 1991 and $2,107,700 in 1990.

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 $522,100 in 1991 and $367,300 in 1990.

(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,	
	1991	1990
Land and improvements	$ 1,301,314	$ 1,301,314
Buildings	63,726,137	63,573,336
Furniture and equipment	35,146,359	32,768,173
	100,173,810	97,642,823
Less accumulated depreciation	49,834,857	46,800,900
Total property, buildings and equipment	$ 50,338,953	$ 50,841,923

(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,	
	1991	1990
Other Revenues		
Data processing revenue	$2,364,284	$2,002,546
Subscription revenue	1,744,775	1,681,241
Assistance to Federal agencies	43,426	332,658
Miscellaneous	367,977	200,780
Total other revenues	$4,520,462	$4,217,225

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(4) Other Revenues and Other Expenses—Cont.

Other Expenses		
Cafeteria operations, net	$ 783,362	$ 694,047
Tuition, registrations and membership fees	692,131	615,534
Equipment and facility rentals	682,962	544,187
Subsidies and contributions	638,975	529,289
Miscellaneous	911,880	605,842
Total other expenses	$3,709,310	$2,988,899

(5) Commitments

The Board has entered into several operating leases to secure office, classroom, and warehouse space for periods ranging from two to ten years. Minimum future rental commitments under those operating leases having an initial or remaining noncancelable lease term in excess of one year at December 31, 1991, are as follows:

1992	$ 611,242
1993	571,978
1994	456,441
1995	406,620
1996	422,796
	$2,469,077

Rental expenses under these operating leases were $635,100 and $471,500 in 1991 and 1990, respectively.

(6) Federal Financial Institutions Examination Council

The Board is one of the five member agencies of the Federal Financial Institutions Examination Council (the "Council"). During 1991 and 1990, the Board paid $241,040 and $146,200, respectively, in assessments for operating expenses of the Council. These amounts are included in subsidies and contributions for 1991 and 1990.

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 $40,000 and $34,000 for 1991 and 1990, respectively.

The Board is not reimbursed for the costs of personnel who serve on the Council and on the various task forces and committees of the Council. ■

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Statistical Tables

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1. Detailed Statement of Condition of All Federal Reserve Banks Combined, December 31, 1991[1]

Thousands of dollars

ASSETS				
Gold certificate account				**11,058,778**
Special drawing rights certificate account				**10,018,000**
Coin				**527,613**
Loans and securities				
Loans to depository institutions			**218,356**	
Federal agency obligations				
Bought outright			**6,044,500**	
Held under repurchase agreement			**552,850**	
U.S. Treasury securities				
Bought outright				
Bills	**132,635,005**			
Notes	**101,519,719**			
Bonds	**32,331,474**			
Total bought outright		**266,486,198**		
Held under repurchase agreement		**15,345,150**		
Total securities			**281,831,348**	
Total loans and securities				**288,647,054**
Items in process of collection				
Transit items			7,093,797	
Other items in process of collection			1,191,655	
Total items in process of collection				**8,285,452**
Bank premises				
Land			144,591	
Buildings (including vaults)	690,804			
Building machinery and equipment	191,695			
Construction account	199,872			
Total bank premises		1,082,371		
Less depreciation allowance		240,249	842,122	
Bank premises, net				**986,714**
Other assets				
Furniture and equipment		819,345		
Less depreciation		480,008		
Total furniture and equipment, net			339,337	
Denominated in foreign currencies[2]			27,626,276	
Interest accrued			3,111,150	
Premium on securities			1,869,578	
Overdrafts			17,312	
Prepaid expenses			354,413	
Suspense account			12,698	
Real estate acquired for banking-house purposes			16,753	
Other			189,675	
Total other assets				**33,537,192**
Total assets				**353,060,803**

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1.—Continued

Liabilities		
Federal Reserve Notes		
Outstanding (issued to Federal Reserve Banks)	366,467,574	
Less held by Federal Reserve Banks	78,561,962	
Total Federal Reserve notes, net		**287,905,612**
Deposits		
Depository institutions		**29,412,997**
U.S. Treasury, general account		**17,696,902**
Foreign, official accounts		**967,609**
Other deposits		
Officers' and certified checks	19,932	
International organizations	79,778	
Other[3]	1,606,070	
Total other deposits		**1,705,780**
Deferred credit items		**7,259,372**
Other liabilities		
Discount on securities	2,319,224	
Sundry items payable	72,311	
Suspense account	34,095	
All other	383,884	
Total other liabilities		**2,809,514**
Total liabilities		**347,757,787**
Capital Accounts		
Capital paid in		**2,651,508**
Surplus		**2,651,508**
Other capital accounts[4]		**0**
Total liabilities and capital accounts		**353,060,803**

1. Amounts in boldface type indicate items in the Board's weekly statement of condition of the Federal Reserve Banks.
2. Of this amount $8,152.3 million was invested in securities issued by foreign governments, and the balance was invested with foreign central banks and the Bank for International Settlements.
3. In closing out the other capital accounts at year-end, the Reserve Bank earnings that are payable to the Treasury are included in this account pending payment.
4. During the year, includes undistributed net income, which is closed out on Dec. 31.

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2. Statement of Condition of Each Federal Reserve Bank, December 31, 1991 and 1990

Millions of Dollars[1]

Item	Total		Boston	
	1991	1990	1991	1990
ASSETS				
Gold certificate account	11,059	11,058	747	750
Special drawing rights certificate account	10,018	10,018	711	711
Coin	528	535	34	41
Loans				
To depository institutions	218	190	0	14
Other	0	0	0	0
Acceptances held under repurchase agreements	0	0	0	0
Federal agency obligations				
Bought outright	6,045	6,342	409	426
Held under repurchase agreements	553	1,341	0	0
U.S. Treasury securities				
Bought outright[2]	266,486	235,090	18,041	15,794
Held under repurchase agreements	15,345	17,013	0	0
Total loans and securities	288,647	259,975	18,450	16,233
Items in process of collection	8,286	6,106	464	287
Bank premises	987	872	89	90
Other assets				
Denominated in foreign currencies[3]	27,626	32,633	1,111	1,207
All other	5,911	6,376	303	287
Interdistrict Settlement Account	0	0	−1,287	1,909
Total assets	**353,061**	**327,573**	**20,623**	**21,515**
LIABILITIES				
Federal Reserve notes	287,906	267,657	18,350	18,879
Deposits				
Depository institutions	29,413	38,658	1,391	2,109
U.S. Treasury, general account	17,697	8,960	0	0
Foreign, official accounts	968	369	6	6
Other	1,706	242	81	3
Total deposits	49,783	48,228	1,478	2,118
Deferred credit items	7,259	3,540	443	132
Other liabilities and accrued dividends[4]	2,810	3,301	156	192
Total liabilities	**347,758**	**322,727**	**20,428**	**21,320**
CAPITAL ACCOUNTS				
Capital paid in	2,652	2,423	99	97
Surplus	2,652	2,423	98	97
Other capital accounts	0	0	0	0
Total liabilities and capital accounts	**353,061**	**327,573**	**20,623**	**21,515**
FEDERAL RESERVE NOTE STATEMENT				
Federal Reserve notes outstanding (issued to Bank)	366,468	304,829	23,044	21,409
Less: Held by Bank	78,562	37,172	4,693	2,530
Federal Reserve notes, net	**287,906**	**267,657**	**18,350**	**18,879**
Collateral for Federal Reserve notes				
Gold certificate account	11,059	11,058	...	...
Special drawing rights certificate account	10,018	10,018	...	...
Other eligible assets	0	0	...	...
U.S. Treasury and federal agency securities	266,829	246,581	...	...
Total collateral	**287,906**	**267,657**	...	...

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Federal Reserve Bank of St. Louis

2.—Continued

New York		Philadelphia		Cleveland		Richmond	
1991	1990	1991	1990	1991	1990	1991	1990
3,914	3,501	318	384	692	688	948	1,008
3,395	3,395	319	319	645	645	961	961
16	16	40	31	30	39	99	105
7	23	45	24	0	0	105	6
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
2,382	2,341	160	185	378	380	478	590
553	1,341	0	0	0	0	0	0
105,022	86,783	7,041	6,846	16,674	14,084	21,079	21,881
15,345	17,013	0	0	0	0	0	0
123,309	107,501	7,246	7,055	17,052	14,464	21,662	22,476
969	570	592	527	354	257	608	341
127	76	44	45	34	36	123	122
7,606	8,844	1,312	1,468	1,428	1,795	1,688	2,023
2,918	2,373	146	179	350	332	374	906
−12,000	−1,044	3,172	−702	1,766	1,077	321	−5,674
130,253	**125,233**	**13,189**	**9,307**	**22,352**	**19,332**	**26,784**	**22,270**
100,834	102,697	10,872	7,078	19,950	17,005	23,426	18,904
6,461	9,934	1,470	1,774	1,572	1,817	2,210	2,654
17,697	8,960	0	0	0	0	0	0
859	259	7	7	8	8	9	9
642	156	74	2	88	2	66	16
25,658	19,310	1,551	1,782	1,667	1,827	2,285	2,679
866	382	490	132	270	83	541	119
1,353	1,511	66	84	143	167	191	271
128,710	**123,899**	**12,979**	**9,077**	**22,029**	**19,082**	**26,443**	**21,974**
771	667	105	115	161	125	171	148
771	667	105	115	161	125	171	148
0	0	0	0	0	0	0	0
130,253	**125,233**	**13,189**	**9,307**	**22,352**	**19,332**	**26,784**	**22,270**
128,066	108,722	13,068	8,380	23,151	18,651	31,583	24,543
27,231	6,026	2,196	1,302	3,201	1,646	8,158	5,639
100,834	**102,697**	**10,872**	**7,078**	**19,950**	**17,005**	**23,426**	**18,904**
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2. Statement of Condition of Each Federal Reserve Bank, December 31, 1991 and 1990—Continued

Millions of Dollars[1]

Item	Atlanta		Chicago	
	1991	1990	1991	1990
ASSETS				
Gold certificate account	479	465	1,370	1,377
Special drawing rights certificate account	303	303	1,336	1,336
Coin	46	54	53	33
Loans				
To depository institutions	1	12	13	20
Other	0	0	0	0
Acceptances held under repurchase agreements	0	0	0	0
Federal agency obligations				
Bought outright	202	221	760	773
Held under repurchase agreements	0	0	0	0
U.S. Treasury securities				
Bought outright[2]	8,912	8,209	33,486	28,672
Held under repurchase agreements	0	0	0	0
Total loans and securities	9,115	8,443	34,259	29,465
Items in process of collection	895	581	799	759
Bank premises	57	58	112	110
Other assets				
Denominated in foreign currencies[3]	2,799	3,198	3,420	4,079
All other	205	336	599	759
Interdistrict Settlement Account	1,987	2,887	237	2,974
Total assets	**15,887**	**16,325**	**42,183**	**40,892**
LIABILITIES				
Federal Reserve notes	11,426	11,768	37,207	36,047
Deposits				
Depository institutions	2,970	3,723	3,102	3,511
U.S. Treasury, general account	0	0	0	0
Foreign, official accounts	15	15	19	19
Other	117	3	211	31
Total deposits	3,102	3,740	3,332	3,560
Deferred credit items	792	226	702	343
Other liabilities and accrued dividends[4]	81	100	301	342
Total liabilities	**15,401**	**15,834**	**41,542**	**40,292**
CAPITAL ACCOUNTS				
Capital paid in	243	246	321	300
Surplus	243	246	321	300
Other capital accounts	0	0	0	0
Total liabilities and capital accounts	**15,887**	**16,325**	**42,183**	**40,892**
FEDERAL RESERVE NOTE STATEMENT				
Federal Reserve notes outstanding (issued to Bank)	17,196	15,085	41,660	39,007
Less: Held by Bank	5,771	3,317	4,452	2,960
Federal Reserve notes, net	**11,426**	**11,768**	**37,207**	**36,047**

1. Components may not sum to totals because of rounding.
2. 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.
3. Valued monthly at market exchange rates.
4. Includes exchange-translation account reflecting the monthly revaluation at market exchange rates of foreign-exchange commitments.

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2.—Continued

St. Louis		Minneapolis		Kansas City		Dallas		San Francisco	
1991	1990	1981	1990	1991	1990	1991	1990	1991	1990
328	346	171	203	370	422	515	585	1,207	1,329
307	307	172	172	334	334	463	463	1,072	1,072
29	36	14	13	31	33	43	44	94	89
25	28	0	6	9	10	3	23	11	25
0	0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0	0
160	184	78	101	168	207	237	226	633	706
0	0	0	0	0	0	0	0	0	0
7,058	6,817	3,445	3,755	7,386	7,672	10,456	8,391	27,886	26,185
0	0	0	0	0	0	0	0	0	0
7,243	7,028	3,523	3,862	7,563	7,890	10,695	8,640	28,528	26,917
275	280	544	365	515	478	773	977	1,498	685
29	28	32	33	53	54	141	72	147	149
724	881	782	979	1,055	1,273	2,105	2,480	3,597	4,405
128	146	77	107	136	168	192	224	482	559
−1,609	183	2,640	−189	−810	−926	1,600	986	3,983	−1,482
7,453	**9,235**	**7,955**	**5,546**	**9,247**	**9,725**	**16,526**	**14,472**	**40,608**	**33,722**
6,035	7,507	6,691	3,929	7,145	7,799	13,530	11,481	32,440	24,563
914	1,410	653	1,028	1,313	1,202	1,646	1,757	5,713	7,741
0	0	0	0	0	0	0	0	0	0
4	4	4	5	6	6	11	11	20	20
42	1	38	6	60	9	97	7	192	7
960	1,415	695	1,039	1,379	1,217	1,754	1,775	5,924	7,768
255	105	399	395	458	430	722	746	1,321	448
73	80	31	46	68	95	96	100	251	313
7,322	**9,108**	**7,816**	**5,408**	**9,049**	**9,540**	**16,103**	**14,102**	**39,936**	**33,092**
66	64	70	69	99	93	211	185	336	315
66	64	70	69	99	93	211	185	336	315
0	0	0	0	0	0	0	0	0	0
7,453	**9,235**	**7,955**	**5,546**	**9,247**	**9,725**	**16,526**	**14,472**	**40,608**	**33,722**
8,883	9,163	8,117	4,698	9,618	9,910	17,683	13,926	44,400	31,335
2,848	1,656	1,427	769	2,473	2,111	4,152	2,445	11,961	6,773
6,035	**7,507**	**6,691**	**3,929**	**7,145**	**7,799**	**13,530**	**11,481**	**32,440**	**24,563**

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3. Federal Reserve Open Market Transactions, 1991[1]

Millions of dollars

Type of transaction	Jan.	Feb.	Mar.	Apr.
U.S. TREASURY SECURITIES				
Outright transactions (excluding matched transactions)				
Treasury bills				
Gross purchases	0	1967	313	908
Gross sales	120	0	0	0
Exchanges	23,702	21,381	18,808	21,981
Redemptions	1,000	0	0	0
Others within 1 year				
Gross purchases	0	100	700	700
Gross sales	0	0	0	0
Maturity shift	989	2,292	413	4,324
Exchanges	−1,326	−3,045	−1,877	−993
Redemptions	1,000	0	0	0
1 to 5 years				
Gross purchases	0	0	2,950	550
Gross sales	0	0	0	0
Maturity shift	−778	−1,909	−213	−4,214
Exchanges	929	2,545	1,877	777
5 to 10 years				
Gross purchases	0	350	50	0
Gross sales	0	0	0	0
Maturity shift	−212	−23	−200	−110
Exchanges	397	400	0	216
More than 10 years				
Gross purchases	0	0	0	0
Gross sales	0	0	0	0
Maturity shift	0	−361	0	0
Exchanges	0	100	0	0
All maturities				
Gross purchases	0	2,417	4,013	2,158
Gross sales	120	0	0	0
Redemptions	1,000	0	0	0
Matched transactions				
Gross sales	137,176	127,589	151,096	185,662
Gross purchases	137,512	127,502	151,412	187,032
Repurchase agreements[2]				
Gross purchases	36,337	44,688	23,821	16,173
Gross sales	38,462	44,809	38,589	16,173
Net change in U.S. Treasury securities	−2,909	2,209	−10,439	3,528
FEDERAL AGENCY OBLIGATIONS				
Outright transactions				
Gross purchases	0	0	0	0
Gross sales	0	0	0	0
Redemptions	0	0	0	91
Repurchase agreements[2]				
Gross purchases	4,416	3,546	2,518	640
Gross sales	3,571	4,466	3,784	640
Net change in agency obligations	845	−920	−1,266	−91
Total net change in System Open Market Account	**−2,064**	**1,290**	**−11,705**	**3,437**

1. Sales, redemptions, and negative figures reduce holdings of the System Open Market Account; all other figures increase such holdings. Details may not sum to totals because of rounding.

2. In July 1984 the Open Market Trading Desk discontinued accepting bankers acceptances in repurchase agreements.

*Less than $500,000 in absolute value.

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3.—Continued

May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
3,411	37	1,359	5,776	529	2,198	2,823	837	20,158
0	0	0	0	0	0	0	0	120
27,548	19,680	25,180	28,009	19,508	25,409	24,141	21,967	277,314
0	0	0	0	0	0	0	0	1,000
200	0	625	340	200	0	178	0	3,043
0	0	0	0	0	0	0	0	0
5,175	0	1,478	3,425	1,131	2,002	1,655	1,570	24,454
–4,887	0	–3,136	–2,443	–2,202	–2,034	–2,585	–3,562	–28,090
0	0	0	0	0	0	0	0	1,000
0	0	0	0	650	0	2,133	300	6,583
0	0	0	0	0	0	0	0	0
–3,410	0	–1,192	–3,425	–1,131	–1,877	–1,492	–1,570	–21,211
4,287	0	2,601	1,993	2,202	1,686	2,135	3,562	24,594
0	0	0	0	0	0	880	0	1,280
0	0	0	0	0	0	0	0	0
–1,605	0	–286	–688	0	–126	163	0	–2,037
400	0	534	300	0	347	300	0	2,894
0	0	0	0	0	0	375	0	375
0	0	0	0	0	0	0	0	0
–160	0	0	–688	0	0	0	0	–1,209
200	0	0	150	0	0	150	0	600
3,611	37	1,984	6,116	1,379	2,198	6,390	1,137	31,439
0	0	0	0	0	0	0	0	120
0	0	0	0	0	0	0	0	1,000
147,796	118,903	120,292	112,414	116,266	137,073	98,063	118,127	1,570,456
147,803	118,239	121,803	110,280	118,481	135,281	97,925	118,263	1,571,534
9,241	9,440	35,149	16,847	40,447	12,432	14,165	51,345	310,084
9,241	8,478	36,111	16,847	40,447	3,718	22,879	36,000	311,752
3,618	335	2,532	3,981	3,595	9,121	–2,462	16,619	29,729
0	0	0	0	0	0	0	0	0
0	0	0	0	5	0	0	0	5
37	0	55	0	0	14	51	45	292
885	1,225	3,245	537	3,061	714	275	1,744	22,807
885	748	3,722	537	3,061	695	294	1,191	23,595
–37	477	–532	0	–5	5	–70	508	–1,085
3,581	**812**	**2,000**	**3,981**	**3,590**	**9,126**	**–2,532**	**17,127**	**28,644**

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4. Federal Reserve Bank Holdings of U.S. Treasury and Federal Agency Securities, December 31, 1989–91[1]

Millions of dollars

Description	December 31			Increase or decrease (–)	
	1991	1990	1989	1991	1990
U.S. Treasury securities, total	**281,831**	**252,103**	**228,367**	**29,728**	**23,736**
By term					
1–15 days[2]	21,109	22,530	9,413	–1,421	13,117
16–90 days	66,759	57,538	55,523	9,221	2,015
91 days to 1 year	90,655	75,428	70,687	15,227	4,741
1–5 years	64,299	58,749	53,509	5,550	5,240
5–10 years	14,469	13,121	12,529	1,348	592
More than 10 years	24,540	24,736	26,706	–196	–1,970
By type of holding					
Held outright					
Treasury bills[3]	132,635	112,520	104,581	20,115	7,939
Treasury notes	101,520	91,407	91,381	10,113	25
Treasury bonds	32,331	31,163	30,814	1,168	350
Held under repurchase agreements	15,345	17,013	1,592	–1,668	15,421
Federal agency obligations, total	**6,045**	**6,342**	**6,525**	**–297**	**–183**
By term					
1–15 days[2]	200	200	153	0	47
16–90 days	811	737	568	74	169
91 days to 1 year	1,329	1,639	1,346	–310	293
1–5 years	2,508	2,555	3,198	–47	–643
5–10 years	1,008	1,022	1,071	–14	–49
More than 10 years	189	188	188	1	0
By type of holding					
Held outright					
Federal Farm Credit Banks	1,440	1,560	1,630	–120	–70
Federal Home Loan Banks	2,029	2,161	2,251	–132	–90
Federal Home Loan Financing Corporation	0	0	0	0	0
Federal Home Loan Mortgage Corporation	0	0	0	0	0
Federal Intermediate Credit Banks[4]	0	0	0	0	0
Federal Land Banks	66	108	130	–42	–22
Federal Home Administration	0	0	0	0	0
Federal National Mortgage Association	2,342	2,346	2,347	–4	–1
Federal National Sinking Fund	0	0	0	0	0
Government National Mortgage Association participation certificates[4]	0	0	0	0	0
U.S. Postal Service	37	37	37	0	0
Washington Metropolitan Area Transit Authority	117	117	117	0	0
General Services Administration	12	12	13	0	–1
Held under repurchase agreements	553	1,341	525	–788	816

1. Details may not sum 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, 1989.

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5. Number and Salaries of Officers and Employees of Federal Reserve Banks, December 31, 1991

Federal Reserve Bank (including) branches	President	Other officers		Employees			Total	
	Annual salary (dollars)	Number	Annual salaries (dollars)	Number: Full-time	Number: Part-time	Annual salaries (dollars)	Number	Annual salaries (dollars)
Boston	162,600	56	4,982,200	1,264	267	45,447,152	1,588	50,591,952
New York	245,400	173	17,254,050	3,834	62	135,587,042	4,070	153,086,492
Philadelphia	173,500	58	4,870,350	1,272	146	38,775,718	1,477	43,819,568
Cleveland	Vacant	62	5,129,800	1,301	70	36,592,862	1,434	41,722,662
Richmond	187,900	87	7,120,600	1,921	132	52,486,264	2,141	59,794,764
Atlanta	196,000	71	5,660,700	2,255	63	62,856,318	2,390	68,713,018
Chicago	209,000	95	7,837,150	2,405	34	74,310,793	2,535	82,356,943
St. Louis	179,000	50	3,718,100	1,072	101	29,596,497	1,224	33,493,597
Minneapolis	162,000	49	3,881,500	989	123	29,999,915	1,162	34,043,415
Kansas City	146,500	58	4,599,000	1,550	46	44,389,377	1,655	49,134,877
Dallas	147,500	58	4,627,300	1,624	49	50,336,327	1,732	55,111,127
San Francisco	210,000	100	9,346,925	2,430	78	79,618,829	2,609	89,175,754
Total	**2,019,400**	**917**	**79,027,675**	**21,917**	**1,171**	**679,997,094**	**24,017**	**761,044,169**

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6. Income and Expenses of Federal Reserve Banks, 1991

Dollars

Item[1]	Total	Boston	New York	Philadelphia	Cleveland
CURRENT INCOME					
Loans	25,571,333	1,845,058	3,526,832	510,153	477,189
U.S. Treasury and federal agency securities	19,262,265,500	1,293,210,618	7,506,681,372	522,542,526	1,181,833,460
Foreign currencies	2,499,370,712	99,778,152	687,140,766	118,175,928	129,935,784
Priced services	737,454,292	49,114,837	105,489,922	37,861,697	43,638,765
Other	28,339,977	1,212,267	18,369,961	824,337	635,040
Total	**22,553,001,814**	**1,445,160,932**	**8,321,208,853**	**679,914,641**	**1,356,520,238**
CURRENT EXPENSES					
Salaries and other personnel expenses	738,153,925	50,947,365	157,898,201	43,484,791	44,513,218
Retirement and other benefits[2]	101,544,004	11,326,125	37,066,336	10,632,465	11,164,188
Fees	20,456,306	2,817,489	2,447,486	512,588	5,872,972
Travel	32,816,521	1,694,429	4,402,544	1,801,676	2,338,517
Software expenses	32,733,641	1,734,559	8,338,608	1,275,675	1,463,654
Postage and other shipping costs	88,175,111	5,130,166	10,876,235	4,916,471	6,209,011
Communications	9,773,482	589,212	2,001,558	453,934	623,744
Materials and supplies	54,576,433	3,383,120	9,921,250	2,913,789	3,059,846
Building expenses					
Taxes on real estate	26,526,902	3,679,240	3,944,404	1,841,755	1,345,599
Property depreciation	35,554,702	2,841,455	3,976,235	1,796,763	1,800,882
Utilities	26,706,109	2,156,338	3,795,032	2,986,575	1,813,805
Rent	23,629,300	651,033	15,935,929	100,276	400,177
Other	20,542,848	880,511	3,103,584	964,753	703,652
Equipment					
Purchases	6,386,264	231,896	41,171	341,693	145,222
Rentals	20,741,963	753,471	4,770,697	811,205	740,619
Depreciation	87,143,920	5,486,594	16,880,471	3,986,909	6,540,737
Repairs and maintenance	51,852,412	3,037,153	8,137,433	2,374,637	3,687,398
Earnings-credit costs	163,976,030	9,180,545	33,190,616	13,986,254	8,545,603
Other	34,791,808	2,428,345	5,556,468	1,641,305	2,351,105
Shared costs, net[3]	0	(1,062,949)	(873,667)	2,424,132	1,874,861
Recoveries	(36,945,993)	(8,977,795)	(4,096,735)	(2,855,095)	(4,152,604)
Expenses capitalized[4]	(2,691,014)	(235,354)	(6,386)	(36,858)	(444,877)
Total	**1,581,444,679**	**98,672,948**	**327,307,470**	**96,355,693**	**100,597,326**
Reimbursements	(152,122,522)	(6,915,454)	(29,467,199)	(17,115,996)	(14,807,673)
Net expenses	1,429,322,157	91,757,494	297,840,271	79,239,697	85,789,653

For notes see end of table.

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6.—Continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
5,441,635	4,229,770	945,379	2,524,832	3,394,970	1,190,054	292,159	1,193,302
1,600,439,605	649,486,457	2,383,565,534	522,560,419	266,252,373	560,940,540	729,589,919	2,045,162,677
152,907,456	252,467,935	309,683,301	65,657,650	71,102,234	95,650,099	190,408,514	326,462,893
64,150,968	89,947,749	95,097,878	31,356,786	39,930,238	47,494,854	49,081,803	84,288,795
838,713	935,572	2,198,281	495,690	425,266	380,806	662,911	1,361,132
1,823,778,377	**997,067,483**	**2,791,490,373**	**622,595,377**	**381,105,082**	**705,656,353**	**970,035,306**	**2,458,468,800**
60,990,329	71,550,121	85,682,157	35,200,543	35,230,037	52,250,411	52,645,903	92,760,850
14,894,132	17,793,529	19,673,511	8,202,399	8,188,371	13,299,790	12,718,401	19,731,480
1,312,589	1,180,655	776,982	578,414	1,210,338	1,165,726	1,318,377	1,262,690
2,518,849	3,126,865	3,624,046	1,777,061	2,008,755	2,603,411	2,429,251	4,491,117
3,077,506	2,353,502	4,263,971	1,614,931	1,786,926	1,544,840	1,822,605	3,456,864
7,516,573	10,401,775	9,835,913	4,064,431	5,879,536	6,024,001	4,534,350	12,786,650
782,050	996,837	1,121,169	521,084	491,719	694,438	779,807	717,930
5,135,240	5,729,944	6,267,190	3,303,832	2,189,054	3,677,754	3,351,103	5,644,311
2,161,783	1,631,583	5,862,998	428,854	1,003,977	834,409	1,255,119	2,537,181
4,300,009	2,960,406	4,576,443	1,684,390	1,297,874	3,043,845	1,486,904	5,789,497
2,468,448	2,331,870	2,654,552	1,591,563	885,798	1,591,706	1,185,138	3,245,283
740,206	892,117	2,155,506	413,323	502,098	291,333	1,327,810	219,493
2,300,283	1,788,087	4,346,653	970,852	894,267	903,517	925,801	2,760,888
785,129	707,555	691,219	266,367	692,486	304,108	524,746	1,654,673
1,047,190	1,992,374	3,537,473	450,210	1,113,096	2,226,718	1,059,684	2,239,226
8,735,006	7,858,882	11,821,842	2,740,652	5,135,159	2,733,877	5,057,737	10,166,054
5,266,409	5,619,705	8,337,465	2,008,891	2,772,736	1,905,121	2,573,953	6,131,511
14,382,148	13,482,866	29,503,710	5,935,048	5,164,840	8,317,915	6,049,595	16,236,890
1,724,207	3,832,039	5,569,728	1,344,225	1,428,432	2,158,378	2,536,879	4,220,697
(4,712,948)	1,155,339	(6,858,100)	2,321,670	2,013,741	1,334,622	1,918,705	464,599
(3,468,751)	(2,375,021)	(3,305,633)	(1,243,942)	(1,169,381)	(895,743)	(705,207)	(3,700,086)
(374,869)	(269,975)	(220,589)	(67,601)	(164,707)	(392,559)	(325,435)	(151,805)
131,581,518	**154,741,055**	**199,918,206**	**74,107,196**	**78,555,152**	**105,617,618**	**104,471,226**	**192,665,993**
(9,845,150)	(12,129,248)	(15,949,065)	(8,686,314)	(5,790,842)	(10,023,655)	(7,341,520)	(14,050,405)
121,736,368	142,611,807	183,969,141	65,420,882	72,764,310	95,593,963	97,129,706	178,615,588

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6. Income and Expenses of Federal Reserve Banks, 1991—Continued

Dollars

Item[1]	Total	Boston	New York	Philadelphia	Cleveland
PROFIT AND LOSS					
Current net income	21,123,679,659	1,353,403,438	8,106,515,306	600,674,945	1,270,730,586
Additions to and deductions from current net income[5]					
Profits on sales of U.S. Treasury and federal agency securities	131,447,796	8,828,460	49,980,606	3,632,617	8,018,932
Profit on foreign exchange transactions	366,450,220	11,931,153	97,121,050	15,218,772	21,833,127
Other additions	153,614	2,546	37,427	3,604	935
Total additions	498,051,630	20,762,159	147,139,083	18,854,993	29,852,993
Total deductions	(1,851,036)	(35,007)	(671,921)	(14,090)	(6,240)
Net additions to or deductions (–) from current net income	496,200,594	20,727,152	146,467,162	18,840,903	29,846,753
Cost of unreimbursed Treasury services	90,471,276	4,517,310	13,380,979	11,939,825	9,694,406
Assessments by Board					
Board expenditures[6]	109,631,000	4,558,600	31,222,600	4,818,600	6,028,900
Cost of currency	261,316,379	18,431,584	100,248,786	6,912,056	16,602,497
Net income before payment to U.S. Treasury	21,158,461,599	1,346,623,096	8,108,130,103	595,845,367	1,268,251,536
Dividends paid	152,553,160	6,006,860	43,267,767	6,134,888	9,032,226
Payments to U.S. Treasury (interest on Federal Reserve notes)	20,777,552,288	1,340,045,736	7,960,494,986	599,783,979	1,223,419,259
Transferred to surplus	228,356,150	570,500	104,367,350	(10,073,500)	35,800,050
Surplus, January 1	2,423,151,600	97,281,500	667,053,050	115,174,000	125,355,700
Surplus, December 31	2,651,507,750	97,852,000	771,420,400	105,100,500	161,155,750

1. Details may not sum 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 sum to current net income. The effect of FASB 87 on the Reserve Banks was a reduction in expenses of $83,146,723.
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. Includes reimbursement from the U.S. Treasury for uncut sheets of Federal Reserve notes, gains-losses on the sale of Reserve Bank buildings, counterfeit currency that is not charged back to the depositing institution, and stale Reseve Bank checks that are written off.
6. For additional details, see the last four pages of the preceding section: Board of Governors, Financial Statements.

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6.—Continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
1,702,042,008	854,455,675	2,607,521,232	557,174,495	308,340,773	610,062,390	872,905,600	2,279,853,211
11,254,137	4,472,899	16,210,524	4,176,758	1,888,462	3,944,925	4,907,714	14,131,763
23,177,649	34,233,757	46,416,592	10,301,032	11,858,119	14,698,435	27,748,498	51,912,037
5,912	5,670	359	239	81,619	1,209	5,674	8,421
34,437,698	38,712,326	62,627,475	14,478,029	13,828,199	18,644,569	32,661,885	66,052,221
(61,619)	(119,710)	(10,535)	(551,842)	(59,531)	(170,160)	(27,877)	(122,504)
34,376,079	38,592,616	62,616,940	13,926,188	13,768,669	18,474,409	32,634,008	65,929,717
6,210,206	6,844,689	9,544,401	4,274,362	3,992,817	6,561,327	4,271,749	9,239,205
6,947,500	10,430,300	13,527,400	2,843,700	2,963,400	4,132,600	8,034,000	14,123,400
18,464,922	11,484,999	35,192,869	7,330,281	3,836,426	7,615,887	11,210,264	23,985,808
1,704,795,459	864,288,303	2,611,873,502	556,652,339	311,316,799	610,226,985	882,023,595	2,298,434,515
9,770,119	14,806,390	18,583,288	3,880,528	4,146,543	5,818,508	11,467,541	19,638,502
1,672,578,641	852,190,013	2,572,456,564	550,749,761	305,855,306	597,599,727	843,853,254	2,258,525,064
22,446,700	(2,708,100)	20,833,650	2,022,050	1,314,950	6,808,750	26,702,800	20,270,950
148,060,400	245,507,100	300,030,900	63,560,300	68,511,400	92,503,350	184,736,800	315,377,100
170,507,100	242,799,000	320,864,550	65,582,350	69,826,350	99,312,100	211,439,600	335,648,050

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7. Income and Expenses of Federal Reserve Banks, 1914–91[1]

Dollars

Period, or Federal Reserve Bank	Current income	Net expenses	Net additions or deductions (–)	Assessments by Board of Governors	
				Board expenditures	Costs of currency
All Banks					
1914–15	2,173,252	2,018,282	5,875	302,304	...
1916	5,217,998	2,081,722	–193,001	192,277	...
1917	16,128,339	4,921,932	–1,386,545	237,795	...
1918	67,584,417	10,576,892	–3,908,574	382,641	...
1919	102,380,583	18,744,815	–4,673,446	594,818	...
1920	181,296,711	27,548,505	–3,743,907	709,525	...
1921	122,865,866	33,722,409	–6,314,796	741,436	...
1922	50,498,699	28,836,504	–4,441,914	722,545	...
1923	50,708,566	29,061,539	–8,233,107	702,634	...
1924	38,340,449	27,767,886	–6,191,143	663,240	...
1925	41,800,706	26,818,664	–4,823,477	709,499	...
1926	47,599,595	24,914,037	–3,637,668	721,724	1,714,421
1927	43,024,484	24,894,487	–2,456,792	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.

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7.—Continued

Dividends paid	Payments to U.S. Treasury			Transferred to surplus (section 13b)	Transferred to surplus (section 7)
	Franchise tax	Under section 13b	Interest on Federal Reserve notes		
217,463	...	...	...	...	...
1,742,775	...	...	...	...	...
6,804,186	1,134,234	...	...	...	1,134,234
5,540,684	...	...	...	...	48,334,341
5,011,832	2,703,894	...	...	...	70,651,778
5.654,018	60,724,742	...	...	...	82,916,014
6,119,673	59,974,466	...	...	...	15,993,086
6,307,035	10,850,605	...	...	...	–659,904
6.552.717	3.613.056	...	...	...	2,545,513
6,682,496	113,646	...	...	...	–3,077,962
6,915,958	59,300	...	...	...	2,473,808
7,329,169	818,150	...	...	...	8,464,426
7,754,539	249,591	...	...	...	5,044,119
8,458,463	2,584,659	...	...	...	21,078,899
9,583,911	4,283,231	...	...	...	22,535,597
10,268,598	17,308	...	...	...	–2,297,724
10,029,760	...	...	...	...	–7,057,694
9,282,244	2,011,418	...	...	...	11,020,582
8,874,262	...	...	...	...	–916,855
8,781,661	...	...	...	–60,323	6,510,071
8,504,974	...	297,667	...	27,695	607,422
7,829,581	...	227,448	...	102,880	352,524
7,940,966	...	176,625	...	67,304	2,616,352
8,019,137	...	119,524	...	–419,140	1,862,433
8,110,462	...	24,579	...	–425,653	4,533,977
8,214,971	...	82,152	...	–54,456	17,617,358
8,429,936	...	141,465	...	–4,333	570,513
8,669,076	...	197,672	...	49,602	3,554,101
8,911,342	...	244,726	...	135,003	40,327,237
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

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7. Income and Expenses of Federal Reserve Banks, 1914–91—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[2]	81,869,800	170,674,979
1988	19,526,431,297	1,205,960,134	(516,910,320)	84,410,500	164,244,653
1989	22,249,275,725	1,332,160,712	1,295,622,583	89,579,700	175,043,736
1990	23,476,603,651	1,349,725,812	2,201,470,397	103,752,200	193,006,998
1991	22,553,001,815	1,429,322,157	496,200,596	109,631,000	261,316,379
Total, 1914–91	**306,789,365,773**	**21,853,044,903**	**5,992,537,781**	**1,573,977,608**	**2,596,878,123**
Aggregate for each Bank, 1914–91					
Boston	16,264,953,430	1,440,486,112	208,440,526	57,377,486	157,926,126
New York	93,387,502,883	4,331,691,989	1,629,214,138	412,102,586	718,017,914
Philadelphia	11,908,379,850	1,168,688,247	266,084,769	75,849,418	108,689,256
Cleveland	20,253,318,881	1,442,044,215	287,609,331	114,705,490	163,790,587
Richmond	24,398,593,168	1,735,274,160	347,089,590	84,821,676	237,382,718
Atlanta	13,091,540,927	1,937,332,109	553,832,021	123,782,760	145,070,727
Chicago	43,134,265,658	2,856,768,715	729,664,356	218,399,072	358,638,108
St. Louis	10,177,663,539	1,139,332,018	154,705,167	47,842,872	94,442,151
Minneapolis	5,541,631,415	1,025,919,831	186,939,633	46,707,415	44,603,140
Kansas City	12,771,936,223	1,405,226,579	243,179,019	66,217,009	116,419,895
Dallas	17,015,823,986	1,291,578,195	499,476,826	105,456,373	145,641,166
San Francisco	38,843,755,814	2,318,238,863	886,302,400	220,715,451	306,256,335
Total	**306,789,365,773**	**21,853,044,903**[4]	**5,992,537,781**	**1,573,977,608**	**2,596,878,123**

1. Details may not sum 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 $2,551,844,799 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 $2,400,910,572 on Dec. 31, 1990.
4. See note 2, table 6.

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7.—Continued

Dividends paid	Payments to U.S. Treasury			Transferred to surplus (section 13b)	Transferred to surplus (section 7)
	Franchise tax	Under section 13b	Interest on Federal Reserve notes		
41,136,551	...	...	3,493,570,636	...	32,579,700
43,488,074	...	...	3,356,559,873	...	40,403,250
46,183,719	...	...	3,231,267,663	...	50,661,000
49,139,682	...	...	4,340,680,482	...	51,178,300
52,579,643	...	...	5,549,999,411	...	51,483,200
54,609,555	...	...	5,382,064,098	...	33,827,600
57,351,487	...	...	5,870,463,382	...	53,940,050
60,182,278	...	...	5,937,148,425	...	45,727,650
63,280,312	...	...	7,005,779,497	...	47,268,200
67,193,615	...	...	9,278,576,140	...	69,141,200
70,354,516	...	...	11,706,369,955	...	56,820,950
74,573,806	...	...	14,023,722,907	...	76,896,650
79,352,304	...	...	15,204,590,947	...	78,320,350
85,151,835	...	...	14,228,816,297	...	106,663,100
92,620,451	...	...	16,054,094,674	...	161,995,900
103,028,905	...	...	17,796,464,292	...	155,252,950
109,587,968	...	...	17,803,894,710	...	91,954,150
117,499,115	...	...	17,738,879,542	...	173,771,400
125,616,018	...	...	17,364,318,571	...	64,971,100
129,885,339	...	...	21,646,417,306	...	130,802,300
140,757,879	...	...	23,608,397,730	...	180,291,500
152,553,160	...	...	20,777,552,290	...	228,356,150
2,583,226,869	**149,138,300**	**2,188,893**	**281,009,629,148**	**(3,657)**	**2,780,200,949**[3]
104,984,470	7,111,395	280,843	14,586,014,730	135,411	107,946,825
702,594,457	68,006,262	369,116	88,180,797,056	(433,412)	808,676,971
135,410,959	5,558,901	722,406	10,529,232,886	290,661	119,430,722
199,352,355	4,842,447	82,930	18,416,818,939	(9,906)	174,389,543
135,323,399	6,200,189	172,493	22,354,295,539	(71,517)	176,386,908
188,909,204	8,950,561	79,264	10,975,794,021	5,491	248,065,540
351,031,319	25,313,526	151,045	39,693,584,132	11,682	336,193,304
9,997,418	2,755,629	7,464	8,885,976,666	(26,515)	70,722,978
73,058,447	5,202,900	55,615	4,449,687,355	64,874	73,703,563
106,452,553	6,939,100	64,213	11,194,234,390	(8,674)	103,452,050
163,819,096	560,049	102,083	15,581,044,712	55,337	215,717,078
342,293,191	7,697,341	101,421	36,162,148,720	(17,089)	345,515,467
2,583,226,869	**149,138,300**	**2,188,893**	**281,009,629,148**	**(3,657)**	**2,780,200,949**

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8. Acquisition Costs and Net Book Value of Premises of Federal Reserve Banks and Branches, December 31, 1991[1]

Dollars

Federal Reserve Bank or Branch	Acquisition costs				Net book value	Other real estate[4]
	Land	Buildings (including vaults)[2]	Building machinery and equipment	Total[3]		
BOSTON	22,073,501	82,486,486	5,582,111	110,142,098	89,218,858	. . .
Annex	27,840	125,317	44,538	197,695	167,185	. . .
NEW YORK	3,436,277	116,649,642	21,735,584	141,821,503	122,920,203	. . .
Annex	447,863	1,136,219	745,855	2,359,936	706,862	. . .
Buffalo	887,844	3,118,698	2,471,014	6,477,557	3,474,280	. . .
PHILADELPHIA	2,251,556	53,271,757	5,903,704	61,427,017	44,271,308	. . .
CLEVELAND	1,074,281	8,740,141	6,858,976	16,673,399	11,539,388	1,224,363
Cincinnati	2,246,599	13,942,719	7,623,142	23,812,459	12,021,662	. . .
Pittsburgh	1,658,376	8,574,545	4,230,643	14,463,564	10,739,757	. . .
RICHMOND	5,237,036	58,593,682	14,420,091	78,250,809	54,293,182	. . .
Annex	572,128	3,725,466	3,924,584	8,222,179	4,631,774	. . .
Baltimore	6,476,335	26,879,073	3,842,189	37,197,597	30,457,607	. . .
Charlotte	3,129,645	27,402,251	4,698,497	35,230,393	33,403,463	. . .
ATLANTA	1,209,360	12,241,666	4,319,451	17,770,477	13,597,584	13,072,919
Birmingham	3,197,830	1,905,770	1,072,438	6,176,039	4,205,538	. . .
Jacksonville	1,665,439	16,485,846	2,363,679	20,514,964	18,490,892	912,813
Miami	3,767,616	11,995,766	2,223,399	17,986,781	14,087,994	. . .
Nashville	592,342	1,474,678	1,416,665	3,483,685	1,417,245	. . .
New Orleans	3,087,693	3,330,539	1,575,492	7,993,725	5,162,943	292,710
CHICAGO	4,511,942	107,526,660	17,197,585	129,236,187	102,856,819	. . .
Annex	53,066	1,016,162	426,419	1,495,648	1,227,377	. . .
Detroit	797,734	4,857,747	5,062,528	10,718,009	8,581,301	. . .
ST. LOUIS	700,378	14,340,398	5,298,206	20,338,982	17,404,159	. . .
Little Rock	1,148,492	2,082,669	1,003,022	4,234,183	2,494,660	. . .
Louisville	700,075	2,870,836	1,131,238	4,702,149	3,332,679	. . .
Memphis	1,135,623	4,216,382	2,280,473	7,632,478	5,335,943	. . .
MINNEAPOLIS	1,394,384	27,604,213	7,851,532	36,850,129	20,350,501	. . .
Helena	1,954,514	9,036,528	486,396	11,477,438	11,256,465	. . .
KANSAS CITY	1,798,804	16,351,116	11,707,026	29,856,947	22,803,073	149,948
Denver	3,187,962	4,507,028	3,711,037	11,406,027	8,734,962	. . .
Oklahoma City	646,386	3,644,075	2,182,552	6,473,013	4,218,228	. . .
Omaha	6,534,583	11,102,353	1,401,083	19,038,019	17,461,651	1,100,000
DALLAS	33,352,767	93,555,687	3,737,706	130,646,160	128,251,554	. . .
El Paso	262,477	1,566,054	404,946	2,233,478	2,036,401	. . .
Houston	2,205,500	3,490,638	1,112,539	6,808,677	6,401,785	. . .
San Antonio	482,284	2,969,399	1,183,116	4,634,799	3,771,644	. . .
SAN FRANCISCO	15,541,937	67,394,008	17,581,323	100,517,269	79,647,327	. . .
Los Angeles	3,891,887	50,604,257	8,398,066	62,894,210	55,810,304	. . .
Portland	415,924	4,174,067	1,128,105	5,718,096	4,776,887	. . .
Salt Lake City	480,222	4,190,703	1,458,650	6,129,575	3,408,941	. . .
Seattle	324,772	2,653,881	1,899,563	4,878,215	2,902,369	. . .
Total	**144,591,273**	**891,835,123**	**191,695,166**	**1,228,121,563**	**987,872,757**	**16,752,753**

1. Details may not sum to totals because of rounding.
2. Includes expenditures for construction at some offices, pending allocation to appropriate accounts.
3. Excludes charge-offs of $17,698,968 before 1952.
4. Covers acquisitions for banking-house purposes and bank premises formerly occupied and being held pending sale.

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9. Operations in Principal Departments of Federal Reserve Banks, 1988–91

Operation	1991	1990	1989	1988
Millions of pieces (except as noted)				
Loans (thousands)	11	15	22	22
Currency received and counted	19,711	19,462	19,857	17,580
Currency verified and destroyed	6,254	6,561	6,319	5,910
Coin received and counted	9,462	12,072	12,668	17,137
Checks handled				
U.S. government checks	503	547	541	547
Postal money orders	166	162	147	144
All other	18,743	18,595	18,014	17,623
Issues, redemptions, and exchanges of U.S. Treasury and federal agency securities[1]	52	44	40	186
Transfer of funds	65	63	60	56
Automated clearinghouse transactions				
Commercial[2]	1,119	915	741	602
Government	521	520	441	408
Food stamps redeemed	3,439	2,875	2,334	2,327
Millions of dollars				
Loans	64,597	194,538	229,358	537,952
Currency received and counted	265,473	252,430	246,598	195,647
Currency verified and destroyed	77,496	65,863	59,985	47,184
Coin received and counted	1,354	1,734	1,828	3,684
Checks handled				
U.S. government checks	610,106	623,008	635,064	608,307
Postal money orders	17,716	16,485	14,284	13,189
All other	12,164,175	12,514,201	12,321,576	11,789,787
Issues, redemptions, and exchanges of U.S. Treasury and federal agency securities[1]	119,114,811	102,332,172	98,130,603	89,516,419
Transfer of funds	192,254,895	199,067,200	182,575,303	160,730,050
Automated clearinghouse transactions				
Commercial[2]	6,188,185	4,173,667	3,840,462	3,372,615
Government	723,426	486,809	391,463	n.a.
Food stamps redeemed	17,888	14,517	11,714	10,748

1. Agents' savings bonds transactions are not included after 1988 and are small in dollar amount.

2. Data for years preceding 1991 do not include items sent to the Reserve Banks by the New York Automated Clearing House.

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10. Federal Reserve Bank Interest Rates, December 31, 1991

Bank	Loans to depository institutions		
	Adjustment credit and seasonal credit[1]	Extended credit[2]	
		First 30 days of borrowing	After 30 days of borrowing[3]
All Federal Reserve Banks..	3.5	3.5	4.85

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.

See section 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. See section 201.3(b)(2) of Regulation A.

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.

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11. Reserve Requirements of Depository Institutions[1]

Type of deposit[2]	Requirements	
	Percent of deposits	Effective date
Net transaction accounts[3]		
$0 million–$42.2 million	3	12/17/91
More than $42.2 million	12	12/17/91
Nonpersonal time deposits[4]	0	12/27/90
Eurocurrency liabilities[5]	0	12/27/90

1. Reserve requirements in effect on Dec. 31, 1991. Required reserves must be held in the form of deposits with Federal Reserve Banks or vault cash. Nonmember institutions 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* or 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 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. 17, 1991, the exemption was raised from $3.4 million to $3.6 million. The exemption applies in the following order: (1) net negotiable order of withdrawal (NOW) accounts (NOW accounts less allowable deductions); and (2) net other transaction accounts. The exemption applies only to accounts that would be subject to a 3 percent reserve requirement.

3. Transaction accounts include all deposits against 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, money market deposit accounts (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).

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 change in transaction accounts held by all depository institutions, determined as of June 30 each year. Effective Dec. 17, 1991 for institutions reporting quarterly and Dec. 24, 1991 for institutions reporting weekly, the amount was increased from $41.1 million to $42.2 million.

4. For institutions that report weekly, the reserve requirement on nonpersonal time deposits with an original maturity of less than 1½ years was reduced from 3 percent to 1½ percent for the maintenance period that began Dec. 13, 1990, and to zero for the maintenance period that began Dec. 27, 1990. The reserve requirement on nonpersonal time deposits with an original maturity of 1½ years or more has been zero since Oct. 6, 1983.

For institutions that report quarterly, the reserve requirement on nonpersonal time deposits with an original maturity of less than 1½ years was reduced from 3 percent to zero on Jan. 17, 1991.

5. The reserve requirement on Euroccurency liabilities was reduced from 3 percent to zero in the same manner and on the same dates as were the reserve requirement on nonpersonal time deposits with an original maturity of less than 1½ years (see note 4).

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12. Initial Margin Requirements under Regulations T, U, G, and X[1]

Percent of market value

Effective date	Margin stocks	Convertible bonds	Short sales, T only[2]
1934, Oct. 1	25–45	...	...
1936, Feb. 1	25–55	...	...
Apr. 1	55	...	...
1937, Nov. 1	40	...	50
1945, Feb. 5	50	...	50
July 5	75	...	75
1946, Jan. 21	100	...	100
1947, Feb. 21	75	...	75
1949, Mar. 3	50	...	50
1951, Jan. 17	75	...	75
1953, Feb. 20	50	...	50
1955, Jan. 4	60	...	60
Apr. 23	70	...	70
1958, Jan. 16	50	...	50
Aug. 5	70	...	70
Oct. 16	90	...	90
1960, July 28	70	...	70
1962, July 10	50	...	50
1963, Nov. 6	70	...	70
1968, Mar. 11	70	50	70
June 8	80	60	80
1970, May 6	65	50	65
1971, Dec. 6	55	50	55
1972, Nov. 24	65	50	65
1974, Jan. 3	50	50	50

1. These regulations, adopted by the Board of Governors pursuant to the Securities Exchange Act of 1934, limit the amount of credit to purchase and carry "margin securities" (as defined in the regulations) when such credit is collateralized by securities. Margin requirements on securities other than options are the difference between the market value (100 percent) and the maximum loan value of collateral as prescribed by the Board. Regulation T was adopted effective Oct. 15, 1934; Regulation U, effective May 1, 1936; Regulation G, effective Mar. 11, 1968; and Regulation X, effective Nov. 1, 1971.

On Jan. 1, 1977, the Board of Governors for the first time established in Regulation T the initial margin required for writing options on securities, setting it at 30 percent of the current market value of the stock underlying the option. On Sept. 30, 1985, the Board changed the required margin on individual stock options, 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 June 6, 1988, the SEC approved new maintenance margin rules, permitting margins to be the current market value of the option plus 20 percent of the market value of the stock underlying the option.

2. From Oct. 1, 1934, to Oct. 31, 1937, the requirement was the margin "customarily required" by the brokers and dealers.

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13. Principal Assets and Liabilities and Number of Insured Commercial Banks, by Class of Bank, June 30, 1991 and 1990[1]

Asset and liability items shown in millions of dollars

Item	Total	Member banks			Nonmember banks
		Total	National	State	
	June 30, 1991				
Loans and investments	2,445,569	1,775,046	1,436,507	338,539	670,523
Gross loans	1,849,239	1,368,963	1,121,475	247,488	480,276
Net loans	1,838,524	1,361,764	1,115,632	246,132	476,760
Investments	596,329	406,083	315,032	91,051	190,247
U.S. Treasury and federal agency securities	453,603	310,807	244,450	66,358	142,796
Other	142,726	95,275	70,582	24,693	47,451
Cash assets, total	191,511	146,926	120,060	26,866	44,585
Deposits, total	2,294,434	1,645,777	1,342,201	303,576	648,657
Interbank	44,983	38,152	29,260	8,892	6,830
Other transaction	604,021	444,565	360,293	84,272	159,456
Other nontransaction	1,868,424	1,316,613	1,080,761	235,852	551,811
Equity capital	221,969	157,296	123,644	33,651	64,674
Number of banks	12,090	4,893	3,907	986	7,197
	June 30, 1990				
Loans and investments	2,399,166	1,764,503	1,430,039	334,464	634,663
Gross loans	1,852,133	1,387,501	1,134,670	252,831	464,633
Net loans	1,839,702	1,378,895	1,127,766	251,129	460,807
Investments	547,033	377,002	295,369	81,633	170,031
U.S. Treasury and federal agency securities	398,815	274,656	218,919	55,738	124,159
Other	148,218	102,346	76,451	25,895	45,872
Cash assets, total	207,721	160,768	129,472	31,297	46,952
Deposits, total	2,224,783	1,607,654	1,314,183	293,471	617,128
Interbank	48,372	41,595	31,095	10,500	6,777
Other demand	590,962	435,794	352,426	83,368	155,168
Other time and savings	1,790,490	1,272,178	1,049,994	222,184	518,312
Equity capital	212,001	150,827	119,371	31,456	61,175
Number of banks	12,439	5,065	4,049	1,016	7,374

1. All insured commercial banks in the United States.
Details may not sum to totals because of rounding.

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14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–91, and Month-End 1991[1]

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding								Gold stock[5]	Special drawing rights certificate account	Treasury currency outstanding[6]
	U.S. Treasury and federal agency securities			Loans	Float[2]	All other[3]	Other Federal Reserve assets[4]	Total			
	Total	Bought outright	Held under repurchase agreement								
1918.....	239	239	0	1,766	199	294	0	2,498	2,873	...	1,795
1919.....	300	300	0	2,215	201	575	0	3,292	2,707	...	1,707
1920.....	287	287	0	2,687	119	262	0	3,355	2,639	...	1,709
1921.....	234	234	0	1,144	40	146	0	1,563	3,373	...	1,842
1922.....	436	436	0	618	78	273	0	1,405	3,642	...	1,958
1923.....	134	80	54	723	27	355	0	1,238	3,957	...	2,009
1924.....	540	536	4	320	52	390	0	1,302	4,212	...	2,025
1925.....	375	367	8	643	63	378	0	1,459	4,112	...	1,977
1926.....	315	312	3	637	45	384	0	1,381	4,205	...	1,991
1927.....	617	560	57	582	63	393	0	1,655	4,092	...	2,006
1928.....	228	197	31	1,056	24	500	0	1,809	3,854	...	2,012
1929.....	511	488	23	632	34	405	0	1,583	3,997	...	2,022
1930.....	739	686	43	251	21	372	0	1,373	4,306	...	2,027
1931.....	817	775	42	638	20	378	0	1,853	4,173	...	2,035
1932.....	1,855	1,851	4	235	14	41	0	2,145	4,226	...	2,204
1933.....	2,437	2,435	2	98	15	137	0	2,688	4,036	...	2,303
1934.....	2,430	2,430	0	7	5	21	0	2,463	8,238	...	2,511
1935.....	2,431	2,430	1	5	12	38	0	2,486	10,125	...	2,476
1936.....	2,430	2,430	0	3	39	28	0	2,500	11,258	...	2,532
1937.....	2,564	2,564	0	10	19	19	0	2,612	12,760	...	2,637
1938.....	2,564	2,564	0	4	17	16	0	2,601	14,512	...	2,798
1939.....	2,484	2,484	0	7	91	11	0	2,593	17,644	...	2,963
1940.....	2,184	2,184	0	3	80	8	0	2,274	21,995	...	3,087
1941.....	2,254	2,254	0	3	94	10	0	2,361	22,737	...	3,247
1942.....	6,189	6,189	0	6	471	14	0	6,679	22,726	...	3,648
1943.....	11,543	11,543	0	5	681	10	0	12,239	21,938	...	4,094
1944.....	18,846	18,846	0	80	815	4	0	19,745	20,619	...	4,131
1945.....	24,252	24,252	0	249	578	2	0	15,091	20,065	...	4,339
1946.....	23,350	23,350	0	163	580	1	0	24,093	20,529	...	4,562
1947.....	22,559	22,559	0	85	535	1	0	23,181	22,754	...	4,562
1948.....	23,333	23,333	0	223	541	1	0	24,097	24,244	...	4,589
1949.....	18,885	18,885	0	78	534	2	0	19,499	24,427	...	4,598
1950.....	20,778	20,725	53	67	1,368	3	0	22,216	22,706	...	4,636
1951.....	23,801	23,605	196	19	1,184	5	0	25,009	22,695	...	4,709
1952.....	24,697	24,034	663	156	967	4	0	25,825	23,187	...	4,812
1953.....	25,916	25,318	598	28	935	2	0	26,880	22,030	...	4,894
1954.....	24,932	24,888	44	143	808	1	0	25,885	21,713	...	4,985
1955.....	24,785	24,391	394	108	1,585	29	0	26,507	21,690	...	5,008
1956.....	24,915	24,610	305	50	1,665	70	0	26,699	21,949	...	5,066
1957.....	24,238	23,719	519	55	1,424	66	0	25,784	22,781	...	5,146
1958.....	26,347	26,252	95	64	1,296	49	0	27,755	20,534	...	5,234
1959.....	26,648	26,607	41	458	1,590	75	0	28,771	19,456	...	5,311
1960.....	27,384	26,984	400	33	1,847	74	0	29,338	17,767	...	5,398
1961.....	28,881	30,478	159	130	2,300	51	0	31,362	16,889	...	5,585
1962.....	30,820	28,722	342	38	2,903	110	0	33,871	15,978	...	5,567
1963.....	33,593	33,582	11	63	2,600	162	0	36,418	15,513	...	5,578
1964.....	37,044	36,506	538	186	2,606	94	0	39,930	15,388	...	5,405

For notes see last two pages of table.

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14.—Continued

Factors absorbing reserve funds											
Currency in circulation	Treasury cash holdings[7]	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve accounts[4]	Required clearing balances	Other Federal Reserve liabilities and capital[4]	Member bank reserves[8]			
		Treasury	Foreign	Other				With Federal Reserve Banks	Currency and coin[9]	Required[10]	Excess[10]
4,951	288	51	96	25	118	0	0	1,636	0	1,585	51
5,091	385	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
39,619	612	820	229	321	1,036	0	0	18,086	4,151	21,663	574

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14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–91 and Month-End 1991[1]—Continued

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding								Gold stock[5]	Special drawing rights certificate account	Treasury currency outstanding[6]
	U.S. Treasury and federal agency securities			Loans	Float[2]	All other[3]	Other Federal Reserve assets[4]	Total			
	Total	Bought outright[12]	Held under repurchase agreement								
1965	40,768	40,478	290	137	2,248	187	0	43,340	13,733	...	5,575
1966	44,316	43,655	661	173	2,495	193	0	47,177	13,159	...	6,317
1967	49,150	48,980	170	141	2,576	164	0	52,031	11,982	...	6,784
1968	52,937	52,937	0	186	3,443	58	0	56,624	10,367	...	6,795
1969	57,154	7,154[3]	0	183	3,440	64	2,743	64,584	10,367	...	6,852
1970	62,142	62,142	0	335	4,261	57	1,123	67,918	10,732	400	7,147
1971	70,804	69,481	1,323	39	4,343	261	1,068	76,515	10,132	400	7,710
1972	71,230	71,119	111	1,981	3,974	106	1,260	78,551	10,410	400	8,313
1973	80,495	80,395	100	1,258	3,099	68	1,152	86,072	11,567	400	8,716
1974	85,714	84,760	954	299	2,001	999	3,195	92,208	11,652	400	9,253
1975	94,124	92,789	1,335	211	3,688	1,126	3,312	102,461	11,599	500	10,218
1976	104,093	100,062	4,031	25	2,601	991	3,182	110,892	11,598	1,200	10,810
1977	111,274	108,922	2,352	265	3,810	954	2,442	118,745	11,718	1,250	11,331
1978	118,591	117,374	1,217	1,174	6,432	587	4,543	131,327	11,671	1,300	11,831
1979	126,167	124,507	1,660	1,454	6,767	704	5,613	140,705	11,172	1,800	13,083
1980	130,592	128,038	2,554	1,809	4,467	776	8,739	146,383	11,160	2,518	13,427
1981	140,348	136,863	3,485	1,601	1,762	195	9,230	153,136	11,151	3,318	13,687
1982	148,837	144,544	4,293	717	2,735	1,480	9,890	63,659	11,148	4,618	13,786
1983	160,795	159,203	1,592	918	1,605	418	8,728	172,464	11,121	4,618	15,732
1984	169,627	167,612	2,015	3,577	833	0	12,347	186,384	11,096	4,618	16,418
1985	191,248	186,025	5,223	3,060	988	0	15,302	210,598	11,090	4,718	17,075
1986	221,459	205,454	16,005	1,565	1,261	0	17,475	241,760	11,084	5,018	17,567
1987	231,420	226,459	4,961	3,815	811	0	15,837	251,883	11,078	5,018	18,177
1988	247,489	240,628	6,861	2,170	1,286	0	18,803	269,748	11,060	5,018	18,799
1989	235,417	233,300	2,117	481	1,093	0	39,631	276,622	11,059	8,518	19,620
1990	259,786	241,432	18,354	190	2,566	0	39,880	302,421	11,058	10,018	20,404
1991	288,429	272,531	15,898	218	1,026	0	34,524	324,197	11,059	10,018	21,038

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. Components may not sum to totals because of rounding.

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. Before Jan. 30, 1934, includes gold held in Federal Reserve Banks and in circulation.

6. Includes currency and coin (other than gold) issued directly by the Treasury. The largest components are fractional and dollar coins. For details see "Currency and Coin in Circulation," *Treasury Bulletin*.

7. Coin and paper currency held by the Treasury, as well as any gold in excess of the gold certificates issued to the Reserve Bank.

8. Beginning in November 1979, includes reserves of member banks, Edge corporations, and U.S. agencies and branches of foreign banks. Beginning on Nov. 13, 1980, includes reserves of all depository institutions.

9. Between Dec. 1, 1959, and Nov. 23, 1960, part was allowed as reserves; thereafter all was allowed.

10. Estimated through 1958. Before 1929, data were available only on call dates (in 1920 and 1922 the call dates were Dec. 29). Beginning on Sept. 12, 1968, the amount is based on close-of-business figures for the reserve period two weeks before the report date.

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14.—Continued

Factors absorbing reserve funds											
Currency in circulation	Treasury cash holdings[7]	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve accounts[4]	Required clearing balances	Other Federal Reserve liabilities and capital[4]	Member bank reserves[8]			
		Treasury	Foreign	Other				With Federal Reserve Banks	Currency and coin[9]	Required[10]	Excess[10,13]
42,056	760	668	150	355	211	0	0	18,447	4,163	22,848	-238
44,663	1,176	416	174	588	-147	0	0	19,779	4,310	24,321	-232
47,226	1,344	1,123	135	563	-773	0	0	21,092	4,631	25,905	-182
50,961	695	703	216	747	-1,353	0	0	21,818	4,921	27,439	-700
53,950	596	1,312	134	807	0	0	0	22,085	5,187	28,173	-901
57,903	431	1,156	148	1,233	0	0	1,986	24,150	5,423	30,033	-460
61,068	460	2,020	294	999	0	0	2,131	27,788	5,743	32,496	1,035
66,516	345	1,855	325	840	0	0	2,143	25,647	6,216	32,044	98[13]
72,497	317	2,542	251	1,419[14]	0	0	2,669	27,060	6,781	35,268	-1,360
79,743	185	2,113	418	1,275[14]	0	0	2,935	25,843	7,370	37,011	-3,798
86,547	483	7,285	353	1,090	0	0	2,968	26,052	8,036	35,197	-1,103[15]
93,717	460	10,393	352	1,357	0	0	3,063	25,158	8,628	35,461	-1,535
103,811	392	7,114	379	1,187	0	0	3,292	26,870	9,421	37,615	-1,265
114,645	240	4,196	368	1,256	0	0	4,275	31,152	10,538	42,694	-893
125,600	494	4,075	429	1,412	0	0	4,957	29,792	11,429	44,217	-2,835
136,829	441	3,062	411	617	0	0	4,671	27,456	13,654	40,558	675
144,774	443	4,301	505	781	0	117	5,261	25,111	15,576	42,145	-1,442
154,908	429	5,033	328	1,033	0	436	4,990	26,053	16,666	41,391	1,328
171,935	479	3,661	191	851	0	1,013	5,392	20,413	17,821	39,179	-945
183,796	513	5,316	253	867	0	1,126	5,952	20,693			
197,488	550	9,351	480	1,041	0	1,490	5,940	27,141			
211,995	447	7,588	287	917	0	1,812	6,088	46,295			
230,205	454	5,313	244	1,027	0	1,687	7,129	40,097			
247,649	395	8,656	347	548	0	1,605	7,683	37,742	n.a.	n.a.	n.a.
260,453	450	6,217	589	1,298	0	1,626	8,486	36,701			
286,965	561	8,960	369	242	0	1,963	8,147	36,695			
307,780	636	17,697	968	1,706	0	3,955	8,113	25,458			

11. Beginning Dec. 1, 1966, includes federal agency obligations held under repurchase agreements and beginning Sept. 29, 1971, federal agency issues bought outright.

12. Beginning in 1969, includes 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.

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14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–91, and Month-End 1991[1]—Continued

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding								Gold stock[5]	Special drawing rights certificate account	Treasury currency outstanding[6]
	U.S. Treasury and federal agency securities			Loans	Float[2]	All other[3]	Other Federal Reserve assets[4]	Total			
	Total	Bought outright[12]	Held under repurchase agreement								
1991											
Jan. ..	257,722	240,648	17,074	180	690	0	41,458	300,049	11,058	10,018	20,461
Feb. ..	259,012	242,978	16,034	506	684	0	38,706	298,907	11,058	10,018	20,519
Mar. ..	247,307	247,307	0	244	2,542	0	36,639	286,731	11,058	10,018	20,577
Apr. ..	250,743	250,743	0	291	1,263	0	36,584	288,881	11,058	10,018	20,644
May ..	254,324	254,324	0	205	503	0	36,166	291,199	11,057	10,018	20,697
June ..	255,136	253,697	1,439	1,479	280	0	34,992	291,887	11,062	10,018	20,752
July ..	257,137	257,137	0	574	1,006	0	35,014	293,731	11,062	10,018	20,783
Aug. ..	261,118	261,118	0	844	191	0	31,334	293,487	11,062	10,018	20,841
Sept. .	264,708	264,708	0	315	285	0	32,365	297,672	11,062	10,018	20,889
Oct. ..	273,834	265,101	8,733	153	798	0	32,765	307,549	11,059	10,018	20,940
Nov. ..	271,302	271,302	0	105	853	0	32,420	304,680	11,058	10,018	20,982
Dec. ..	288,429	272,531	15,898	218	1,026	0	34,524	324,197	11,059	10,018	21,038

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14.—Continued

Factors absorbing reserve funds												
Currency in circulation	Treasury cash holdings[7]	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve accounts[4]	Required clearing balances	Other Federal Reserve liabilities and capital[4]	Member bank reserves[8]				
		Treasury	Foreign	Other				With Federal Reserve Banks	Currency and coin[9]	Required[10]	Excess[10,13]
283,011	590	27,810	271	183	0	2,275	9,820	17,627	n.a.	n.a.	n.a.
285,176	605	23,898	329	171	0	2,434	8,216	19,674			
286,685	623	10,922	228	188	0	2,674	5,670	21,393			
286,794	652	13,682	292	276	0	2,909	6,826	19,172			
290,509	629	6,619	196	225	0	3,018	8,570	23,205			
291,563	613	11,822	224	213	0	3,034	7,082	19,167			
292,596	605	5,831	314	212	0	3,147	8,165	24,724			
294,892	605	6,745	256	219	0	3,165	8,729	20,798			
293,512	607	7,928	385	283	0	3,177	9,522	24,228			
296,522	631	18,111	223	213	0	3,310	8,354	22,203			
301,817	636	6,317	346	221	0	3,795	10,156	23,450			
307,780	636	17,697	968	1,706	0	3,955	8,113	25,458			

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15. Changes in Number of Banking Offices in the United States, 1991[1]

Type of office and change	Total	Commercial banks[2]						Mutual savings banks	
		Total	Member			Nonmember			
			Total	National	State	Insured	Noninsured[3]	Insured	Noninsured
Banks, Dec. 31, 1990	13,032	12,669	5,040	3,986	1,054	7,356	273	363	0
Changes during 1991									
New banks	105	102	39	31	8	63	0	3	0
Ceased banking operation	-155	-136	-57	-49	-8	-67	-12	-19	0
Banks converted into branches	-417	-408	-187	-151	-36	-221	0	-9	0
Other[4]	66	48	3	2	1	28	17	18	0
Net change	-401	-394	-202	-167	-35	-197	5	-7	0
Banks, Dec. 31, 1991	**12,631**	**12,275**	**4,838**	**3,819**	**1,019**	**7,159**	**278**	**356**	**0**
Branches and additional offices, Dec. 31, 1990	54,191	51,305	33,270	27,365	5,905	17,928	107	2,886	0
Changes during 1991									
De novo	2,694	2,480	1,595	1,375	220	881	4	214	0
Banks converted into branches	417	408	255	215	40	153	0	9	0
Discontinued	-1,240	-1,164	-822	-692	-130	-340	-2	-76	0
Sale of branch	0	50	38	19	19	12	0	-50	0
Other[4]	79	130	663	244	419	-533	0	-51	0
Net change[4]	1,950	1,904	1,729	1,161	568	173	2	46	0
Branches and additional offices, Dec. 31, 1991	**56,141**	**53,209**	**34,999**	**28,526**	**6,473**	**18,101**	**109**	**2,932**	**0**

1. Preliminary. Final data will be available in the *Annual Statistical Digest, 1991*, forthcoming.
2. Includes stock savings banks, nondeposit trust companies, private banks, industrial banks, and nonbank banks.
3. As of Dec. 31, 1988, includes noninsured national trust companies.
4. Includes interclass changes.

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16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1991

Correction: On page 254 of the Board's *77th Annual Report, 1990,* the entry for the merger of Texas Bank with Citizens National Bank contains an error. The entry should read:

Texas Bank, Weatherford, Texas *to merge with* **Citizens National Bank, Denton, Texas**

Isabella Bank and Trust, Mt. Pleasant, Michigan *to acquire certain assets and liabilities of the* **Beal City branch of First of America Bank, Mt. Pleasant, Michigan**

SUMMARY REPORT BY THE ATTORNEY GENERAL (12/5/90)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (01/14/91)
Isabella Bank (Applicant) has assets of $183 million and the Beal City branch (Branch) has assets of $3.9 million. Applicant and Branch operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

United New Mexico Bank at Albuquerque, Albuquerque, New Mexico *to acquire the assets and liabilities of* **American Bank, N.A., Rio Rancho, New Mexico**

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 (1/25/91)
United New Mexico Bank (Applicant) has assets of $360 million and American Bank (Bank) has assets of $22 million. The OCC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Fleet Bank of Maine, Portland, Maine *to acquire the assets and liabilities of* **Maine Savings Bank, Portland, Maine**

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 (2/1/91)
Fleet Bank of Maine (Applicant) has assets of $1.8 billion and the Maine Savings Bank (Bank) has assets of $1.4 billion. The Maine Superintendent for the Bureau of Banking has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Dollar Savings and Trust Company, Youngstown, Ohio *to acquire the assets and liabilities of* **The McKinley Bank, Niles, Ohio**

SUMMARY REPORT BY THE ATTORNEY GENERAL
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard the depositors.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2/22/91)
Dollar Savings and Trust Company (Applicant) has assets of $1.0 billion and The McKinley Bank (Bank) has assets of $66 million. The State of Ohio has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Moorcroft State Bank, Moorcroft, Wyoming *to acquire the assets and liabilities of* **The National Bank of Newcastle, Newcastle, Wyoming**

SUMMARY REPORT BY THE ATTORNEY GENERAL (1/24/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/4/91)
Moorcroft State Bank (Applicant) has assets of $11.0 million and The National Bank of Newcastle (Bank) has assets of $20.5 million. Applicant and Bank do not operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Citizens Bank & Trust Company, Blackstone, Virginia *to acquire the assets and liabilities of the* **Blackstone, Virginia, branch of First Colonial Savings Bank, Hopewell, Virginia**

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16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1991—Continued

SUMMARY REPORT BY THE ATTORNEY GENERAL (3/5/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/8/91)
Citizens Bank & Trust Company (Applicant) has assets of $122.6 million and the Blackstone branch (Branch) has assets of $8.7 million. Applicant and Bank operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

First United Bank, Boca Raton, Florida *to acquire the assets and liabilities of* **First Marine Bank of Florida, Palm City, Florida**

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 (3/8/91)
First United Bank (Applicant) has assets of $50.2 million and First Marine Bank of Florida (Bank) has assets of $16.5 million. The Department of Banking and Finance, State of Florida has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

The Peoples Bank, Pratt, Kansas *to acquire the assets and liabilities of* **Sharon Valley State Bank, Sharon, Kansas**

SUMMARY REPORT BY THE ATTORNEY GENERAL (01/01/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/8/91)
The Peoples Bank (Applicant) has assets of $134 million and Sharon Valley State Bank (Bank) has assets of $6 million. Applicant and Bank do not operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

SouthTrust Bank of Pinellas County, St. Petersburg, Florida *to acquire the assets and liabilities of* **Commonwealth Federal Savings and Loan, Fort Lauderdale, Florida through SouthTrust of Florida FSB, St. Petersburg, Florida**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3/5/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/8/91)
SouthTrust Bank of Pinellas County (Applicant) has assets of $252.3 million and Commonwealth Federal Savings and Loan (Thrift) has assets of $33.1 million. Applicant and Thrift operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

UnionBank/Streator, Streator, Illinois *to acquire the assets and liabilities of* **Ottawa National Bank, Ottawa, Illinois**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3/8/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/22/91)
UnionBank/Streator (Applicant) has assets of $151.9 million and Ottawa National Bank (Bank) has assets of $54.9 million. Applicant and Bank operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Tiog State Bank, Spencer, New York *to acquire the assets and liabilities of the* **Waverly branch of Norstar Bank, N.A., Buffalo, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (2/21/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/5/91)
Tiog State Bank (Applicant) has assets of $78.7 million and the Waverly branch (Branch) has assets of $13.5 million. Applicant and Branch operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

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Caliber Bank, Phoenix, Arizona *to acquire the assets and liabilities of the* **Phoenix and Mesa Arizona branches of Arizona Commerce Bank, Tucson, 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.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/10/91)
Caliber Bank (Applicant) has assets of $1.0 million and the Phoenix and Mesa Arizona branches (Branches) of Arizona Commerce Bank have assets of $20.5 million. The State Banking Commissioner has recommended immediate action by the Federal Reserve System to prevent the probable failure of Arizona Commerce Bank.

Manufacturers Hanover Trust Company, New York, New York *to acquire the assets and liabilities of* **thirteen branches of Goldome, Buffalo, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (4/11/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/19/91)
Manufacturers Hanover Trust Company (Applicant) has assets of $58 billion and the thirteen branches of Goldome (Branches) have assets of $1.5 billion. Applicant and Branches operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Chemical Bank Bay Area, Bay City, Michigan *to acquire the assets and liabilities of the* **Marlette, Michigan, branch of First Federal Savings Bank and Trust, Pontiac, Michigan from Old Kent Bank–Central, Owosso, Michigan**

SUMMARY REPORT BY THE ATTORNEY GENERAL (4/19/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/23/91)
Chemical Bank (Applicant) has assets of $232 million and the Marlette branch (Branch) has assets of $15.9 million. Applicant and Branch operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Vectra Bank, Denver, Colorado *to merge with* **Columbine Valley Bank and Trust, Littleton, Colorado**

SUMMARY REPORT BY THE ATTORNEY GENERAL (4/1/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (04/26/91)
Vectra Bank (Applicant) has assets of $42.5 million and Columbine Valley Bank and Trust (Bank) has assets of $7.2 million. Applicant and Branch operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Signet Bank/Virginia, Richmond, Virginia *to acquire the assets and liabilities of* **Madison National Bank of Virginia, McLean, Virginia**

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 (5/10/91)
Signet Bank/Virginia (Applicant) has assets of $8.2 billion and Madison National Bank of Virginia (Bank) has assets of $139.8 million. The OCC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Centura Bank, Rocky Mount, North Carolina *to acquire the assets and liabilities of the* **Wilmington, North Carolina, branch of Pioneer Savings Bank, Inc., Rocky Mount, North Carolina**

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.

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16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1991—Continued

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (5/17/91)
Centura Bank (Applicant) has assets of $2.3 billion and the Wilmington branch (Branch) has assets of $11.1 million. The RTC has recommended immediate action by the Federal Reserve System to prevent probable failure of Pioneer Savings Bank.

Centura Bank, Rocky Mount, North Carolina *to acquire the assets and liabilities of* **Watauga Savings and Loan Association, Inc., Boone, North Carolina**

SUMMARY REPORT BY THE ATTORNEY GENERAL (4/12/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (5/17/91)
Centura Bank (Applicant) has assets of $2.3 billion and Watauga Savings and Loan (Thrift) has assets of $120.1 million. Applicant and Thrift do not operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Manufacturers and Traders Trust Co., Buffalo, New York *to acquire the assets and liabilities of various branches of* **Goldome, Buffalo, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (4/17/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (5/31/91)
Manufacturers and Traders Trust Co. (Applicant) has assets of $5.3 billion and the Goldome branches (Branches) have assets of $1.9 billion. Applicant and Branches operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Chemical Bank Michigan, Midland, Michigan *to acquire the assets and liabilities of the* **Harrison, Michigan, office of Mutual Savings Bank, FSB, Bay City, Michigan**

SUMMARY REPORT BY THE ATTORNEY GENERAL (5/17/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (6/14/91)
Chemical Bank Michigan (Applicant) has assets of $147.7 million and the Harrison branch (Branch) has assets of $6.3 million. Applicant and Branch operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

United Jersey Bank, Hackensack, New Jersey *to acquire the assets and liabilities of the* **North Arlington and Tenafly branches of Howard Savings Bank, Livingston, New Jersey**

SUMMARY REPORT BY THE ATTORNEY GENERAL (5/13/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (6/28/91)
United Jersey Bank (Applicant) has assets of $6 billion and the North Arlington and Tenafly branches (Branches) have assets of $172 million. Applicant and Branches operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Fleet Bank of Maine, Portland, Maine *to acquire the assets and liabilities of* **New Maine National Bank, Portland, Maine**

SUMMARY REPORT BY THE ATTORNEY GENERAL (6/28/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (7/1/91)
Fleet Bank of Maine (Applicant) has assets of $2.8 billion and the New Maine National Bank (Bank) has assets of $1.0 billion. Applicant and Bank operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Crestar Bank, Richmond, Virginia *to acquire the assets and liabilities of the* **Heritage Federal Savings Bank, Richmond, Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL
No report received. Request for report on the competitive factors was dispensed with, as autho-

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rized 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 (7/5/91)
Crestar Bank (Applicant) has assets of $11.7 billion and Heritage Federal Savings Bank (Bank) has assets of $542 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Fifth Third Bank, Cincinnati, Ohio, and Fifth Third Bank of Columbus, Ohio *to acquire the assets and liabilities of* **nine branches of the Chase Bank of Ohio, Columbus, Ohio**

SUMMARY REPORT BY THE ATTORNEY GENERAL (7/9/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (7/12/91)
Fifth Third Bank of Cincinnati has assets of $4.5 billion and Fifth Third Bank of Columbus (Applicants) have assets of $422 million and the nine branches (Branches) have total assets of $225 million. Applicants and Branches operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

St. Bernard Bank & Trust Company, Arabi, Louisiana *to acquire the assets and liabilities of* **Commonwealth Federal Savings Association, New Orleans, Louisiana**

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 (7/12/91)
St. Bernard Bank & Trust Company (Applicant) has assets of $180.1 million and Commonwealth Federal Savings Association (Thrift) has assets of $30.8 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Thrift.

The Bank of Tidewater, Virginia Beach, Virginia *to acquire the assets and liabilities of the* **Haygood and Kempsville branches of Atlantic Permanent, FSB, Norfolk, Virginia**

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 (7/12/91)
The Bank of Tidewater (Applicant) has assets of $79.7 million and the Haygood and Kempsville branches (Branches) have assets of $24.4 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Atlantic Permanent.

The Bank of New York, FSB, New York, New York *to acquire the assets and liabilities of the* **Monsey branch of Ensign FSB, New York, New York**

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 (7/19/91)
The Bank of New York (Applicant) has assets of $36.6 billion and the Monsey branch (Branch) has assets of $100 million. Applicant and Branch operate in the same market. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Ensign.

Chemical Bank, New York, New York *to acquire the assets and liabilities of* **nine New York City and two Westchester County, New York, branches of Ensign FSB, New York, New York**

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 (7/19/91)
Chemical Bank (Applicant) has assets of $47.6 billion and the branches (Branches) have assets of

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$588 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Ensign.

First State Bank, Beebe, Arkansas *to acquire the assets and liabilities of the* **Indian Hills branch of First Savings of Arkansas, F.A., Little Rock, Arkansas**

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 (7/26/91)
First State Bank (Applicant) has assets of $25.1 million and the Indian Hills Branch (Branch) has assets of $13 million. The OTS has recommended immediate action by the Federal Reserve System to prevent the probable failure of First Savings.

Central Bank of Oklahoma City, Oklahoma City, Oklahoma *to merge with* **Lakeshore Bank, N.A., Oklahoma City, Oklahoma**

SUMMARY REPORT BY THE ATTORNEY GENERAL (6/12/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (8/1/91)
Central Bank (Applicant) has assets of Bank (Bank) has assets of $270.6 million. Applicant and Bank operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Central Bank, Monroe, Louisiana *to acquire the assets and liabilities of* **Homestead Savings Bank**

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 (8/2/91)
Central Bank (Applicant) has assets of $677.4 million and Homestead Savings Bank (Bank) has assets of $77.4 million. The OTS and RTC have recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

1st United Bank, Boca Raton, Florida *to acquire the assets and liabilities of* **Bank of South Palm Beaches, Hypoluxo, Florida**

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 (8/9/91)
1st United Bank (Applicant) has assets of $65.5 million and Bank of South Palm Beaches (Bank) has assets of $43.2 million. The Florida State Banking Commissioner has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Banco Popular de Puerto Rico, Hato Rey, Puerto Rico *to acquire the assets and liabilities of a* **branch of The New York Capital Bank, N.A., New York, New York**

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 (8/13/91)
Banco Popular de Puerto Rico (Applicant) has assets of $8.8 billion and the branch (Branch) has assets of $68 million. The OCC has recommended immediate action by the Federal Reserve System to prevent the probable failure of The New York Capital Bank.

Citizens Fidelity Bank and Trust Company, Louisville, Kentucky *to acquire the assets and liabilities of the* **main office and the Shively, Jeffersontown, Okolona/Highview, Highlands, Fern Creek/Buechel, St. Matthews, Pleasure Ridge Park, and Middletown branches in Louisville and the Glasgow and Tompkinsville, Kentucky, branch offices of Future FSB, Louisville, Kentucky**

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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 (8/30/91)
Citizens Fidelity Bank and Trust Company (Applicant) has assets of $52 billion and the branches (Branches) have assets of $326 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Future.

Trustco Bank New York, Schenectady, New York *to acquire the assets and liabilities of* **Home & City Savings Bank, Albany, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (06/03/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (8/30/91)
Trustco Bank New York (Applicant) has assets of $927 million and Home & City Savings Bank (Bank) has assets of $866 million. Applicant and Bank operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Premier Bank (formerly Bank of Shawsville), Shawsville, Virginia *to acquire the assets and liabilities of* **Bank of Speedwell, Speedwell, Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (8/16/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/6/91)
Premier Bank (Applicant) has assets of $42 million and Bank of Speedwell (Bank) has assets of $105 million. Applicant and Bank operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Johnstown Bank and Trust Company, Johnstown, Pennsylvania *to acquire the assets and liabilities of* **Peoples FSB, New Kensington, Pennsylvania through BT Interim FSB, Johnstown, Pennsylvania**

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 (9/6/91)
Johnstown Bank and Trust Company (Applicant) has assets of $437.9 million and Peoples Federal Savings Bank (Bank) has assets of $97.1 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Commercial Trust and Savings Bank, Mitchell, South Dakota *to acquire the assets and liabilities of* **First FSB, Huron, South Dakota, through Mitchell Interim FSB, Mitchell, 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 the depositors.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/13/91)
Commercial Trust and Savings Bank (Applicant) has assets of $140.9 million and First FSB (Bank) has assets of $26.4 million. The OTS and RTC have recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Hand County State Bank, Miller, South Dakota *to acquire the assets and liabilities of* **Miller Savings, Miller, 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 the depositors.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/13/91)
Hand County State Bank (Applicant) has assets of $44.8 million and Miller Savings (Bank) has assets

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of $5.4 million. The OTS and RTC have recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Pioneer Bank of Longmont, Longmont, Colorado *to acquire the assets and liabilities of* **First America Federal Savings Bank, Longmont, Colorado**

SUMMARY REPORT BY THE ATTORNEY GENERAL
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard the depositors.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/13/91)
Pioneer Bank of Longmont (Applicant) has assets of $24.2 million and First America Federal Savings Bank (Bank) has assets of $10.7 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Farmers & Merchants Bank, Huron, South Dakota *to acquire the assets and liabilities of* **Farmers & Merchants Savings Bank, FSB, Huron, 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 the depositors.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/13/91)
Farmers & Merchants Bank (Applicant) has assets of $143 million and Farmers & Merchants Savings Bank (Bank) has assets of $3.7 million. The OTS and RTC have recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Crestar Bank, Richmond, Virginia *to acquire the assets and liabilities of* **United FSB, Vienna, Virginia through CRFC Interim FSB, Richmond, Virginia**

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 (9/20/91)
Crestar Bank (Applicant) has assets of $10.3 billion and United FSB (Bank) has assets of $272 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

Marine Bank of Springfield, Springfield, Illinois *to acquire the assets and liabilities of the* **Taylorsville branch of United Savings Association of America, Chicago, Illinois**

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 (9/27/91)
Marine Bank of Springfield (Applicant) has assets of $694.4 million and the Taylorsville branch (Branch) has assets of $31.4 million. The OTS has recommended immediate action by the Federal Reserve System to prevent the probable failure of United.

Ireland Bank, Malad City, Idaho *to acquire the assets and liabilities of the* **Soda Springs, Grace, and Lava Hot Springs branches of Security State Bank, Soda Springs, Idaho**

SUMMARY REPORT BY THE ATTORNEY GENERAL (8/2/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10/4/91)
Ireland Bank (Applicant) has assets of $42 million and the branches (Branches) have assets of $14 million. Applicant and Branches operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Beaver Trust Company, Beaver, Pennsylvania *to merge with* **Colony FSB, Wexford, Pennsylvania through Interim FSB, New Castle, Pennsylvania**

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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 (10/11/91)
Beaver Trust Company (Applicant) has assets of $285 million and Colony FSB (Bank) has assets of $222 million. The OTS and RTC have recommended immediate action by the Federal Reserve System to prevent the probable failure of Bank.

SouthTrust Bank of Pinellas County, St. Petersburg, Florida *to acquire the assets and liabilities of a* **branch of Florida Bank of Commerce, Clearwater, Florida**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10/11/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10/30/91)
SouthTrust Bank of Pinellas County (Applicant) has assets of $257.2 million and the branch (Branch) has assets of $18.0 million. Applicant and Branch operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Centura Bank, Rocky Mount, North Carolina *to acquire the assets and liabilities of* **Citizens Federal Savings and Loan Association, Rutherfordton, North Carolina, through Centura Interim Bank, Rutherfordton, North Carolina**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10/4/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/1/91)
Centura Bank (Applicant) has assets of $2.2 billion and Citizens Federal Savings and Loan Association (Thrift) has assets of $79.2 million. Applicant and Thrift operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Chemical Bank, New York, New York *to acquire the assets and liabilities of* **Community National Bank & Trust Company of New York, Staten Island, New York**

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 (11/8/91)
Chemical Bank (Applicant) has assets of $47.6 billion and Community National Bank & Trust Company of New York (Bank) has assets of $322 million. The OCC has recommended immediate action by the Federal Reserve system to prevent the probable failure of Bank.

The Provident Bank, Cincinnati, Ohio *to merge with* **Hunter Savings Association, Cincinnati, Ohio**

SUMMARY REPORT BY THE ATTORNEY GENERAL (9/13/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/13/91)
The Provident Bank (Applicant) has assets of $22 billion and Hunter Savings Association (Thrift) has assets of $1.0 billion. Applicant and Thrift operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Clifton Trust Bank, Cockeysville, Maryland *to merge with* **The Commercial Bank, Bel Air, Maryland**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10/18/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/13/91)
Clifton Trust Bank (Applicant) has assets of $66 million and Commercial Bank (Bank) has assets of $215 million. Applicant and Bank operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

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16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1991—Continued

Johnstown Bank and Trust Company, Johnstown, Pennsylvania *to acquire the assets and liabilities of* **Somerset branch of Atlantic Financial Savings, FA, Bala Cynwyd, Pennsylvania, through BT Interim FSB, Johnstown, Pennsylvania**

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 (11/15/91)
Johnstown Bank and Trust Company (Applicant) has assets of $516.3 million and the branch (Branch) has assets of $26.2 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of Atlantic Financial.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

First State Bank of Taos, Taos, New Mexico *to merge with* **National Bank of Albuquerque, Albuquerque, New Mexico**

SUMMARY REPORT BY THE ATTORNEY GENERAL (9/27/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/15/91)
First State Bank of Taos (Applicant) has assets of $57 million and National Bank of Albuquerque (Bank) has assets of $54 million. Applicant and Bank operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Auburn State Bank, Auburn, Indiana *to merge with* **Citizens State Bank, Waterloo, Indiana**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10/25/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/18/91)
Auburn State Bank (Applicant) has assets of $93.6 million and Citizens State Bank (Bank) has assets of $16.1 million. Applicant and Bank operate in the same market.

Fifth Third Bank of Columbus *to acquire the assets and liabilities of* **one branch office of Chase Bank of Ohio, Columbus, Ohio**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10/16/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/19/91)
Fifth Third Bank (Applicant) has assets of $441.9 million and the branch (Branch) has assets of $58.7 million. Applicant and Branch operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

1st Source Bank, South Bend, Indiana *to acquire the assets and liabilities of the* **LaPaz branch, LaPaz, Indiana, of Norcen Bank, Culver, Indiana**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10/4/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/21/91)
1st Source Bank (Applicant) has assets of $980.6 million and the LaPaz branch (Branch) has assets of $25.6 million. Applicant and Bank operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Manufacturers and Traders Trust Company, Buffalo, New York *to merge with* **The First National Bank of Highland, Newburgh, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (11/8/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/27/91)
Manufacturers and Traders Trust Company (Applicant) has assets of $6.6 billion and The First National Bank of Highland (Bank) has assets of

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16.—Continued

$451.5 million. Applicant and Bank do not operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Fifth Third Bank, Cincinnati, Ohio *to acquire the assets and liabilities of* **MidFed Savings Bank, Middletown, Ohio**

SUMMARY REPORT BY THE ATTORNEY GENERAL (11/1/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/26/91)
Fifth Third Bank (Applicant) has assets of $4.9 billion and MidFed Savings Bank (Bank) has assets of $240.5 million. Applicant and Bank do not operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Chemical Bank, New York, New York *to merge with* **Manufacturers Hanover Trust Company, New York, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (11/21/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/29/91)
Chemical Bank (Applicant) has assets of $48.5 billion and Manufacturers Hanover Trust Company (Bank) has assets of $59.3 billion. Applicant and Bank operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Fifth Third Bank, Cincinnati, Ohio *to acquire the assets and liabilities of* **five branches of Chase Bank of Ohio, Columbus, Ohio**

SUMMARY REPORT BY THE ATTORNEY GENERAL (11/1/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/29/91)
Fifth Third Bank (Applicant) has assets of $4.9 billion and the five branches (Branches) have assets of $257.1 million. Applicant and Branches do not operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Marine Bank of Springfield, Springfield, Illinois *to acquire the assets and liabilities of the* **Taylorville, Illinois, branch of Champion Federal Savings and Loan Association**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10/4/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11/29/91)
Marine Bank of Springfield (Applicant) has assets of $745.1 million and the Taylorville branch (Branch) has assets of $74.2 million. Applicant and Branch operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Lorain County Bank, Elyria, Ohio *to merge with* **the Greenwich and Shiloh, Ohio, branches of Society Bank and Trust, Toledo, Ohio**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10/31/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12/9/91)
Lorain County Bank (Applicant) has assets of $421 million and the branches (Branches) have assets of $19.9 million. Applicant and Bank operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

1st United Bank, Boca Raton, Florida *to merge with* **Mizner Bank, Boca Raton, Florida**

SUMMARY REPORT BY THE ATTORNEY GENERAL (11/1/91)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12/17/91)
1st United Bank (Applicant) has assets of $103.9 million and Mizner Bank (Bank) has assets

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16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1991—Continued

of $43.6 million. Applicant and Bank operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Mergers Approved Involving Wholly Owned Subsidiaries of the Same Bank Holding Company

The following transactions involve banks that are subsidiaries of the same bank holding company. In each case, the summary report by the Attorney General indicates that the transaction would not have a significantly adverse effect on competition because the proposed merger is essentially a corporate reorganization. The Board of Governors, the Federal Reserve Bank, or the Secretary of the Board of Governors, whichever approved the application, determined that the competitive effects of the proposed transaction, the financial and managerial resources and prospects of the banks concerned, as well as the convenience and needs of the community to be served were consistent with approval.

Institution[1]	Assets (millions of dollars)	Date of approval
First of America Bank–Northern Michigan, Traverse City, Michigan	588	1/8/91
Merger		
First of America Bank–Manistee, Manistee, Michigan	101	
PrimeBank, Federal Savings Bank, Grand Rapids, Michigan	425	3/1/91
Merger		
First of America Bank–Holland, N.A., Holland, Michigan	130	
United Jersey Bank, Hackensack, New Jersey	6249	3/15/91
Merger		
United Jersey Bank/Northwest, Randolph, New Jersey	535	
Comerica Bank–Detroit, Detroit, Michigan	10,200	3/21/91
Merger		
Comerica Bank, N.A., Jackson, Michigan	1,800	
Star Bank, Northern Kentucky, Covington, Kentucky	298	4/9/91
Merger		
Star Bank, N. A., Newport, Kentucky	182	
Farmers Loan & Trust Company, Columbia City, Indiana	81	4/19/91
Merger		
INB National Bank, Indianapolis, Indiana	104[2]	
United New Mexico Bank at Albuquerque, Albuquerque, New Mexico	361	4/26/91
Merger		
United New Mexico Bank at Rio Rancho, Rio Rancho, New Mexico	60	
Centura Bank, Rocky Mount, North Carolina	2340	5/17/91
Merger		
Watauga Savings and Loan Association, Inc., Boone, North Carolina	120	
Jackson Exchange Bank and Trust Company, Jackson, Missouri	167	6/27/91
Merger		
First Exchange Bank of Madison County, Fredericktown, Missouri	4	

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16—Continued

Institution [1]	Assets (millions of dollars)	Date of approval
Central Bank of Oklahoma City, Oklahoma City, Oklahoma	247	8/1/91
Merger		
Lakeshore Bank, N.A., Oklahoma City, Oklahoma	478	
First of America Bank–Ann Arbor, Ann Arbor, Michigan	618	8/1/91
Merger		
First of America Bank–Wayne, Wayne, Michigan	104	
Boatmen's Bank of Vandalia, Vandalia, Missouri	39	8/5/91
Merger		
Boatmen's National Bank of St. Louis, St. Louis, Missouri	46 [2]	
Norstar Bank of Upstate NY, Albany, New York	4,600	8/30/91
Merger		
Norstar Bank of Central NY, Syracuse, New York	125	
Old Kent Bank of Kalamazoo, Kalamazoo, Michigan	788	9/30/91
Merger		
Old Kent Bank–Southwest, Niles, Michigan	351	
First of America Bank–West Michigan, Grand Rapids, Michigan (formerly PrimeBank, FSB)	578	9/30/91
Merger		
First of America Bank–Muskegon, Muskegon, Michigan	380	
Signet Bank/Maryland, Baltimore, Maryland	3,307	10/3/91
Merger		
Signet Bank, National Association, Washington, D. C.	14 [2]	
United Missouri Bank Northeast, Monroe City, Missouri	32	10/31/91
Merger		
United Missouri Bank of Paris, Paris, Missouri	38	
Commonwealth Bank, Williamsport, Pennsylvania	1,327	11/21/91
Merger		
County Bank, Montrose, Pennsylvania	184	
First Bank of Troy, Troy, Michigan	135	
Liberty State Bank, Mount Carmel, Pennsylvania	64	
First Bank of Greater Pittston, Pittston, Pennsylvania	137	
Manufacturers and Traders Trust Company, Buffalo, New York	6,600	11/27/91
Merger		
The First National Bank of Highland, Newburgh, New York	452	
Citizens Fidelity Bank and Trust Company, Louisville, Kentucky	5,200	11/29/91
Merger		
Citizens Fidelity Bank and Trust Company, Lexington, Kentucky	455	
Chemical Bank Michigan, Clare, Michigan	146	12/9/91
Merger		
Chemical Bank Gladwin County, Beaverton, Michigan	67	

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16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1991—Continued

Institution[1]	Assets (millions of dollars)	Date of approval
Old Kent Bank–Chicago, Chicago, Illinois	537	12/24/91
Merger		
Old Kent Bank, N. A., Elmhurst, Illinois	740	

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. Involves the acquisition of only certain assets and liabilities of the affiliated bank.

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, whichever approved the application, determined that the proposal would, in itself, have no adverse competitive effects and that the financial factors and considerations relating to the convenience and needs of the community were consistent with approval.

Institution[1]	Assets (millions of dollars)[2]	Date of approval
Commercial State Bank Interim of Orlando, Orlando, Florida	...	7/12/91
Merger		
Commercial State Bank of Orlando, Orlando, Florida	56	
Commercial Savings Bank of Florida, Miami, Florida	...	7/19/91
Merger		
Commercial Bank of Florida, Miami, Florida	69	
Teutopolis Interim Bank, Teutopolis, Illinois	...	9/5/91
Merger		
Teutopolis State Bank, Teutopolis, Illinois	25	
C & D Banking Company, Marietta, Ohio	...	9/20/91
Merger		
The Dime Bank, Marietta, Ohio	35	
Millersburg Interim Bank, Millersburg, Ohio	...	11/14/91
Merger		
The Commercial & Savings Bank of Millersburg, Millersburg, Ohio	154	

1. Each proposed transaction was to be effected under the charter of the first-named bank. The entries are in chronological order of approval.

2. Where no assets are listed, the bank is newly organized and not in operation.

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Federal Reserve Directories and Meetings

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Board of Governors of the Federal Reserve System

December 31, 1991

	Term expires
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DAVID W. MULLINS, JR., of Arkansas, *Vice Chairman*[1]	January 31, 2000
SUSAN M. PHILLIPS of Iowa	January 31, 1998
WAYNE D. ANGELL of Kansas	January 31, 1994
LAWRENCE B. LINDSEY of Virginia	January 31, 2000
EDWARD W. KELLEY, JR., of Texas	January 31, 2004
JOHN P. LAWARE of Massachusetts	January 31, 2002

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1. The Chairman is currently serving under a recess appointment which will expire at the end of the 102d Congress. The designation of Vice Chairman expires on July 24, 1995, unless the service of this member of the Board shall have terminated sooner.
2. On loan from the Division of Information Resources Management.

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3. On loan from Federal Reserve Bank of Richmond.

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Federal Reserve Bank of St. Louis

Federal Open Market Committee

December 31, 1991

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Associate Economist
LAWRENCE SLIFMAN,
Associate Economist
SHEILA L. TSCHINKEL,
Associate Economist

PETER D. STERNLIGHT, *Manager for Domestic Operations, System Open Market Account*
VACANCY, *Manager for Foreign Operations, System Open Market Account*

During 1991, the Federal Open Market Committee held eight meetings (see Record of Policy Actions of the Federal Open Market Committee in this REPORT.)

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Federal Advisory Council

December 31, 1991

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District 8—DAN W. MITCHELL, *Chairman*, Old National Bancorp and Old National Bank of Evansville, Evansville, Indiana

District 9—LLOYD P. JOHNSON, *Chairman and Chief Executive Officer*, Norwest Corporation, Minneapolis, Minnesota

District 10—JORDAN L. HAINES, *Chairman*, Fourth Financial Corporation and BANK IV Wichita, Wichita, Kansas

District 11—RONALD G. STEINHART, *Chairman and Chief Executive Officer*, Team Bank, Dallas, Texas

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Directors

IRA STEPANIAN

TERRENCE A. LARSEN

DAN W. MITCHELL

The Federal Advisory Council met on January 31–February 1, May 2–3, September 5–6, and October 31–November 1, 1991. The Board of Governors met with the council on February 1, May 3, September 6, and November 1, 1991. 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.

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Consumer Advisory Council

December 31, 1991

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JAMES FLETCHER, *President and Director*, South Shore Bank Chicago, Chicago, Illinois

GEORGE C. GALSTER, *Professor of Economics*, The College of Wooster, Wooster, Ohio

E. THOMAS GARMAN, *Professor of Consumer Studies*, Virginia Polytechnic Institute and State University, Blacksburg, Virginia

DONALD A. GLAS, *President*, First State Federal Savings and Loan Association, Hutchinson, Minnesota

DEBORAH B. GOLDBERG, *Reinvestment Specialist*, Center for Community Change, Washington, D.C.

MICHAEL M. GREENFIELD, *Professor of Law*, Washington University, St. Louis, Missouri

JOYCE HARRIS, *President and Chief Executive Officer*, Telco Community Credit Union, Madison, Wisconsin

COLLEEN D. HERNANDEZ, *Executive Director*, Kansas City Neighborhood Alliance, Kansas City, Missouri

JULIA E. HILER, *Executive Vice President*, Sunshine Mortgage Corporation, Marietta, Georgia

HENRY JARAMILLO, JR., *President*, Ranchers State Bank, Belen, New Mexico

BARBARA KAUFMAN, *Co-Director*, KCBS Call for Action, San Francisco, California

KATHLEEN E. KEEST, *Staff Attorney*, National Consumer Law Center, Boston, Massachusetts

MICHELLE S. MEIER, *Counsel for Government Affairs*, Consumers Union, Washington, D.C.

BERNARD F. PARKER, JR., *Executive Director*, Community Resource Projects, Detroit, Michigan

OTIS PITTS, JR., *President*, Tacolcy Economic Development Corp., Miami, Florida

VINCENT P. QUAYLE, *Director*, St. Ambrose Housing Aid Center, Baltimore, Maryland

CLIFFORD N. ROSENTHAL, *Executive Director*, National Federation of Community Development Credit Unions, New York, New York

NANCY HARVEY STEORTS, *President*, Nancy Harvey Steorts and Associates, Dallas, Texas

ALAN M. SILBERSTEIN, *Executive Vice President*, Chemical Bank, New York, New York

DAVID B. WARD, ESQ., *Consultant*, Beneficial Management Corp., Chester, New Jersey

SANDRA L. WILLETT, *Consultant on Quality Service*, Boston, Massachusetts

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Consumer Advisory Council—Continued

Officers

JAMES W. HEAD, *Chairman*

LINDA K. PAGE, *Vice Chairman*

The Consumer Advisory Council met with members of the Board of Governors on March 14, June 20, and October 10, 1991. 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, 1991

Members

DANIEL C. ARNOLD, *Chairman and President*, Farm & Home Financial Corporation, Houston, Texas

JAMES L. BRYAN, *President and Chief Executive Officer*, TEXINS Credit Union, Richardson, Texas

DAVID L. HATFIELD, *President*, Fidelity Savings Bank, FSB, Kalamazoo, Michigan

LYNN W. HODGE, *President and Chief Executive Officer*, United Savings Bank, Inc., Greenwood, South Carolina

ELLIOTT K. KNUTSON, *Chairman and Chief Executive Officer*, Washington Federal Savings and Loan Association, Seattle, Washington

JOHN WM. LAISLE, *President and Chief Executive Officer*, MidFirst Bank SSB, Oklahoma City, Oklahoma

RICHARD A. LARSON, *Chairman and Chief Executive Officer*, West Bend Savings Bank, West Bend, Wisconsin

PRESTON MARTIN, *Chairman and Chief Executive Officer*, WestFed Holdings, Inc., San Francisco, California

RICHARD D. PARSONS, *President and Chief Executive Officer*, The Dime Savings Bank of New York, FSB, New York, New York

MARION O. SANDLER, *President and Chief Executive Officer*, World Savings and Loan Association, Oakland, California

EDMOND M. SHANAHAN, *President and Chief Executive Officer*, Bell Federal Savings and Loan Association, Chicago, Illinois

WOODBURY C. TITCOMB, *President and Chief Executive Officer*, Peoples Bancorp of Worcester, Inc., and Peoples Savings Bank, Worcester, Massachusetts

Officers

MARION O. SANDLER, *President*

LYNN W. HODGE, *Vice President*

The members of the Thrift Institutions Advisory Council met with the Board of Governors on March 8, May 9, September 13, and November 15, 1991. The council, which is composed of representatives from credit unions, savings and loan associations, and savings banks, consults with and advises the Board on issues pertaining to the thrift industry and on various other matters within the Board's jurisdiction.

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Officers of Federal Reserve Banks, Branches, and Offices

December 31, 1991[1]

BANK, Branch, or *facility*	Chairman[2] Deputy Chairman	President First Vice President	Vice President in charge of Branch
BOSTON[3]	Richard N. Cooper Jerome H. Grossman	Richard F. Syron Cathy E. Minehan	
NEW YORK[3]	Cyrus R. Vance Ellen V. Futter	E. Gerald Corrigan James H. Oltman	
Buffalo	Mary Ann Lambertsen		James O. Aston
PHILADELPHIA	Peter A. Benoliel Jane G. Pepper	Edward G. Boehne William H. Stone, Jr.	
CLEVELAND[3]	John R. Miller A. William Reynolds	Vacant William H. Hendricks	
Cincinnati	Kate Ireland		Charles A. Cerino[4]
Pittsburgh	Robert P. Bozzone		Harold J. Swart[4]
RICHMOND[3]	Anne Marie Whittemore Henry J. Faison	Robert P. Black Jimmie R. Monhollon	
Baltimore	John R. Hardesty, Jr.		Ronald B. Duncan[4]
Charlotte	Anne M. Allen		Albert D. Tinkelenberg[4]
Culpeper			John G. Stoides[4]
ATLANTA	Larry L. Prince Edwin A. Huston	Robert P. Forrestal Jack Guynn	 Donald E. Nelson
Birmingham	Roy D. Terry		Fred R. Herr[4]
Jacksonville	Hugh M. Brown		James D. Hawkins[4]
Miami	Dorothy C. Weaver		James T. Curry III
Nashville	Shirley A. Zeitlin		Melvyn K. Purcell
New Orleans	JoAnn Slaydon		Robert J. Musso
CHICAGO[3]	Charles S. McNeer Richard G. Cline	Silas Keehn Daniel M. Doyle	
Detroit	Phyllis E. Peters		Roby L. Sloan[4]
ST. LOUIS	H. Edwin Trusheim Robert H. Quenon	Thomas C. Melzer James R. Bowen	
Little Rock	L. Dickson Flake		Karl W. Ashman
Louisville	Lois H. Gray		Howard Wells
Memphis	Katherine Hinds Smythe		Raymond Laurence
MINNEAPOLIS	Delbert W. Johnson Gerald A. Rauenhorst	Gary H. Stern Thomas E. Gainor	
Helena	James E. Jenks		John D. Johnson

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BANK, Branch, or *facility*	Chairman[2] Deputy Chairman	President First Vice President	Vice President in charge of Branch
KANSAS CITY	Fred W. Lyons, Jr. Burton A. Dole, Jr.	Thomas M. Hoenig Henry R. Czerwinski	
Denver	Barbara B. Grogan		Kent M. Scott
Oklahoma City	Ernest L. Holloway		David J. France
Omaha	Herman Cain		Harold L. Shewmaker
DALLAS	Hugh G. Robinson Leo E. Linbeck, Jr.	Robert D. McTeer, Jr. Tony J. Salvaggio	
El Paso	W. Thomas Beard III		Sammie C. Clay
Houston	Gilbert D. Gaedcke, Jr.		Robert Smith III[4]
San Antonio	Roger R. Hemminghaus		Thomas H. Robertson
SAN FRANCISCO	Robert F. Erburu Carolyn S. Chambers	Robert T. Parry Patrick K. Barron	
Los Angeles	Yvonne B. Burke		John F. Moore[4]
Portland	William A. Hilliard		Leslie R. Watters
Salt Lake City	D. N. Rose		Andrea P. Wolcott
Seattle	Judith Runstad		Gerald R. Kelly[4]

1. A current list of these officers appears each month in the *Federal Reserve Bulletin*.
2. The Chairman of a Federal Reserve Bank, by statute, serves as Federal Reserve Agent.
3. Additional offices of these Banks are located at Lewiston, Maine; Windsor Locks, Connecticut; Cranford, New Jersey; Jericho, New York; Utica at Oriskany, New York; Columbus, Ohio; Columbia, South Carolina; Charleston, West Virginia; Des Moines, Iowa; Indianapolis, Indiana; and Milwaukee, Wisconsin.
4. Senior Vice President.

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 May 29 and 30, and on December 4 and 5, 1991.

The Executive Committee of the Conference of Chairmen during 1991 comprised Peter A. Benoliel, Chairman; Hugh G. Robinson, Vice Chairman; and Larry L. Prince, member.

On December 5, 1991, the Conference elected its Executive Committee for 1992, naming Anne Marie Whittemore as Chairman, Delbert W. Johnson as Vice Chairman, and Richard N. Cooper as the third 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 19, 1990, the Conference elected Thomas C. Melzer, President of the Federal Reserve Bank of St. Louis, as its Chairman for 1991–92, and Robert T. Parry, President of the Federal Reserve Bank of San Francisco, as its Vice Chairman. The Conference appointed Frances E. Sibley, of the Federal Reserve Bank of St. Louis, as its Secretary and Elizabeth Masten, of the Federal Reserve Bank of San Francisco, 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 October 16, 1990, the Conference elected Jimmie R. Monhollon, First Vice President of the Federal Reserve Bank of Richmond, as its Chairman for 1991, and William H. Hendricks, First Vice President

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of the Federal Reserve Bank of Cleveland, as its Vice Chairman. The Conference appointed Marsha S. Shuler, of the Federal Reserve Bank of Richmond as its Secretary, and Creighton R. Fricek, of the Federal Reserve Bank of Cleveland, 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."

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		Term expires Dec. 31
DISTRICT 1—BOSTON		
Class A		
William H. Chadwick	Vice Chairman of the Board and Chief Operating Officer, Banknorth Group, Inc., Burlington, Vermont	1991
Terrence Murray	Chairman of the Board, President, and Chief Executive Officer, Fleet/Norstar Financial Group, Inc., Providence, Rhode Island	1992
Norman F. C. Kent	President, First National Bank of Portsmouth, Portsmouth, New Hampshire	1993
Class B		
Edward H. Ladd	Chairman and Chief Executive Officer, Standish, Ayer and Wood, Inc., Boston, Massachusetts	1991
Joan T. Bok	Chairman of the Board, New England Electric System, Westborough, Massachusetts	1992
Stephen R. Levy	Chairman of the Board and Chief Executive Officer, Bolt Beranek and Newman, Inc., Cambridge, Massachusetts	1993
Class C		
Jerome H. Grossman	Chairman of the Board and Chief Executive Officer, New England Medical Center, Inc., Boston, Massachusetts	1991
Richard N. Cooper	Maurits C. Boas Professor of International Economics, Harvard University, Cambridge, Massachusetts	1992
John E. Flynn	Executive Director, The Quality Connection, East Dennis, Massachusetts	1993
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	1991
Victor J. Riley, Jr.	Chairman of the Board, President, and Chief Executive Officer, KeyCorp, Albany, New York	1992
Barbara Harding	Chairman of the Board and Chief Executive Officer, Phillipsburg National Bank and Trust Company, Phillipsburg, New Jersey	1993
Class B		
Richard L. Gelb	Chairman of the Board and Chief Executive Officer, Bristol-Myers Squibb Company, New York, New York	1991
John A. Georges	Chairman of the Board and Chief Executive Officer, International Paper, Purchase, New York	1992

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DISTRICT 2, *Class B*—Continued

Rand V. Araskog	Chairman and Chief Executive Officer, ITT Corporation, New York, New York	1993

Class C

Maurice R. Greenberg	Chairman and Chief Executive Officer, American International Group, Inc., New York, New York	1991
Cyrus R. Vance	Presiding Partner, Simpson Thacher & Bartlett, New York, New York	1992
Ellen V. Futter	President, Barnard College, New York, New York	1993

BUFFALO BRANCH

Appointed by the Federal Reserve Bank

Richard H. Popp	Operating Partner, Southview Farm, Castile, New York	1991
Robert G. Wilmers	Chairman of the Board and Chief Executive Officer, Manufacturers and Traders Trust Company, Buffalo, New York	1991
Wilbur F. Beh	President and Chief Executive Officer, FNB of Rochester, Rochester, New York	1992
Susan A. McLaughlin	President, Eastman Savings and Loan Association, Rochester, New York	1993

Appointed by the Board of Governors

Mary Ann Lambertsen	Former Vice President - Human Resources and Information Systems, Fisher-Price, Division of The Quaker Oats Company, East Aurora, New York	1991
Herbert L. Washington	HLW Fast Track, Inc., Rochester, New York	1992
Joseph J. Castiglia	President and Chief Executive Officer, Pratt & Lambert, Inc., Buffalo, New York	1993

DISTRICT 3—PHILADELPHIA

Class A

H. Bernard Lynch	President and Chief Executive Officer, The First National Bank of Wyoming, Wyoming, Delaware	1991
Samuel A. McCullough	Chairman of the Board and Chief Executive Officer, Meridian Bancorp, Inc., Reading, Pennsylvania	1992
Gary F. Simmerman	President and Chief Executive Officer, United Jersey Bank/South, N.A., Cherry Hill, New Jersey	1993

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		Term expires Dec. 31
DISTRICT 3—Continued		
Class B		
Nicholas Riso	Executive Vice President, AHOLD, U.S.A., Harrisburg, Pennsylvania	1991
David W. Huggins	President, R M S Technologies, Inc., Marlton, New Jersey	1992
James M. Mead	President, Capital Blue Cross, Harrisburg, Pennsylvania	1993
Class C		
Donald J. Kennedy	Business Manager, International Brotherhood of Electrical Workers, Local Union No. 269, Trenton, New Jersey	1991
Peter A. Benoliel	Chairman of the Board, Quaker Chemical Corporation, Conshohocken, Pennsylvania	1992
Jane G. Pepper	President, The Pennsylvania Horticultural Society, Philadelphia, Pennsylvania	1993
DISTRICT 4—CLEVELAND		
Class A		
William T. McConnell	President, The Park National Bank, Newark, Ohio	1991
Frank Wobst	Chairman of the Board and Chief Executive Officer, Huntington Bancshares Incorporated, Columbus, Ohio	1992
Alfred C. Leist	President, Chairman and Chief Executive Officer, Apple Creek Banking Company, Apple Creek, Ohio	1993
Class B		
Douglas E. Olesen	President and Chief Executive Officer, Battelle Memorial Institute, Columbus, Ohio	1991
Laban P. Jackson, Jr.	Chairman of the Board, Clearcreek Properties, Lexington, Kentucky	1992
Verna K. Gibson	Business Consultant, Columbus, Ohio	1993
Class C		
John R. Miller	Former President and Chief Operating Officer, The Standard Oil Company (Ohio), Cleveland, Ohio	1991
A. William Reynolds	Chairman and Chief Executive Officer, GenCorp, Fairlawn, Ohio	1992
John R. Hodges	President, Ohio AFL-CIO, Columbus, Ohio	1993
CINCINNATI BRANCH		
Appointed by the Federal Reserve Bank		
Allen L. Davis	President and Chief Executive Officer, The Provident Bank, Cincinnati, Ohio	1991

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DISTRICT 4, CINCINNATI BRANCH

Appointed by the Federal Reserve Bank—Continued

Name	Position	*Term expires Dec. 31*
Clay Parker Davis	President and Chief Executive Officer, Citizens National Bank, Somerset, Kentucky	1992
Jack W. Buchanan	President, Sphar & Company, Inc., Winchester, Kentucky	1993
Harry A. Shaw III	Chairman and Chief Executive Officer, Huffy Corporation, Dayton, Ohio	1993

Appointed by the Board of Governors

Name	Position	Term expires Dec. 31
Kate Ireland	National Chairman of the Board, Frontier Nursing Service, Wendover, Kentucky	1991
Eleanor Hicks	Advisor for Intl. Liaison Protocol and Services and Associate Professor of Political Science, University of Cincinnati, Cincinnati, Ohio	1992
Marvin Rosenberg	Partner, Towne Properties, Ltd., Cincinnati, Ohio	1993

PITTSBURGH BRANCH

Appointed by the Federal Reserve Bank

Name	Position	Term expires Dec. 31
E. James Trimarchi	President and Chief Executive Officer, First Commonwealth Financial Corporation, Indiana, Pennsylvania	1991
William F. Roemer	Chairman and Chief Executive Officer, Integra Financial Corporation, Pittsburgh, Pennsylvania	1992
George A. Davidson, Jr.	Chairman of the Board and Chief Executive Officer, Consolidated Natural Gas Company, Pittsburgh, Pennsylvania	1993
I. N. Rendall Harper, Jr.	President, American Micrographics Company, Inc., Monroeville, Pennsylvania	1993

Appointed by the Board of Governors

Name	Position	Term expires Dec. 31
Jack B. Piatt	Chairman of the Board, Millcraft Industries, Inc., Washington, Pennsylvania	1991
Robert P. Bozzone	President and Chief Executive Officer, Allegheny Ludlum Corporation, Pittsburgh, Pennsylvania	1992
Sandra L. Phillips	Executive Director, Pittsburgh Partnership for Neighborhood Development, Pittsburgh, Pennsylvania	1993

DISTRICT 5—RICHMOND

Class A

Name	Position	Term expires Dec. 31
C. R. Hill, Jr.	Executive Vice President, Beckley National Bank, Oak Hill, West Virginia	1991
A. Pierce Stone	Chairman, President, and Chief Executive Officer, Virginia Community Bank, Louisa, Virginia	1992

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		Term expires Dec. 31
DISTRICT 5, *Class A*—Continued		
James G. Lindley	Chairman, President, and Chief Executive Officer, South Carolina National Bank, Columbia, South Carolina	1993
Class B		
Edward H. Covell	President, The Covell Company, Easton, Maryland	1991
R. E. Atkinson, Jr.	Chairman, Dilmar Oil Company, Inc., Florence, South Carolina	1992
Paul A. DelaCourt	Chairman, The North Carolina Enterprise Corporation, Raleigh, North Carolina	1993
Class C		
Anne Marie Whittemore	Partner, McGuire, Woods, Battle & Boothe, Richmond, Virginia	1991
Henry J. Faison	President, Faison Associates, Charlotte, North Carolina	1992
Stephen Brobeck	Executive Director, Consumer Federation of America, Washington, D.C.	1993

BALTIMORE BRANCH

Appointed by the Federal Reserve Bank		
Joseph W. Mosmiller	Chairman of the Board, Loyola Federal Savings and Loan Association, Baltimore, Maryland	1991
F. Levi Ruark	Chairman of the Board and President, The National Bank of Cambridge, Cambridge, Maryland	1991
Richard M. Adams	Chairman and Chief Executive Officer, United Bankshares, Inc., Parkersburg, West Virginia	1992
Daniel P. Henson III	Senior Development Director, Struever Bros., Eccles & Rouse, Inc., Baltimore, Maryland	1993
Appointed by the Board of Governors		
Thomas R. Shelton	President, Case Foods, Inc., Salisbury, Maryland	1991
John R. Hardesty, Jr.	President, Preston Energy, Inc., Kingwood, West Virginia	1992
William H. Wynn	International President, United Food and Commercial Workers International Union, AFL-CIO & CLC, Washington, D.C.	1993

CHARLOTTE BRANCH

Appointed by the Federal Reserve Bank		
Crandall C. Bowles	President, The Springs Company, Lancaster, South Carolina	1991
L. Glenn Orr, Jr.	Chairman, President, and Chief Executive Officer, Southern National Corporation, Lumberton, North Carolina	1991

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DISTRICT 5, CHARLOTTE BRANCH
Appointed by the Federal Reserve Bank—Continued

Name	Position	Term expires Dec. 31
David B. Jordan	President, Chief Executive Officer, and Director, Omni Capital Group, Inc. and OMNIBANK, Salisbury, North Carolina	1992
Jim M. Cherry, Jr.	President and Chief Executive Officer, Williamsburg First National Bank, Kingstree, South Carolina	1993

Appointed by the Board of Governors

Name	Position	Term expires Dec. 31
Harold D. Kingsmore	President and Chief Operating Officer, Graniteville Company, Graniteville, South Carolina	1991
Anne M. Allen	President, Anne Allen & Associates, Inc., Greensboro, North Carolina	1992
William E. Masters	President, Perception, Inc., Easley, South Carolina	1993

DISTRICT 6—ATLANTA

Class A

Name	Position	Term expires Dec. 31
Virgil H. Moore, Jr.	Chairman of the Board, First Farmers and Merchants National Bank, Columbia, Tennessee	1991
W. H. Swain	Chairman of the Board, First National Bank, Oneida, Tennessee	1992
James B. Williams	Chairman and Chief Executive Officer, SunTrust Banks, Inc., Atlanta, Georgia	1993

Class B

Name	Position	Term expires Dec. 31
Saundra H. Gray	Co-Owner, Gemini Springs Farm, DeBary, Florida	1991
J. Thomas Holton	Chairman of the Board and President, Sherman International Corporation, Birmingham, Alabama	1992
Andre M. Rubenstein	Chairman of the Board and Chief Executive Officer, Rubenstein Brothers, Inc., New Orleans, Louisiana	1993

Class C

Name	Position	Term expires Dec. 31
Larry L. Prince	Chairman and Chief Executive Officer, Genuine Parts Company, Atlanta, Georgia	1991
Leo Benatar	Chairman of the Board and President, Engraph, Inc., Atlanta, Georgia	1992
Edwin A. Huston	Senior Executive Vice President-Finance, Ryder System, Inc., Miami, Florida	1993

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DISTRICT 6—Continued

BIRMINGHAM BRANCH

Appointed by the Federal Reserve Bank

Name	Position	Term expires Dec. 31
Shelton E. Allred	Chairman of the Board, President, and Chief Executive Officer, Frit Industries, Inc., Ozark, Alabama	1991
William F. Childress	President, First American Federal Savings and Loan Association, Huntsville, Alabama	1991
Robert M. Barrett	Chairman and President, The First National Bank of Wetumpka, Wetumpka, Alabama	1992
Julian W. Banton	Chairman, President, and Chief Executive Officer, SouthTrust Bank of Alabama, N.A., Birmingham, Alabama	1993

Appointed by the Board of Governors

Name	Position	Term expires Dec. 31
Roy D. Terry	President and Chief Executive Officer, Terry Manufacturing Company, Inc., Roanoke, Alabama	1991
Nelda P. Stephenson	President, Nelda Stephenson Chevrolet, Inc., Florence, Alabama	1992
Donald E. Boomershine	President, Better Business Bureau of Central Alabama, Inc., Birmingham, Alabama	1993

JACKSONVILLE BRANCH

Appointed by the Federal Reserve Bank

Name	Position	Term expires Dec. 31
Perry M. Dawson	President and Chief Executive Officer, Suncoast Schools Federal Credit Union, Tampa, Florida	1991
Samuel H. Vickers	Chairman, President, and Chief Executive Officer, Design Containers, Inc., Jacksonville, Florida	1991
Merle L. Graser	Chairman and Chief Executive Officer, First National Bank of Venice, Venice, Florida	1992
Hugh H. Jones, Jr.	Chairman of the Board and Chief Executive Officer, Barnett Bank of Jacksonville, N.A., Jacksonville, Florida	1993

Appointed by the Board of Governors

Name	Position	Term expires Dec. 31
Hugh M. Brown	President and Chief Executive Officer, BAMSI, Inc., Titusville, Florida	1991
Lana Jane Lewis-Brent	Vice Chairman of the Board, President, and Chief Executive Officer, Sunshine Jr. Stores, Inc., Panama City, Florida	1992
Joan Dial Ruffier	General Partner, Sunshine Cafes, and Vice President, Vista Landscaping, Orlando, Florida	1993

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		Term expires Dec. 31
DISTRICT 6—Continued		
MIAMI BRANCH		
Appointed by the Federal Reserve Bank		
Roberto G. Blanco	Vice Chairman of the Board and Chief Financial Officer, Republic National Bank of Miami, Miami, Florida	1991
A. Gordon Oliver	President and Chief Executive Officer, Citizens and Southern National Bank of Florida, Fort Lauderdale, Florida	1992
Steven C. Shimp	President, O-A-K/Florida, Inc., Fort Myers, Florida	1993
Pat L. Tornillo, Jr.	Executive Vice President, United Teachers of Dade, Miami, Florida	1993
Appointed by the Board of Governors		
Dorothy C. Weaver	President, Intercap Equities, Inc., Coral Gables, Florida	1991
R. Kirk Landon	Chairman and Chief Executive Officer, American Bankers Insurance Group, Miami, Florida	1992
Michael T. Wilson	President, Vinegar Bend Farms, Inc., Belle Glade, Florida	1993
NASHVILLE BRANCH		
Appointed by the Federal Reserve Bank		
William Baxter Lee III	Chairman of the Board and President, Southeast Services Corporation, Knoxville, Tennessee	1991
Marguerite W. Sallee	President and Chief Executive Officer, Corporate Child Care, Inc., Nashville, Tennessee	1991
James D. Harris	President and Chief Executive Officer, Brentwood National Bank, Brentwood, Tennessee	1992
Williams E. Arant, Jr.	President and Chief Executive Officer, First National Bank of Knoxville, Knoxville, Tennessee	1993
Appointed by the Board of Governors		
Shirley A. Zeitlin	President, Shirley Zeitlin & Co. Realtors, Nashville, Tennessee	1991
Harold A. Black	Professor and Head, Department of Finance, College of Business Administration, University of Tennessee, Knoxville, Tennessee	1992
Victoria B. Jackson	President and Chief Executive Officer, Diesel Sales and Service, Inc., and Prodiesel, Inc., Nashville, Tennessee	1993

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DISTRICT 6—Continued

NEW ORLEANS BRANCH

Appointed by the Federal Reserve Bank

Joel B. Bullard, Jr.	President, Joe Bullard Automotive Companies, Mobile, Alabama	1991
Kay L. Nelson	President-Owner, Nelson Capital Corporation, New Orleans, Louisiana	1991
Earl W. Lundy	Chairman of the Board and Chief Executive Officer, First National Bank of Vicksburg, Vicksburg, Mississippi	1992
A. Hartie Spence	President, Calcasieu Marine National Bank, Lake Charles, Louisiana	1993

Appointed by the Board of Governors

JoAnn Slaydon	President, Slaydon Consultants, Baton Rouge, Louisiana	1991
Lucimarian Tolliver Roberts	Commission President, Mississippi Coast Coliseum, Pass Christian, Mississippi	1992
Victor Bussie	President, Louisiana AFL-CIO, Baton Rouge, Louisiana	1993

DISTRICT 7—CHICAGO

Class A

John W. Gabbert	President and Chief Executive Officer, First of America Bank-LaPorte, N.A., LaPorte, Indiana	1991
B. F. Backlund	Chairman of the Board and Chief Executive Officer, Bartonville Bank, Peoria, Illinois	1992
David W. Fox	Chairman, President, and Chief Executive Officer, The Northern Trust Corporation and The Northern Trust Company, Chicago, Illinois	1993

Class B

Max J. Naylor	President, Naylor Farms, Inc., Jefferson, Iowa	1991
Paul J. Schierl	Financial Consultant, Green Bay, Wisconsin	1992
A. Charlene Sullivan	Associate Professor of Management, Krannert Graduate School of Management, Purdue University, West Lafayette, Indiana	1993

Class C

Charles S. McNeer	Retired Chairman of the Board and Chief Executive Officer, Wisconsin Energy Corporation, Milwaukee, Wisconsin	1991

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DISTRICT 7, *Class C*—Continued

		Term expires Dec. 31
Richard G. Cline	Chairman of the Board, President, and Chief Executive Officer, NICOR, Inc., Naperville, Illinois	1992
Robert M. Healey	President, Chicago Federation of Labor and Industrial Union Council, AFL-CIO, Chicago, Illinois	1993

DETROIT BRANCH

Appointed by the Federal Reserve Bank

Robert J. Mylod	Chairman of the Board, President, and Chief Executive Officer, Michigan National Corporation, Farmington Hills, Michigan	1991
Norman F. Rodgers	President and Chief Executive Officer, Hillsdale County National Bank, Hillsdale, Michigan	1992
Charles E. Allen	President and Chief Executive Officer, Graistone Realty Advisors, Inc., Detroit, Michigan	1993
William E. Odom	Chairman, Ford Motor Credit Company, Dearborn, Michigan	1993

Appointed by the Board of Governors

Phyllis E. Peters	Director, Professional Standards Review, Deloitte & Touche, Detroit, Michigan	1991
J. Michael Moore	Chairman of the Board and Chief Executive Officer, Invetech Company, Detroit, Michigan	1992
Beverly Beltaire	President, P R Associates, Inc., Detroit, Michigan	1993

DISTRICT 8—ST. LOUIS

Class A

Henry G. River, Jr.	President and Chief Executive Officer, First National Bank in Pinckneyville, Pinckneyville, Illinois	1991
W. E. Ayres	Chairman of the Board and Chief Executive Officer, Simmons First National Bank of Pine Bluff, Pine Bluff, Arkansas	1992
Ray U. Tanner	Chairman of the Board and Chief Executive Officer, Jackson National Bank and Volunteer Bancshares, Inc., Jackson, Tennessee	1993

Class B

Thomas F. McLarty III	Chairman of the Board and Chief Executive Officer, Arkla, Inc., Little Rock, Arkansas	1991
Frank M. Mitchener, Jr.	President, Mitchener Farms, Inc., Sumner, Mississippi	1992
Warren R. Lee	President, W. R. Lee & Associates, Inc., Louisville, Kentucky	1993

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DISTRICT 8—Continued

		Term expires Dec. 31
Class C		
Robert H. Quenon	Mining Consultant, St. Louis, Missouri	1991
H. Edwin Trusheim	Chairman of the Board and Chief Executive Officer, General American Life Insurance Company, St. Louis, Missouri	1992
Janet McAfee Weakley	President, Janet McAfee, Inc., St. Louis, Missouri	1993

LITTLE ROCK BRANCH

Appointed by the Federal Reserve Bank		
Barnett Grace	Chairman and Chief Executive Officer, First Commercial Bank, N.A., Little Rock, Arkansas	1991
Patricia M. Townsend	President, Townsend Company, Stuttgart, Arkansas	1992
James V. Kelley III	Chairman, President and Chief Executive Officer, First United Bancshares, Inc., El Dorado, Arkansas	1993
Mahlon A. Martin	President, Winthrop Rockefeller Foundation, Little Rock, Arkansas	1993
Appointed by the Board of Governors		
James R. Rodgers	Airport Manager, Little Rock Regional Airport, Little Rock, Arkansas	1991
L. Dickson Flake	President, Barnes, Quinn, Flake & Anderson, Inc., Little Rock, Arkansas	1992
Vacancy		1993

LOUISVILLE BRANCH

Appointed by the Federal Reserve Bank		
Douglas M. Lester	Chairman of the Board, President, and Chief Executive Officer, Trans Financial Bancorp, Inc., Bowling Green, Kentucky	1991
Morton Boyd	Chairman and Chief Executive Officer, First Kentucky National Corporation, Louisville, Kentucky	1992
Laura M. Douglas	Legal Director, Metropolitan Sewer District, Louisville, Kentucky	1993
Vacancy		1993
Appointed by the Board of Governors		
Lois H. Gray	Chairman of the Board, James N. Gray Construction Company, Inc., Glasgow, Kentucky	1991
Daniel L. Ash	Managing Director, Louisville Energy and Environment Corporation, Louisville, Kentucky	1992
John A. Williams	Chairman and Chief Executive Officer, Computer Services, Inc., Paducah, Kentucky	1993

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Term expires Dec. 31

DISTRICT 8—Continued

MEMPHIS BRANCH

Appointed by the Federal Reserve Bank

Vacancy		1991
Michael J. Hennessey	President, Munro & Company, Inc., Wynne, Arkansas	1992
Thomas M. Garrott	President and Chief Operating Officer, National Bank of Commerce and National Commerce Bancorporation, Memphis, Tennessee	1993
Larry A. Watson	Chairman of the Board and President, Liberty Federal Savings Bank, Paris, Tennessee	1993

Appointed by the Board of Governors

Katherine Hinds Smythe	President, Memorial Park, Inc., Memphis, Tennessee	1991
Sandra B. Sanderson-Chesnut	President and Chief Executive Officer, Sanderson Plumbing Products, Inc., Columbus, Mississippi	1992
Seymour B. Johnson	Owner, Kay Planting Company, Indianola, Mississippi	1993

DISTRICT 9—MINNEAPOLIS

Class A

James H. Hearon III	Chairman of the Board and Chief Executive Officer, National City Bank, Minneapolis, Minnesota	1991
Rodney W. Fouberg	Chairman of the Board, Farmers and Merchants Bank and Trust Co., Aberdeen, South Dakota	1992
Charles L. Seaman	President and Chief Executive Officer, First State Bank of Warner, Warner, South Dakota	1993

Class B

Duane E. Dingmann	President, Trubilt Auto Body, Inc., Eau Claire, Wisconsin	1991
Bruce C. Adams	Partner, Triple Adams Farms, Minot, North Dakota	1992
Earl R. St. John, Jr.	President, St. John Forest Products, Inc., Spalding, Michigan	1993

Class C

Jean D. Kinsey	Professor, Consumption and Consumer Economics, Department of Agricultural and Applied Economics, University of Minnesota, St. Paul, Minnesota	1991
Gerald A. Rauenhorst	Chairman of the Board and Chief Executive Officer, Opus Corporation, Minneapolis, Minnesota	1992

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		Term expires Dec. 31
DISTRICT 9, *Class C*—Continued		
Delbert W. Johnson	President and Chief Executive Officer, Pioneer Metal Finishing, Minneapolis, Minnesota	1993

HELENA BRANCH

Appointed by the Federal Reserve Bank

Beverly D. Harris	President, Empire Federal Savings and Loan Association, Livingston, Montana	1991
Robert T. Gerhardt	Chairman, President and Chief Executive Officer, First Interstate Bank of Montana, N.A., Kalispell, Montana	1992
Nancy M. Stephenson	Executive Director, Neighborhood Housing Services, Great Falls, Montana	1992

Appointed by the Board of Governors

James E. Jenks	Jenks Farms, Hogeland, Montana	1991
J. Frank Gardner	President, Montana Resources, Inc., Butte, Montana	1992

DISTRICT 10—KANSAS CITY

Class A

Robert L. Hollis	Chairman of the Board and Chief Executive Officer, First National Bank and Trust Co. of Okmulgee, Okmulgee, Oklahoma	1991
Harold L. Gerhart, Jr.	Chairman and Chief Executive Officer, First National Bank, Newman Grove, Nebraska	1992
Roger L. Reisher	Co-Chairman of the Board, FirstBank Holding Company of Colorado, Lakewood, Colorado	1993

Class B

Frank J. Yaklich, Jr.	President, CF & I Steel Corporation, Pueblo, Colorado	1991
Frank A. McPherson	Chairman of the Board and Chief Executive Officer, Kerr-McGee Corporation, Oklahoma City, Oklahoma	1992
Don E. Adams	Buffalo, Oklahoma	1993

Class C

Burton A. Dole, Jr.	Chairman of the Board and President, Puritan-Bennett Corporation, Overland Park, Kansas	1991
Fred W. Lyons, Jr.	President, Marion Merrell Dow Inc., Kansas City, Missouri	1992
Thomas E. Rodriguez	President and General Manager, Thomas E. Rodriguez & Associates, P.C., Aurora, Colorado	1993

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Term expires Dec. 31

DISTRICT 10—Continued

DENVER BANCH

Appointed by the Federal Reserve Bank

Norman R. Corzine	President and Chief Executive Officer, First National Bank in Albuquerque, Albuquerque, New Mexico	1991
W. Richard Scarlett III	Chairman of the Board and Chief Executive Officer, Jackson State Bank, Jackson Hole, Wyoming	1991
Henry A. True III	Partner, True Companies, Casper, Wyoming	1992
Peter R. Decker	President, Decker & Associates, Denver, Colorado	1993

Appointed by the Board of Governors

Barbara B. Grogan	President, Western Industrial Contractors, Inc., Denver, Colorado	1991
Sandra K. Woods	Vice President, Corporate Real Estate, Adolph Coors Company, Golden, Colorado	1992
Gilbert Sanchez	President, New Mexico Highlands University, Las Vegas, New Mexico	1993

OKLAHOMA CITY BRANCH

Appointed by the Federal Reserve Bank

C. Kendric Fergeson	Chairman of the Board and Chief Executive Officer, The National Bank of Commerce, Altus, Oklahoma	1991
W. Dean Hidy, M.D.	Chairman of the Board, Triad Bank, N.A., Tulsa, Oklahoma	1992
John Wm. Laisle	President, MidFirst Bank, SSB, Oklahoma City, Oklahoma	1992

Appointed by the Board of Governors

Ernest L. Holloway	President, Langston University, Langston, Oklahoma	1991
William R. Allen	President and Chief Executive Officer, Union Equity Cooperative Exchange, Enid, Oklahoma	1992

OMAHA BRANCH

Appointed by the Federal Reserve Bank

Sheila Griffin	Special Advisor to the Governor for International Trade, Lincoln, Nebraska	1991
John T. Selzer	Chairman of the Board and Chief Executive Officer, FirsTier Bank, N.A., Scottsbluff, Nebraska	1991
John R. Cochran	President and Chief Executive Officer, Norwest Bank Nebraska, N.A., Omaha, Nebraska	1992

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DISTRICT 10, OMAHA BRANCH—Continued

Appointed by the Board of Governors

		Term expires Dec. 31
LeRoy W. Thom	President, T-L Irrigation Company, Hastings, Nebraska	1991
Herman Cain	President and Chief Executive Officer, Godfather's Pizza, Inc., Omaha, Nebraska	1992

DISTRICT 11—DALLAS

Class A

Charles T. Doyle	Chairman of the Board and Chief Executive Officer, Gulf National Bank, Texas City, Texas	1991
Robert G. Greer	Chairman of the Board, Tanglewood Bank, N.A., Houston, Texas	1992
T. C. Frost	Chairman of the Board, Frost National Bank, San Antonio, Texas	1993

Class B

Peyton Yates	President, Yates Drilling Company and Executive Vice President, Yates Petroleum Corporation, Artesia, New Mexico	1991
Gary E. Wood	President, Texas Research League, Austin, Texas	1992
J. B. Cooper, Jr.	Farmer, Roscoe, Texas	1993

Class C

Hugh G. Robinson	Chairman of the Board and Chief Executive Officer, The Tetra Group, Inc., Dallas, Texas	1991
Leo E. Linbeck, Jr.	Chairman of the Board and Chief Executive Officer, Linbeck Construction Corporation, Houston, Texas	1992
Henry G. Cisneros	Chairman and Chief Executive Officer, Cisneros Asset Management Co., San Antonio, Texas	1993

EL PASO BRANCH

Appointed by the Federal Reserve Bank

Humberto F. Sambrano	President, SamCorp General Contractors, El Paso, Texas	1991
Wayne Merritt	President, Claydesta National Bank, Midland, Texas	1992
Veronica K. Callaghan	Vice President and Principal, KASCO Ventures, Inc., El Paso, Texas	1993
Ben H. Haines, Jr.	President, First National Bank of Dona Ana County, Las Cruces, New Mexico	1993

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Term expires Dec. 31

DISTRICT 11, EL PASO BRANCH—Continued

Appointed by the Board of Governors

Name	Position	Term expires Dec. 31
Alvin T. Johnson	Senior Vice President and Founder, Management Assistance Corporation of America, El Paso, Texas	1991
W. Thomas Beard III	President, Leoncita Cattle Company, Alpine, Texas	1992
Diana S. Natalicio	President, The University of Texas at El Paso, El Paso, Texas	1993

HOUSTON BRANCH

Appointed by the Federal Reserve Bank

Name	Position	Term expires Dec. 31
Jeff Austin, Jr.	President, First National Bank of Jacksonville, Jacksonville, Texas	1991
Jenard M. Gross	President, Gross Builders, Inc., Houston, Texas	1992
Walter E. Johnson	President and Chief Executive Officer, Southwest Bank of Texas, Houston, Texas	1993
Clive Runnells	President and Director, Runnells Cattle Company, Bay City, Texas	1993

Appointed by the Board of Governors

Name	Position	Term expires Dec. 31
Gilbert D. Gaedcke	Chairman of the Board and Chief Executive Officer, Gaedcke Equipment Company, Houston, Texas	1991
Judy Ley Allen	Partner and Administrator, Allen Investments, Houston, Texas	1992
Milton Carroll	President, Instrument Products, Inc., Houston, Texas	1993

SAN ANTONIO BRANCH

Appointed by the Federal Reserve Bank

Name	Position	Term expires Dec. 31
Jane Flato Smith	Investor and Rancher, San Antonio, Texas	1991
Gregory W. Crane	Chairman of the Board, President, and Chief Executive Officer, Broadway National Bank, San Antonio, Texas	1992
Javier Garza	Executive Vice President, The Laredo National Bank, Laredo, Texas	1993
Sam R. Sparks	President, Sam R. Sparks, Inc., Santa Rosa, Texas	1993

Appointed by the Board of Governors

Name	Position	Term expires Dec. 31
Roger R. Hemminghaus	Chairman of the Board, President, and Chief Executive Officer, Diamond Shamrock, Inc., San Antonio, Texas	1991
Lawrence E. Jenkins	Vice President (Retired), Lockheed Missiles and Space Company, Austin, Texas	1992
Erich Wendl	President, Maverick Markets, Inc., Corpus Christi, Texas	1993

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		Term expires Dec. 31
DISTRICT 12—SAN FRANCISCO		
Class A		
William E. B. Siart	President, First Interstate Bancorp, Los Angeles, California	1991
Warren K. K. Luke	President and Director, Hawaii National Bancshares, Inc., and Vice Chairman of the Board, Hawaii National Bank, Honolulu, Hawaii	1992
Richard L. Mount	Chairman, President, and Chief Executive Officer, Saratoga Bancorp, Saratoga, California	1993
Class B		
William L. Tooley	Chairman, Tooley & Company, Investment Builders, Los Angeles, California	1991
E. Kay Stepp	President, Portland General Electric, Portland, Oregon	1992
John N. Nordstrom	Co-Chairman of the Board, Nordstrom, Inc., Seattle, Washington	1993
Class C		
Carolyn S. Chambers	President and Chief Executive Officer, Chambers Communications Corp., Eugene, Oregon	1991
Robert F. Erburu	Chairman of the Board and Chief Executive Officer, The Times Mirror Company, Los Angeles, California	1992
James A. Vohs	Chairman of the Board, Kaiser Foundation Health Plan, Inc., and Kaiser Foundation Hospitals, Oakland, California	1993
LOS ANGELES BRANCH		
Appointed by the Federal Reserve Bank		
David R. Lovejoy	Former Vice Chairman of the Board, Security Pacific National Bank, Los Angeles, California	1991
Ignacio E. Lozano, Jr.	Editor-in-Chief, La Opinion, Los Angeles, California	1991
Fred D. Jensen	Chairman of the Board, President, and Chief Executive Officer, National Bank of Long Beach, Long Beach, California	1992
Anita Landecker	Director of California Programs, Local Initiatives Support Corporation, Los Angeles, California	1993
Appointed by the Board of Governors		
Harry W. Todd	Managing Partner, Carlisle Enterprises, L.P., Coronado, California	1991
Yvonne Brathwaite Burke	Partner, Jones, Day, Reavis & Pogue, Los Angeles, California	1992

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		Term expires Dec. 31
DISTRICT 12—LOS ANGELES BRANCH		
Appointed by the Board of Governors—Continued		
Donald G. Phelps	Chancellor, Los Angeles Community College District, Los Angeles, California	1993

PORTLAND BRANCH

Appointed by the Federal Reserve Bank

Stuart H. Compton	Chairman of the Board and Chief Executive Officer, Pioneer Trust Bank, N.A., Salem, Oregon	1991
Elizabeth K. Johnson	President and Chief Operating Officer, Transwestern Helicopters, Inc., Scappoose, Oregon	1992
Cecil W. Drinkward	President and Chief Executive Officer, Hoffman Construction Company, Portland, Oregon	1993
Stephen G. Kimball	President and Chief Executive Officer, Baker Boyer Bancorp, Walla Walla, Washington	1993

Appointed by the Board of Governors

William A. Hilliard	Editor, The Oregonian, Portland, Oregon	1991
Wayne E. Phillips, Jr.	Vice President, Phillips Ranch, Inc., Baker, Oregon	1992
Ross R. Runkel	Director, Willamette University Center for Dispute Resolution, Salem, Oregon	1993

SALT LAKE CITY BRANCH

Appointed by the Federal Reserve Bank

Gerald R. Christensen	President and Chairman, First Federal Savings Bank, Salt Lake City, Utah	1991
Ronald S. Hanson	President, Zions First National Bank, Salt Lake City, Utah	1992
Curtis H. Eaton	Vice President; Manager, Community Banking Area; and Member of the Board of Directors, First Security Bank of Idaho, N.A., Twin Falls, Idaho	1993
Virginia P. Kelson	Partner, Ralston & Associates, Salt Lake City, Utah	1993

Appointed by the Board of Governors

D. N. Rose	President and Chief Executive Officer, Mountain Fuel Supply Company, Salt Lake City, Utah	1991
Gary G. Michael	Chairman and Chief Executive Officer, Albertson's, Inc., Boise, Idaho	1992
Constance G. Hogland	Executive Director, Boise Neighborhood Housing Services, Inc., Boise, Idaho	1993

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		Term expires Dec. 31
DISTRICT 12—Continued		
SEATTLE BRANCH		
Appointed by the Federal Reserve Bank		
Robert P. Gray	President, National Bank of Alaska, Anchorage, Alaska	1991
H. H. Larison	President, Columbia Paint & Coatings, Spokane, Washington	1992
B. R. Beeksma	Chairman of the Board, InterWest Savings Bank, Oak Harbor, Washington	1993
Gerry B. Cameron	President and Chief Operating Officer, U.S. Bank of Washington, N.A., Seattle, Washington	1993
Appointed by the Board of Governors		
William R. Wiley	Senior Vice President, Technology Management; and Director, Northwest Division, Battelle Memorial Institute, Richland, Washington	1991
Judith M. Runstad	Managing Partner, Foster Pepper and Shefelman, Seattle, Washington	1992
George F. Russell, Jr.	Chairman, President, and Chief Executive Officer, Frank Russell Company, Tacoma, Washington	1993

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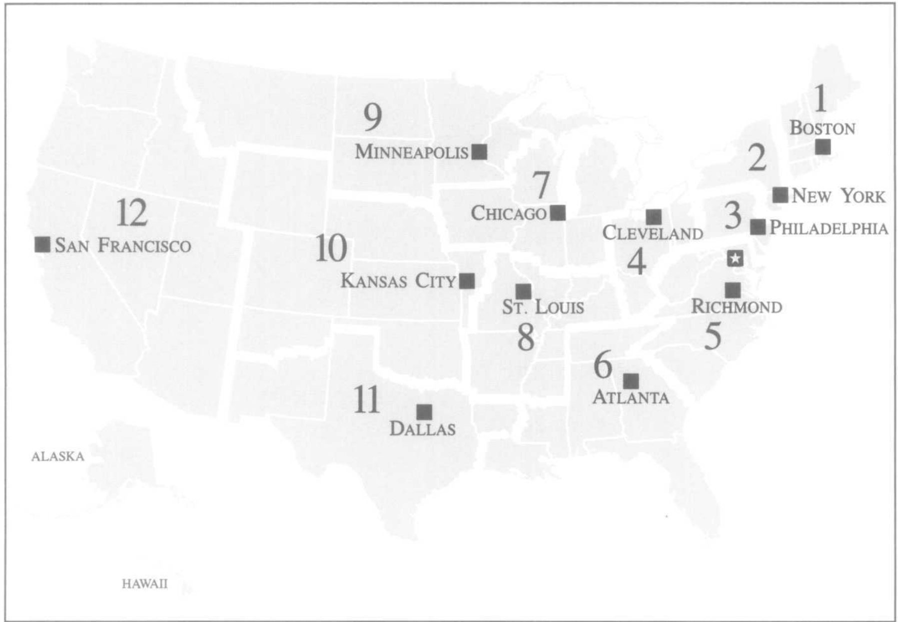
Maps of the Federal Reserve System



LEGEND

Both pages

- ■ Federal Reserve Bank city
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Facing page

- • Federal Reserve Branch city
- — Branch boundary

NOTE

The Federal Reserve officially identifies 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 branch boundaries of the System most recently in December 1991.

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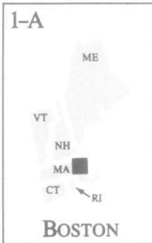

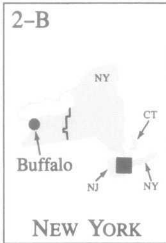

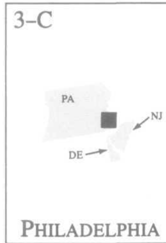

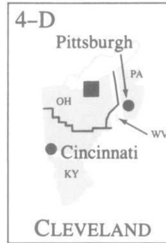

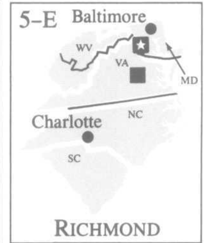

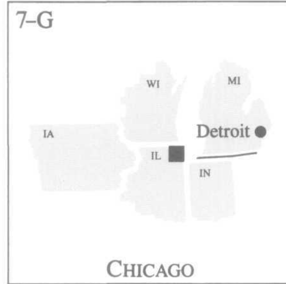

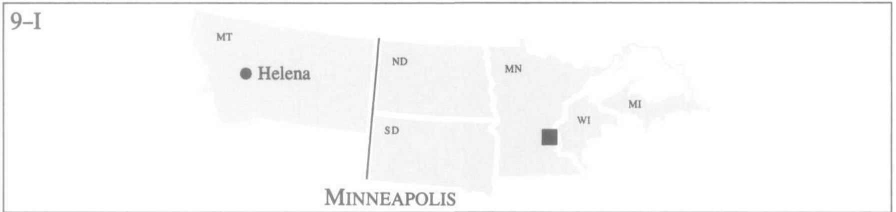

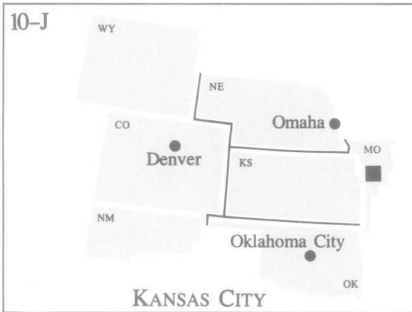

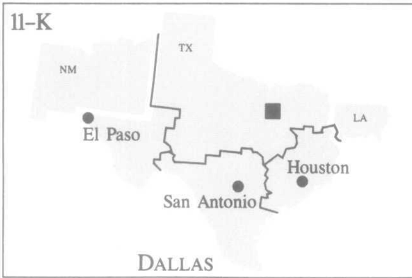

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