80th Annual Report 1993

Board of Governors of the Federal Reserve System

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Letter of Transmittal

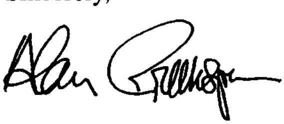
BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
Washington, D.C., April 15, 1994

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 Eightieth Annual Report of the Board of Governors of the Federal Reserve System.

This report covers operations of the Board during calendar year 1993.

Sincerely,



Chairman

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Part 1

Monetary Policy and the U.S. Economy in 1993

Introduction

Nineteen ninety-three was a favorable year for the U.S. economy, with notable gains in real output, declines in joblessness, and a further small drop in the rate of inflation. Financial conditions conducive to growth prevailed throughout the year and gave considerable impetus to activity. With the Federal Reserve keeping reserve market pressures unchanged, short-term interest rates held steady during the year at unusually low levels, especially when measured relative to inflation or inflation expectations. In addition, long-term rates declined further, partly in response to actions taken by the Congress and the Administration to put the federal deficit on a more favorable trend.

Against this backdrop, households and businesses were able to take further steps to reduce their burden of debt service, and more expansive attitudes toward spending and the use of credit seemed to take hold. Spending in the interest-sensitive sectors of the economy surged ahead, with particularly large advances in residential investment, business outlays for fixed capital, and consumer durable goods. The growth of real gross domestic product picked up sharply in the second half, and the increases for all of 1993 cumulated to about 3¼ percent according to preliminary estimates. In the labor market, employment moved up at a moderate pace, and the unemployment rate dropped almost a percentage point over the year. Measured by the consumer price index, the rate of inflation edged lower in 1993, with the rise in prices over the four quarters of the year amounting to only 2¾ percent. The performance of the U.S. economy stood in sharp contrast to the continued sluggish growth in many of the other industrial countries and helped to buoy the trade-weighted value of the dollar on foreign exchange markets.

The strength in spending was supported by increased borrowing by both households and businesses. Continuing declines in a number of interest rates, which sparked considerable refinancing of existing obligations, helped to trim debt service burdens for both sectors, undoubtedly facilitating the pickup in borrowing and spending. Indicators of financial stress, including loan default rates and bankruptcy filings, took a decided turn for the better in 1993. Borrowing by households was robust enough to raise the ratio of debt to disposable income; business debt, held down in part by equity issuance, declined relative to income. All told, the debt of the nonfinancial sectors is estimated to have grown 5 percent, the same as in 1992, as a diminution of the net funding needs of the federal government was about offset by the pickup in private demand. This growth placed the debt aggregate in the lower half of its 4 percent to 8 percent monitoring range.

The growth of M2 slowed in 1993, albeit considerably less than the deceleration in nominal GDP. For the year, M2 advanced 1½ percent, placing it a little above the lower bound of its 1 percent

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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 1994). Data cited here and in the next three chapters are those available as of mid-March 1994.

to 5 percent annual growth cone. M3 expanded ½ percent, the same pace as in 1992, and a bit above the lower bound of its 0 percent to 4 percent annual range. The ranges had been adjusted down by the Federal Open Market Committee during 1993. The adjustments were technical in nature and reflected the Committee's judgment as to the extent of the ongoing distortions of financial flows relative to historical patterns and of consequent increases in velocities—that is, the ratios of nominal GDP to money.

The special factors shaping the growth of the monetary aggregates included a marked preference by borrowers for capital market financing, rather than bank loans, and a configuration of market returns that enticed investors away from the traditional financial products offered by depositories. Bond and stock mutual funds were the primary beneficiaries of this shift, with inflows into such funds in 1993 setting a new record. This continuing redirection of credit flows has rendered the movements of the broad monetary aggregates less representative of the pace of nominal spending than was evident in the longer historical record. In 1993, nominal GDP grew about 5½ percent, or 4 percentage points above the rate of expansion of M2 and nearly 5 percentage points above that of M3. In light of uncertainties about the relationship between money and nominal income, the Federal Reserve continued to rely heavily on a variety of financial and economic indicators in formulating policy.

Along with the immediate economic gains achieved in 1993 came further progress in putting the economy on sounder footing for the long haul. With the slowing of price increases of recent years, the underlying rate of inflation has been reduced to the lowest level in a generation. In addition, labor productivity, the ultimate source of rising living standards, appears to be trending up at a stronger pace than it did through much of the 1970s and 1980s.

The prospects for sustained growth also have been bolstered by government actions in the areas of fiscal policy and trade policy. In the fiscal area, steps that were taken in 1993 have been helpful in bringing about a decline in the federal budget deficit and reducing the growth of federal debt, thereby freeing up a greater portion of the nation's limited saving for use in financing investment and growth. In the trade area, the nation's long-standing support of an open world trading system was reaffirmed by the passage of the North American Free Trade Agreement and the agreement in the Uruguay Round—actions that will yield important benefits over time not only to the United States but also to its trading partners.

In the area of monetary policy, the strategies pursued in recent years have been instrumental in achieving progress against inflation and promoting conditions favorable to economic growth. The challenge ahead is to build on that favorable performance in an economy that will likely be operating at higher levels of resource utilization than it has in recent years. With success in keeping the economy on course toward the long-run goal of price stability, the prospects for sustained expansion will be greatly enhanced. ■

The Economy in 1993

The economy recorded significant gains in 1993, lifted, as in 1992, by a surge in activity in the latter part of the year. Job creation picked up, and the unemployment rate fell appreciably. Inflation continued to trend lower.

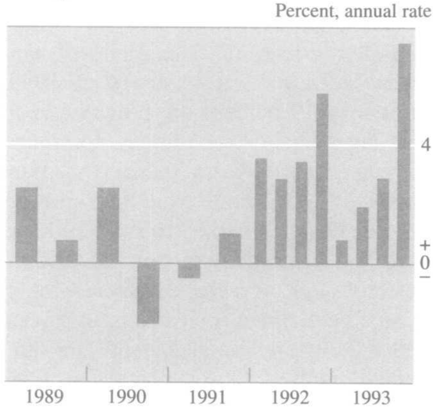
The rise in real gross domestic product over the year amounted to about 3¼ percent, according to preliminary data from the Department of Commerce. For a second year, the growth of activity was propelled chiefly by rapid gains in the investment outlays of households and businesses. Households boosted their purchases of homes and motor vehicles considerably, and spending for household durables also rose rapidly. Business investment in computers continued to grow at an extraordinary pace in 1993, and outlays for other types of capital equipment strengthened. Investment in nonresidential structures, which had gone through a protracted decline in the latter part of the 1980s and early 1990s, rose moderately. Bolstered by the gains in these sectors, the four-quarter rise in the final purchases of households and businesses amounted to 5 percent in real terms in 1993, matching the large 1992 rise. Not since the 1983–84 period had private final purchases exhibited a comparable degree of strength.

The increase in private spending in 1993 was augmented by a pickup in the spending of state and local governments, especially for construction. By contrast, real federal purchases of goods and services—the part of federal spending that is included in GDP—fell sharply, as outlays for national defense continued to trend lower. The federal budget deficit declined somewhat in fiscal 1993, but the combined deficit in the operating and capital accounts of state and local governments increased further.

Growth of the economy continued to be significantly influenced in 1993 by the changing patterns of transactions with foreign economies. The weakness of activity in a number of foreign countries that are major trading partners of the United States tended to limit the gains in U.S. exports of goods and services. At the same time, a significant portion of the rise in domestic spending in this country continued to translate into rapid increases in imports. Net exports of goods and services thus fell for the second year in a row, after a run of several years in which real export growth had outpaced the growth of real imports by a considerable margin.

The CPI rose 2.7 percent over the four quarters of 1993, after increases of about 3 percent in both 1991 and 1992. Price increases were damped last

Change in Real GDP



The data are seasonally adjusted and come from the Department of Commerce; they are measured in terms of 1987 dollars.

year by falling oil prices, near-stable prices for non-oil imports, and a further rise in labor productivity, which held down production costs in the domestic economy.

The Household Sector

Consumer spending recorded a second year of brisk growth in 1993. Support for the rise in expenditures came from declines in interest rates and moderate increases in real incomes. Household balance sheets continued to strengthen in 1993 and debt servicing burdens diminished, easing the financial strains that had inhibited spending earlier in the 1990s.

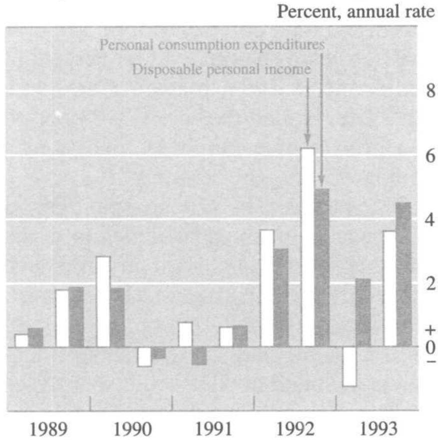
In real terms, the 1993 advance in personal consumption expenditures (fourth quarter to fourth quarter) amounted to about 3¼ percent. After surging in late 1992, growth of real outlays slowed in the first quarter of 1993. Whatever tendency there may have been for a "payback" after a period of unusually rapid growth was reinforced by a severe late-winter storm on the East Coast, which temporarily hurt retail sales. Thereafter, spending proceeded at a relatively strong pace over the remaining three quarters of the year.

Consumer expenditures for motor vehicles increased 6 percent in real terms over the four quarters of 1993, after rising 9 percent the previous year. The advance in expenditures continued to come partly from the replacement needs of individuals who had put off buying vehicles earlier in the 1990s, as well as from growth in consumers' desired stock of vehicles. Increasingly, buyers have opted for vans, light trucks, and other vehicles instead of cars, and annual sales of these vehicles in 1993 reached the highest level on record. Car sales also rose, but they remained well below previous highs.

Expenditures for a number of other types of durable goods also rose rapidly in 1993. Outlays for furniture and appliances scored further hefty gains, in conjunction with sharp increases in sales of new and existing homes. Consumer purchases of home computers and other electronic equipment remained on a steep uptrend. In total, outlays for durable goods other than motor vehicles increased more than 9 percent over the year, after a rise of 10 percent in 1992. Other types of consumer expenditures, which typically exhibit less cyclical variation than do outlays for durables, rose moderately, on balance, during 1993. Consumer purchases of nondurable goods increased about 2 percent, after a jump of more than 3½ percent in 1992. Spending for services rose nearly 3 percent during 1993, an increase of roughly the same magniture as that of the previous year.

Real income continued to advance in 1993, although its trend was masked by tax considerations that caused a sizable volume of bonuses that would have been

Change in Real Income and Consumption



The data are seasonally adjusted and come from the Department of Commerce; they are measured in terms of 1987 dollars.

paid to workers in early 1993 to be shifted into the latter part of 1992. Abstracting from these shifts in timing, the beneficial effects of continued economic expansion showed through in most categories of income, much as they had in 1992. Wage and salary accruals, a measure of income as it is earned rather than as it is disbursed, rose about 4½ percent in nominal terms over the four quarters of 1993, considerably outpacing the rate of inflation for the second year in a row. Further gains also were reported over the course of 1993 in dividends and in the income of proprietors, both farm and nonfarm. Transfer payments, which tend to vary inversely with the state of the economy, slowed in 1993 after rising at rates of 10 percent or more in each of the four previous years. Interest income, which had declined on net in 1991 and 1992, edged up slightly over the four quarters of 1993. Because of the shift in timing of bonuses, growth of real disposable income in 1993 was noticeably less than in 1992. However, the cumulative gain over the two-year period was about 6 percent, a clear step-up from the performance of the three previous years, when real income growth had averaged less than 1 percent per year.

The personal saving rate—measured as the percentage of nominal after-tax income disbursements that are not used for consumption or other outlays—declined nearly 2 percentage points, on net, over the course of 1993. However, the saving rate in late 1992 had been temporarily elevated by the aforementioned speedup of bonus payments. Looking through that blip of late 1992, a downward drift still is evident in the saving rate from mid-1992 to the end of 1993. Such a pattern is not uncommon when economic recovery is taking hold and consumer purchases of durable goods are rising rapidly. In effect, households have been holding part of their saving in the form of consumer durables, which, at the time of purchase, are counted fully as consumption in the national accounts, but which in reality will yield households a flow of services over time.

Household wealth rose further in 1993. As in 1992, the total nominal value of household assets increased at a pace moderately faster than the rate of inflation. Large increases in stocks and bonds boosted the nominal holdings of financial assets, more than offsetting a reduction in the aggregate holdings of deposits and credit market instruments. The nominal value of tangible assets was lifted by heavy investment in consumer durables and residential structures and by a rise in the average price of existing residential properties. With a jump in the growth of consumer credit and a slight pickup in the growth of home mortgage debt, household liabilities rose somewhat faster than in 1992. Nonetheless, net worth appears to have increased in both real and nominal terms. The incidence of financial stress among households diminished further in 1993, as delinquency rates on various types of household debt continued to decline, in some cases to the lowest levels since the first half of the 1970s. According to survey data, households' own assessments of their financial situations improved, on net, with some survey readings the most upbeat in more than three years.

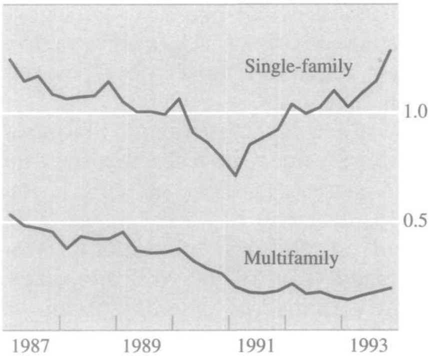
Residential investment increased nearly 8 percent in real terms over the four quarters of 1993, building on the 18 percent rise of 1992. As in 1992, most of the advance came from increased construction of new single-family homes. The construction of multifamily housing continued to be adversely affected by a persistent overhang of vacant rental units.

In the single-family market, the impetus for activity continued to come mainly from declines in mortgage interest rates, which by autumn had dropped to their lowest levels in more than two decades. Fairly sharp declines in mortgage interest rates took place early in the year, but the effect on housing activity was apparently short-circuited for a time by a number of influences. A severe blizzard on the East Coast in mid-March temporarily waylaid the start-up of construction in that region, and a huge run-up in lumber prices during late winter also may have discouraged some new construction for a while. Concerns about the possible loss of jobs perhaps continued to deter some potential homebuyers. Other buyers may simply have been holding back, waiting to see how far rates eventually would fall.

In any event, the effects of the drop in mortgage rates began to show through with greater force over the summer and fall, and considerable strength had emerged by year-end in all the major indicators of single-family housing activity. Sales of existing homes rose without interruption from April on. By the fourth quarter they had climbed to the highest level on record (the series goes back to 1968). Although sales of new homes proceeded more erratically from month to month, their increase over the four quarters of the year amounted to nearly 25 percent. Housing construction also strengthened. The number of single-family starts increased about 18 percent over the year, reaching the highest quarterly level since 1979. According to survey data, consumers' assessments of home-buying conditions continued to be very upbeat at year-end, as were builders' ratings of market conditions.

Activity in the multifamily housing market remained depressed in 1993. In the mid-1980s, tax incentives and the relatively easy availability of credit encouraged overbuilding in many locales. The proportion of multifamily rental units that were vacant soared and has remained high even as the construction of multifamily units has dwindled. Starts of these units reached the lowest levels on record early in 1993, and they picked up only slightly thereafter, despite restoration of tax credits for low-income units.

Private Housing Starts



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

The Business Sector

The year saw appreciable gains in most important barometers of business activity. Output of the nonfarm business sector increased more than 4 percent, slightly more than during 1992. Profits rose further, business balance sheets continued to strengthen, and capital spending surged.

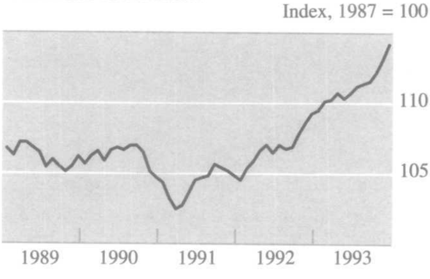
In the industrial sector, production rose 4¼ percent, the largest advance in six years. The production gain was at least moderate in each quarter, and in the final quarter it was quite large—on the order of 6¾ percent at an annual rate. Output of business equipment held to a strong uptrend throughout the year, as did the production of materials that are used as inputs in the durable goods industries. The output of construction supplies rose moderately in the first half of the year and at a stronger pace in the second half. Motor vehicle assemblies also rose appreciably, with strength early in 1993 and in the year's final quarter more than offsetting a stretch of sluggishness through the middle part of the year. By contrast, output of consumer goods other than motor vehicles rose only a small amount, and production of defense and space equipment fell 9½ percent further, extending a downward trend that began in 1987.

The amount of spare capacity in the industrial sector continued to diminish. The utilization rate in December, 83.0 percent, was up more than 2 percentage points from the level of a year earlier and was at the highest level since the summer of 1989. In manufacturing, capacity use in primary-processing industries was above its long-run average throughout 1993, and the rate of utilization in advanced-processing industries had moved up almost into line with its long-run average by year-end.

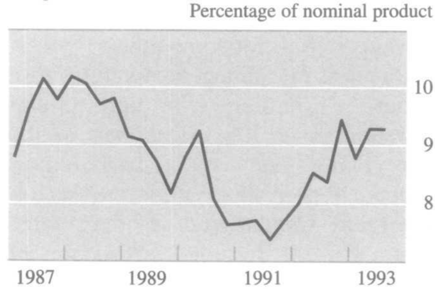
Corporate profits, which had surged in 1992, increased an additional 6½ percent over the first three quarters of 1993 and appear to have risen further in the year's final quarter. Financial institutions in general continued to benefit in 1993 from the persistence of a relatively wide margin between their cost of funds and the interest rates on their assets; insurers' profits suffered less drag from natural disasters than in 1992, the year of hurricane Andrew. The profits of nonfinancial corporations moved up slightly further over the first three quarters, boosted by the rise in the volume of output over that period. Operating profits per unit of output held fairly steady, close to the high level reached in the final quarter of 1992. Although nonfinancial corporations raised their prices by only a small amount over those three quarters, they were able to maintain unit profit margins through continued tight control over costs. Gains in productivity restrained the rise in unit labor costs, and net interest expenses per unit of output continued to edge lower.

Business fixed investment increased 15 percent in real terms over the four quarters of 1993, after a rise of 7½ percent in 1992. A spectacular increase in outlays for office and computing equipment accounted for about half of the 1993 gain. Business expenditures for these items increased more than 25 percent in nominal terms over the year, the steepest annual gain since 1984, and the rise in real terms was greater still. The latest computers are far more powerful than those that were at the forefront only

Industrial Production



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.

a few years ago, and highly competitive market conditions have kept prices on a downward course. The many businesses eager to boost labor productivity and overall operating efficiency provided a huge market for the new products.

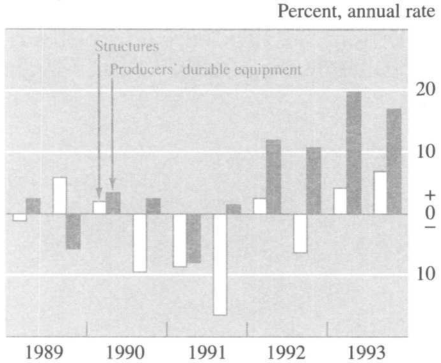
Excluding office and computing equipment, outlays for capital equipment increased about 11½ percent in real terms during 1993, the biggest rise in ten years. Business expenditures for motor vehicles advanced about 14 percent, as investment in trucks, which had strengthened considerably in 1992, climbed further. Factories producing heavy trucks were operating at or near full capacity at year-end. Spending for communication equipment also advanced sharply, as did real outlays for many other types of machinery and equipment. Diminished slack in many industries and expectations of continued business expansion were among the chief factors giving rise to the increase in these outlays. Internal cash flow provided a ready source of finance.

Commercial aircraft was the most notable exception to the general upward trend in equipment spending. Outlays for aircraft plunged in the second half of 1993, and survey data pointed to continued weakness in 1994. The reductions in outlays had been foreshadowed by earlier declines in new orders, and producers of aircraft have been scaling back their operations for some time.

Business investment in structures rose about 5½ percent, the first annual increase since 1989. Declines in the intervening years had cumulated to about 18 percent. Within the sector, divergent trends were evident once again. Outlays for the construction of office buildings fell for the sixth consecutive year, to a level two-thirds below the peak of the mid-1980s. Several indicators suggested, however, that the worst of the decline in office construction might be over. The rate at which real outlays fell in 1993 was much smaller than the declines of the three previous years. In addition, the national vacancy rate for office buildings, while still quite high, moved down somewhat; the improvement was most noticeable in suburban areas, where vacancy rates previously had been the highest. The value of contracts for construction of office buildings firmed over the course of the year.

Investment increased for most other types of structures. Outlays for industrial structures, which had declined sharply in 1991 and 1992, rose about 9½ percent, on net, over the four quarters of 1993. Outlays for commercial structures other than office buildings increased sharply for a second year; by the fourth quarter, they had retraced nearly half of the steep decline that took place during 1990 and 1991. Investment in drilling also rose as incentives from rising prices for natural gas apparently offset the disincentives associated with falling oil prices. Spending for other types of structures rose by a small amount in the aggregate.

Change in Real Business Fixed Investment



The data are seasonally adjusted and come from the Department of Commerce; they are measured in terms of 1987 dollars.

Swings in business inventory investment played only a small role in the 1993 economy. Inventory accumulation in the nonfarm business sector picked up in the early part of the year but slowed thereafter. Accumulation for the year as a whole was of only modest proportions, especially when compared with the rates of buildup seen during previous business expansions. Conceivably, the usual cyclical patterns in inventory change have been tempered to some degree by the more sophisticated inventory control procedures that have become widespread in the business sector in recent years. Toward year-end, inventories appeared to be comfortably aligned with sales in most industries and were lean in some. Most notable among the latter were the stocks of motor vehicles, which were drawn down by production delays through the summer and strength in sales through the latter part of the year. In view of those developments, producers of motor vehicles scheduled a hefty rise in production for the first quarter of 1994.

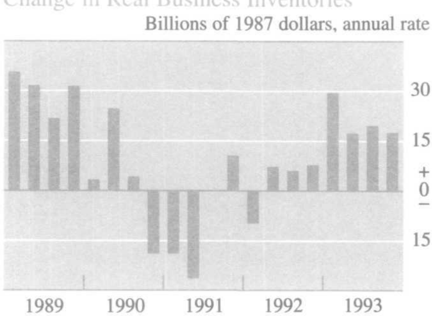
In the farm sector, inventories declined. Stocks were pulled down by weather-related reductions in crop output, especially in parts of the Midwest, where the worst flood of the century took millions of acres out of production and cut deeply into yields of the crops that were planted. Inventories of some major field crops tightened markedly. Farmers whose crops were hurt by weather suffered income losses in 1993, while the producers whose crops were not hurt benefited from rising prices. Total net farm income appears to have held in the range of other recent years, at a level well within the extremes of either boom or bust.

Trends in business finance remained favorable for sustained expansion. Business expenditures for fixed capital and inventories were financed almost entirely with funds generated internally, and, in the aggregate, the relatively little external financing that did take place came partly from positive net issuance of equity. Debt rose slowly, both in absolute terms and relative to the rapid pace seen in the 1980s. With little growth in debt and interest rates down, the portion of business cash flow required for the repayment of principal and interest declined further.

The Government Sector

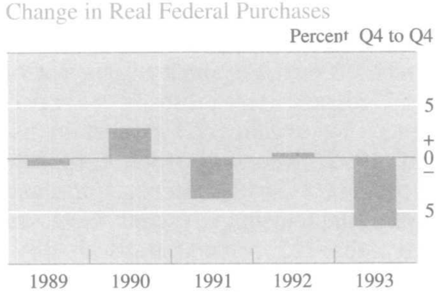
Federal purchases of goods and services, the portion of federal outlays that are included in GDP, fell 6½ percent in real terms over the four quarters of 1993. Real outlays for national defense,

Change in Real Business Inventories



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

Change in Real Federal Purchases



The data are from the Department of Commerce.

which have been trending down since 1987, declined nearly 9 percent. Nondefense outlays fell slightly, on net, after rising fairly rapidly in each of the three previous years. The level of real federal purchases in the fourth quarter of 1993 was down more than 10 percent from the peak of six years earlier. Real defense purchases dropped about 20 percent over that six-year stretch.

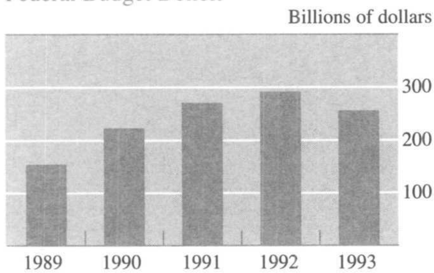
Total federal outlays, measured in nominal terms in the unified budget, rose 2 percent in fiscal 1993, the smallest increase in six years. Outlays for defense fell about 2½ percent in nominal terms, and net interest payments were down slightly—the first decline in that category since 1961. Net expenditures for deposit insurance, which had been slightly positive in 1992, were negative in fiscal 1993, held down in part by delays in funding the activities of the Resolution Trust Corporation. Federal spending for income security slowed from the rapid pace of 1991 and 1992, as economic expansion led to a reduction in outlays for unemployment compensation and a less rapid rate of increase in outlays for food stamps. The growth in federal expenditures for Medicare and other health programs also slowed, but the rate of increase continued to exceed the growth of nominal GDP by a considerable margin.

The growth of federal receipts picked up a bit in fiscal 1993, to a pace roughly matching that of nominal GDP growth. Combined receipts from individual income taxes and social insurance taxes, which account for about 80 percent of total federal receipts, rose about 5½ percent, after a gain of 3 percent in fiscal 1992. Receipts from corporate income taxes, which account for about half of the remaining receipts, increased more than 17 percent in fiscal 1993, after only a small gain in the previous fiscal year.

Taken together, the slowing of federal outlays and the pickup of receipts led to a decline in the size of the federal budget deficit in fiscal 1993, after three years of sharp increases. The 1993 deficit amounted to $255 billion and was equal to 4.0 percent of nominal GDP. The previous year, the deficit had amounted to $290 billion and was equal to 4.9 percent of nominal GDP. In fiscal 1989, toward the end of the last economic expansion, the size of the deficit relative to nominal GDP had reached a cyclical low of 2.9 percent.

In the state and local sector, receipts moved up about in step with the growth of nominal GDP in 1993, but state and local expenditures rose still faster. In nominal terms, the increases in spending cumulated to a rise of about 7 percent over the four quarters of the year. State and local transfer payments to persons slowed from the extraordinary rates of increase seen in the early 1990s, a reflection of improvement in the economy and intensified efforts among state and local governments to tighten control over these types of outlays. Nonetheless, the rate of rise in these payments remained above 10 percent in 1993. Nominal purchases of goods and services rose moderately but at a pace somewhat faster than that of 1992. The

Federal Budget Deficit

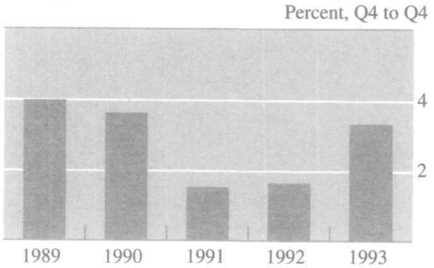


The data are for fiscal years. They are on a unified budget basis and are from the Department of the Treasury.

deficit in the combined operating and capital accounts of state and local governments widened further during the first three quarters of the year, from an end-of-1992 level that already was quite sizable; in the fourth quarter, the deficit apparently shrank, but not by enough to fully retrace the earlier increases.

In real terms, purchases of goods and services by state and local governments increased nearly 3½ percent over the four quarters of 1993, after gains of about 1½ percent per year in both 1991 and 1992. State and local expenditures for structures rose almost 12 percent in real terms over the year, according to preliminary data. Some of the spending went for the repair or replacement of structures that had been damaged in recent natural disasters, such as the summer flooding in the Midwest. In addition, the efforts of state and local governments to cope with the needs of growing populations prompted increased investment in schools, highways, and other state and local facilities. Low interest rates probably convinced state and local officials to undertake more of this new construction in 1993 than they would have otherwise. Growth in other types of state and local purchases continued to be fairly restrained. Employee compensation, which makes up nearly two-thirds of state and local purchases, rose about 1¼ percent in real terms, the same as in 1992. Employment in the state and local sector again grew slowly by historical standards, and increases in hourly compensation were relatively small. State and local purchases of goods rose moderately in real terms.

Change in Real State and Local Purchases



The data are from the Department of Commerce.

Labor Market Developments

The labor market strengthened in 1993, as economic expansion began to translate more forcefully into increased job creation. Payroll employment, a measure of jobs that is derived from a monthly survey of establishments, rose more than 2 million over the twelve months of the year. Although this gain was only moderate when compared with increases in many years of the 1970s and 1980s, it was about twice the increase of 1992.

Hiring picked up in most major sectors in 1993. The number of jobs in retail and wholesale trade increased more than one-half million, the largest annual rise since 1988. The number of jobs in finance, insurance, and real estate picked up a bit, after a five-year period that had encompassed three years of sluggish growth and two years of unprecedented reductions. Construction employment rose 200,000, after three years of sharp declines.

The services industry added about 1.2 million new jobs in 1993. More than one-third of the increase came at firms that supply services to other businesses; in that group, the most rapid growth by far was in personnel supply firms—companies that essentially lease the services of their employees to other businesses, usually on a temporary basis. Many companies requiring additional labor apparently have been attracted by the flexibility of such arrangements, as well as by cost advantages, at least over the short run.

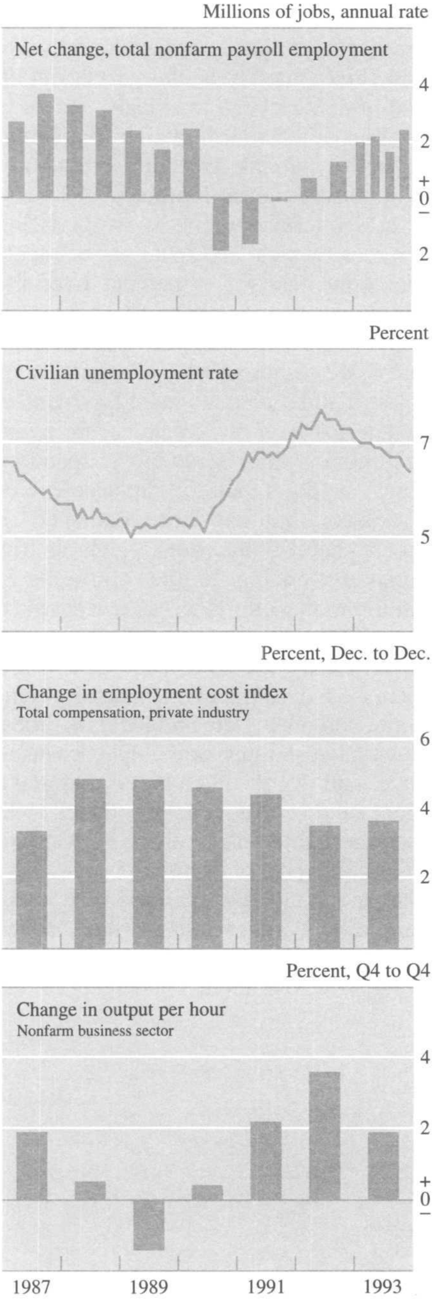
Elsewhere in the services industry, health services continued to generate a substantial number of new job opportunities in 1993, even though the gain was not quite as large as those of other recent years. Small to moderate employment gains also were reported during the year at firms supplying a wide variety of other types of services.

Manufacturing employment continued to decline in 1993, but at a slower pace than in any of the three previous years. Although manufacturers boosted output considerably, the gain was achieved mainly through another sizable rise in factory productivity. Labor input in manufacturing reportedly increased only slightly and only in the form of a lengthened workweek rather than increased hiring. By the latter part of the year, the average workweek in manufacturing had reached 41¾ hours, the longest since World War II. Hiring did pick up late in the year, however. Reliance by manufacturers on workers from personnel supply firms reportedly has increased in recent years; because these workers are carried on the payrolls of the personnel firms, actual labor input in manufacturing in 1993 was greater than the data indicate.

Like the survey of establishments, the monthly survey of households showed significant improvement in labor market conditions in 1993. The measure of employment that is derived from this survey rose 2½ million over the twelve months of 1993, after an increase of about 1½ million during the previous year. At the same time, the number of unemployed persons fell more than 1 million over the course of 1993, and the civilian unemployment rate declined nearly a full percentage point, to a year-end level of 6.4 percent.

Growth of the civilian labor force—the sum of persons who are employed and those who are looking for work—

Labor Market Conditions



The data are from the Department of Labor.

was relatively sluggish again in 1993. The rise over the four quarters of the year was 1.2 percent, only slightly faster than the rate of growth of the working-age population. Over the four years ended in 1993, labor force growth averaged less than 1 percent per year, and the labor force participation rate edged down slightly, on net. The number of individuals who desired work but did not seek it because of a perceived lack of job openings changed little over the course of 1993. In addition, the number of individuals outside the labor force and not wanting a job rose about 0.8 percent during the year, pulled up, in part, by a sharp increase in the number of retirees. Workers whose careers were cut short by business restructurings and defense cutbacks probably augmented the normal flow of workers into retirement. Growth in the number of persons not wanting a job because of attendance in school also increased during 1993. To the extent that these individuals have been building their job skills, their lack of current participation in the labor force could turn into a positive factor for the economy over the longer run.

The slowing of nominal increases in hourly compensation came to a halt in 1993. The employment cost index for private industry—a labor cost measure that includes wages and benefits and covers the entire nonfarm business sector—increased 3.6 percent from December 1992 to December 1993, about the same as the rise of the previous year. Wages rose 3.1 percent over the year, ½ percentage point more than in 1992, and the growth of benefits slowed only a little, to 5.0 percent. Compensation gains picked up for workers in some white-collar occupations, notably sales workers and managers. Slightly bigger gains than in 1992 also were realized by workers in some blue-collar occupations. By contrast, the rate of compensation growth held steady in service occupations and edged down in some blue-collar occupations in which fewer specialized skills are required. The overall rise in hourly compensation during 1993 exceeded the rise in consumer prices by about 1 percentage point. Hourly wage gains more than kept pace with inflation, and the value of benefits provided to workers by their employers continued to rise rapidly in real terms.

Labor productivity continued to increase in 1993, albeit less rapidly than in the earlier stages of the cyclical expansion. According to preliminary data, output per hour in the nonfarm business sector rose 1.9 percent during the year, after increases of 2.2 percent in 1991 and 3.6 percent in 1992. Part of the gain over this three-year period is no doubt a reflection of normal cyclical processes. The data, however, also seem to suggest that the longer-run trend in productivity is tilting up a bit more sharply than in the 1970s and 1980s, a result of heavy investment by business in new information technologies, the rising skill of workers in exploiting those technologies, and, perhaps, the more quiescent inflation environment of recent years. With gains in labor productivity offsetting part of the 1993 increase in compensation per hour, unit labor costs in the nonfarm business sector increased just 0.9 percent, the smallest rise in ten years.

Price Developments

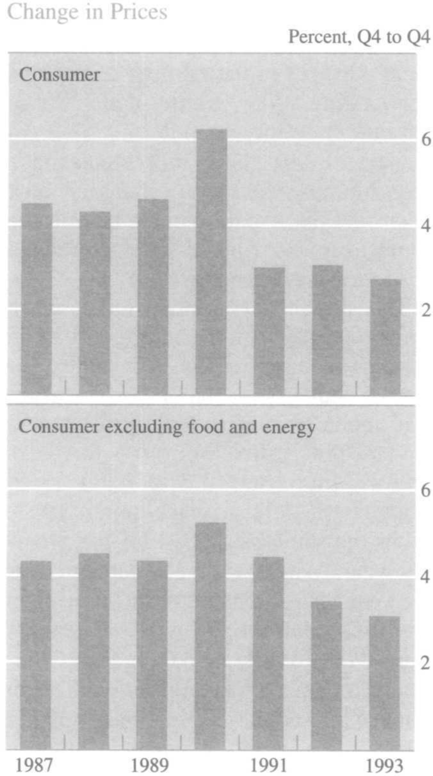
Inflation edged down a bit further in 1993. The 2.7 percent rise in the CPI over the four quarters of the year was the smallest increase since 1986, and the four-quarter rise of 3.1 percent in the CPI excluding food and energy was the smallest increase in that measure in more than twenty years. At the same time, however, progress toward lower inflation was sporadic during the year, and the slowing of price increases was less widespread than it had been in 1992. Scattered upward price pressures showed up in the commodity markets from time to time during 1993; late in the year these increases became more widespread.

The patterns of price change for items other than food and energy were more checkered in 1993 than they had been in 1992, a year when deceleration was widespread among both commodities and services. The CPI for commodities other than food and energy rose only 1.6 percent over the four quarters of 1993, 1 percentage point less than in 1992. Within this category, the CPI for tobacco fell 5 percent, after many years of large increases, and the price of apparel rose less than 1 percent, an even smaller increase than in 1992. By contrast, the prices of motor vehicles moved up somewhat faster than in 1992; the price rise for trucks was the largest in recent years.

The CPI for non-energy services increased 3.8 percent over the four quarters of 1993, about the same as the rise during the previous year. The index for medical care services slowed for the third year in a row, but airfares rose sharply for a second year. Price increases for other services generally were little different from those in 1992, with a small deceleration for some items and a small acceleration for others.

Food prices picked up in 1993. The consumer price index for food increased 2.7 percent over the four quarters of the year, an acceleration of about 1 percentage point from the pace of the two previous years. Because price increases in those two previous years had been held down, in part, by unusually favorable supply developments in agriculture, some pickup of food price inflation might have been in store for 1993 even had weather conditions been no worse than average. In the event, the weather was unusually bad. Severe winter weather disrupted livestock production early in the year; drought in the eastern states hurt crop production in that region during the summer; and flooding of historic severity in the Missouri and Mississippi river basins cut deeply into the production of major field crops. At retail, effects of the various supply disruptions showed through in the prices of meats, poultry, and fresh produce. Price increases for other foods, which represent by far the larger share of total food in the CPI, showed almost no accelera-

Change in Prices



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

tion in 1993; most of the value added in production of these other foods comes from nonfarm inputs.

Consumer energy prices declined 0.4 percent over the four quarters of 1993 after rising only moderately in 1992. With world oil production outstripping demand, crude oil prices fell sharply during the last three quarters of 1993, to levels in December that were about 25 percent below those of a year earlier. Gasoline prices, after increasing in the early part of 1993, turned down in March and fell for six additional months thereafter. The string of declines was interrupted in October when federal gasoline taxes were raised, but they resumed in November and continued through year-end. Average pump prices for the fourth quarter were about 4 percent below the level of a year earlier. Fuel oil prices fell about 3 percent over the same period. Prices of the service fuels—electricity and natural gas—increased during 1993. The rise for electricity amounted to 1.7 percent, slightly less than the increase posted in 1992. Natural gas prices rose nearly 5 percent for the second year in a row; consumption of natural gas has picked up in recent years, after trending lower through much of the 1970s and a large part of the 1980s.

The producer price index for finished goods, which includes both consumer goods and capital equipment and covers only the prices received by domestic producers, increased just 0.2 percent over the four quarters of 1993. An identical increase was reported in the PPI for finished goods other than food and energy; the increase in this measure was the smallest in its history, which goes back to 1974. As at retail, price increases for these domestically produced goods were held down, in part, by the sharp drop in prices of tobacco products. More broadly, competition from imports and further increases in labor productivity in manufacturing were important elements in pricing restraint. The prices of intermediate materials excluding food and energy rose 1.5 percent over the four quarters of 1993, a small step-up from the pace of the previous year.

In the markets for raw commodities and other primary inputs, scattered upward price pressures emerged from time to time during the first three quarters of 1993, and fairly widespread increases were reported in the year's final quarter. The producer price index for crude materials excluding food and energy thus moved up sharply over the year, by more than 10 percent in all. The weight of these inputs in GDP is quite small, however, and in the absence of more general cost pressures, increases in their prices usually do not impart much upward thrust to the prices of finished goods.

Inflation expectations, as reported in various surveys of consumers and other respondents, flared up for a time during 1993 but retreated in the latter part of the year. The most pronounced swing in expectations was reported in the survey conducted by the University of Michigan Survey Research Center, in which the rate of price increase expected one year into the future moved up from an average of 3.8 percent in the final quarter of 1992 to an average of 4.7 percent in the third quarter of 1993; the rise was fully reversed in the fourth quarter, however. As in 1992, the surveys continued to show one-year expectations of price change running somewhat higher than the actual increases of recent years. Longer-run expectations of price change remained higher still; for interviews conducted in the second half of 1993, the Survey Research Center's series on average inflation rates that are expected over a five- to ten-year horizon ranged from 4½ percent to 5 percent, down only slightly from the average rates reported earlier in the 1990s. ■

Monetary Policy and Financial Markets in 1993

Financial repair continued in 1993 amid increasing signs that borrowers and lenders were more comfortable with their balance sheet positions. Households, in particular, and firms, to a lesser extent, stepped up their borrowing as the year progressed. Depository institutions, for their part, were sufficiently encouraged by the stronger economy and the improvement in their own financial conditions to ease the terms and conditions of credit for businesses and households.

Nonetheless, with efforts to strengthen financial positions continuing, financing remained concentrated in capital markets, largely bypassing banks and thrift institutions. In part spurred by the higher returns available in those markets, investors found bonds and stocks to be more attractive alternatives than deposits, and flows into bond and stock mutual funds were at record levels. As a consequence, the monetary aggregates continued to grow quite slowly relative to the expansion of nominal income. Recognizing the ongoing redirection of financial flows relative to historical norms, the Federal Open Market Committee in February and July 1993 lowered the annual ranges for M2 and M3 for 1993 in two technical adjustments totaling 1½ percentage points for M2 and 1 percentage point for M3. Uncertainty about the extent and duration of the unusual change in velocity meant that growth in the aggregates could not be relied upon to guide changes in reserve conditions, and the Committee continued to employ a wide variety of information about financial and economic conditions for this purpose.

In assessing the incoming information, the Federal Reserve judged that no change was needed in reserve and money market conditions during 1993 to sustain the economic expansion without engendering inflationary pressure. With money market rates remaining in a range not much, if at all, above the core rate of inflation, however, the members of the Committee believed that a tightening in reserve conditions at some point would likely be needed to avoid pressures on capacity and a pickup in inflation.

The Implementation of Monetary Policy

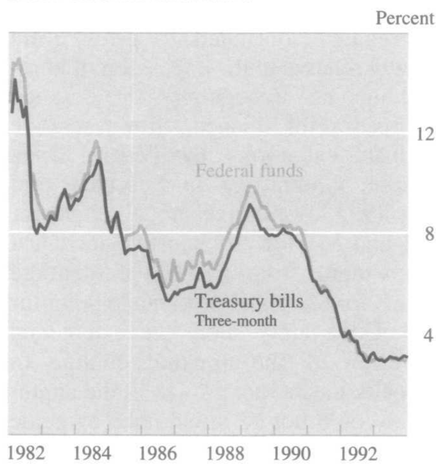
Most short-term interest rates ended 1993 where they had begun the year, at quarter-century lows that had resulted from the substantial easing in reserve conditions engineered by the Federal Reserve from 1989 to 1992. The rate charged for adjustment borrowing at the discount window remained at 3 percent, and federal funds traded around the same rate. Despite the stability of short-term interest rates, longer-term interest rates fell as much as 1 percentage point over the course of 1993, to settle at levels not seen on a sustained basis since the late 1960s. Investors apparently were encouraged by the prospects for low inflation and reduced federal budget deficits. Helped by the decline in long-term rates and by brighter earnings reports, the stock market enjoyed strong gains.

In February 1993, the time of the first Committee meeting of the year, incoming information suggested that the economy had exhibited considerable strength in the fourth quarter of 1992. Final estimates for that quarter put the increase in real gross domestic product at a 5¾ percent annual rate and the growth of nominal GDP in excess of 9 percent. Final demand was seen to be strong, paced by household consumption and business investment. With slack relative to capacity still considerable—the unemployment rate averaged 7¼ percent—upward price pressures were not perceived to be near at hand. The expansion of the monetary aggregates had faltered around the turn of the year, but special factors—importantly including a decline of mortgage prepayments that constricted the level of transactions deposits—seemed to account for some of the weakness. Against this backdrop, it appeared to the members of the Committee that unchanged reserve conditions would support economic expansion and still be consistent with further declines in inflation and inflation expectations. Moreover, the situation did not seem to call for a presumption of the likely direction of any intermeeting adjustment in reserve conditions; such a symmetric directive had been issued to the Account Manager of the System Open Market Account at the end of the December 1992 meeting as well.

Investor confidence in the longer-term prospects in capital markets apparently strengthened in the weeks that followed, in part because of a growing perception that significant progress in reducing the path of future budget deficits might be in the offing. By the time of the March Committee meeting, bond yields had fallen appreciably, touching levels last observed in 1973, with the largest declines posted at the longest maturities. Indicators of real activity suggested some slowing from the torrid fourth-quarter pace, but, in labor markets, payroll employment had strengthened and the unemployment rate had moved down further. Readings on inflation sparked some concern about the potential for a buildup of inflationary momentum. With fundamental forces still suggesting further disinflation, however, and with those concerns not evident in capital market indicators, or in the exchange value of the dollar, which remained relatively steady, the Committee retained its symmetric directive.

In May, Committee members were confronted with ambiguous indicators of economic activity, prices, and the financial aggregates, which were all made more confusing by a spell of bad weather that had distorted somewhat the seasonal patterns of spending and production. As for the prices of goods and services, many analysts thought that the major indexes were distorted by difficulties in seasonal adjustment, but data releases showing a variety of labor compensation and price indexes on the high side of investor expectations still roiled financial markets. Slack in the economy remained appreciable, which weighed

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.

against any pickup in inflation, but inflation expectations were in danger of ratcheting higher, with possible adverse consequences for inflation itself. Mean-

Reserves, Money Stock, and Debt Aggregates

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

Item	1990	1991	1992	1993				
				Year	Q1	Q2	Q3	Q4
Depository institution reserves[2]								
Total	2.2	8.7	20.1	12.3	9.3	10.8	12.4	14.6
Nonborrowed	2.4	9.1	20.3	12.3	9.5	10.6	10.9	16.0
Required	1.8	9.4	20.3	12.6	8.7	12.4	12.3	14.6
Monetary base[3]	9.4	8.2	10.4	10.4	9.5	10.2	10.6	9.9
Concepts of money[4]								
M1	4.2	7.9	14.3	10.5	8.3	10.7	12.0	9.4
Currency and travelers checks	11.0	7.9	9.1	9.9	9.3	10.0	10.0	8.9
Demand deposits	-.7	3.2	17.7	13.4	7.0	16.0	15.9	12.2
Other checkable deposits	3.5	12.3	15.6	8.4	8.6	6.5	10.0	7.3
M2	4.0	2.9	1.9	1.4	-1.3	2.2	2.6	2.1
Non-M1 components	4.0	1.2	-2.4	-2.3	-5.2	-1.4	-1.5	-1.2
MMDAs, savings, and small-denomination time deposits	2.8	.9	-2.4	-2.9	-4.6	-2.3	-2.4	-2.2
General-purpose and broker–dealer money market mutual fund assets	12.0	4.6	-4.2	-1.8	-7.7	.1	-1.8	2.1
Overnight RPs and Eurodollars (n.s.a.)	2.3	-3.8	4.8	9.7	-15.3	-5.6	30.6	29.9
M3	1.7	1.2	.5	.6	-3.2	2.1	1.1	2.4
Non-M2 components	-7.1	-6.0	-6.3	-3.5	-12.8	1.6	-6.6	3.9
Large-denomination time deposits	-9.7	-12.8	-15.7	-6.8	-17.4	-2.1	-7.0	-1.4
Institution-only money market mutual fund assets	21.5	33.4	18.4	-5.4	-17.6	-2.2	-10.4	8.8
Term RPs (n.s.a.)	-12.4	-20.2	8.3	16.9	9.4	37.2	24.3	-5.8
Term Eurodollars (n.s.a.)	-13.6	-10.7	-22.6	-1.1	-2.6	7.7	-32.8	25.6
Domestic nonfinancial sector debt	6.6	4.6	5.0	5.0	4.0	4.5	5.7	5.2
Federal	10.2	11.3	10.7	8.4	7.6	10.4	9.2	5.5
Nonfederal	5.5	2.6	3.1	3.7	2.7	2.4	4.5	5.1

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 all quarterly reporters, and for all weekly reporters without required reserve balances, the excess of current vault cash over the amount applied to satisfy current reserve requirements. For further details, see the Federal Reserve's H.3 Statistical Release.

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 savings deposits (including money market deposit accounts); small-denomination time deposits (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; 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 at all banking offices in Canada and the United Kingdom and at foreign branches of U.S. banks worldwide net of money fund holdings. For further details, see the Federal Reserve's H.6 Statistical Release.

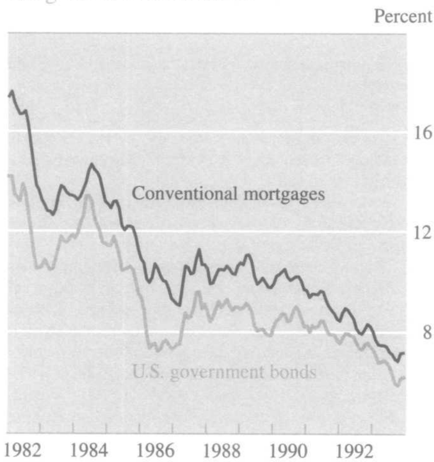
n.s.a. Not seasonally adjusted.

while, the latest readings on the monetary aggregates showed a burst of growth in early May, but tax-induced distortions and a surge in prepayments of mortgage-backed securities made this information particularly difficult to interpret. In the view of a majority of the members of the Committee, wage and price developments were sufficiently worrisome to warrant positioning policy for a move toward restraint should signs of mounting inflation pressures continue to multiply. Although they saw no immediate need to alter the degree of reserve pressure, they agreed that current conditions made it easier to envisage a tightening rather than an easing over the intermeeting period, a sense that was embodied in an asymmetric policy directive.

In advance of the July meeting of the Committee, the unemployment rate had moved back up to 7 percent, and industrial production had changed little over the preceding few months. The surge in the monetary aggregates in May apparently had not marked a trend toward more rapid expansion in broad measures of money. Overall, the evidence pointed toward a sustained economic expansion and some ebbing of the recent upsurge in inflationary pressures. News in that vein, along with progress in the Congress toward adoption of a deficit-reduction package, had fostered a drop in longer-term bond yields in the days leading up to the meeting. The durability of that improvement in market sentiment remained an open question, however. Monetary policy could be viewed as relatively expansive in light of the behavior of a variety of other indicators, including the growth in narrow measures of the monetary aggregates and reserves and the low levels of money market interest rates in both nominal and, in particular, real terms. In such an environment, Committee members agreed that it was necessary to remain especially alert to the potential for a pickup in inflation. As a result, the Committee decided to retain the current degree of restraint in the reserve market and an asymmetric directive toward tightening.

At the time of the August meeting of the Committee, readings on inflation were encouraging: Consumer prices had changed little, and producer prices had fallen over recent months. Data on spending and production had a weakish cast, and the persistence of the sluggishness in the second quarter had become more apparent. These data releases had bolstered investor confidence in the prospects for continued disinflation, and the recently passed legislation on the federal budget offered the promise of meaningful cuts in the deficit over the next several years. Accordingly, longer-term yields fell about 40 basis points.

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 Department of the Treasury.

The resulting capital gains apparently added to the allure of stock and bond mutual funds, thereby weakening M2, which moved up only slightly in July. At this meeting, policymakers saw existing reserve conditions as consistent with their goals. Moreover, the dissipation of the inflation threat and the encouraging downward tilt to expectations of inflation suggested to members of the Committee that the risks were more evenly balanced than of late. As a result, the Committee reverted to a symmetric directive—instructions that carried no presumption as to the direction of an intermeeting move—which was retained for the remainder of 1993.

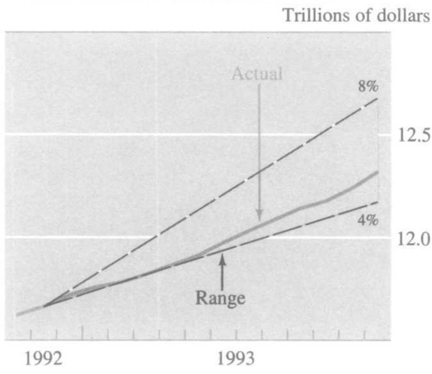
In the period leading up to the September Committee meeting, the unemployment rate had edged lower, to 6.7 percent, housing starts had declined, and retail sales were flat in real terms. Substantial drags on economic growth remained: cutbacks in the defense sector, uncertainties regarding the effects of other government policies that had the potential to raise labor and production costs, and slow growth on average in the foreign industrial economies. However, sources of stimulus were also apparent: the cumulative spur to spending provided by low interest rates, especially at longer maturities; the lessening of balance sheet constraints on households and firms; and the improving financial condition of the depository sector, which was making credit more available. Given these conflicting influences on spending, the Committee determined that leaving reserve conditions unchanged would be most consistent with maintaining sustainable economic growth.

The incoming data in advance of the final two Committee meetings of 1993 indicated a robust near-term expansion in activity with no immediate inflationary pressure. There was a sense that with reserves ample and money-market rates at the low end of the range of experience over the past three decades, the next move in policy would be to tighten, but the members of the Committee agreed that until trends became clearer, the current stance of policy should be maintained. The prospects of heightened credit demands and forecasts of looming capacity pressures pushed up longer-term interest rates over the latter part of the year; by year-end, long-term rates were about ⅜ percentage point from their yearly lows set in mid-October. Over that same span, the dollar showed notable strength on foreign exchange markets.

Money and Credit Flows

The long expansion of the 1980s was associated with growth of total debt of domestic nonfinancial sectors that was about 1½ times the pace of nominal GDP growth. In the wake of this phenomenal leveraging, the recession together with the tepid economic recovery from 1990 to 1992 was importantly a balance sheet phenomenon that was reflected in a slowing in debt growth. In retrospect, the deceleration in debt was

Total Domestic Nonfinancial Debt



The range was adopted by the FOMC for the period from 1992:Q4 to 1993:Q4.

one symptom of the general dissatisfaction of both borrowers and lenders with their financial conditions, a concern that also led to some restraint on spending and asset accumulation. Nineteen ninety-three saw some lessening of this restraint, and the growth of the debt of the nonfinancial sectors expanded 5 percent, close to the pace of nominal GDP growth. This performance put the debt aggregate in the lower portion of its 4 percent to 8 percent monitoring range, a range that had been set at the first meeting of the year.

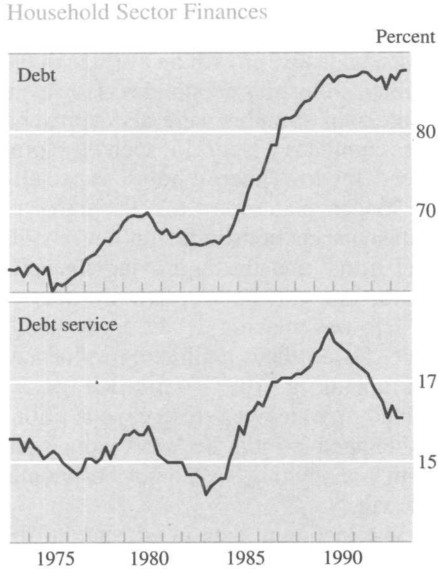
The debt of the nonfederal sectors (nonfinancial businesses, households, and state and local governments) expanded 3¾ percent last year. For nonfinancial corporations, a pickup in fixed investment and inventory investment outpaced increases in internally generated funds, pushing the financing gap into positive territory after two years of negative readings; as those firms sought outside funds, they turned in the main to long-term debt markets, but net equity issuance remained sizable as well. The debt markets in 1993 saw far more activity, however, than the net requirements for external funds implied. Low longer-term rates induced many firms to refinance existing obligations, pushing the gross issuance of public debt by nonfinancial firms above $190 billion.

Earlier efforts to restructure balance sheets, along with the opportunities afforded by lower long-term rates to refinance existing obligations, apparently put households in a better position to take on new debt in 1993. With debt-service burdens holding at about 16 percent of income, or about 2¼ percentage points below the peak set at the end of the previous decade, and loan rates declining substantially, households assumed new liabilities rapidly enough, on net, to push up the ratio of their total liabilities to disposable income to just under 90 percent in 1993. The largest swing was in the consumer credit category, as households evidently became more confident of the sustainability of the economic expansion and made previously delayed purchases of durable

Financing Gap of the Nonfinancial Corporate Sector

Percentage of gross domestic product. Financing gap is capital expenditures less internal funds arising from domestic operations.

Household Sector Finances



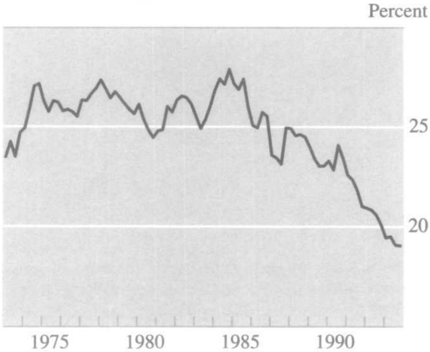
Percentage of disposable personal income. Debt is total credit market debt of the household sector. Debt service is a staff estimate of scheduled payments of principal and interest on home mortgages and consumer debt.

goods, especially autos. The record volume of mortgage originations mostly involved refinancings, but with a pickup in construction activity and some cashing out of equity in the process of refinancing, home mortgages expanded about 7 percent, on net, last year.

Overall, this pickup in liabilities was dwarfed by a substantial expansion of the asset side of the household balance sheet last year, raising net worth to a level about 4¾ times that of disposable income. In the allocation of their assets, households continued to shun deposits in favor of the investment products of nonbank intermediaries, notably mutual funds and insurance companies. As a result, deposits shrank to less than 20 percent of total household assets, a low for the period since World War II. Much of the declining role for deposits probably was attributable to the pattern of financial returns: investors, confronted by a steep yield curve, sought out the higher yields provided by longer maturity instruments, which were mostly available from outside the depository sector.

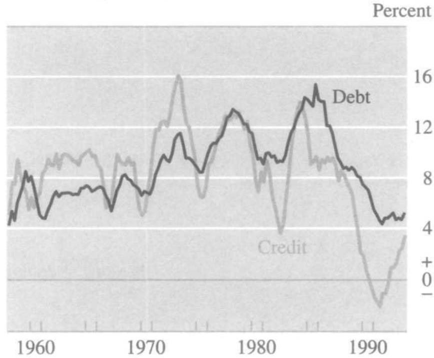
Depository institutions, pressed by their own balance sheet problems, were unaggressive in seeking deposits and extending credit in the early 1990s. But by 1993, commercial banks had made substantial strides in improving their capital standing. About three-quarters of the assets at commercial banks were on the books of well-capitalized institutions as of September 1993, 2½ times the proportion at the end of 1990. Partly as a consequence, banks reported on Federal Reserve surveys a substantial easing of terms and standards on business and consumer loans during the year. Borrowers, however, endeavoring to lock in longer-term funds, which are not typically supplied by banks, continued to rely heavily on capital markets, keeping the need of depositories to fund asset expansion subdued. Depository credit did expand moderately in 1993, marking a substantial rebound from the declines posted in the previous three years. The increase in depository credit

Household Deposits



Deposits of the household sector at all depository institutions in the United States and in money market mutual funds, as a percentage of household assets.

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.

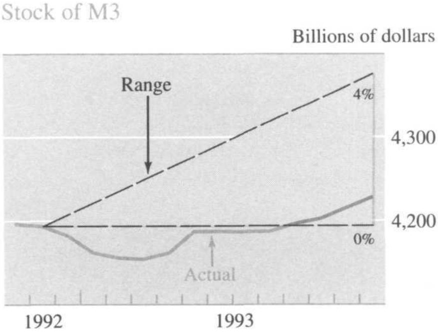
Depository credit is the sum of credit market funds advanced by savings institutions and commercial banks.

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 changes are then used in computing four-quarter moving averages.

exceeded the growth of deposit funds, as depositories made extensive use of equity, subordinated debt, and other nondeposit funds to finance the expansion of depository balance sheets. Bank credit increased 5 percent last year, after two years of growth around 3½ percent, while thrift credit contracted only a bit. Indeed, thrift credit is estimated to have expanded in the second half of the year, pulled up by extensions of loans by credit unions that outweighed continuing, albeit slackening, runoffs at savings and loans.

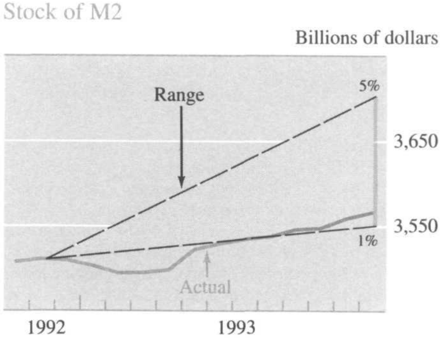
The slow expansion of depository credit, together with the increased reliance by banks on nondeposit funds, damped the growth of M3 in 1993. From the fourth quarter of 1992 to the fourth quarter of 1993, M3 grew ½ percent, ending the year a little above the lower bound of its annual range of 0 percent to 4 percent. This range had been adjusted down for technical reasons to acknowledge the appreciable upward trend to M3 velocity over the past few years, which accompanied the shrinking role of depositories in intermediating funds. The part of M3 exclusive to that aggregate declined 3½ percent, fourth quarter to fourth quarter, being pulled down by a steep drop in institution-only money market mutual funds. Overall, M3 velocity rose nearly 5 percent in 1993, down about 1½ percentage points from the previous year.

Stock of M3



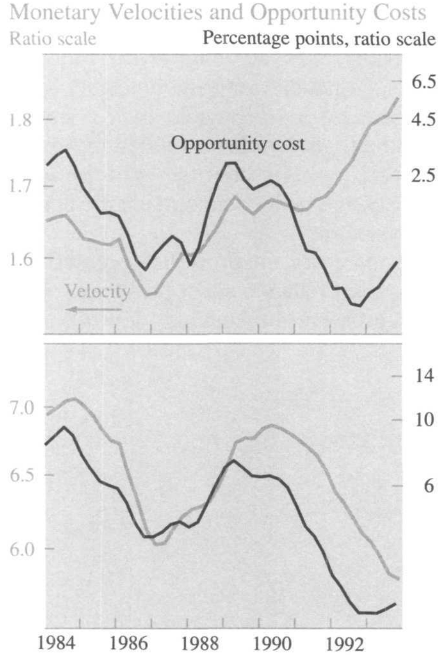
The range was adopted by the FOMC for the period from 1992:Q4 to 1993:Q4.

Stock of M2



The range was adopted by the FOMC for the period from 1992:Q4 to 1993:Q4.

Monetary Velocities and Opportunity Costs



The velocity of each aggregate is the ratio of gross domestic product, measured in current dollars, to the stock of the aggregate. 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. The calculation of the opportunity cost of M1 corresponds to that of M2 and assumes a zero return on demand deposits.

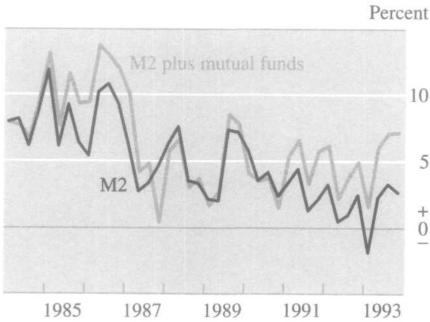
The velocity of M2 rose 4 percent in 1993 after increasing nearly 5 percent in 1992. The rise in velocity was posted even as the return on many competing short-term assets remained relatively constant, and it was this ongoing drift upward in the ratio between nominal GDP and the aggregate that led the FOMC to reduce the annual growth range for M2 from the spread of 2 percent to 6 percent that was set in February to the 1 percent to 5 percent range that was ultimately in effect. In the event, M2 grew 1½ percent from the fourth quarter of 1992 to the fourth quarter of 1993, slowing slightly from the 2 percent growth rate in 1992. Even this anemic expansion was accounted for in part by special factors. In particular, foreign demands for currency were strong, and transactions deposits were boosted late in the year by the surge in mortgage refinancings that followed a drop in mortgage rates to levels not seen in a generation. Refinancings are associated with the temporary parking of funds in highly liquid deposit accounts.

Especially after taking account of such special factors, the growth of M2 was quite subdued in 1993, in large part because of the attractiveness of capital market instruments. Although the bond market rally trimmed as much as 1 percentage point from longer-term yields, the term structure still retained an abnormally steep tilt through all of 1993. Some investors were willing to expose themselves to the greater price risk inherent in capital market mutual funds in the pursuit of higher average returns. Commercial banks took some measures to keep those customers, if not their deposits: Many banks made it possible to buy stock and bond mutual funds in their lobbies. Promotion of these services picked up, and some banks sponsored their own mutual funds or established exclusive marketing arrangements with mutual fund companies; these developments undoubtedly encouraged the diversion of deposits to mutual funds.

At the end of 1993, assets in stock and bond mutual funds totaled about $1½ trillion, up $400 billion from year-end 1992. About one-half of the December 1993 total was held by institutions and in retirement accounts—two categories generally not in M2. M2 plus the remainder of stock and bond funds expanded at around a 5½ percent annual rate in 1993, a pace roughly in line with that of nominal GDP over the period.

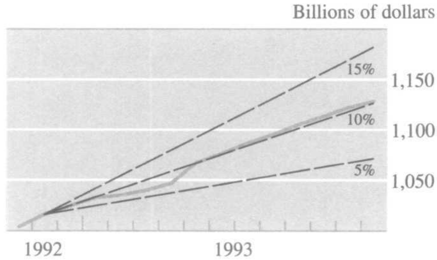
M1 grew 10½ percent in 1993, spurred on by sizable increases in currency and demand deposits. As noted above, the former was importantly boosted by foreign demands, while the latter was closely related to swings

Change in M2 and in M2 Plus Stock and Bond Mutual Funds



Mutual fund data exclude institutional holdings and IRA and Keogh balances.

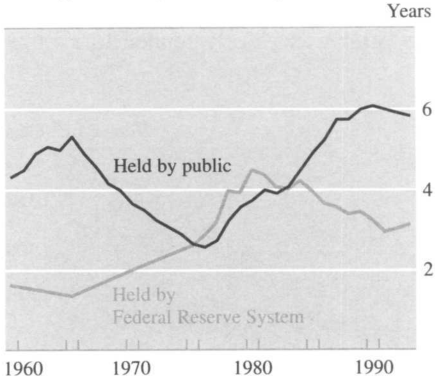
Stock of M1



in mortgage refinancing. M1 velocity declined 4½ percent despite the relative stability of money market interest rates. In contrast, the narrow aggregate's velocity had followed the path of short rates down during the easing of monetary policy from 1989 to 1992. Altogether, the drop in M1 velocity in recent years illustrates both its sensitivity to interest rates and the fairly loose relationship of M1 with interest rates and income. With the rapid expansion of transactions deposits, total reserves grew at a 12¼ percent annual rate last year, down from the 20 percent pace posted in 1992. Adding the increase in currency resulted in 10½ percent growth for the monetary base in 1993, the same performance as in the previous year.

Confronted with this rapid expansion in transaction deposits, and therefore required reserves, and directed by the FOMC to keep reserve market pressures unchanged over all of 1993, the Domestic Desk at the Federal Reserve Bank of New York added about $35 billion of securities, on net, to the System Open Market Account over the course of the year. In keeping with previous FOMC instructions, those purchases were weighted more heavily than in the past toward longer-maturity instruments. As a result, the average maturity of the Treasury securities held by the Federal Reserve moved up slightly over 1993, to 3.2 years. ■

Average Maturity of Treasury Debt



International Developments

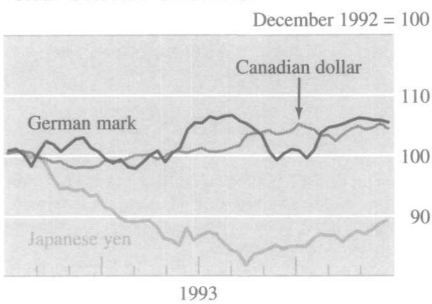
Economic activity in the major foreign industrial countries remained weak in 1993 and unemployment increased. These conditions kept increases in consumer prices low; on average, inflation in the foreign G-10 economies was only about 2¼ percent.[1] Foreign authorities responded to the ongoing economic slack by easing money market conditions and by adopting stimulative fiscal measures where scope to do so existed.

In contrast, many developing countries experienced another year of strong economic growth. Continued rapid expansion of trade among Asian countries, especially with China, contributed to growth in this region. Ongoing economic reforms in several Latin American countries helped raise output growth there. In addition, stimulative policies pushed up the pace of economic activity in Brazil. But in Mexico, authorities responded to signs of overheating and adopted policies that slowed growth to nearly zero.

Stagnant economic activity in several important U.S. export markets contributed to a further widening in the U.S. merchandise trade deficit. U.S. exports were limited to a rate of growth of only about half that of U.S. imports, which increased rapidly as the U.S. economic expansion continued. Net service and investment receipts, held down by the slow growth abroad, remained at about the same level as in 1992, and net unilateral transfers did not change, so

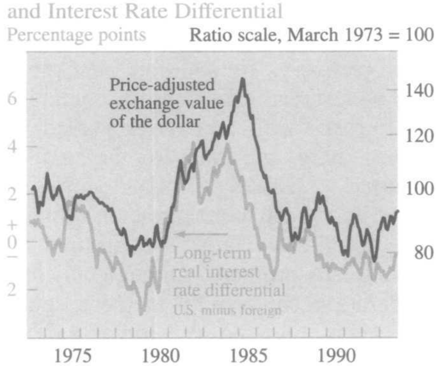
1. The Group of 10 consists of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States. Unless otherwise indicated, growth rates and inflation rates are calculated from the fourth quarter of 1992 to the fourth quarter of 1993, and averages for groups of countries are weighted by the gross domestic products of the countries as valued after adjusting for differences in the purchasing power of their currencies.

Exchange Value of the Dollar versus Selected Currencies



Foreign currency units per dollar. The data are weekly.

Exchange Value of the Dollar and Interest Rate Differential



The exchange value of the U.S. dollar is its weighted average exchange value in terms of the currencies of the other Group of 10 (G-10) countries using 1972–76 total trade weights. Price adjustments are made using 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.

the current account deficit worsened at a pace about in line with that of the trade deficit.

The value of the dollar rose about 6 percent from December 1992 to December 1993 in terms of a trade-weighted average of the other G-10 currencies. The dollar's appreciation was slightly greater after adjustment for changes in consumer price levels here and abroad because U.S. consumer price inflation exceeded the average rate of inflation in the other G-10 countries by about ½ percentage point. The main factor behind the increase in the dollar's value appears to have been the weakening of activity abroad during the strengthening of activity in the United States. This divergence in economic performance was associated with a substantial decline in foreign interest rates relative to U.S. rates.

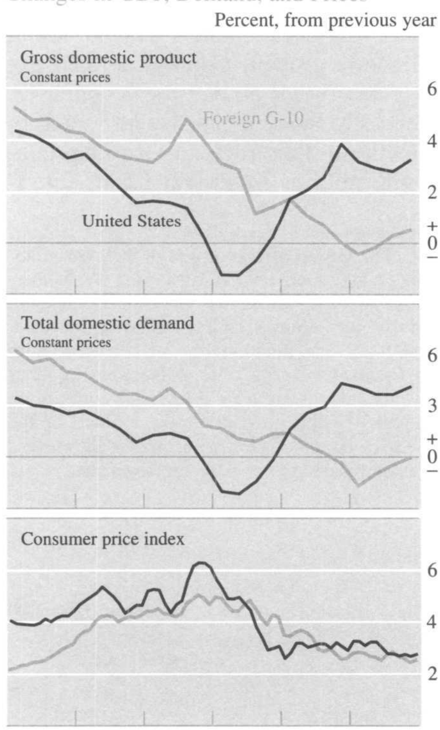
Foreign Economies

Real output in both Japan and western Germany moved erratically in 1993 and gave little indication of sustained near-term recovery. In addition, weakness was widespread elsewhere in continental Europe, with recoveries stalled in France, Italy, and many of the smaller countries. However, clear signs of expansion began to emerge in the United Kingdom, and Canada continued to make steady progress, although only at a moderate pace; activity in these countries was boosted by lower-valued currencies and firmer growth of export demand, especially from the United States.

In Poland, Hungary, and the Czech Republic, output stabilized, and further progress was made in installing market-based economies. In Russia, however, where average monthly inflation exceeded 20 percent and political support for economic reform crumbled, output continued to contract.

Labor-market conditions in most foreign industrial countries worsened in 1993, raising concerns that structural conditions as well as cyclical factors may be responsible for recent increases in unemployment. By the end of the year, unemployment rates in France and Italy had moved up to 11¾ percent and 14¼ percent respectively. Although unemployment rates in Switzerland, Sweden, the Netherlands, and other

Changes in GDP, Demand, and Prices



Data for the foreign G-10 countries are weighted by the countries' GDP as valued after adjusting for differences in the purchasing power of their currencies; the data 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.

smaller European countries with traditionally lower unemployment did not reach the double-digit range, they too increased. In eastern Germany, the rate of unemployment stabilized near 15 percent, and in western Germany it moved up to 8 percent. Even in Japan, where measured unemployment has been very low historically, the unemployment rate was nearly 3 percent at the end of 1993; more sensitive indicators, such as the ratio of job offers to applicants, also showed further deterioration of labor market conditions. The exceptions to the overall picture were Canada and the United Kingdom, where unemployment rates edged down from high levels.

Slack labor markets and wide gaps between actual and potential output moderated inflation pressures in the foreign G-10 countries. Italy's inflation rate, 4 percent, was the lowest in nearly 25 years, even though the lira's external value declined significantly. In France, downward pressure on unit labor costs helped keep inflation near 2 percent. In Japan, recession and the deflationary effect of a sizable appreciation in the yen kept consumer price inflation to only 1¼ percent. Even in Canada and the United Kingdom, where output gaps narrowed somewhat and currencies depreciated, inflation remained below 3 percent. In western Germany, inflation picked up to about 3¾ percent in 1993 mainly because of the effect on consumer prices of additional indirect taxes; without tax effects, inflation remained at about 3¼ percent.

Government budget deficits increased in response to cyclical factors in all foreign G-10 countries in 1993, and some foreign authorities, most notably in Japan, took expansionary actions that further enlarged their deficits. Accordingly, scope for additional fiscal measures narrowed in most G-10 countries and the burden of promoting recovery fell increasingly on monetary policy.

Money market conditions generally continued to ease in 1993; foreign short-term interest rates, measured by a trade-weighted average, fell about 300 basis points. German short-term interest rates were cautiously lowered in several steps, to 6 percent; these moves were accompanied by declines in interest rates in the countries that held their currencies well within the widened bands of the European Monetary System's exchange rate mechanism (ERM).[2] Free from ERM constraints, Italian authorities and, to a lesser extent, U.K. authorities maintained the downward movement in short-term rates that they had aggressively begun after leaving the ERM in 1992. Short-term rates were lowered about 300 basis points in Canada. In Japan, the discount rate was cut twice during the year, to a historic low of 1¾ percent, and at year-end short-term interest rates were close to 2 percent. Although the growth of key monetary aggregates remained subdued in most countries, it did pick up in the United Kingdom. The Bundesbank's most closely watched monetary aggregate, M3, remained above its target range of 4½ percent to 6½ percent throughout 1993, a development that German authorities found worrisome in their efforts to limit inflationary pressures.

The combined current account surplus of the foreign G-10 countries widened nearly $60 billion in 1993, to $110 billion. This development was in large part due to domestic demand,

2. The countries that continued to participate in the exchange rate mechanism after the departure of Italy and the United Kingdom in 1992 were Belgium, Denmark, France, Germany, Ireland, Luxembourg, the Netherlands, Portugal, and Spain.

which grew more slowly in these economies than it did in key trading partners in Asia and North America. In Japan, the slump in the domestic economy and temporary valuation effects from the strengthening of the yen contributed to a $13 billion widening of the surplus. The lower-valued lira was a key factor in a $30 billion swing to a small surplus in Italy, while France's improved competitiveness helped widen its surplus about $7 billion.

The rate of growth of real output in developing countries as a group was 5½ percent in 1993, essentially the same as in 1992.[3] In Asian countries, real economic activity was particularly strong and even accelerated about ½ percentage point, to a rate of growth of 7¾ percent. Gross domestic product in China increased 13 percent for the second consecutive year despite a new economic retrenchment program announced in the middle of the year. Hong Kong, Korea, Taiwan, and Singapore, the so-called newly industrializing Asian economies, expanded their collective output 5½ percent in 1993, about matching their 1992 performance. These economies benefited from the strong demand elsewhere in Asia and in the United States for their exports of electronic gear and other high technology equipment. Growth in some Asian countries was also stimulated by increased real investment associated with large capital inflows, which were attracted by recent financial liberalizations and, in China, by the fast growing market.

The growth of output in Latin America increased slightly in 1993, reaching a rate of 3¼ percent. Brazil's gross domestic product expanded 5 percent after the authorities adopted more stimulative fiscal and monetary policies. Large-scale privatizations lent credibility to the permanence of ongoing monetary and fiscal reforms in Argentina, where real output rose 6 percent, and in Chile, where it rose 5 percent. These two countries have seen a substantial influx of foreign capital and related real investment in recent years, in sharp contrast to the conditions associated with the depressed rate of capital inflows recorded directly after the debt crisis. In Mexico, policies designed to limit increases in the current account deficit and to reduce inflation contributed to a further slowing in the growth of output, from 2½ percent in 1992 to ½ percent in 1993. Political uncertainty and rising inflation in Venezuela may have contributed to a slight fall in gross domestic product there in 1993, after three years of substantial growth.

The expansion of economic activity in the Middle East fell from 10 percent in 1992 to 3½ percent in 1993 as the early stages of recovery from the Gulf War were completed and as a moderation in the demand for oil in industrial countries helped push down its price about 20 percent.

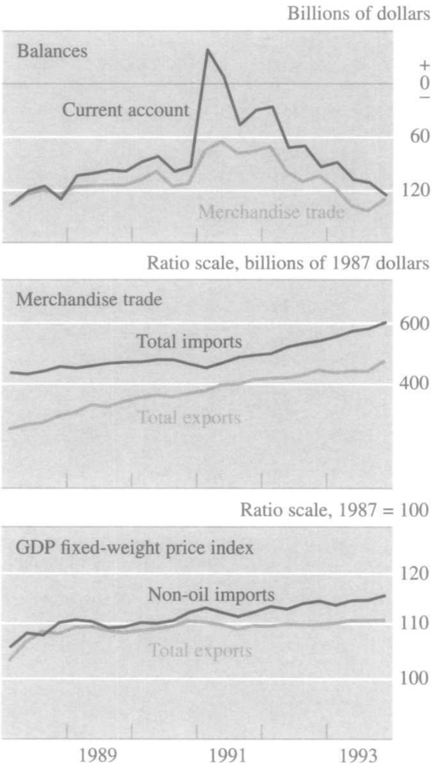
Patterns of merchandise trade in developing countries varied considerably among regions. The merchandise exports of Asian countries expanded rapidly, while their merchandise imports, stimulated by the rapidly rising level of overall economic activity, increased at an even faster pace. Elsewhere, demand for imports decelerated markedly, primarily because of the substantial slowing of economic activity in Mexico and Venezuela. But weak demand in many trading partners of Latin American countries also severely limited the expansion of exports from these economies.

3. The growth of output in developing countries is calculated by comparing measures of total annual output rather than fourth-quarter figures.

U.S. International Transactions

The U.S. current account deficit expanded from $66 billion in 1992 to $109 billion in 1993. The nominal merchandise trade deficit, measured on a balance of payments basis, widened $37 billion, to $133 billion, while other elements of the current account balance changed little. Imports rose much faster than exports, partly because economic expansion continued in the United States while economic growth in many U.S. export markets remained slow. The appreciation in the real value of the dollar, which began in August 1992, also tended to depress U.S. real net exports.

U.S. International Trade



The data are from the Department of Commerce; they are quarterly at annual rates and seasonally adjusted. The 1993 data are preliminary.

U.S. merchandise exports increased 6 percent in real terms over the four quarters of 1993. Exports, which changed little over the first three quarters of the year, strengthened in the fourth quarter with the rise in shipments of machinery and automotive products to Canada and Mexico. The very rapid expansion in the volume of computer exports that has been observed in recent years slowed somewhat but still amounted to 20 percent in 1993. Agricultural exports declined, in part because U.S. crop output was reduced by flooding in the Midwest and drought in the Southeast. Most of the 1993 increase in merchandise exports went to Canada. Shipments to the sluggish economies in continental Europe flattened, but exports to Mexico and developing countries in Asia increased at a healthy pace. Exports to OPEC countries, whose revenues have been depressed by declining oil prices, increased only marginally.

Merchandise imports rose about 13 percent in real terms during 1993. This increase was spread fairly evenly among import categories. Rising demand for computers accounted for one-third of the import expansion measured in real terms, but imports of other machinery, industrial supplies, consumer goods, and automotive products also rose rapidly. Low inflation abroad and the appreciation of the dollar held import prices in check during 1993. The average price of imports other than oil rose only slightly and was more than offset by a sharp drop in the price of oil imports.

Recorded net capital inflows balanced only part of the substantial U.S. current account deficit in 1993. The statistical discrepancy was positive and large. One significant cause of this discrepancy is the shipments of U.S. currency to foreigners that are not recorded in U.S. international accounts.

Net official inflows amounted to $71 billion in 1993. Part of these inflows represented funds acquired by G-10 countries as the consequence of intervention in foreign exchange markets. Other sources were the authorities in some Latin American and other developing countries, where the sterilization of large private capital inflows added substantially to official dollar holdings.

Although gross inflows and outflows of private capital were close to balanced in 1993, flows in both directions continued to expand with broadening opportunities for cross-border transactions. U.S. net purchases of foreign securities, which were about evenly divided between stocks and bonds, reached a record $125 billion. Net purchases from market participants in Europe, Canada, and Japan increased sharply and, as usual, constituted the bulk of these transactions. However, net purchases from entities in other countries, particularly emerging markets, increased even more rapidly in 1993. Foreign private net purchases of U.S. government securities and corporate bonds also remained strong, and foreign holdings of U.S. corporate stocks once again showed a net

U.S. International Transactions [1]

Billions of dollars, seasonally adjusted

Transaction	Year		Quarter				
			1992	1993 p			
	1992	1993 p	Q4	Q1	Q2	Q3	Q4
Merchandise trade, net	−96	−133	−26	−29	−34	−36	−33
Exports	440	457	114	112	113	112	120
Imports	536	589	140	141	148	148	153
Services, net	56	56	13	15	15	14	13
Receipts	180	187	45	47	47	47	47
Payments	123	131	32	32	32	33	34
Investment income, net	6	0	−1	0	0	2	−1
Direct investment, net	48	46	10	11	12	13	11
Portfolio investment, net	−42	−46	−11	−11	−12	−11	−12
Unilateral transfers, private and government, net	−33	−33	−10	−8	−7	−8	−10
Current account balance	**−66**	**−109**	**−24**	**−22**	**−27**	**−28**	**−32**
Private capital flows, net	36	13	2	3	−5	10	6
Bank-related capital, net (outflows, −)	44	47	−5	9	4	33	*
U.S. net purchases (−) of foreign securities	−48	−125	−17	−27	−24	−46	−29
Foreign net purchases (+) of U.S. securities							
Treasury securities	37	24	21	14	−1	3	8
Corporate and other non-Treasury bonds	35	61	9	6	15	15	26
Corporate stocks	−4	18	4	4	*	3	12
U.S. direct investment abroad	−35	−50	−12	−9	−12	−8	−21
Foreign direct investment in United States	2	32	3	9	10	3	10
Other corporate capital flows, net	5	6	−2	−3	2	7	n.a.
Foreign official assets in United States (increase, +)	41	71	6	11	18	19	23
U.S. official reserve assets, net (increase, −)	4	−1	2	−1	1	−1	−1
U.S. government foreign credits and other claims, net	−2	*	−1	1	*	*	*
Total discrepancy	−12	27	15	9	14	*	3
Seasonal adjustment discrepancy	0	0	1	6	1	−7	*
Statistical discrepancy	−12	27	14	3	13	7	3

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. p Preliminary.

SOURCE. Department of Commerce, Bureau of Economic Analysis.

gain. Moreover, capital inflows from foreign direct investors in the United States resumed in 1993, while capital outflows by U.S. direct investors abroad surged to a record level.

Foreign Exchange Markets

Measured against the major European currencies and the Canadian dollar, the external value of the dollar rose in 1993, but it fell in terms of the yen.

The value of the dollar increased 8 percent relative to the German mark in 1993. During the first half of the year, the mark-dollar exchange rate fluctuated in response to revisions in expectations about the pace of Bundesbank easing. It peaked in late July, when German authorities were widely thought to be on the verge of easing monetary conditions aggressively because of weak economic activity. Pressures on currency arrangements in Europe also contributed to the strength of the dollar at this time. When German easing did not materialize, the dollar's value began to decline, and its slide continued until the Bundesbank lowered its official interest rates in mid-September. Over this period, the dollar's value fell 8½ percent relative to the mark. From mid-October, the dollar appreciated in response to further German interest rate reductions and an improving U.S. economy; by late December, the dollar had again attained its level of late July in terms of the mark.

Stresses on currency arrangements in Europe, which resulted in an exchange rate crisis in the fall of 1992, re-emerged during the first half of 1993 and intensified during the summer. To reduce pressures, the fluctuation margins for currencies participating in the exchange rate mechanism of the European Monetary System were widened to 15 percent in early August. Despite this dramatic change, the dollar thereafter rose about the same amount in terms of the remaining ERM currencies as it did versus the mark. The other countries participating in the ERM did not make use of their greater exchange rate leeway to lower interest rates faster than Germany did. By contrast, authorities in Italy sharply lowered short-term interest rates, and the dollar rose about 20 percent in terms of the lira. Political uncertainties and massive budget deficits also weighed on the exchange value of the lira. Similar concerns, although on a smaller scale, contributed to the Canadian dollar's depreciation of nearly 5 percent relative to the U.S. dollar. U.K. authorities also pushed down short-term interest rates, but more slowly than the Bundesbank, and the dollar moved up only about 4 percent versus sterling.

Japan's rising external surplus strengthened the view of many market participants that an appreciation of the yen would be needed to reduce the surplus. From January through mid-August, the yen rose 17 percent relative to the dollar. After U.S. officials expressed concern in mid-August over the dollar's weakness and initiated U.S. intervention in the market for yen, the dollar's slide halted. As economic activity in Japan continued to stagnate over the remainder of the year, the dollar appreciated, partially offsetting its earlier decline. Overall, the yen rose 12 percent relative to the dollar in 1993.

Foreign Currency Operations

U.S. monetary authorities intervened in foreign exchange markets on a moderate scale in 1993. As the dollar depreciated relative to the yen during the spring, U.S. authorities, in cooperation with Japanese authorities, sold $1,268 million of yen; mid-August sales of $165 million of yen brought the total for the year to

$1,433 million. The sales were split evenly between the Federal Reserve System and the Treasury.

At year-end, the System held $22,345 million of foreign currencies valued at current exchange rates, almost entirely in marks and yen. No Treasury balances were warehoused with the System during 1993. The System realized $172 million in profits on sales of foreign currency during 1993 and recorded a translation gain of $93 million on foreign currency balances.

Intervention in dollars by fifteen major foreign central banks amounted to net purchases of about $34 billion in 1993. There was no activity involving the Federal Reserve swap network during the year. ■

Monetary Policy Reports to the Congress

Given below are reports submitted to the Congress on February 19 and July 20, 1993, pursuant to the Full Employment and Balanced Growth Act of 1978.

Report on February 19, 1993

Monetary Policy and the Economic Outlook for 1993

Last July, when the Federal Reserve Board presented its semiannual monetary policy report to the Congress, there was considerable uncertainty about the prospects for the economy in the second half of 1992. After a promising start at the beginning of the year, growth of the economy had slowed once again in the spring, and various structural adjustments that had been impeding the pace of the expansion retained considerable force. However, with drag from the structural adjustments expected to diminish gradually over time and with the economy continuing to benefit from the substantial easing of money market conditions that the System had implemented over the years, the most likely prospect for the economy was thought to be one of moderate growth in the second half of the year.

In the event, economic growth did indeed proceed at an improved pace in the second half of 1992, although the pickup did not start to become evident in the incoming economic data until well into the autumn. Fueled by strong increases in household and business spending, real gross domestic product rose at an annual rate of 3.6 percent in the second half of the year. The increase over the four quarters of the year amounted to 2.9 percent. This was the largest gain in output since 1988, and, while far from robust by the standards of past cyclical upswings in activity, it was a much stronger performance than many analysts—inside and outside government—had thought likely, given the extraordinary headwinds with which the economy had to contend. Indeed, the performance of the U.S. economy stands in sharp contrast to that of a number of major foreign industrial economies that appear still to be laboring to regain forward momentum.

Employment has grown since the middle of last year, but at only a gradual pace. Hiring has been damped by the ability of firms to meet their output objectives through hefty increases in productivity. The unemployment rate, which had risen in the first half of 1992 in conjunction with a surge in the share of the working-age population in the labor force, turned down thereafter as labor force participation fell back. The unemployment rate in January of this year was 7.1 percent, more than half a percentage point below the peak rate of last summer.

Price developments remained favorable in the second half of 1992, and the rise in the consumer price index over the four quarters of the year amounted to about 3 percent, matching the low rate achieved in the previous year. Consumer energy prices turned back up in 1992, but the prices of other goods and services that enter into the CPI generally rose less rapidly than they had in 1991. Although the CPI spurted ½ percent this past month, the underlying trends in labor costs and prices remain encouraging. The success to date in keeping inflation in check, while restoring growth, has had highly salutary effects on financial markets and on the process of financial reconstruction, the continuing progress of which is essential to the achievement of renewed and sustainable prosperity.

The hesitant pace of the economy evident in incoming information throughout much of last year, along with notable weakness in the monetary and credit aggregates and steady gains against inflation, prompted the Federal Reserve to ease monetary conditions three times, bringing short-term rates down another full percentage point over the year. The discount rate was reduced to 3 percent, and short-term rates generally are now at their lowest levels since the early 1960s.

Long-term rates also fell, on balance. Declines were limited at times, however, by concerns about prospective federal budget deficits and about the possibility that inflation might begin to move higher as the expansion proceeded. Notable decreases in long rates were registered in late 1992 and early 1993, as inflation remained subdued and as statements by Administration officials suggested that they would seek only limited near-term fiscal stimulus and that proposals to make substantial cuts in the federal budget deficit over time were under serious consideration. The trade-weighted foreign exchange value of the dollar in terms of the other Group of Ten currencies appreciated on balance over the course of 1992 and rose further during the first weeks of 1993. The dollar benefited from the improved performance of the U.S. economy relative to conditions in other industrial countries.

Growth of the monetary aggregates slowed last year despite an acceleration in nominal spending and income. For the year, M2 advanced 1.9 percent, below the 2½ percent lower end of its target range. M3 also came in under its 1 percent to 5 percent target range, growing only 0.5 percent. The Federal Reserve did not make greater efforts to boost growth to within these ranges because, as the year went on, it became increasingly clear that slow growth of the broad money aggregates did not indicate that financial market conditions were impeding the expansion of spending and income. In fact, growth of nominal GDP exceeded that of M2 by 3½ percentage points last year and that of M3 by 4¾ percentage points. Not only did data on spending itself show a firming trend over the year, but narrow money (M1) and reserves were expanding rapidly—suggesting to some that liquidity was quite ample—and the growth of debt, while restrained, was considerably in excess of that of the broader monetary aggregates.

Nominal GDP growth last year, which picked up to 5.4 percent from 3.5 percent in 1991, was fueled by spending that was financed largely outside banks and other depositories, whose liabilities constitute the lion's share of the monetary aggregates. Spurred in part by advances in equity prices and by declines in longer-term interest rates, businesses and households strengthened their balance sheets by raising funds in bond, mortgage, and equity markets and repaying bank loans and other short-term debt. This shift in the focus of financing efforts toward the capital markets, a process that has been in progress for the last couple of years, has helped to redress financial distortions that accompanied the buildup of debt and the rapid rise in some asset prices in the 1980s.

The low level of credit demanded from depositories has meant that these institutions have not needed to seek large volumes of deposits. As a consequence, rates paid on deposits have been adjusted downward rapidly as short-term market rates have declined. Savers, reacting to the lower deposit rates and to attractive returns on bonds and equity, have shifted funds from M2 deposits into the capital markets. One method savers have used to capture these higher capital market yields has been the purchase of bond and stock mutual funds, which are not included in the monetary aggregates and which together experienced record inflows in 1992. Moreover, consumer loan rates have fallen by less than deposit rates, and households appear to be using M2 assets to repay consumer debt or restrain its growth. The combination of rate incentives, desires to strengthen balance sheets, and the greater availability at low transaction cost of a broadened array of savings vehicles beyond traditional deposits appear to have distorted, at least for a time, the traditional relationship between levels of M2 and M3 assets and given levels of spending.

Although growth of M2 and M3 was very weak last year, M1 accelerated to 14.3 percent, the second fastest annual increase recorded in the official series, which begins with 1959. This pickup owed in part to the expansion of spending, but it mainly reflected the tendency for rates on liquid deposits to adjust downward less rapidly than those on time deposits. In response, savers shifted substantial volumes of funds from maturing time deposits to NOW accounts. In addition, businesses boosted their demand deposits substantially. To support this growth in transactions deposits, the Federal Reserve added substantial volumes of reserves in 1992. Total reserves increased 20 percent last year, and the monetary base, which includes currency outstanding as well as reserves, increased 10.5 percent, the highest rate ever registered in the official series.

Decisions to strengthen balance sheets had a smaller but significant effect on debt growth. The debt of nonfinancial sectors is estimated to have expanded 4.6 percent, only slightly faster than in 1991 and just above the lower end of its monitoring range. With debt growing less rapidly than income and with declines in market interest rates allowing higher-cost debt to be rolled over at lower rates, households and businesses made substantial further progress in reducing debt-service burdens.

Monetary Objectives for 1993

The aim of the Federal Open Market Committee in 1993 is to promote financial conditions that will help to maintain the greater momentum that the economy developed in 1992 and to consolidate the trend toward lower inflation. The objectives for the monetary aggregates in 1993 were set with that aim in mind.

At its July 1992 meeting, the Committee had provisionally chosen the same ranges for 1993 as it was confirming for 1992—2½ percent to 6½ percent for M2 and 1 percent to 5 percent for M3, with a monitoring range for the nonfinancial debt aggregate of 4½ percent to 8½ percent. At that time, the Committee noted that the extent and duration of deviations of money growth from historical relationships remained

Ranges for Growth of Monetary and Debt Aggregates[1]

Percent

Aggregate	1991	1992	1993
M2	2½–6½	2½–6½	2–6
M3	1–5	1–5	½–4½
Debt[2]	4½–8½	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.

highly uncertain and that the actual setting, in February, of 1993 ranges consistent with the basic policy objectives would need to be made in light of additional experience and analysis.

At its February meeting, in reviewing the ranges provisionally chosen for 1993, the Committee noted that nominal spending had accelerated considerably in 1992 despite the quite-sluggish growth of M2 and M3 throughout the year. The Committee viewed this development as underscoring the importance that special, and historically anomalous, forces have had in restraining the growth of broad money relative to spending. Although the intensity of some of these forces might diminish in 1993, as borrowers and lenders achieve more comfortable balance sheet positions, the forces are unlikely to disappear. For example, the substantial volume of liquid securities on banks' balance sheets suggested that banks will not become vigorous bidders for deposits in 1993 even if, as expected, lending picks up. In addition, the yield curve, although it had begun to flatten a bit early in the new year, is likely to continue to provide savers an incentive to shift funds out of monetary assets and into capital markets—a process facilitated by the growing availability of mutual funds at banks and thrift institutions.

Given that these and other forces tending to channel funds around depository institutions and hence to raise velocity (the ratio of nominal GDP to money) seem likely to persist in 1993, a downward adjustment of the money ranges is appropriate to take account of the expected atypical behavior of velocity: Money growth lower than normally expected would be sufficient to support substantial growth in income. With this in mind, the Committee made a technical downward adjustment in the target growth ranges for M2 and M3, reducing the upper and lower ends of each range by ½ percentage point.

The strength of the influences depressing money growth relative to income remains somewhat uncertain, however. If they persist in 1993 to the same extent as in 1992, growth of M2 and M3 in the lower portions of their reduced target ranges would be consistent with substantial further growth of nominal spending. Alternatively, the upper ends of the target ranges would accommodate ample provision of liquidity to support further economic expansion, even if the growth of money and income were to begin coming into more normal alignment and the recent high rate of increase in velocity were to slow. The Committee will continue to examine money growth as the year unfolds for evidence on developing economic and financial conditions. As in the past, the Federal Reserve will also be guided by a careful assessment of a wide variety of other financial and economic indicators. The Committee's primary concern, as in 1992, will remain fostering financial conditions conducive to sustained economic expansion and a noninflationary environment.

For debt growth, which has been less damped by special forces than has the expansion of the broader monetary aggregates, last year's range was retained for 1993. Federal debt growth again is likely to be substantial. Growth of the debt of nonfederal sectors is expected to accelerate somewhat as borrowers' balance sheets continue to improve, as intermediaries become more willing to lend, and as the economy expands. Nevertheless, the growth of nonfederal debt is expected to remain below that of nominal GDP, a development the Committee sees as contributing to building the sound financial foundation crucial to a sustained economic expansion.

Economic Projections for 1993

Although the economy and the financial markets continue to face difficult adjustments, the governors and Bank presidents think that the most likely prospect for 1993 is that economic growth will proceed at a moderate pace. The growth of output probably will be supported by further gains in productivity, the ultimate source of increased real income and improved living standards over the long run. In addition, increases in employment are expected to be large enough to bring further gradual declines in the unemployment rate over the course of 1993. Inflation is expected to remain subdued, boding well for sustained expansion in 1993 and beyond.

The governors' and Bank presidents' forecasts of real GDP growth over the four quarters of 1993 span a range of 2½ percent to 4 percent, with the central tendency of the forecasts in a range of 3 percent to 3¼ percent. In considering the possible outcomes for 1993, the governors and Bank presidents cited the degree of momentum that appears to have developed in the economy in the latter part of 1992 and early 1993. The various balance sheet problems that apparently retarded growth of the economy during the early phases of the current expansion, while by no means fully resolved, seem to be receding. In addition, such sectors as residential construction, business investment, and consumer durables clearly are benefiting from the declines that have occurred in interest rates.

However, impediments to more rapid expansion are still present. Government spending for defense appears likely to continue to decline for some time to come. More broadly, balance sheet repair and business restructuring, which have exerted major restraint on economic activity in recent years, are still in process, despite the apparent improvement in business finances in 1992. Indeed, the new year has brought additional announcements of business restructurings in a variety of industries, both defense-related and other. These changes are leading to an economy that is more productive and competitive, but at the cost of some dislocation and disruption in the short run. The magnitude of structural changes like these is a special uncertainty in the economic outlook for the remainder of the year. With regard to the external sector, many foreign industrial countries are experiencing prolonged economic weakness. Under the circumstances, the growth of U.S. exports, while remaining positive, may well fall short of the growth of imports again in 1993, exerting a drag on real GDP in contrast to the substantial impetus in the period up to early 1991.

Economic Projections of FOMC Members and Nonvoting Reserve Bank Presidents for 1993

Percent

Measure	Range	Central tendency	MEMO 1992 actual
Change, fourth quarter to fourth quarter [1]			
Nominal GDP	5¼–6¼	5½–6	5.4
Real GDP	2½–4	3–3¼	2.9
Consumer price index [2]	2½–3	2½–2¾	3.1
Average level, fourth quarter			
Unemployment rate [3]	6½–7	6¾–7	7.3

1. Change from average for fourth quarter of preceding year to average for fourth quarter of year indicated.

2. All urban consumers.

3. Civilian labor force.

Despite the job cutbacks at some large companies, other firms, especially smaller ones, are adding to payrolls, albeit cautiously, and total employment has been rising modestly. The governors and Bank presidents expect this pattern to persist, with net gains in employment during 1993 likely to be sufficient to bring the unemployment rate down somewhat further over the year. The central tendency of the unemployment rate forecasts for the fourth quarter of 1993 extends from 6¾ percent to 7 percent; the remaining forecasts of the System officials range down to about 6½ percent.

The governors' and Bank presidents' forecasts of the rise in the consumer price index over the four quarters of 1993 extend from a low of 2½ percent to a high of 3 percent. Within that range, a large majority of the forecasts are clustered in the span of 2½ percent to 2¾ percent. The considerable progress that has been made in bringing down inflation during the past decade is providing one of the essential underpinnings for the sustained growth of real living standards over the long run.

However, achieving a satisfactory economic performance in 1993—and in the years thereafter—will depend on initiatives in many types of policy other than monetary policy. In coming months, the Congress and the new Administration will be grappling with a host of issues, including those related to fiscal policy, regulatory policy, and foreign trade policy. Farsighted approaches are needed in all those areas if the economy is to perform at its full potential over the long haul. In framing regulatory policy and foreign trade policy, the Congress and the Administration will need to keep an eye on potential costs and rigidities that could sap the vigor of a market economy. With regard to fiscal policy, credible action to reduce the prospective size of future federal budget deficits could yield a very direct and meaningful payoff in the form of lower long-term interest rates than otherwise would prevail. Such action would encourage capital investment and would go far toward relieving anxieties that many of the nation's citizens still have about longer-run economic prospects.

The Performance of the Economy in 1992

The economy began to exhibit renewed firmness in 1992, overcoming a host of impediments that have been working to retard the growth of activity. With the strengthening of growth in the second half, to a 3.6 percent rate, the rise in real GDP over the year cumulated to 2.9 percent, the strongest gain since 1988. Employment also picked up in 1992, but rather slowly; the unemployment rate continued to move up in the first half of the year, but thereafter followed a course of gradual decline. Inflation continued to trend lower in 1992, with most broad price indexes showing increases that were among the smallest since the mid-1960s.

The growth of household and business expenditures picked up appreciably in 1992. Households, for their part, began to spend more freely on motor vehicles and other goods, and their purchases of homes also strengthened, spurring additional gains in residential construction. Businesses began investing more heavily in new equipment; much of the gain went for computers and other electronic equipment embodying new technologies. Business outlays for nonresidential construction declined, on net, over the year, but by a much smaller amount than in 1991. In total, the final purchases of households and businesses rose about 4¼ percent in real terms in 1992, after declining in each of the two previous years; the 1992 gain matched that of 1988 and otherwise was the largest in eight years. By contrast, governments at all levels continued to be burdened by huge budget deficits in 1992, and for a second year their combined purchases of goods and services changed little in real terms. In addition, export growth was slowed by weakness of activity in several foreign industrial economies; despite improvement in the second half, the rise in real exports of goods and services over the year, 3½ percent, was only about half as large as the annual gains in 1990 and 1991. Meanwhile, the faster growth of domestic spending pushed up the growth in imports of goods and services to 9¼ percent in 1992.

Further progress was made in reducing inflation last year. The consumer price index excluding food and energy—a measure widely used in gauging the underlying trend of inflation—increased about 3½ percent over the four quarters of 1992; this was a full percentage point less than the increase during 1991. The total CPI rose about 3 percent over the four quarters of 1992, the same as in the previous year; energy prices, which had fallen sharply in 1991, turned up slightly this past year, while increases in food prices were quite small for the second year in a row. Except for 1986, when the CPI was pulled down by a collapse of world oil prices, the increases of the past two years are the smallest in a quarter century.

The Household Sector

The financial condition of households improved in 1992. Income growth picked up a little in the aggregate, the strains on household balance sheets eased a bit, and the spirits of consumers brightened markedly toward year-end. Growth in consumer spending followed a stop-and-go pattern through midsummer, but the gains thereafter were steadier and fairly sizable overall. Spending for residential investment also advanced over the year, by a considerable amount in total.

The aggregate wealth of households appears to have increased further during 1992. With stock prices increasing, the value of households' financial assets rose moderately, and the value of residential real estate also moved up, on average. On the liability side, households remained cautious in taking on new debt in 1992, and the burden of carrying debt continued to ease, owing both to slow growth in the volume of debt outstanding and to the further reductions in interest rates, which facilitated the ongoing substitution of new, lower-cost debt for old, higher-cost obligations. The incidence of households experiencing loan-repayment difficulties diminished over the year.

Income growth picked up moderately in 1992. Wages and salaries rose about 4¼ percent in nominal terms, after a gain of only 2¼ percent in 1991. In addition, proprietors' incomes benefited from the strengthening of economic activity, and, with corporate profits on the rise, the dividends paid to shareholders more than reversed their decline of the previous year. Transfer payments, which had soared as the economy softened in 1990 and 1991, continued to grow rapidly in 1992. By contrast, interest income trended sharply lower, as the rates of return on household deposits and other financial assets fell further. Total after-tax income got a temporary boost in 1992 from an adjustment of federal tax withholdings that took effect at the start of March. With inflation low, real disposable personal income increased nearly 2½ percent over the year—not a large gain by past cyclical standards, but nonetheless the biggest since 1988.

Real personal consumption expenditures rose about 3¼ percent over the four quarters of 1992, after essentially no gain over the two previous years. For a considerable part of 1992, the increases in spending were interspersed with stretches of sluggishness. A surge in consumer expenditures early in the year was followed by listlessness during the spring, and a second jump in spending around midyear was followed by still another bout of slow growth during the summer. However, the last few months of the year brought fairly sizable advances, boosting the growth of consumption expenditures to a rate of more than 4 percent in the fourth quarter.

Consumer expenditures for motor vehicles increased about 9 percent over the four quarters of 1992. More than half the gain came in the fourth quarter, when sales of new vehicles were boosted by special promotional incentives and, apparently, by a growing perception among consumers that better economic conditions lay ahead. At the start of 1993, after some of the more highly publicized promotional programs had ended, sales of cars and light trucks fell sharply for a brief time, but they since appear to have regained strength. More than likely, some fundamental support for sales is coming from the replacement needs of persons who had put off buying new vehicles during the recession and the early phases of the recovery.

Spending picked up during the second half of 1992 for many items other than motor vehicles, with notable gains in categories in which an element of discretion typically enters into households' purchasing decisions. Real outlays for furniture and household equipment rose at an annual rate of nearly 15 percent in the second half of 1992, and real expenditures for apparel climbed at nearly a 10 percent rate. In total, spending for consumer durables other than motor vehicles grew about 9 percent in real terms over the four quarters of 1992, after declining in each of the two previous years. Real outlays for nondurables, which also had fallen in both 1990 and 1991, rose almost 3 percent in the latest year. Real expenditures for services increased about 2 percent during 1992, slightly faster than in other recent years.

The personal saving rate—the share of disposable income not used for consumption or other outlays—rose moderately in the first half of the year, when concerns of households about the prospects for the economy apparently led them to adopt more cautious attitudes toward spending. The rate then turned down in the second half of the year as consumers began to spend more freely. The fourth-quarter rate was slightly below the average for 1992, but it was well within the range of quarterly observations seen over the past several years.

Real outlays for residential investment rose 15 percent during 1992, climbing to a fourth-quarter level nearly 25 percent above their recession low of early 1991. Most of the 1992 rise in residential investment came in the form of increased construction of single-family housing units, which benefited from the further net reduction in mortgage interest rates over the course of the year. Outlays for home improvements, which make up about one-fifth of total residential investment, also increased in 1992, after declining in each of the three previous years; repair of the damage caused by Hurricane Andrew accounted for part of that gain. By contrast, multifamily housing remained depressed; high vacancy rates and unfavorable demographic trends continued to be big obstacles to new construction activity in that portion of the market.

As with consumer spending, the gains in single-family housing activity tended to come in intermittent bursts through much of 1992. Sales of new homes surged early in the year, weakened in the spring, surged again during the summer, and then fell back just a touch in the fourth quarter; on net, the increase over the year amounted to 12 percent. Mortgage interest rates, although lower than in 1991, exhibited some mild swings during 1992, and these swings appear to have contributed to the fluctuations in home sales. Proposals early in the year for a tax credit for first-time homebuyers also may have affected the timing of purchases to some degree.

Construction activity in the single-family sector also had its ups and downs in 1992, influenced by unusual weather patterns as well as by the fluctuations in sales. Nonetheless, the trend over the year as a whole was decidedly upward, and the average level of starts in the fourth quarter was about 20 percent above that of a year earlier. In January, single-family starts fell back somewhat; volatility in the monthly data on starts is not unusual at this time of year, however.

Despite the large gains seen in 1992, starts in the single-family sector have retraced only part of the decline that took place in the late 1980s and early 1990s. Strong impetus for recovery has come from declines in mortgage interest rates, which have been considerably lower this past year than they were in 1986, when single-family starts were at their most recent annual peak. However, a number of other developments have continued to retard the recovery of housing activity. Uncertainties about job prospects no doubt have deterred some buyers from taking advantage of the lower rates on home mortgages. More broadly, recent demographic trends have been less favorable to growth in the demand for single-family housing than were the trends of the mid-1980s. The declines in house prices in a number of regions in recent years—and the more general lack of any real price appreciation to speak of—also may have affected demand to some extent; certainly, housing is no longer viewed by potential buyers as the sure-fire, high-yield investment that it was once thought to be.

Builders, for their part, have remained a little cautious, as have the lenders who finance new construction. In many cases, houses are being started only when a buyer is lined up; eagerness to build in anticipation of future sales is not widely apparent.

In the multifamily sector, the number of units started in 1992 was about 75 percent below the peak rates of the mid-1980s; the sector accounted for only 6 percent of total residential investment this past year. The overbuilding that occurred in the multifamily sector in the mid-1980s led to high vacancy rates that have stymied activity ever since. In that regard, little progress was made in reducing vacancy rates for multifamily rental units in 1992, despite the greatly diminished level of new construction. The speed at which the excess supply of space can be worked off is being limited by declines in the population of young adults, as well as by the slow rate of depreciation of these long-lived structures.

The Business Sector

The past year brought moderate increases in activity in the business sector of the economy. Production, sales, and orders rose, on net, over the year, and business profits continued to swing back up from the recession lows of

1991. Many businesses continued to undertake major structural changes designed to cut costs and enhance efficiency. The changes were manifest both through reorganization of existing operations and through investment in new technologies. Businesses also continued to shore up their finances, trimming away debt and building equity. Financial pressures persisted in the business sector in 1992, but, in general, they seemed to become less acute as the year progressed.

Industrial output rose nearly 3 percent from December 1991 to December 1992. Production fell in the first month of 1992 but then picked up, rising about ½ percent per month from February through May. During the summer, the expansion of activity seemed to be losing momentum; orders and shipments fell slightly, on net, from May to August, factory inventories backed up a little, and industrial production essentially flattened out over a four-month stretch. However, orders and shipments began moving up once again in September, and they increased considerably in the fourth quarter. Industrial production also picked up once again in the fourth quarter, and a further gain, amounting to 0.4 percent, was recorded in January of this year.

Business profits, which had taken a turn for the better late in 1991, improved further during 1992. The operating profits earned by nonfinancial corporations from their domestic operations rose 18 percent from the final quarter of 1991 to the third quarter of 1992, and a further gain seems implicit in the available data for the fourth quarter. (An actual estimate of fourth-quarter profits will not be published by the Commerce Department until late March.) Profits of these firms have been lifted, in part, by increases in the volume of output since the end of the recession. In addition, tight control over costs has led to increases in profits per unit of output. Unit labor costs of nonfinancial corporations have risen only slightly since the start of the current economic expansion, and their net interest costs have declined sharply, owing to lower interest rates and restraint in the use of debt. The domestic profits of financial corporations were strong in the first half of 1992 but were severely depressed in the third quarter by the unprecedented losses that insurance companies suffered in the wake of Hurricane Andrew; in the absence of the hurricane, profits in the financial sector would have increased in the third quarter.

The economic condition of smaller companies also seemed to improve somewhat in 1992. The past year's estimated rise in the profits of nonfarm proprietors was the largest annual gain since the mid-1980s; increases had been relatively small over the three previous years.

The net income of farm proprietors turned back up in 1992 after a moderate decline in 1991. Farm output rose to a record high in 1992, with strong gains for both crops and livestock. Prices, meanwhile, lagged year-earlier levels through much of 1992, but most of that slippage in farm prices already had taken place by the start of the year; the average level of farm prices in December 1992 actually was about the same as that a year earlier. Farm production expenses edged down for a second year as farm operators, like their nonfarm counterparts, continued to maintain tight control over costs.

Business investment in fixed capital rose about 8 percent in real terms during 1992, more than reversing the decline of the previous year. Spending for equipment increased in each quarter of 1992, and the gains cumulated to nearly 12 percent by the fourth quarter; with spare capacity still extensive in most industries in 1992, much of the gain in equipment spending over the year probably was a result of the desire of businesses to modernize their operations. Meanwhile, nonresidential construction spending, which had plunged 14 percent in 1991, fell by a much smaller amount in 1992—1½ percent according to the estimate in the most recent GDP report.

Spending for computers was at the forefront of the rise in equipment outlays in 1992. In terms of annual averages, the nominal outlays for office and computing equipment rose about 17 percent; the gains in real terms were much greater still, as technological advances and competitive market conditions combined to continue driving down the price of real, effective computing power. Businesses also boosted their outlays for telecommunications equipment, especially in the second half of 1992. Spending for motor vehicles strengthened in 1992, and investment in industrial equipment edged up after three years of decline. Spending for aircraft traced out a volatile pattern during 1992 and, for the year as a whole, was down only moderately from the high level of 1991; however, these outlays closed out the year on a weak note, and prospects for 1993 are not encouraging, given the losses that have been experienced by airline companies and the related cancellations and stretch-outs of orders.

The small decline in nonresidential construction outlays during 1992 reflected some widely divergent trends across the various types of construction activity. Spending for new office buildings fell sharply further during the year, to a fourth-quarter level that was about 60 percent below the peak of the mid-1980s. In addition, real outlays for industrial structures declined in 1992 for the second year in a row, influenced, no doubt, by the current high levels of unused industrial capacity and by the ongoing trend toward tighter control of inventories and concomitant reductions in needed storage space. Annual outlays for oil and gas drilling also fell further in 1992; a rise in drilling in the year's final quarter probably was prompted mainly by a year-end phaseout of certain tax incentives, although some drillers may also have been responding to an upturn in natural gas prices over the year.

Other types of construction activity fared better in 1992. Spending for commercial structures other than office buildings moved up over the year, after sharp declines in both 1990 and 1991, and the outlays of utilities rose appreciably, boosted by environmental requirements as well as by further moderate additions to capacity. Increases in construction spending also were reported for various types of institutional structures, such as religious facilities and hospitals.

The Government Sector

Government purchases of goods and services, the portion of government spending that is included in GDP, increased slightly in real terms over the course of 1992, after declining slightly during 1991. Federal purchases fell ½ percent in real terms over the year, as a further decline in real defense purchases more than offset another year of increase in real nondefense purchases. State and local purchases of goods and services increased about 1½ percent during 1992, a rise slightly larger than in 1991 but still well below the rates of increase seen through much of the 1980s.

Governments at all levels continued to be plagued by severe budgetary imbalances in 1992. At the federal level, the unified budget deficit rose about

$20 billion in fiscal year 1992, to a level of $290 billion. With the economy gradually strengthening, the rate of increase in federal receipts picked up a little, to 3½ percent, from only 2¼ percent in fiscal 1991. However, spending once again rose faster than receipts; total federal outlays were up 4½ percent in fiscal 1992, after a rise of nearly 5¾ percent in the previous fiscal year.

The rates of growth in total spending in 1991 and 1992 may well understate the degree of upward momentum in federal outlays in those years. In 1991, total spending was held down considerably by a convention used in the federal budget to account for the flow of contributions to the United States from its allies in the Gulf War. Those contributions were counted as negative defense outlays rather than additions to receipts. Additional contributions from the allied countries were received in fiscal year 1992, but they were much smaller than in 1991. Another important factor at work in 1992, however, was a delay in funding the activities of the Resolution Trust Corporation, which kept the 1992 outlays for deposit insurance programs much lower than they otherwise would have been.

Excluding the outlays for deposit insurance and the effect of the allied contributions on reported levels of defense spending, federal expenditures rose about 6½ percent in nominal terms in fiscal year 1992, after an increase of nearly 9 percent in fiscal year 1991. Spending for entitlements, especially those related to health care and income support, continued to grow very rapidly in 1992. In the health area, federal outlays for Medicaid increased nearly 30 percent, and spending for Medicare rose 14 percent. Spending for income security was boosted in 1992 by further large increases in unemployment benefits and food stamp disbursements. In dollar terms, the combined rise in outlays for health care and income security amounted to about $60 billion. Increased expenditures for social security added almost another $20 billion.

Combined spending for all other programs rose only slightly in fiscal year 1992. Within that broad and diverse grouping, defense outlays fell sharply in nominal terms, once adjustment is made for the allied contributions, but some nondefense functions posted large increases in outlays.

State and local governments saw no relief from budgetary pressures in 1992. The combined deficit in their operating and capital accounts, net of social insurance funds, widened a bit over the first three quarters of the year, reversing the small improvement that had been achieved in the latter part of 1991. As is true at the federal level, a rapidly rising level of mandated transfer payments to individuals for health and income support is at the core of the budget difficulties of many states and localities; in nominal terms, transfer payments in the fourth quarter were about 16 percent above the level of a year earlier.

Construction spending by state and local governments picked up in 1992. According to preliminary data, the real gain in these outlays amounted to about 3½ percent over the four quarters of the year. Spending for highways increased considerably in 1992, and outlays for buildings other than schools were strong in the first half of the year. Construction of educational facilities, which has been boosted by increases in the school-age population in recent years, rose further in 1992, but the increase was small, both in absolute terms and relative to the gains in most other recent years.

Growth in other major categories of state and local expenditures was restrained. Compensation of employees, which accounts for more than half of total state and local expenditures, increased about 1½ percent in real terms over the four quarters of 1992; in nominal terms, the rise over the year amounted to about 4½ percent, similar to that of 1991 but much less than the nominal increases seen in the years before 1991. Restraint on wage growth was widespread in the state and local sector in 1992, and although total employment in the sector grew a little faster than in 1991, hiring freezes, furloughs, and layoffs continued to be reported in some hard-pressed jurisdictions. State and local purchases of durable and nondurable goods—such things as equipment and supplies—apparently grew little in real terms over the course of 1992. Real purchases of services from outside suppliers apparently edged down for the third year in a row.

Many states and localities have implemented tax increases in recent years in an effort to bolster receipts. In addition, grants-in-aid from the federal government have been rising rapidly, and, in 1992, improvement in the economy helped boost receipts to some degree. In total, state and local receipts rose 7½ percent in annual average terms in 1992, outpacing the growth of nominal GDP by a considerable amount. However, for the third year in a row, the increase in receipts fell short of the annual rise in nominal expenditures, which amounted to 8 percent in 1992.

The External Sector

The trade-weighted foreign exchange value of the U.S. dollar, measured in terms of the other G-10 currencies, rose nearly 6 percent on balance from December 1991 to December 1992. The dollar increased over the first three months of 1992 amid expectations of strengthening economic recovery in the United States and slowing economic growth abroad. Over the summer, however, the dollar declined to a point below the previous year's low as growth of the U.S. economy was perceived to be more sluggish than expected and as the Federal Reserve eased short-term interest rates further. The dollar reversed direction again in the fall, strengthening sharply in the wake of turmoil in the European Monetary System and, more important, on evidence of increased momentum in the U.S. economic expansion and sluggish conditions in foreign industrial economies. The dollar's rise continued into the early weeks of 1993.

On a bilateral basis, the net rise in the weighted average dollar over 1992 primarily reflected sharp increases in the dollar's value against several European currencies and against the Canadian dollar. Denmark's rejection of the Maastricht Treaty in early June called into question the future of European monetary and political union and led to pressures on the exchange rate mechanism (ERM) of the European Monetary System. In September, those pressures intensified enough to force Italy and the United Kingdom to withdraw from the ERM, and their currencies depreciated sharply. For the year as a whole, the dollar appreciated against those two currencies by 19 percent and 18 percent respectively. Several other European currencies, including those of Spain, Portugal, and the Scandinavian countries, also depreciated sharply against the dollar in the autumn. The parity of the French franc with the German mark was maintained within the ERM, but at the cost of relatively high French short-term interest rates in the face of a sluggish French economy and rising unemployment.

The dollar fell more than 7 percent against the German mark from December 1991 to August 1992, as German monetary policy, responding to relatively high German money growth and inflation, remained tight longer than market participants had expected. That decline of the dollar was more than reversed during the fall and winter, however, as it became clear that German economic activity had turned significantly downward and as German monetary policy was eased somewhat. By mid-February 1993, the dollar was about 5 percent higher against the mark than it had been in December 1991.

The dollar depreciated about 6 percent on balance against the Japanese yen during 1992 and early 1993, despite a noticeable decline in Japanese GDP during the second and third quarters and a significant reduction in Japanese interest rates. The net strengthening of the yen probably can be attributed, at least in part, to market reactions to a substantial widening of Japan's external surplus.

The U.S. merchandise trade deficit widened to about $84 billion in 1992, compared with $65 billion in 1991 (Census basis). Imports grew about twice as fast as exports as the U.S. economic recovery gained some momentum, while economic growth in U.S. markets abroad was sluggish on average. Early in the year, the deficit narrowed somewhat when a drop in oil prices lowered the value of imports. The deficit widened sharply in the second quarter, however, when imports surged and exports remained about unchanged. During the second half of 1992, imports continued to expand somewhat more rapidly than exports, and the deficit increased further.

The current account balance worsened substantially more than the trade deficit, moving from near balance in 1991 to a deficit of $51 billion at an annual rate over the first three quarters of 1992. However, one-time cash transfers associated with the Gulf War accounted for most of the difference; these transfers had reduced the current account deficit by $42 billion in 1991, but they reduced it by only about $2 billion at an annual rate during the first three quarters of 1992. Excluding these transfers, the current account deficit weakened somewhat less than the trade deficit, owing to a strengthening of net service receipts.

U.S. merchandise exports grew 4½ percent in real terms over the four quarters of 1992. Most of the increase occurred in the second half of the year and consisted largely of stronger shipments of agricultural goods, computers, other machinery, and automotive products. Excluding agricultural products and computers, the quantity of exports grew only 1 percent in 1992, compared with a rise of 6½ percent in 1991; the slowdown was mainly a reflection of sluggish demand in key industrial countries. By region of the world, most of the increase in exports during 1992 went to areas that continued to register moderate to fairly strong rates of economic growth—primarily developing countries in Asia and Latin America. Exports to Japan and to European countries, whose growth rates probably averaged less than 1 percent when weighted by the shares of those countries in U.S. exports, actually declined in 1992.

Merchandise imports grew 10½ percent in real terms during 1992. Two categories—oil and computers, the latter of which includes peripherals and parts—accounted for a significant portion of that rise. Oil imports rose 13 percent over the four quarters of 1992 as U.S. consumption of petroleum products recovered from depressed levels in 1991 and as domestic oil production resumed its long-run downtrend. U.S. domestic sales of computers were very strong beginning in the summer, fueled by price wars and by a push on the part of U.S. businesses to upgrade PCs and workstations to take advantage of improvements in software. Most of the sales were at the lower end of the spectrum of computer products—items that often are imported. Imports of products other than oil and computers increased 5¼ percent in 1992 as domestic demand in the United States picked up. The strongest increases were in a wide range of consumer goods, especially from China and various other developing countries in Asia. Imports of telecommunications equipment, electric machinery, and other types of machinery also showed significant increases in 1992, for the first time since 1988.

For the first three quarters of 1992, the substantial current account deficit was more than matched by recorded net capital inflows, both official and private. Net official inflows amounted to more than $30 billion at an annual rate, despite substantial net outflows associated with intervention sales of dollars by major foreign industrial countries. Net private inflows were almost as large, with banks accounting for a large part of these inflows. The agencies and branches of Japanese-based banks used funds from abroad to substitute for a runoff in CDs outstanding in the United States, while other foreign-based banks used funds from abroad to help finance asset expansion in the United States. A reduction in the holdings of Eurodeposits by U.S. residents also contributed to the net private capital inflow during the first three quarters of the year, but that reduction was partially reversed in the fourth quarter.

Although securities transactions contributed little to the net inflow of capital in the first three quarters of 1992, the continued impact of the globalization of financial markets was apparent. U.S. net purchases of foreign stocks and bonds were very strong, accompanied by a near-record pace of foreign bond issues in the United States. During the same period, foreigners added substantially to their holdings of U.S. government and corporate bonds; however, they made net sales of U.S. equities.

U.S. direct investment abroad was very strong in the first three quarters of 1992. Outflows to Europe remained high, while outflows to Latin America and Asia grew. In contrast, foreign direct investment in the United States fell further, producing a net outflow. The rate of new foreign direct investment in the United States has declined dramatically in recent years from large inflows recorded during the latter part of the 1980s, partly reflecting the sharp drop in mergers and acquisitions in the U.S. business sector. In addition, the very low rates of return reported by foreign direct investors on their holdings in the United States in recent years may have helped discourage new investment.

Labor Market Developments

The labor market remained relatively sluggish in 1992. Some large companies continued to undergo major restructurings or reorganizations, and these changes led in many cases to permanent work force reductions at those firms. More generally, businesses remained hesitant to take on new workers, even as the recovery progressed. The still-sluggish pace of output growth in the first half of the year tended to limit labor requirements during that period. Later on, when firms started to expand output more rapidly, they were able to do so without making major long-term hiring commitments. Needs for additional workers were met, in many cases, through use of temporary-help firms, rather than through permanent additions to companies' own payrolls.

Nonetheless, the tilt of the overall employment trend was positive, rather than negative as it had been in 1990 and 1991. Payroll employment, a measure that is derived from a monthly survey of business establishments, was up about 600,000 during 1992 and an additional 100,000 in January. The number of jobs in manufacturing fell further in 1992, but not as much as in either of the two previous years; small increases in the number of factory jobs were reported toward year-end and in early 1993. In addition, employment in construction changed little in 1992, after two years of sharp decline.

About 900,000 new jobs were created in the service-producing sector of the economy in 1992. The number of jobs in retail trade turned up a little, on net, after dropping about one-half million over the two previous years. In addition, firms that provide services to other businesses recorded strong employment growth in 1992; more than likely, these firms were the ones that benefited most from the tendency of businesses to purchase labor and services from other firms rather than hire additional workers of their own. Employment in health services, which had remained on a strong upward trend right through the recession, continued to grow rapidly in 1992.

The employment measure that is derived from the monthly survey of households was stronger than the payroll measure in 1992; it showed an increase of about 1½ million in the number of persons holding jobs and by year-end had moved back close to the previous cyclical peak of mid-1990. Reasons for the stronger performance of the household series are not entirely clear. Differences in coverage between the household survey and the payroll survey accounted for only a small part of the 1992 gap, and other possible explanations are little more than conjecture at this point. A portion of the gap between the two series was eliminated in January, as the rise in jobs reported in the payroll survey in that month was accompanied by a decline in the household measure of employment.

The number of unemployed persons increased in the first half of 1992, to a peak in June of nearly 9.8 million. Job losses—many of them apparently permanent—continued to mount in the first half of the year, and new job opportunities did not open up fast enough to fully absorb either those workers or others entering the work force for the first time. As a result, the unemployment rate rose more than ½ of a percentage point in the first half of the year, to a June level of 7.7 percent.

The second-half outcome was more favorable. The number of unemployed persons declined about one-half million from June to December, and the unemployment rate moved down over that period, to a level of 7.3 percent at year-end. Some of the workers who had been laid off temporarily were recalled in the second half of the year. In addition, the number of unemployed workers not expecting to be recalled—the so-called permanent job losers—also declined; presumably, these workers either found new jobs elsewhere in the economy or dropped out of the labor force altogether. A similar story applied to unemployed new entrants, a category of jobless workers whose ranks were a little thinner at the end of 1992 than they had been at midyear. In January of this year, the number of unemployed persons fell further, and the unemployment rate edged down to 7.1 percent.

In the aggregate, the civilian labor force—the sum of those persons who are employed and those who are looking for work—rose sharply in the first half of 1992 but changed relatively little thereafter. Its level in January of 1993 was up about one million from that of a year earlier. The labor force participation rate—the proportion of the working-age population that is in the labor force—fell over the second half of the year and into January of 1993, leaving it about where it had been at the end of 1991.

Against a backdrop of slack in labor markets and in the context of reduced inflation, the rate of rise in workers' hourly compensation continued to slow in 1992. The employment cost index for private industry—a measure of labor cost that includes both wages and benefits and that covers the entire nonfarm business sector—increased 3½ percent from December of 1991 to December of 1992. The index had risen nearly 4½ percent in the previous twelve-month period, and as recently as mid-1990 its twelve-month rate of change had exceeded 5 percent. The employment cost index for wages and salaries increased only 2.6 percent during 1992; this was the smallest annual rise ever reported in this measure, which dates back to 1975. The rate of rise in the cost of benefits provided by firms to their employees also slowed in 1992, but the size of the increase—5¼ percent—was still relatively large. Many firms, both large and small, continued to be pressured by the rising cost of medical care for their employees and by the increased cost of workers compensation insurance; the difficulty of bringing these costs under control may well have been a serious deterrent to increased hiring in 1992.

Despite the further slowdown in nominal compensation per hour in 1992, the purchasing power of an hour's labor appears to have risen in real terms, as the nominal increase in hourly wages and benefits, as measured by the employment cost index, outpaced the rise in consumer prices for the second year in a row. Real compensation, computed in this manner, had declined sharply in 1990, and the increase in 1989 had been barely positive.

Sustained increases in real living standards depend ultimately on achieving advances in the productivity of the work force, and on that score the economy performed well in 1992. Output per hour worked in the nonfarm business sector jumped 3 percent over the year, the largest annual gain since 1975. Although a portion of this large rise is no doubt a reflection of normal cyclical tendencies, longer-range improvement in productivity growth also may be in progress. The jump in output per hour in 1992, combined with the slowing of compensation gains, held the annual increase in unit labor costs to just 0.7 percent.

Price Developments

The consumer price index rose 3 percent over the four quarters of 1992, the same as in the previous year. Energy prices, which had fallen in 1991, turned up a little in 1992, but price increases elsewhere in the economy were generally smaller than those of the previous year. The limited rise in labor costs in 1992 was one important factor exerting restraint on the rate of price increase. In addition, the cost of materials used in production rose only moderately over the year, as did the prices of goods imported from abroad. Although inflation expectations, as reported in various surveys of consumers and business officials, have remained a step or so above actual inflation rates, they too appear to have moved lower over time. On average, their recent levels are about in line with—or, according to some surveys, less than—the lower bound of the range of inflation expectations reported during the 1980s. In view of these recent trends in prices, labor costs, and inflation expectations, the January rise of

0.5 percent in the CPI appears to be something of an aberration.

The CPI for food increased a bit less than 1¾ percent in 1992, the same as in 1991. Not since the 1960s has there been a two-year period in which the cumulative increase in food prices was so small. This low rate of food price inflation in 1991 and 1992 was, in part, a reflection of the same factors that were working to pull inflation down in other parts of the economy. In addition, food prices have been restrained by favorable supply conditions in the farm sector. Meat production rose further in 1992, and the output of crops soared. Dryness in some regions imparted temporary volatility to crop prices in late spring. Thereafter, growing conditions turned exceptionally favorable and remained so through the summer and into early autumn. Unusually wet conditions in some regions later on in the autumn apparently made only a small dent in the eventual size of the harvest.

The rise in consumer energy prices over the four quarters of 1992 amounted to about 2½ percent. The previous year, energy prices had fallen 8 percent. With no major supply or demand shocks springing up in world oil markets in 1992, the price of West Texas Intermediate stayed in the relatively narrow trading range of about $18 to $23 per barrel; the price has remained in that range in the early part of 1993. At the retail level, price changes for petroleum products were mixed in 1992; the price of gasoline rose about 3 percent, while fuel oil prices declined moderately. The CPI for natural gas rose about 5 percent in 1992, considerably more than in other recent years. Although much of that rise in gas prices came in the second half of the year in the wake of supply disruptions caused by Hurricane Andrew, prices of gas at the wellhead had already moved up considerably before the hurricane hit, in response to a somewhat tighter supply–demand balance than had existed over the previous year or so.

The CPI excluding food and energy rose 3.4 percent over the four quarters of 1992, a percentage point less than it had risen in 1991. The slowdown was widespread among the various categories of goods and services that are included in this measure of core inflation. The rate of rise in the cost of shelter—the single most important category in the CPI, with a weight equal to more than one-fourth of the total—slowed further in 1992; rents for both apartments and houses apparently were damped by the large amount of vacant housing that was available in many parts of the country. The prices of other services that are included in the CPI—which collectively make up another one-fourth of the total index—also slowed appreciably in 1992; nonetheless, their overall rate of increase remained relatively high. The costs of medical care services and tuition continued to rise much faster than prices in general in 1992, and airfares rebounded from their 1991 decline. The CPI for commodities other than food and energy rose 2½ percent during 1992, after an increase of more than 4 percent over the four quarters of 1991. Price increases for this broad category of goods were restrained by the cost and price developments in manufacturing: Unit labor costs in manufacturing actually declined in 1992, and the producer price index for finished goods rose less than 2 percent.

After falling sharply from mid-1990 to the end of 1991, the prices of industrial commodities generally changed little, on balance, during 1992. By the end of 1992, however, prices for some industrial metals had begun to tilt up, consistent with the pickup in the pace of industrial expansion toward year-end, and additional price increases have been reported in some of these markets in early 1993. The prices of lumber and plywood—following a path considerably different from that of most other commodities—rose substantially during 1992, and further steep increases have been evident in early 1993. The surge in prices of these products appears to be a reflection of the uptrend in single-family housing construction, weather-related supply disturbances in some timber regions, and adjustment of the logging industry to environmental restrictions that have been implemented in some areas of the country. Prices of some other wood products, such as pulp, also rose sharply at the producer level in 1992.

The recent increases in prices of these raw materials have shown through to some extent to broader measures of producer prices. For example, the producer price index for intermediate materials excluding food and energy—a price index that encompasses a wide range of production materials—rose 1 percent during 1992 after declining about ¾ of a percentage point during 1991, and the past couple of months have seen some further pickup in that measure of price change. From an economywide perspective, however, that pickup in materials prices has not been sufficient to dominate the deceleration in labor costs, which account for a far greater share of total production costs.

Monetary and Financial Developments in 1992

Federal Reserve policy in 1992 was directed at promoting and extending the recovery from the 1990–91 recession, in the context of continued progress toward price stability. The difficulty of designing and implementing constructive monetary policies during this period has been exceptional. In 1992, as earlier, economic activity was held back to an unusual degree by the efforts of households, nonfinancial businesses, and some key providers of credit to the economy, including commercial banks, to strengthen their balance sheets. These forces have tended to alter the normal relations between financial flows—particularly those reflected in movements in M2 and M3—and the behavior of the economy. Under the circumstances, the Federal Reserve has had to take a flexible approach to the use of money and credit aggregates as intermediate policy targets; specifically, in light of evidence that expansion in economic activity was being financed to an unusual extent in capital markets rather than through banks and other depositories, the System tolerated shortfalls of M2 and M3 from their target ranges.

The Federal Reserve judged it appropriate to ease reserve conditions on three occasions in 1992, when financial and economic data suggested that the economy might be losing momentum. The extent of the easings last year was considerably less than in 1991, however, as the underlying trend of the economy overall was more positive. Partly as a result of the cumulative effect of the monetary easings of recent years, economic activity accelerated in 1992 to its fastest pace since 1988. This pickup was achieved even as various measures of inflation evidenced further slowing, with the "core" inflation rate falling to levels last seen in the early 1970s. Thus, 1992 was a year not only of financial repair, but also of improved aggregate economic performance in the United States.

The Implementation of Monetary Policy

The year 1992 began with short-term interest rates at their lowest levels in more than a quarter of a century, following a series of actions by the Federal Reserve in the latter part of 1991 that reduced the discount rate and the level around which the federal funds rate was expected to trade to 3½ percent and 4 percent respectively. Long-term rates were also at lower levels, reflecting the policy actions and a weakening of economic activity in the final quarter of 1991.

Evidently in the expectation that these rate cuts would revive the recovery, the stock market began the year with strong upward momentum, and the dollar appreciated. However, other evidence that the economy was picking up remained scanty in the initial part of the year, despite the significant monetary stimulus already in place and the positive developments in equity and capital markets. Apart from rising housing starts, a phenomenon in part related to special weather and tax factors, the economy appeared sluggish and confidence levels were low. Spending by households and businesses seemed to be restrained by efforts to strengthen financial positions, and banks had done little to reverse the substantial tightening of lending standards that occurred in 1990 and 1991. In view of the still-tentative nature of the recovery and the solid progress against inflation that had been made to that point, the Federal Open Market Committee at its first meeting of 1992 instructed the Manager of the Open Market Account at the Federal Reserve Bank of New York to remain especially alert to evidence that money market conditions might need to be eased before the next scheduled meeting of the Committee. Such a policy stance biased toward ease had prevailed over much of 1991.

M2 and M3, which had posted moderate gains in January, surged in February, owing partly to stronger income and earlier sharp declines in short-term interest rates and partly to special factors—above-average tax refunds and a jump in mortgage refinancing, which results in funds being held temporarily in demand deposits. Underlying money growth remained very weak, however, and well below that consistent with expectations based on the historical relationship of money with income, deposit rates, and market interest rates. In March, as the influence of the special factors abated, M2 was about flat and M3 contracted.

The economy seemed to be improving during much of the first quarter: Retail sales and housing starts were strong, industrial production turned up, and confidence levels of the business and household sectors were rising, as was the quality of their balance sheets. The signs of recovery and the market view that the prospects for further near-term monetary ease had faded caused long-term interest rates to increase, and the dollar rose on foreign exchange markets as well. Increases in private interest rates were less than increases in rates on Treasuries, likely reflecting perceived reductions in the riskiness of private debt as the economy strengthened coupled with concerns about enlarged Treasury demands on credit markets stemming from discussions of possible fiscal stimulus. Areas of weakness in the economy remained, however—some attributable to the substantially overbuilt commercial real estate sector and some to the transition to a smaller defense sector. In addition, the backup in long-term interest rates threatened to slow the pace of balance sheet adjustment and could damp housing and its related industries as well as business investment spending, and the outlook for exports clouded.

In early April, the System eased reserve conditions again. The action was taken on indications that the monetary aggregates, already at the bottom of their target ranges after their flat performance in March, were beginning to contract, that the balance of evidence was beginning to suggest a slowing of the economic expansion, and that inflation was continuing to recede. Short-term interest rates fell more than the ¼ percentage point drop in the trading level of the federal funds rate, as market participants judged the economy sufficiently weak to make further near-term monetary easing moves likely. The easing buoyed the stock market, but long-term rates showed a limited response and remained well above year-end levels.

In the weeks following the easing, the economy appeared to improve a bit, but the evidence continued to be mixed. Single-family housing starts, which had contracted in March, fell considerably further in April, and retail sales were little changed on balance between February and April. On the other hand, nonfarm payroll employment and industrial production continued to expand. Weakness in the monetary aggregates persisted into April, but concerns on this front were allayed to some degree by evidence that this was importantly related to the ongoing rechanneling of credit away from depository institutions and into capital markets, and by expectations that this rechanneling and other financial restructuring would continue to damp money growth considerably more than economic activity. Moreover, what restraint balance sheet restructuring was exerting on spending was seen as likely to abate in view of the considerable progress that by then had been made in this area, both by the borrowing sectors and by depository institutions, as banks added rapidly to capital. At its mid-May meeting, the Committee determined that its bias toward ease in assessing possible intermeeting policy changes was no longer appropriate.

Data becoming available over subsequent weeks, however, suggested that the forces restraining economic expansion continued to be quite strong. The contraction of consumer credit accelerated, and bank loans more generally began to run off. With the forces that had been constraining money growth intensifying, all three monetary aggregates contracted in June.

Nonfinancial data confirmed that the economy remained slack. Although both nonfarm payroll employment and industrial production increased in May for the fourth straight month, the unemployment rate rose sharply, owing to a rising labor force participation rate. Moreover, homebuying and retail sales, other than of automobiles, slowed from the pace earlier in the year, and demand for U.S. exports was held down as growth in some foreign industrial countries slowed or turned negative while other countries struggled to recover from their downturns in 1991 or remained in recession.

With the tenor of incoming economic news having become distinctly negative, long-term Treasury rates, which had been little changed over most of May and June, turned down around midyear, although they remained above year-end lows. In light of these developments, and with the downward trend in inflation continuing, the System reinstated its bias toward ease at its midyear meeting. Immediately after that meeting, on July 2, with evidence of a weakening economy confirmed by a further rise in the unemployment rate, to 7¾ percent in June, the Federal Reserve reduced both the discount rate and the federal funds rate by ½ percentage point, to 3 percent and 3¼ percent respectively. Banks lowered their prime rate, also by ½ percentage point, to 6 percent, leaving its unusually wide spread over market rates intact.

Long-term interest rates fell in response to the employment data and the monetary easing, and they moved down further into early August as the incoming economic news continued to be poor. The drop in yields brought long-term rates to the lowest levels since the early 1970s, and the dollar continued to retreat from its peak levels reached in April.

In early September, with another weak labor report and in the context of contracting industrial production and expansion in the monetary and credit aggregates that, while now positive, was weaker than had been expected, reserve conditions were eased further and the federal funds rate fell to around 3 percent. Shorter-term market rates dropped on this action, bringing them to the neighborhood of zero in real terms. Despite the poor economic news and expectations that further easing moves were in the offing, long-term rates, although they initially declined, drifted back up on renewed concerns that the federal deficit would be enlarged by fiscal actions taken to stimulate the economy.

Throughout the late summer and early fall, policy was conducted against a background of tension in foreign exchange markets; a strong deutsche mark had caused several European countries to raise interest rates sharply to preserve fixed exchange rate relationships with and within the exchange rate mechanism of the European Monetary System at a time when aggregate demand in these countries was slowing or sluggish. The dollar continued to decline into early September but then began to firm. The rise in long-term rates contributed to the reversal, as did actions by several European countries to devalue their currencies, in some cases dropping out of the ERM, and to lower interest rates.

With short-term interest rates in the United States lower, the monetary aggregates continued to expand in September. The implications of the strength of M2 were difficult to assess, however, because it reflected to an uncertain degree the impact of mortgage refinancing on demand deposits as well as strong foreign demands for U.S. currency. Stronger income also appeared to be contributing to money growth, as private employment edged up and the unemployment rate declined in September. Nevertheless, the outlook for the economy remained uncertain. Final demand seemed weak and was being met in part through higher imports, holding down industrial production and employment, and business and consumer sentiment remained relatively depressed.

In these circumstances, the Committee established a strong bias toward ease at its early October meeting. In the event, however, an improvement in economic indicators immediately after the meeting, along with evidence of some strength in M2 and bank credit, stayed any further easing actions. Because anticipation of further easing had been built into the structure of interest rates, short-term rates backed up after the meeting. Rates also rose at the long end, responding to growing expectations that fiscal stimulus could follow the upcoming presidential election, as well as to the indications of improved economic performance.

Evidence of greater economic strength continued to accumulate in a variety of indicators of production and spending over the fourth quarter. Although this news initially put further upward pressures on longer-term interest rates, these came to be muted and then reversed as the better economic prospects, along with statements and actions of the incoming Administration, began to be viewed as reducing the likelihood of outsized fiscal stimulus. Also helping to lower longer-term rates was continuing good news on inflation. These factors, buttressed by an increasing focus in public discourse on reducing the federal deficit, continued to play an important role as long-term rates fell further into the new year.

With the better economic news, the Federal Reserve kept reserve conditions and short-term interest rates unchanged as the year ended, and the Committee at its December meeting decided to move back to a symmetric policy stance. Reflecting the improved economic outlook, a stock market rally developed that rivaled in strength the rally at the beginning of the year, and the dollar rose further.

Although the monetary aggregates strengthened a bit in the fourth quarter, the depressing effects of balance sheet restructuring continued to be important, a fact that became clearer once the hard-to-measure temporary boost to deposits deriving from higher mortgage refinancing abated after October. The velocities of both M2 and M3 rose significantly further in the final quarter of the year, contributing to the exceptional velocity increases posted by both measures for the year as a whole.

Monetary and Credit Flows

Credit flows again were quite damped in 1992, and money growth was exceptionally weak. Despite an appreciable pickup in nominal GDP growth last year, the broad monetary aggregates decelerated further, and expansion of the nonfinancial debt aggregate edged up only a bit. As had been the case for the last couple of years, considerable efforts by key sectors of the economy to improve balance sheets had a significant restraining effect on credit and, especially, on money growth—a much greater effect than they had on spending itself. Growth of the debt of nonfinancial borrowers other than the federal government edged up only ¼ percentage point from 1991, to 2½ percent, as businesses and households restrained borrowing by financing spending out of cash flow and equity issuance and by limiting accumulation of financial assets. The expansion of federal debt slowed slightly to a still- rapid 10¾ percent, held down by the lack of activity by the Resolution Trust Corporation (RTC) after April, when it exhausted its legislative authority to fund losses at savings and loans. Reflecting the slowdown in the activities of the RTC and the improving health of depositories, federal outlays attributable to deposit insurance activity fell from around $50 billion in 1991 to nil last year. The total nonfinancial debt aggregate expanded about 4½ percent last year, at the lower end of its monitoring range.

The sluggishness in credit and money growth last year appeared to represent mainly weak demand, rather than any new tightening of credit supply terms. At banks, loan flows were depressed, and, in the absence of appreciable credit demands, bank asset growth mainly took the form of security acquisitions. Some have argued that the shift to government securities over recent years has been motivated by the Basle risk-weighted capital standards, which require capital against loans but not against many government securities. However, the effect of these standards appears to be relatively minor. As in 1990 and 1991, banks that had already achieved adequate capital positions were the major purchasers of U.S. Treasury and agency securities last year, and loan flows were depressed at these banks as well. Moreover, other regulatory factors may be contributing to a reduction in willingness to take deposits and make loans, including rising deposit insurance premiums and the tighter regulations and requirements of new laws governing banks and thrift institutions in recent years. A similar pattern of asset growth concentrated in government securities occurred at credit unions, which are not subject to the Basle capital standards. Although loan growth at banks remained lackluster, it strengthened in the final quarter of the year as the economy began to expand more rapidly. At the same time, the growth of bank holdings of government securities, which had been very rapid all year, slowed.

To be sure, the pickup of bank lending toward year-end seemed primarily related to stronger demand. Banks gave little indication in Federal Reserve surveys that they had begun to ease the tighter lending standards and terms that they had put in place in 1990 and 1991, and the unusually wide spread of the prime rate over market rates persisted. Banks do seem better positioned to meet increases in demand than they were a few years ago. Not only has their liquidity improved with the acquisition of government securities, but they have made substantial progress in improving capital positions, including leverage ratios—which are unaffected by asset composition—as both profits and debt and equity issuance reached record levels in 1992. Moreover, the quality of their assets showed some scattered signs of improvement last year; the delinquency rate for bank loans, though still high, began to turn down, as did the rate of charge-offs.

Other financial intermediaries also have taken steps to strengthen balance sheets, and the availability of credit from these lenders also remains somewhat constrained—though probably not more so than in 1991. Life insurance companies, for example, have suffered from an abundance of bad loans and remain saddled with poor-quality commercial real estate loans. Such firms have been limiting acquisitions primarily to high-quality, easily marketable assets, meaning that, as in 1991, some medium-sized, below-investment-grade companies found credit from life insurance companies difficult to obtain in 1992. Some business finance companies also have experienced high and rising levels of nonperforming loans, many of which were secured by commercial real estate, with effects on their willingness to make new loans.

Downgradings of the manufacturing parents of automobile sales finance companies have led to some increases in their funding costs. To date, however, there has been little or no effect on the cost or availability of consumer credit, as these finance companies have increased the volume of loans they have securitized. The availability of credit at thrift institutions likely improved a bit last year. Reflecting the declines in interest rates, profits of private sector savings and loan associations had reached a record level as of the third quarter, sustained by a wide spread between interest earned on assets and the cost of funds as well as by a decline in the industry's still high level of troubled assets.

Weak credit demand and constraints on some sources of supply have produced generally sluggish borrowing in each major nonfinancial sector other than the federal government. Overall household borrowing accelerated slightly but continued moderate, as demand was depressed by insecurity about employment as well as by efforts to restructure balance sheets. Declines in mortgage rates promoted only about a ½ percentage point boost to net home mortgage growth, but they spurred a substantial volume of refinancing. Some of the proceeds of mortgage refinancings likely were used to pay down higher-cost consumer credit. Consumer credit also was held down last year as households apparently used funds that otherwise would have been held in low-yielding deposits to reduce high-cost debt.

With the pace of debt accumulation by the household sector damped, and with rates on consumer debt falling and mortgage debt being refinanced at lower rates, the ratio of debt-servicing payments to household income declined considerably further last year. Another sign of improving household financial conditions has been recent trends in delinquency rates. Consumer loan delinquency rates mostly fell last year, although they remain at high levels. Home mortgage delinquency rates were little changed on balance last year and still somewhat above their pre-recession levels, but well below those of the mid-1980s.

Business debt grew only slightly last year as internally generated funds exceeded investment spending. Taking advantage of the strong stock and bond markets, nonfinancial corporations stepped up their equity issuance and refinanced large volumes of longer-term debt at more favorable rates. In part, the proceeds of these issues were used to pay down short-term debt, particularly bank loans, thereby lengthening liability structures.

The hospitality of the capital markets extended even to lower-graded business borrowers, which issued substantially more bonds than in recent years. Overall public gross bond issuance by nonfinancial corporations was well above the 1991 level. Likewise, gross equity issuance by nonfinancial corporations also rose from the already high pace of 1991 and was four times that of the late 1980s and early 1990s. As a result of debt refinancing and sales of equity, corporate net interest payments as a percentage of cash flow fell for the second year. As declining interest rates allowed firms to reduce debt burdens, and as the economy advanced, corporate debt ratings began to improve and quality spreads narrowed.

The state and local sector also benefited from the rate declines last year, with large amounts of debt being refinanced, including a large volume that was called. Net debt growth continued to be moderate, however, as this sector's spending remained constrained.

Although balance sheet restructuring has damped credit flows and spending, its greatest impact has been on the monetary aggregates, as an unusually high proportion of spending in recent years has been financed outside the depository system, whose liabilities make up the bulk of the monetary aggregates. Some of this spending has been supported through sources other than borrowing, for example, by issuing equity or restraining the accumulation of liquid assets. Depository credit expanded last year, following two years of contraction, but it continued to shrink as a share of nonfinancial debt as borrowers concentrated their credit demands in long-term securities markets—bonds for corporations and fixed-rate mortgages for households.

The sluggish expansion of depository credit was echoed in M3, which comprises most—though not all—of the instruments depositories use to finance their credit extensions. In fact, growth of M3 slowed last year to ½ percent despite the pickup in depository credit, as depositories relied much more on equity issuance and sales of subordinated debt, which are not in M3. Large time deposits at banks and thrift institutions fell rapidly. The tendency for spending to be financed outside of depositories, along with the latter's reliance on non-M3 funds, produced a sizable increase in M3 velocity last year—at a rate far above that of recent years. The rise in velocity of M3 would have been even greater had it not been for strong inflows into institution-only money funds over the first three quarters of the year. The attractiveness of these funds increases when short-term interest rates are falling, a phenomenon caused by the fact that the funds do not mark to market, so that their yields tend to exceed market rates when those rates are declining.

M2 increased about 2 percent last year, below the 2½ percent lower end of its target range. M2 registered modest growth in the first and last quarters of the year but was about flat over the middle quarters. The underlying weak money growth appeared to stem from several important factors, many related to the unattractiveness of holding funds in M2 assets relative to other possible uses of savings.

Growth of Money and Debt

Percent

Measurement period	M1	M2	M3	Domestic non-financial debt
Year[1]				
1980	7.4	8.9	9.5	9.5
1981	5.4 (2.5[2])	9.3	12.3	10.0
1982	8.8	9.1	9.9	9.3
1983	10.4	12.2	9.9	11.4
1984	5.5	8.1	10.8	14.3
1985	12.0	8.7	7.6	13.8
1986	15.5	9.3	8.9	14.0
1987	6.3	4.3	5.8	10.1
1988	4.3	5.3	6.4	9.2
1989	.6	4.7	3.7	8.1
1990	4.3	4.0	1.8	6.9
1991	8.0	2.8	1.1	4.3
1992	14.3	1.9	.5	4.6
Quarter (annual rate)[3]				
1992: 1	15.5	3.3	2.0	4.3
2	10.6	.6	−.3	5.4
3	11.6	.8	.1	4.2
4	16.8	2.9	.2	4.2

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.

Contributing to the relative attractiveness of nonmonetary assets was the rapidity with which banks adjusted down offering rates on retail deposits as market rates declined last year. Banks' unaggressive pricing of deposits reflected substantial paydowns of bank debt by households and businesses, which kept loan demand low and banks' need for funds to finance them quite limited. In addition, banks and thrift institutions have been discouraged from going after deposits by the rising cost of issuing deposits to make loans; among the factors accounting for this increase have been increases in deposit insurance rates and higher capital ratios occasioned by market and regulatory forces.

The prompt declines and low level of deposit rates have combined with several other factors to induce savers to cut back on holdings of assets in M2. One important influence was the unprecedented steepness of the yield curve, which was pulling deposit funds into capital markets. An important method for accomplishing this portfolio shift was mutual funds, which experienced record inflows last year. Not only were yields on these funds attractive, but they have become increasingly available through banks and thrift institutions. Assets in bond and equity mutual funds (apart from those held by institutions and those in IRA and Keogh accounts) increased $125 billion last year, up from $117 billion in 1991 and an average of $30 billion over the previous five years. In 1991 and 1992 for the first time, increases in mutual fund assets exceeded increases in M2.

Money growth has also weakened as consumer loan rates have moved downward less rapidly than deposit rates. As a consequence, households face a considerable interest rate incentive, particularly after taking account of changes in the tax deductibility of consumer interest payments, to use funds in deposit accounts to pay down, or limit the accumulation of, debt. In fact, the rise in consumption has been accompanied by an unusually small increase in debt, implying that consumption has been financed to a large extent by reducing or limiting holdings of financial assets.

The cuts in bank deposit rates were particularly evident for larger (and presumably more interest sensitive) accounts and at longer maturities. Small time deposits ran off throughout the year. Some of these funds appeared to flow into more-liquid deposit accounts, as rates on small time deposits fell faster than those on savings and checkable deposits. General purpose and broker–dealer money market mutual funds (MMMFs) also contracted over the year, despite the yield advantage these assets offered vis-à-vis other money market rates in an environment of declining yields. This appeared to be another example of the attraction that bond and equity mutual funds and other capital market instruments provided to investors last year. MMMFs grew in October and November, however, perhaps reflecting capital losses in bond funds resulting from the rise in long-term rates in September and October.

The overall effect of the unusual forces that have been influencing M2 is summed up by the behavior of its velocity, which accelerated for the second year in a row, to a 3½ percent rate, despite the sharp downward trend in short-term interest rates over this period. Over previous decades, the velocity of M2 and short-term rates had moved together in a reasonably predictable way. This occurred because deposit rates lagged market rates. When, for example, short-term rates fell, deposit rates dropped by less, providing an incentive to shift assets from market instruments to deposits and depressing velocity. However, because of the unusual configuration of forces discussed above, these incentives to hold M2 have not followed their usual pattern in the current cycle. As noted, despite the drop in short-term interest rates, a combination of the steep yield curve, sluggish adjustment of loan rates, and other factors has *decreased*, not increased, the incentives to hold M2 in the last year. In other words, the opportunity cost—the earnings given up—in holding M2 actually has widened, rather than narrowed as has happened in the past when market interest rates fell, and this helps to explain why M2 velocity has risen atypically.

Another indication of the unusual behavior of the velocity of M2 is the recent performance of the Board staff's P* model in predicting inflation. The model is premised on reasonably stable M2 velocity over time and under this premise predicts the price level and inflation rates that are consistent with M2 growth. If the velocity of M2 is rising atypically, slow growth of M2 would not be associated with the degree of disinflationary pressures that would be predicted by the P* model, which assumes normal velocity behavior. In fact, consistent with the notion that velocity is behaving abnormally, the model, using actual M2 growth, underpredicted inflation in 1992.

The growth of M2 over the year was entirely attributable to its currency and transactions deposit components, as M1 growth surged to about 14¼ percent in 1992. This performance reflected the advance in income growth but stemmed mainly from declines in both short- and long-term interest rates. Long-term rate declines prompted large volumes of mortgage-rate refinancings, particularly in the first and last quarters. Because a large portion of prepayments are held in demand deposits until the mortgage servicer remits the funds, the level of demand deposits is temporarily boosted by mortgage refinancings. Falling short-term rates boosted demand deposits by lowering the opportunity cost of holding them and by increasing the amount of deposits businesses needed to hold under compensating balance arrangements. In addition, NOW accounts were boosted by funds shifted from small time deposits, as rates on the latter fell faster than those offered on the former. Growth in NOW accounts last year accelerated from the already brisk pace of 1991, and demand deposits posted the largest increase since at least 1959.

To accommodate the growth in transactions deposits associated with the process of easing reserve conditions, the Federal Reserve supplied large volumes of new reserves in 1992. Total reserves grew at around 20 percent, more than twice the rate of increase in 1991. Currency growth also was rapid, in part owing to shipments abroad, and as a consequence the monetary base increased 10½ percent last year—the highest growth rate in the Board's official series, which begins in 1959.

Report on July 20, 1993

Monetary Policy and the Economic Outlook for 1993 and 1994

In February, when the Federal Reserve prepared its monetary policy plans for 1993, the broad trends in the economy appeared favorable. After a hesitant beginning, the economic expansion had picked up steam in the latter part of 1992, while inflation seemed still to be headed downward. Most members of the Federal Open Market Committee and nonvoting presidents anticipated that 1993 would be a good year for growth and would also see further progress toward price stability.

As the year has unfolded, however, the economy's performance has fallen short of these expectations. Economic growth has slowed appreciably from the pace late last year; in part, this has reflected a retreat in business and consumer confidence and the effects on our trade balance of weakness in a number of other industrial countries. Like most private forecasters, the Board members and Bank presidents generally have trimmed their projections of growth in real gross domestic product for the year as a whole, although they continue to foresee increases in output large enough to extend the reduction in the unemployment rate that began last summer. Events on the price side also have been disappointing. The inflation rate in the first part of this year was higher than in late 1992. There is evidence that some of the pickup in the consumer price index may have reflected difficulties in seasonal adjustment, and price data for the past couple of months have been much more favorable. Nonetheless, a broad array of indicators points to a leveling out of the underlying inflation trend.

In this circumstance, and with short-term interest rates unusually low, especially when compared with inflation, the Federal Reserve recognized a need to be alert to the possibility that the balance of risks in the economy could shift soon in a direction dictating some firming of policy; failure to act in a timely manner could lead to a buildup of inflationary pressures, to adverse reactions in financial markets, and ultimately to the disruption of the growth process. To this point, however, the moderate thrust of aggregate demand and considerable slack in the economy, taken together with the more subdued price data of late, do not suggest that a sustained upswing in inflation is at hand. Accordingly, the Federal Reserve has not adjusted its monetary policy instruments.

The pace of economic growth in the final quarter of 1992 was not expected to be sustained, but the slowing in the first quarter of 1993 was surprisingly sharp. With the exception of business fixed investment, the slowdown cut across the major categories of final demand. After stepping up their spending in late 1992, consumers became more pessimistic about their economic prospects and more cautious in their spending decisions; the uncertainty surrounding the efforts to reduce the federal deficit may have been a factor in the weakening of household sentiment. Housing activity, which also had been exceptionally strong late last year, hit a lull—even before the March blizzard on the East Coast—and real defense purchases plunged. Moreover, net exports deteriorated sharply, as exports declined and imports surged; the drop in exports was attributable in part to continued weak growth in some other industrial countries and in part was an adjustment to the big increase in late 1992.

The more recent statistical indicators, taken together, point to a resumption of moderate growth in real GDP in the second quarter. Most notably, on the positive side, the increase in aggregate hours worked for the quarter as a whole—a useful indicator of movements in overall output—was the largest of the current expansion. Sales of motor vehicles also exhibited considerable vigor. But other key indicators were less robust. In particular, after allowing for the effects of the blizzard, consumer spending on items other than motor vehicles was lackluster, and housing activity improved only modestly. In the manufacturing sector, orders generally remained soft, and factory output, after having posted solid gains over the preceding seven months, is estimated to have declined somewhat over May and June.

Broad measures of inflation picked up in early 1993, with monthly increases through April in the upper part of the range of the past couple of years. Although readings on consumer and producer prices were much more favorable in May and June, the cumulative price and wage data for the year to date suggest that underlying inflation has flattened out, after having trended down over the preceding two years. Excluding the especially volatile food and energy components, the twelve-month change in the CPI has held in the range of 3¼ to 3½ percent since the summer of 1992.

In financial markets, short-term interest rates have changed little so far in 1993, while intermediate- and long-term interest rates have fallen ¾ to 1 percentage point, reaching their lowest levels in more than twenty years. The decline in longer-term rates seems largely to have been a response to the enhanced prospects for credible fiscal restraint, though the slower pace of economic expansion may also have played a role. Falling interest rates have helped stock market indexes set new records. Despite a decline in the dollar versus the yen, the average value of the dollar on a trade-weighted basis relative to G-10 currencies has risen, on balance, since the end of 1992. Although foreign intermediate-term interest rates have been down, on average, about as much as U.S. interest rates, short-term rates abroad have decreased substantially relative to U.S. rates, as foreign monetary authorities have taken steps to bolster weak economies.

Declining U.S. market interest rates contributed to robust growth in narrow measures of money and in reserves over the first half of the year, but broad monetary aggregates were very weak and their velocities continued to show exceptional increases. Credit demands on depositories remained quite subdued relative to spending, considerable depository credit was funded from nonmonetary sources, and savers continued to demonstrate a marked preference for capital market instruments over money stock assets.

In part because of the drop in bond and stock yields, as well as the desire to strengthen balance sheets, corporate borrowers have continued to concentrate credit demands on long-term securities markets, using the proceeds in part to repay bank loans; business loans at banks have not grown this year, although there were tentative signs of a pickup over May and June. Total lending and credit growth at banks has risen only slightly from the depressed pace of 1992, and these institutions have therefore not needed to pursue deposits. Thrifts have continued to contract but at a much slower pace than in recent years.

Banks have eased lending standards for smaller firms for several quarters, and they recently relaxed standards for medium- and large-sized firms as well. An increased willingness to lend on the part of banks has been associated with considerably more comfortable capital positions. Banks have continued to strengthen their balance sheets by issuing large volumes of equity and subordinated debt while retaining a substantial amount of earnings. As a result, the portion of the industry that is well-capitalized (taking account of supervisory ratings as well as capital ratios) increased from about one-third at the end of 1991 to more than two-thirds by March 1993.

In turning to equity and other nondeposit funds, banks have reduced the share of depository credit that is financed by monetary liabilities. Depositors, for their part, have continued to shift funds into capital markets, attracted by still-high returns in these markets relative to earnings on deposits. Inflows into bond and equity mutual funds have run at record levels this year, and banks have facilitated investing in mutual fund products by increasingly offering them in their lobbies. As a consequence of these various forces, M2 increased at only a ¾ percent annual rate from its fourth-quarter 1992 average through June, while M3 fell slightly. The sum of M2 and estimated household holdings of long-term mutual funds grew at about a 4¾ percent rate from the fourth quarter through June, a pace little changed from that of recent years.

Debt growth has edged up this year, despite a deceleration in nominal spending, perhaps buoyed by improvements in financial positions achieved over the past few years by both borrowers and lenders. Investment outlays are estimated to have exceeded the internal funds of corporations for the first time in two years, while household borrowing has picked up relative to spending. In addition, Treasury financing needs have remained heavy. Nevertheless, nonfinancial debt has grown at only a 5 percent rate this year.

Monetary Objectives for 1993 and 1994

In reviewing the annual ranges for the monetary aggregates in 1993, the Federal Open Market Committee (FOMC) noted that the relationship of broadly defined money to income has continued to depart from historical patterns. The annual velocities of these aggregates last fell in 1986, and their prolonged upward movements since then strongly suggest breaks from previous long-run trends of flat velocity for M2 and slowly decreasing velocity for M3. The rise in the velocity measures has been particularly surprising in the last four years, a period of declining interest rates, normally associated with a reduction in velocity.

In February, anticipating that further balance sheet restructuring and portfolio shifts from deposits to mutual funds would result in further increases in velocity, the FOMC lowered the 1993 growth ranges for M2 and M3 by ½ percentage point from the provisional ranges set in July 1992. In fact, velocities of the broad monetary aggregates have been especially strong; in the first quarter of 1993, the velocities of M2 and M3 posted substantial increases of 6¼ percent and 8 percent, respectively, and appear to have recorded additional, but smaller, gains in the second quarter. As a consequence, at its meeting this month, the Committee reduced the 1993 range for M2 by an additional percentage point and the range for M3 by another ½ percentage point, leaving them at 1 to 5 percent for M2 and 0 to 4 percent for M3.

The reductions of these growth ranges represented further technical adjustments in response to actual and anticipated increases in velocity and not a shift in monetary policy, which remains focused on fostering sustainable economic expansion while making continued progress toward price stability. With further substantial increases in velocities, continued sluggish expansion of M2 and M3, which are now at the lower ends of their revised ranges, would be consistent with an acceptable track for the economy. Also at the July meeting, the annual monitoring range for the domestic nonfinancial debt aggregate was reduced by ½ percentage point, to 4 to 8 percent; growth in this aggregate is likely to continue to be roughly in line with that of nominal GDP.

Although the future behavior of the velocities of broad money aggregates was recognized to be difficult to predict with precision at a time of ongoing structural changes in the financial sector, it appeared likely that the forces contributing to the unusual strength in velocities would continue for some time, and the FOMC carried forward the revised 1993 ranges for the monetary and debt aggregates to 1994 as well. With considerable uncertainty persisting about the relationship of the monetary aggregates to spending, the behavior of the aggregates relative to their annual ranges will likely be of limited use in guiding policy over the next eighteen months, and the Federal Reserve will continue to utilize a broad range of financial and economic indicators in assessing its policy stance.

Ranges for Growth of Monetary and Debt Aggregates[1]

Percent

Aggregate	1992	1993		1994
		As of February	As of July	
M2	2½–6½	2–6	1–5	1–5
M3	1–5	½–4½	0–4	0–4
Debt[2]	4½–8½	4½–8½	4–8	4–8

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.

Economic Projections for 1993 and 1994

The members of the Board of Governors and the Reserve Bank presidents, all of whom participate in the deliberations of the FOMC, generally anticipate that economic activity will strengthen in the second half of 1993 and continue to expand moderately in 1994. The growth of output is likely to be accompanied by further gains in productivity, but increases in employment are projected to be large enough to keep the unemployment rate moving down. Inflation is not expected to change materially over this period.

The economic growth forecasted by the Board members and Reserve Bank presidents for 1993 is somewhat weaker than that forecasted in February, mainly because of the shortfall in real growth in the first quarter. Most expect output gains over the balance of the year to be large enough to result in a four-quarter change in real gross domestic product in the range of 2¼ percent to 2¾ percent; for 1994, the central tendency of the forecasts spans a range of 2½ to 3¼ percent. The civilian unemployment rate, which averaged 7 percent in the second quarter of 1993, is projected to fall to the area of 6¾ percent by the fourth quarter of this year and to drop slightly further over the course of 1994.

Economic Projections of FOMC Members and Nonvoting Reserve Bank Presidents for 1993 and 1994

Percent

Measure	Range	Central tendency
	1993	
Change, fourth quarter to fourth quarter[1]		
Nominal GDP	4¾–6¼	5–5¾
Real GDP	2–3½	2¼–2¾
Consumer price index[2]	3–3½	3–3¼
Average level, fourth quarter		
Unemployment rate[3]	6½–7	6¾
	1994	
Change, fourth quarter to fourth quarter[1]		
Nominal GDP	4½–6¾	5–6½
Real GDP	2–3¼	2½–3¼
Consumer price index[2]	2–4¼	2–3½
Average level, fourth quarter		
Unemployment rate[3]	6¼–7	6½–6¾

1. Change from average for fourth quarter of preceding year to average for fourth quarter of year indicated.
2. All urban consumers.
3. Civilian labor force.

Recent developments in the financial sphere should be conducive to the sustained increases in spending projected for the quarters ahead. The financial positions of many households and businesses have continued to improve, and banks are showing signs of greater willingness to make loans. Short-term interest rates are relatively low, and the appreciable declines in long-term interest rates over the past several months should further the process of balance sheet adjustment and are anticipated to provide considerable impetus to business investment and residential construction. It is likely that business investment also will continue to be bolstered by the ongoing push to improve products and boost efficiency through the use of state-of-the-art equipment. Moreover, with at least a moderate pickup in average growth in foreign industrial countries, the external sector should be exerting a less negative influence on economic activity in the United States.

Despite the improvement in financial conditions, there are reasons to be cautious about the near-term outlook. Efforts this year to bring the federal budget deficit under control already have helped to ease pressures on long-term interest rates, and a successful agreement to reduce deficits significantly will produce substantial benefits over the longer run. But such actions also are expected to exert some restraint on aggregate demand this year and next. Government outlays for defense will continue to contract, extending the dislocations and disruptions that have been evident for some time in industries and regions that depend heavily on military spending. Prospects for higher taxes may already be influencing the behavior of some households and businesses, and the constraint is likely to intensify in 1994. In addition, uncertainties about prospective federal policies reportedly are weighing on businesses and consumers; although the outcome of the congressional budget deliberations will be known shortly, uncertainties about health care reform are not anticipated to be resolved fully for some time.

Most Board members and Bank presidents expect the rise in the consumer price index over the four quarters of 1993 to be in the range of 3 percent to 3¼ percent, about the same as the increase over the four quarters of 1992. At this stage, the food and energy sectors are not expected to have much effect, on balance, on the broad price measures in 1993, but the flooding in the Midwest raises the risk of higher food prices in the quarters ahead. For 1994, the central tendency forecast is for CPI inflation in the range of 3 to 3½ percent, not much different than in 1992 and 1993.

The fundamentals remain consistent with additional disinflation; businesses continue to focus on controlling costs, and slack in labor and product markets is anticipated to decrease only gradually in the period ahead. However, the disappointing price performance in the first half of the year suggests that further progress will not come easily—in part perhaps because inflation expectations remain high. Lowering inflation and inflation expectations over time, and achieving sustained reductions in long-term interest rates, will depend importantly on a monetary policy that remains committed to fostering further progress toward price stability. The performance of prices and the economy also will depend on government policies in other areas. Namely, a sound fiscal policy, a judicious approach to foreign trade issues, and regulatory policies that preserve flexibility and minimize the costs they impose are crucial to reestablishing the disinflation trend of the past couple of years and allowing the economy to perform at its full potential.

The Administration has not yet released the mid-year update to its economic and budgetary projections. However, statements by Administration officials suggest that the revised forecasts for real growth and inflation in 1993 and 1994 are not likely to differ significantly from those of the Federal Reserve.

The Performance of the Economy in 1993

Economic activity has continued to advance in fits and starts. After posting robust gains in the second half of 1992, real GDP rose at an annual rate of less than 1 percent in the first quarter of 1993. The slowing in activity was evident in a broad range of production and spending indicators. The more recent data suggest that the economy expanded at a firmer pace in the second quarter, although growth probably was not as rapid as in the second half of last year.

To some extent, the slackening in economic activity in the first quarter of 1993 can be interpreted as a payback after two quarters of strong growth. In particular, much of the slowing was in consumer spending, where large gains in the second half of 1992 had outpaced income growth by a substantial margin. In addition, there was a sharp contraction in defense spending; although real defense purchases clearly will remain on a downtrend for some time, the first-quarter plunge followed a spurt in the second half of 1992 and is not likely to be repeated in coming quarters. In the external sector, exports declined in the first quarter after a big increase late last year, while imports rose markedly. Activity was also depressed, especially in the housing sector, by unusually bad weather last winter.

Moderate growth in real GDP appears to have resumed in the second quarter. Nonetheless, experience thus far in 1993 has underscored that the impediments to a more rapid pace of economic expansion over the near term remain sizable. Besides defense cutbacks, the process of balance sheet adjustment goes on, as do the restructuring efforts under way at many large firms. Moreover, the continued disappointing economic performance of some major foreign industrial countries is taking a toll on U.S exports. Finally, uncertainties about prospective federal policies on a variety of fronts, although difficult to measure, are reportedly making some businesses and consumers reluctant to make major hiring and spending commitments.

News on the price side was also worrisome in the first half of the year. Month-to-month movements in prices were on the high side through April, but they moderated in May and June. The more favorable recent data helped to ease concerns that a significant pickup in inflation was under way. Nonetheless, the disinflation process seemingly has stalled, with underlying inflation, as measured by the twelve-month change in the CPI excluding food and energy, holding in a narrow band between 3¼ percent and 3½ percent since last summer.

The Household Sector

Growth of consumer spending on goods and services continued in a stop-and-go pattern in early 1993: It hit a lull in the first quarter after surging in the second half of 1992. Averaging through the quarterly data, consumption grew at about a 3 percent annual rate over those three quarters, and available data point to a moderate increase in the second quarter. Housing activity appears to have revived in recent months, after sagging earlier in the year.

Consumer spending increased only about 1 percent at an annual rate in real terms in the first quarter. Outlays for goods were especially weak, down at about a 2 percent annual rate; although a part of the drop was probably attributable to the severe blizzard on the East Coast in March, signs of some retreat in spending had already appeared in January and February. Meanwhile, spending on services remained on the moderate uptrend that had been evident for the past few years.

Spending rose appreciably in April, spurred by a post-blizzard bounce-back in outlays for motor vehicles and other goods. Demand for motor vehicles remained strong through June, resulting in an average sales pace for the quarter of almost 14½ million units (annual rate)—the highest since early 1990. Sales were boosted by the replacement needs of households that put off buying vehicles during the 1990–91 recession and the early recovery period. In addition, price increases—at least for models with domestic nameplates, which have accounted for almost all of the rise in sales this year—have been relatively small, and financing terms favorable. Meanwhile, real spending on goods other than motor vehicles appears to have posted a moderate gain for the quarter as a whole, and outlays for services rose slowly through May.

The downshift in overall spending growth this year does not appear to be attributable to any worsening of the current trends in household incomes and financial positions, but it has coincided with a deterioration in consumer confidence. In contrast to the ebullience evident last fall, surveys conducted by the University of Michigan and the Conference Board this year have found respondents more pessimistic about their job and income prospects. Spending may also have been crimped by smaller-than-usual tax refunds—or larger tax bills—this year. Although the change in withholding schedules in March 1992 raised workers' take-home pay, and thus provided the wherewithal to fund additional purchases last year, many households may well have found themselves less liquid than usual in early 1993. More fundamentally, the slowing in spending appears to reflect a return to trend after a surge that outstripped the rise in real disposable income in the second half of last year. Indeed, after having risen somewhat over the preceding couple of years, the personal saving rate dropped from 5¼ percent in the second quarter of 1992 to 4½ percent in the fourth quarter, in the lower part of the range of recent years. The saving rate retraced some of that decline in the first quarter, but it appears to have fallen back in the spring.

Real disposable income has remained on the moderate uptrend that has been evident for the past several quarters: In May, it stood about 2¼ percent above the level of a year earlier. Growth in wages and salaries has stayed relatively sluggish despite the firmer pace of employment growth this year. Meanwhile, transfer payments have continued to expand, although recent increases have been diminished by a drop in unemployment insurance benefits as the number of unemployed has declined. Interest income, which fell appreciably over 1992, has only edged down thus far this year.

Household financial positions have continued to show signs of improvement. The value of household assets has been buoyed by the rising stock market, while debt growth has remained moderate. Moreover, reductions in interest rates have continued to lower debt-servicing burdens; when measured in relation to disposable income, the repayment burden has fallen back to the levels of the mid-1980s. The incidence of financial stress among households also appears to have eased further. Delinquency rates on consumer loans generally dropped again in the first quarter and are down significantly from their recent peaks, and delinquencies on home mortgages are at the low end of the range of the past decade.

Housing activity turned surprisingly soft in the first quarter, after a burst at the end of 1992. However, the most recent monthly indicators suggest that the sector remains on a path of gradual expansion. In the single-family area, both starts and sales of new homes fell back at the beginning of the year and remained below trend through March. Single-family starts rebounded in April and edged up further in May, lifting the average level for the two months about 5 percent above the first-quarter pace; new home sales gyrated in the spring but also were higher, on average, than in the first quarter.

Undoubtedly, some of the recent improvement reflects a reversal of transitory factors that damped homebuilding in the first quarter. The East Coast blizzard delayed both builders and their customers in March; in addition, the weather for the nation as a whole was slightly worse than usual in January and February. Lumber prices ran up sharply between October and March: As measured by the producer price index, prices rose about one-third over that period, and spot market quotes for some lumber products more than doubled. The jump in lumber costs, which has since been reversed, seems not to have left much of a mark on the prices recorded in sales transactions; indeed, the inability of builders to pass along the cost increases may have accounted for some of the disruption in construction activity.

In any event, low mortgage rates clearly are helping to stimulate housing demand. Interest rates on fixed-rate home mortgages, like most other long-term interest rates, fell to near their twenty-year lows last winter and have since declined further; initial rates on adjustable-rate mortgages have been the lowest since these loans first became widely available at the beginning of the 1980s. Given the trends in house prices, these interest rates have pushed the cost of home purchase—as measured by the share of household income needed to make the mortgage payments on an average home—to the lowest levels since the mid-1970s.

Nonetheless, the trends in house prices this year—small rises in some markets, declines in others—have not been a uniform positive for demand, mainly because they have muted the investment motive for owning a home. Moreover, although most respondents to the Michigan survey in recent months reported that it was a good time to buy a house, only about one-third of those who already owned homes thought it was a good time to sell. In fact, industry reports suggest that first-time homebuyers have accounted for an unusually large share of all home purchases in the past two years, and that sales and prices in many localities have been strongest at the lower end of the market.

Construction of multifamily housing this year has been at its lowest level since the 1950s. These structures—most of which are intended for rental use—now account for less than 5 percent of total residential investment expenditures, compared with a figure of about 15 percent in the mid-1980s. Despite the reduced production in the past several years, vacancy rates and rents have not yet shown clear signs of tightening for the nation overall. By contrast, improvements to all existing housing units have trended up over the past year and now account for nearly one-fourth of total residential construction expenditures.

The Business Sector

Developments in the business sector generally were favorable in the first half of 1993. Business fixed investment, which continued to grow briskly, was boosted by ample profits and cash flow, the relatively low cost of capital, and ongoing efforts to improve productivity. Meanwhile, business balance sheets strengthened further as growth of business debt remained relatively slow and many firms continued to take advantage of lower bond yields and high stock prices to enhance liquidity by funding out short-term liabilities.

Real business fixed investment increased at a 13 percent annual rate in the first quarter of 1993. Real outlays for equipment posted another healthy gain, and investment in structures, which had been on a protracted decline for some time, was about unchanged for a second quarter. The indicators in hand suggest that real business fixed investment remained strong in the second quarter.

Equipment spending has continued to be a mainstay of economic growth. It rose at an annual rate of about 18 percent in real terms in the first quarter, after a 12½ percent rise over the course of 1992. Real outlays for computers and related devices have continued to soar; since early 1991, they have roughly doubled, boosted by product innovations, extensive price-cutting by computer manufacturers, and the ongoing efforts of businesses to achieve efficiencies through the utilization of new information-processing technologies. However, demand for other, more traditional types of equipment also began to grow around the middle of 1992 and continued to expand in early 1993. Domestic purchases of aircraft spurted in the first quarter; but, given the financial problems besetting the airlines, this increase will likely be reversed in coming quarters.

Investment in nonresidential structures appears to be stabilizing after several years of steep declines. Construction outlays were essentially flat in real terms over the fourth and first quarters, and the advance indicators suggest that the bottom has been reached or is close at hand. Trends within the construction sector have been divergent. In the office sector, the excess of unoccupied space remains huge, and spending continues to contract. However, spending for commercial structures other than office buildings, which also had fallen sharply over the past several years, has apparently turned the corner because of both the stronger pace of retail sales over the past year and the ongoing shift of retailing activity to large suburban stores. Outlays for industrial construction have not exhibited the normal cyclical rebound—mainly because utilization of existing capacity has tightened only gradually—but they seem, at least, to be leveling out. Meanwhile, activity in the public utilities sector has continued to trend up, mainly because of capacity expansion at electric utilities but also because of the installation of pollution abatement technology, which the Clean Air Act requires be in place by 1995. In contrast, drilling activity remains depressed.

Nonfarm business inventories, which had shown only small changes, on net, since the middle of 1991, rose considerably last winter and spring. Although the buildup early in the year was likely motivated in part by the need to replenish stocks drawn down by surprisingly strong sales in late 1992, some of the recent increase may be attributable to softer-than-expected sales. Notably, the inventory–sales ratio for non-auto retail stores remained in May around the high end of the range of recent years. By contrast, inventories at factories and at wholesale trade establishments generally seem to be reasonably well aligned with sales.

After advancing markedly over the course of 1992, economic profits of U.S. corporations were little changed overall in the first quarter of 1993. The pretax profits earned by nonfinancial corporations on their domestic operations weakened after a fourth-quarter surge, but they still stood nearly 35 percent above the cyclical low reached in 1991; the upswing in these profits over the past two years has reflected primarily a combination of moderation in labor costs and reductions in net interest expenses. Domestic profits of financial corporations have been buffeted in recent quarters by the losses that insurance companies sustained from major natural disasters; without such losses, domestic financial profits in the first quarter would have surpassed the high reached in the first quarter of 1992.

The farm economy has been beset by numerous weather disruptions so far this year. In the first quarter, severe weather in some regions retarded livestock production and damaged fruit and vegetable crops. In many regions, spring planting was hampered by wet weather, and, in parts of the Midwest, continued heavy rains around mid-year caused major flooding. Because of the planting delays and the floods, uncertainties about acreage and yields are considerably greater than usual for this time of year, and farmers in the flooded regions obviously have suffered financial losses.

Despite the weather-related supply disruptions, farm income and farm financial conditions for the nation as a whole seem to have held up reasonably well in the first half of 1993. On average, farm prices in the first half were slightly above those of a year earlier, with declines for farm crops being offset by higher prices for livestock. Farm subsidies, which have been running well above their 1992 pace, have been lifting farm income and cash flow, and farm investment in new machinery has picked up. The recent jump in crop prices—a consequence of the flooding—will boost the incomes of the many farm producers whose crops are still in good condition.

The Government Sector

Governments at all levels continue to struggle with budgetary difficulties. At the federal level, the unified budget deficit over the first eight months of fiscal year 1993—the period from October to May—totaled $212 billion, somewhat less than during the comparable period of fiscal 1992. However, excluding deposit insurance and adjusting for the inflow of contributions to the Defense Cooperation Account in fiscal 1992, the eight-month deficit was about $230 billion in both fiscal years. In the main, the underlying deficit has failed to drop because the restraint in discretionary spending that was legislated in 1990 and the deficit-closing effects of stronger economic activity have been offset by continued large increases in spending for entitlement programs.

In total, federal outlays in the first eight months of fiscal 1993 were only about 2 percent higher than during the same eight months of fiscal 1992. Outlay growth was damped significantly by a sharp swing in net outlays for deposit insurance that was attributable largely to the improved health of depository institutions. In fact, so far this year, receipts from insurance premiums and proceeds from sales of assets taken over by the government have exceeded by $18½ billion the gross outlays to resolve troubled institutions. Defense spending was also quite weak in the first eight months of fiscal 1993. Outlays for Medicare and Medicaid continued to rise rapidly; however, the increase so far this year—about 10 percent—was only half as large as the one in the preceding year. The deceleration in health care spending appears to stem, in part, from federal regulations issued in 1992 that limit the states' ability to shift Medicaid costs to the federal government.

Federal purchases of goods and services—the part of federal spending included directly in gross domestic product—declined at an annual rate of 18 percent in real terms in the first quarter of 1993. A sharp decrease in defense spending more than accounted for the drop. Real defense purchases have been falling noticeably since early 1991, but the decline has been erratic; at least part of the first-quarter plunge can be interpreted as a correction after a few quarters of surprisingly strong spending. Meanwhile, real nondefense purchases have been almost flat over the past couple of quarters.

Federal receipts in the first eight months of fiscal 1993 were about 5 percent greater than in the same period of a year earlier; the rise was roughly the same as that in nominal GDP. Boosted by the upswing in business profits, corporate taxes rose sharply. However, they account for less than one-tenth of total receipts, and growth in other categories was only moderate in the aggregate.

States and localities continue to face sizable budget deficits: As measured in the national income and product accounts (NIPA), the combined deficit (net of social insurance funds) in the sector's operating and capital accounts has been stuck around $40 billion since late 1990. These outsized deficits have persisted despite ongoing efforts by many governments to adjust spending and taxes. As at the federal level, deficit reduction has been complicated by the upsurge in payments to individuals for health and income support; in the first quarter of 1993, state and local transfer payments for Medicaid and Aid to Families with Dependent Children (in nominal terms) were nearly 20 percent above those of a year earlier.

The deficit-reduction efforts of state and local governments in recent quarters have been concentrated on the spending side. Their purchases of goods and services were nearly flat in real terms in the first quarter of 1993 and have changed little, on net, since early 1992. Outlays for construction, which fell at an annual rate of 7 percent, on average, in the fourth and first quarters, have been especially weak. For all major categories except sewer and water, outlays in recent months have been running significantly below year-earlier levels. State and local employment has continued to expand at the somewhat slower pace that has been evident since 1991, while these governments have continued to hold the line on wages and benefits. The approximately 3½ percent increase in state and local compensation rates over the year ended in March was similar to the rise for workers in private industry; by contrast, in the 1980s, state and local workers received increases that, on average, were more than 1 percentage point per year greater than those in private industry.

Receipts of state and local governments, restrained by the relatively tepid cyclical upswing in the sector's tax bases, have grown only moderately over the past year. Also, these governments have lately been reluctant to raise taxes, after the sizable hikes they enacted in 1990 and 1991. All told, the sector's own-source general receipts, which comprise income, corporate, and indirect business taxes, rose 5 percent over the four quarters ended in the first quarter of 1993, an increase about the same as that in nominal GDP.

The External Sector

Since December 1992, the trade-weighted foreign exchange value of the dollar has risen about 5 percent, on balance, in terms of the currencies of the other Group of Ten (G-10) countries. This net increase has reflected much larger movements in the dollar's value against individual currencies: In particular, a sharp decline against the Japanese yen was more than offset by substantial increases against major European currencies.

Relative to the monthly average for December 1992, the dollar has declined nearly 15 percent against the yen to record lows, prompting heavy Japanese official purchases of dollars and moderate dollar purchases by U.S. authorities. The strengthening of the yen has occurred despite the weak performance of the Japanese economy and market expectations that Japanese short-term interest rates will remain near historically low levels over the next year; it seems to be based largely on the perception that Japan's external surplus, which has grown rapidly over this period, is not sustainable.

Against the German mark, the dollar has risen almost 10 percent since December, reflecting a substantial easing of German interest rates and the expectation of further declines in light of the sharp contraction in German economic activity. The dollar has also appreciated against other European currencies, and it has remained little changed against the Canadian dollar.

Economic activity in the major foreign industrial countries generally has been sluggish so far this year. The recovery in Canada now seems to be reasonably well established, and real GDP in the United Kingdom has been growing slowly. However, continental Europe remained in recession in the first quarter, with a sizable reduction in real GDP in western Germany; recent indicators point to continued weakness in the second quarter. After falling for much of 1992, Japanese real GDP advanced in the first quarter, a rise in large part reflecting the effects of earlier fiscal measures; however, indicators for the second quarter are mixed, and the appreciation of the yen will likely result over time in a drag on net exports.

Unemployment rates have continued to rise (into the double-digit range in many instances) in the countries still in recession; even in the countries showing signs of recovery, unemployment has remained high. Partly as a consequence, wage pressures have ebbed, and underlying inflation has continued to decelerate, on average. A notable exception is western Germany, where the CPI rose more than 4 percent over the twelve months ended in June, partly because of an increase in the value-added tax early this year and large increases in the prices of housing services.

In contrast to the overall weakness of activity in foreign industrial countries, real growth so far this year in major developing countries, especially in Asia, appears to have remained at around the strong pace of 1992.

After expanding rapidly at the end of 1992, real merchandise exports declined during the first quarter of 1993, but they bounced back to their fourth-quarter 1992 high in April and May. Shipments to developing countries, which had risen sharply over 1992, dropped back during the January-to-May period. In the aggregate, exports to industrial countries rose somewhat in the first five months of 1993, but Canada and the United Kingdom accounted for most of the increase.

Real merchandise imports, extending the rapid pace of growth recorded over the four quarters of 1992, rose sharply over the first five months of 1993. Trade in computers continued to soar and was responsible for about one-third of the increase in merchandise imports. More broadly, imports were boosted by the rapid growth of U.S. domestic final demand in the second half of 1992 and inventory restocking this year. In addition, the prices of non-oil imports, reflecting the lagged effects of the appreciation of the dollar during the last quarter of 1992, fell somewhat in the first quarter; much of that decline appears to have been reversed in the second quarter. The price of oil imports fluctuated in a relatively narrow range over the first half of 1993. Mild weather and strong OPEC production pushed oil prices down early in the year, but prices subsequently retraced the decline on signs that OPEC would effectively curb production. Recently, oil prices have dropped on Kuwait's decision not to participate in OPEC's quota allocations for the third quarter and speculation that Iraq may be allowed to resume exporting sooner than had been expected.

The merchandise trade deficit widened to $116 billion (at an annual rate) in the first quarter of 1993, nearly $10 billion greater than in the second half of 1992; it increased somewhat further in April and May, on average. With moderate increases in net income from direct investments and a slight further widening of the surplus on net service transactions, the deficit in the current account deficit rose somewhat less than the trade deficit, to $89 billion (annual rate) in the first quarter, compared with $83 billion in the second half of 1992.

Net capital inflows recorded in the first quarter of 1993 were largely attributable to substantial increases in foreign official assets held in the United States, particularly in those of some newly industrializing Asian economies and of certain Latin American countries. Net private capital inflows were relatively small. Private foreigners added significantly to their holdings of U.S. securities, particularly Treasury bonds. However, U.S. net purchases of foreign bonds reached record levels, and net purchases of foreign stocks, although down from peak levels reached in the last half of 1992, remained heavy. New bond issues by foreigners in the United States also were very strong.

Capital inflows associated with foreign direct investment in the United States recovered substantially in the first quarter but remained far below the peaks reached in 1989. Foreign direct investment in the United States apparently has been deterred by unfavorable returns realized on earlier investments and by financial market conditions less favorable to acquisitions. In contrast, capital outflows associated with U.S. direct investment abroad remained strong.

Labor Market Developments

The labor market showed signs of improvement in the first half of 1993. According to the payroll survey, employment increased about 1 million; this number compares with a rise of about 600,000 over the second half of last year and brings the total increase since the cyclical low in 1991 to about 2 million.

Nonetheless, job gains have continued to fall far short of the norms set by earlier business cycle expansions. For example, only in May did payroll employment return to its pre-recession peak, two years after the cyclical trough; by contrast, recessionary job losses typically have been reversed within the first year of the expansion. Job growth has continued to be restrained by the temperate pace of economic activity and employers' ongoing efforts to improve productivity. In addition, firms are confronting cost pressures associated with sizable increases in health insurance premiums and in other fringe benefits; uncertainties about the future course of government policies may also be contributing to the reluctance of some firms to expand their permanent full-time work forces.

Moreover, firms are relying increasingly on temporary workers, in part because doing so affords them greater flexibility in responding to fluctuations in demand for their products. Indeed, employment at personnel supply firms, which consist largely of temporary-help agencies, rose more than 150,000 between December and June. Over the past two years, the increase has been about 500,000; thus, although these firms currently account for less than 2 percent of total payroll employment, they are responsible for one-quarter of the increase in total employment over this period.

Job gains in the first half of 1993 also reflected a continuation of the steady uptrend in employment in health services. In addition, gains occurred at trade establishments, construction payrolls improved with the recent stronger housing activity, and there were scattered increases in services other than health and personnel supply.

Meanwhile, manufacturing employment declined further, on balance, over the first six months of the year. Although factory output increased steadily through April, firms relied mainly on a combination of productivity improvements and longer workweeks to meet their output objectives; in May and June, output decreased somewhat. Job losses in the first half were concentrated in the durable goods sector, with particular weakness at producers of aircraft and motor vehicles. Since its last peak in January 1989, manufacturing employment has fallen about 1¾ million; layoffs in defense-related industries (those industries that depend on defense expenditures for at least 50 percent of their output) have accounted for about one-fifth of the decrease in total factory payrolls.

Employment as measured by the monthly survey of households rose about 900,000 over the first six months of the year—essentially the same as in the payroll series. The number of unemployed fell appreciably at the beginning of the year, and the civilian unemployment rate dropped from 7.3 percent in December to 7.0 percent in February; it has shown little change since that time.

The civilian labor force expanded only moderately over the first six months of 1993—less than 1 percent at an annual rate. Labor force growth continued to be damped by the relatively small increase in the working-age population. In addition, perceptions of meager employment opportunities evidently continued to deter many potential job seekers. The labor force participation rate, which measures the percentage of the working age population that is either employed or looking for work, spurted in late spring; however, this spurt followed a sharp decline earlier in the year, and the level at mid-year was about the same as that in late 1992.

Output-per-hour in the nonfarm business sector declined at an annual rate of 1½ percent in the first quarter, echoing the sharp deceleration in output. Nonetheless, the first-quarter drop followed a string of sizable increases; all told, the rise in productivity over the year ended in the first quarter of 1993 was 1½ percent—smaller than the gains recorded earlier in the economic expansion but still noticeably larger than the norms for the past decade. Productivity growth in the manufacturing sector, where downsizing and restructuring efforts have been under way for some time, has continued to be especially impressive, totaling more than 5 percent over the past year.

Labor compensation has tilted up of late. The employment cost index for private industry—a measure that includes wages and benefits—rose at an annual rate of 4¼ percent over the first three months of the year. Even so, the data are volatile, and the total increase since March 1992 amounted to only 3½ percent; by contrast, this index had risen 4¼ percent over the preceding twelve months, and, as recently as early 1990, the twelve-month change had exceeded 5 percent. The increase in wages over the past year was less than 3 percent, whereas the cost of fringe benefits, pushed up by the steep rise in the cost of medical insurance and by higher payments for workers' compensation, rose more rapidly. Primarily because of the drop in productivity, unit labor costs deteriorated markedly in the first quarter, but they still were up less than 2 percent over the past year.

Price Developments

Inflation exhibited considerable month-to-month volatility in the first half of the year. Broad measures of inflation picked up somewhat in early 1993, with monthly readings through April in the upper part of the range of the past couple of years. However, price changes at the consumer and the producer levels were small in May and June. Cutting through the monthly data, the disinflation process evident in 1991 and 1992 seems to have stalled, with underlying inflation, as measured by the twelve-month change in the CPI excluding food and energy, holding in the range of 3¼ percent to 3½ percent that has prevailed since last summer. The total CPI, held down by essentially flat energy prices, has risen 3 percent over the past twelve months.

The CPI for food increased at an annual rate of 2 percent in the first half of 1993, a shade above the rate of increase during 1992. Meat prices jumped sharply during the first few months of the year as production fell short of year-earlier levels. In addition, the prices of fresh vegetables were boosted during the spring by weather-related production setbacks in several regions of the country. By late spring, these supply problems had abated, and the June CPI brought price declines in food categories where the sharpest upward pressures previously had been evident. Since the end of June, however, farm crop prices have moved up in response to the severe flooding in the Midwest. The increases in crop prices have already been reflected in the form of large advances in some commodity price indexes and have raised the possibility that renewed upward pressures on consumer food prices could soon emerge.

Consumer energy prices changed little, on net, over the first half of the year. With world oil markets remaining relatively quiescent, the price of West Texas intermediate generally fluctuated between $18 and $20 per barrel but has weakened recently. Retail prices for refined petroleum products changed fairly little on the whole through April and dropped, on balance, in May and June. Residential natural gas prices rose considerably over the first half, in part because of inventory adjustments associated with last winter's colder-than-usual weather; although recent declines in wellhead prices suggest that some of the increase at the retail level may be retraced in coming months, over the longer haul, natural gas prices are being supported by an ongoing shift toward the use of cleaner-burning fuels.

All told, the CPI excluding food and energy increased at an annual rate of 3½ percent over the first half of the year, after rising 3 percent over the second half of 1992. The CPI for goods soared in January and February, with large increases reported for several items. Apparel prices jumped early in the year, in part because strong sales in late 1992 limited the need for post-Christmas markdowns. Some retailers may also have seen opportunities to widen profit margins on other merchandise; the recent decrease in prices of home furnishings, for example, suggests that not all of these increases stuck.

Increases in prices of non-energy services were steadier but also somewhat larger than in 1992. Part of the step-up was in shelter costs, which account for about half of non-energy services and had posted some unsustainably small increases last summer. However, the substantial deceleration in medical care prices (for both goods and services) that has been in train over the past few years extended into 1993. In fact, the CPI for medical care rose only about 6 percent over the twelve months ended in June; this increase was among the smallest of the past decade.

To some extent, the higher underlying CPI inflation rates in the first half of 1993 may be a statistical phenomenon that will be reversed in the second half: Indeed, over the past several years, price increases early in the year have tended to exceed those for the year as a whole, even after seasonal adjustment by the Bureau of Labor Statistics. But, even allowing for this phenomenon, inflation seems to have leveled out. The lack of further deceleration is puzzling in light of the considerable slack in labor and product markets. One possible explanation is that the pickup in economic activity late last year may have triggered a round of price increases; if so, some deceleration in prices is likely in the wake of the subdued performance of the economy in the first half. Another may be the apparent failure of inflation expectations, as measured by various surveys of consumers and businessmen, to reflect fully the reduction in actual inflation over the past few years; although the survey measures vary considerably, respondents seem to share a sense that inflation has bottomed out.

Prices received by domestic producers have slowed in recent months, after undergoing a pickup earlier in the year. All told, the twelve-month change in the producer price index for finished goods other than food and energy was less than 2 percent in June, down somewhat from a year earlier. At earlier stages of processing, where price movements tend to track cyclical fluctuations in demand, prices of intermediate materials (excluding food and energy) firmed a little early in the year, but they subsequently moderated; although the pattern was exaggerated by the spike in lumber prices, it was evident for some other materials as well. In commodity markets, prices of precious metals have moved up sharply over the past couple of months, and some scattered increases have been evident elsewhere. More broadly, however, industrial commodity prices were down slightly, on net, over the first half of the year.

Monetary and Financial Developments in 1993

Monetary policy in 1993 has been directed toward the goal of sustaining the economic expansion while preserving and extending the progress made toward price stability in recent years. In the first half of the year, economic activity slowed markedly from the very rapid pace of the fourth quarter, while inflation indicators fluctuated widely. Although inflation readings were a source of concern for the Federal Open Market Committee, the intensification of price pressures did not seem likely to be sustained over an extended period, and reserve conditions were kept unchanged. With short-term rates steady, prices of fixed-income securities were buoyed by prospects for significant fiscal restraint and by a slowing of the economic expansion, although fears of a pickup in inflation at times prompted partial reversals in bond rates. Yield spreads on private securities relative to Treasury rates remained historically narrow, and stock price indexes set new records.

The monetary aggregates have been sluggish this year, as both the share of depository institutions in overall debt finance and the proportion of depository credit funded with monetary liabilities have fallen further. The reduced role for depositories largely reflects weak demands for loans and deposits by the public. Corporate borrowers have continued to issue heavy volumes of stocks and bonds in part to pay down bank debt, while households have withdrawn deposits to invest in bond and equity funds that finance, among others, corporate issuers. After two years of no growth, bank loans weakened further early this year, but increased fairly vigorously in May and June, posting a small net gain for the first six months of the year. The growth of nonfinancial sector debt so far this year has edged up from the subdued pace of 1992, despite a deceleration of nominal spending, as investment spending is estimated to have exceeded the internal funds of corporations, household borrowing has picked up relative to spending, and Treasury financing needs have remained heavy.

The Implementation of Monetary Policy

Early in the year, incoming data suggested that the faster pace of economic activity that had emerged in the third quarter of 1992 had been maintained through year-end. Indicators of industrial production, retail sales, business fixed investment, and residential construction activity all posted solid gains. Financial impediments to the expansion appeared to be diminishing as the balance sheets of households, business firms, and financial institutions continued to improve, although money and credit growth remained weak. Wage and price data suggested a continuing trend toward lower inflation. Intermediate- and long-term interest rates had declined somewhat, in part reflecting a view that the new Administration's fiscal stimulus package was likely to be modest and that material reductions in future deficits were in prospect. The economic outlook remained clouded, however, by uncertainties regarding details of fiscal policy plans, continued restructuring and downsizing of large businesses, and lingering restraints on credit supplies. At its early February meeting, the FOMC decided that its directive to the Federal Reserve Bank of New York regarding domestic open market operations should retain a symmetric stance regarding possible reactions over the intermeeting period to incoming indicators; such a directive, which implied no presumption in how quickly changes in operations should be made toward tightness or ease, had been instituted in December, following directives that had been biased toward easing over much of the previous two years.

Economic activity appeared to decelerate in the early months of the year, however, in part because of adverse weather conditions, with softness in retail sales, housing starts, and nonresidential construction. Bank credit was failing to expand significantly, while broad money was declining because of temporary factors and a weak underlying trend. Although short-term interest rates were little changed, bond markets rallied further on weaker economic activity and improved prospects for fiscal restraint, which would reduce the government's demand for credit. Long-term rates fell to the lowest levels in almost twenty years in early March, before backing up somewhat on reports of a second month of substantial increases in consumer and producer prices. The drop in interest rates buoyed stock markets to record highs and contributed to a small decline in the weighted-average value of the dollar. The dollar depreciated substantially against the yen, as market attention focused on Japan's growing trade surplus.

Signs of price pressures were a concern for the FOMC, but the fundamentals of continued slack in labor and capital utilization, subdued unit labor costs, and protracted weakness in credit and broad money suggested that a higher trend inflation rate was not setting in. With the economy slowing, reserve pressures were kept unchanged and a symmetric policy directive was retained at the meeting in March.

After pausing in March, producer and consumer prices leaped again in April.

Long-term interest rates backed up further in response; the price of gold surged, and the dollar fell more rapidly. With the Japanese authorities buying dollars in foreign exchange markets, the U.S. Treasury and the Federal Reserve also purchased dollars for yen in late April. After extended weakness, the monetary aggregates jumped in early May by more than could be explained by temporary factors.

At its May meeting, the FOMC was confronted with weak output growth and intensified inflation readings. It was difficult to identify reasons for this juxtaposition. Price increases by business firms in early 1993 could have reflected optimism engendered by strong demand conditions in the second half of 1992 or an upward adjustment of inflation expectations. However, considerable slack remained in labor and product markets, and the pace of economic activity had slowed markedly. The Committee concluded that no policy adjustment was needed at its meeting, but the risks of increased inflation and inflation expectations warranted a directive that contemplated a relatively prompt tightening of reserve pressures if signs of intensifying inflation continued to multiply.

The subsequent readings on inflation for May and June were subdued; moreover, evidence of heightened inflation expectations did not emerge in markets for fixed-income securities. Consequently, the stance of monetary policy was not changed following the May FOMC meeting. The dollar rebounded on foreign exchange markets in June and early July in the wake of the fall of the Japanese government and evidence that economic conditions in Europe had deteriorated further.

On balance, since the beginning of the year, short-term interest rates are little changed, while intermediate- and long-term rates have fallen ¾ to 1 percentage point, reaching the lowest levels in more than twenty years. In particular, the thirty-year Treasury bond has reached a low of 6.54 percent, while the ten-year Treasury note has touched 5.71 percent, its lowest level since 1971. The interest rate on fixed-rate thirty-year mortgages has dropped to 7.16 percent, a record low in the twenty-two year history of the series. The fall in intermediate-term interest rates in the United States was roughly matched on average abroad, and the trade-weighted value of the dollar in terms of G-10 currencies has increased about 5 percent from its December average, as overseas economies weakened and foreign short-term rates declined substantially.

Monetary and Credit Flows

Growth of the broad money measures was quite slow over the first half of 1993, falling below the subdued pace of 1992, and leaving them near the lower arms of the revised growth cones for 1993. This deceleration did not, however, reflect a moderation in overall credit flows or a tightening in financial conditions. Rather, it resulted from a further diversion of credit flows from depository institutions as well as continued financing of depository credit through capital accumulation rather than deposits. Indeed, growth of the debt of all nonfinancial sectors is estimated to have edged up this year—to 5 percent—despite an apparent slowing in nominal GDP. Continued substantial demand for credit by the federal government as well as more comfortable financial positions and consequent signs of a greater willingness to borrow and lend by private sectors likely supported debt expansion. Nevertheless, overall debt growth remains in the lower portion of its revised 4 to 8 percent annual range for

1993. Nonfederal debt growth has expanded at a still-modest 3¼ percent pace, after two years of even weaker growth.

Taking advantage of low long-term interest rates and the strong stock market, businesses have issued an exceptionally large volume of bonds and equity; the proceeds have been used mainly to refund other marketable debt and repay bank loans. Stresses associated with the restructuring of the economy and the earlier buildup of debt linger. However, downgradings of corporate debt by rating agencies have dropped well below the peak levels of a few years ago, and a growing number of firms have received upgradings, as corporate cash flows have strengthened substantially relative to interest expenses.

Debt service burdens of households also have continued to decline relative to disposable income, as households have repaid high interest debt or taken advantage of lower rates to refinance. Indeed, the decline in long-term interest rates during the year has brought a new surge of refinancings of mortgages. With balance sheets improved, households have become somewhat more willing to borrow, and consumer credit has begun growing moderately after two years of weakness. Some of that growth, though, may reflect heavy promotion of credit cards carrying special incentives for use in transactions, such as "frequent-flier miles" or merchandise discounts. Net mortgage debt is estimated to have grown only a bit more than the low rate of 1992.

Gross issuance of state and local government debt has been particularly robust this year. However, refunding volume has accounted for nearly 70 percent of the offerings, compared with about 45 percent in 1992, a record year for refundings. Net debt of state and local governments has grown only moderately again in 1993. The budgetary situations of some state and local governments have improved, as tax receipts have been stronger than expected, but severe financial problems remain in other locales.

With corporate borrowers still relying heavily on financing through capital markets, and depository lending spreads over market rates remaining high, the trend decline in the share of total credit flows provided by depository institutions was extended through the first half of 1993. From the fourth quarter of 1992 to June, bank credit expanded at a 4¼ percent annual rate, only a slight pickup from the sluggish pace of the previous two years. Securities acquisitions accounted for most of the expansion, as loans increased at only a 1¾ percent rate. The growth of securities portfolios at banks in part reflects additions to holdings of securitized mortgage and consumer loans; bank financing of consumer spending and real estate transactions is thus stronger than indicated by bookings of loans in those sectors. Although commercial and industrial loans have been about flat on balance so far this year, a few signs of easing in bank lending terms and conditions have recently emerged, and business loans rebounded in May and June. Judging by business loan growth at smaller banks so far this year, a pickup has occurred in lending to smaller nonfinancial firms. Thus, the continuing weakness in overall business loan growth does not appear to be driven primarily by restrictive supply conditions but rather by the preference of larger firms to fund through capital markets.

Lower market interest rates over the past few years have helped strengthen the financial positions of banks and thrifts. The lower rates have resulted in capital gains on securities and improved interest margins—as deposit rates have fallen more than lending rates. Lower rates also have helped bank borrowers by decreasing interest expenses and boosting economic activity, thereby reducing loan loss provisions for banks. Banks posted record earnings in 1992 and remained very profitable in early 1993; prices of their shares on equity markets have risen substantially.

Thrift institutions have continued to contract in 1993, though at a much slower pace than over the past four years. A lack of funding for the Resolution Trust Corporation caused a hiatus in the closure of institutions under its conservatorship. However, privately operated thrifts have not expanded and the industry continues to consolidate.

Slower growth in nominal GDP, moderate demand for credit relative to spending, and the reduced share of credit provided by depositories have all contributed to the lack of significant growth in the broad monetary aggregates this year. Another factor inhibiting money growth has been continued substantial funding of bank and thrift assets with subordinated debt and equity issues as well as with retained earnings—all a byproduct of ongoing efforts to build capital positions. Only about one-third of the industry (by asset volume) had capital ratios and supervisory ratings high enough at the end of 1991 to be considered well-capitalized, but more than two-thirds was so positioned by early 1993. About $10 billion was added to bank equity and subordinated debt during the first quarter, a pace about the same as that in 1992; data on new debt and equity issues indicate another sizable gain over the second quarter.

Distribution of Assets of Domestic Commercial Banks, by Adjusted Capital Category[1]

Percent

Category	End of year 1991	End of year 1992	March 1993
Well capitalized	34	68	70
Adequately capitalized	45	22	20
Undercapitalized	21	10	10

1. Capital categories adjusted for overall supervisory rating according to the rule of thumb of downgrading a bank by one category for a low examination rating by its supervisory agency (CAMEL 3, 4, or 5).

Depositories have also recently relied more heavily on other nondeposit sources of funds. Weak economies and credit demand abroad have prompted the U.S. offices of foreign banks to draw more funding from overseas and the domestic offices of U.S. banks to reduce foreign lending this year. Overall shifts from deposits to other sources of funding may be driven partly by regulatory inducements—including higher insurance premiums on deposits and incentives to bolster capital. But changes in investor preferences from short-term deposits to longer-term debt and equity may also be playing a role in motivating the restructuring of bank and thrift sources of funds.

Greater reliance by borrowers on capital markets has been facilitated by concurrent shifts in saving preferences away from monetary assets and into capital market investments. Such portfolio realignments are evident in record inflows to bond and stock mutual funds, and money balances were also likely invested directly in stocks and bonds. The incentives for what appears to be an extraordinary adjustment of household portfolios are varied. Interest rates paid on retail time deposits, NOW accounts, and money market deposit accounts (MMDAs) have fallen well below any rate offered since the inception of deregulated deposits in the early 1980s, and savings deposit rates are now the lowest in more than thirty years. The shock effect of historically low deposit interest rates caused many depositors to investigate alternative investments. With the yield curve extraordinarily steep, much higher returns have been available in recent years on longer-term investments. A bond or stock mutual fund offers investors a chance to earn these higher yields and still enjoy liquidity features, including in some cases a check-writing facility. However, investment in such a mutual fund carries with it a higher risk of loss as well, because unlike monetary assets, its principal value fluctuates with market prices. Indeed, the higher yield on bonds relative to short-term instruments probably anticipates some capital losses. Whether all households accurately assess relative risks when comparing returns recently earned on mutual funds with those on money balances remains an open question.

Shifts into mutual funds have become much easier and less costly for households, most notably because many banks have begun offering mutual funds for sale in their lobbies. While many banks now offer discount brokerage services, a survey by the Federal Reserve found that larger banks have recently been making special efforts to promote mutual fund investments among their depositors. An increasing number of banks have sponsored their own mutual funds or entered into exclusive sales relationships with nonbank sponsors of funds. Some banks have promoted these products as a defensive measure to retain long-run relationships with valued depositors. In other cases, however, banks have promoted funds as part of a strategy to earn fee income without booking assets, thereby avoiding the need to raise additional capital.

Substitution between money and long-term mutual funds appears to have become evident in the aggregate data in recent years. There was little increase in such funds from 1987 through 1990, but inflows have surged since then, at the same time that accretions to M2 balances have declined. A comparison of the quarterly growth rates of M2 and the sum of M2 and bond and stock funds shows that growth of the sum has not weakened as dramatically as that of M2 over the last two and half years; it has averaged nearly a 5 percent annual rate, compared with less than 2 percent for M2. Although adding mutual funds and M2 together captures some substitution out of M2 in recent years, the total remains quite volatile, indicating that other forces have affected both M2 and mutual funds. Partly as a consequence, the relationship of the total to aggregate spending is subject to considerable uncertainty. Investments in bond and stock funds are themselves subject to potentially volatile capital gains and losses. More fundamentally, with the public's holdings of mutual funds now vastly expanded, its responses to a variety of interest rate and stock price movements has yet to be tested.

Because weakness in the demand for broad money has resulted largely from shifts of portfolio preferences rather than changes in spending intentions, it has not been reflected in comparable weakness in nominal GDP. Furthermore, the effects of a declining share for depositories in overall credit growth have been substantially offset by increased funding through capital markets, where households now invest a larger share of wealth. The velocity of M2 has been subject to extraordinary and unpredictable surges that have reduced the value of M2 as a guide to policy. Traditional models of velocity based on the difference between short-term market interest rates and interest rates on deposits and money market mutual funds, and even broader models that take account of longer-term interest rates and after-tax loan rates faced by households, cannot explain the full 4 percent rise in M2 velocity in 1992, nor what may be a somewhat faster rate of increase in the first half of 1993.

Money growth in the first quarter was depressed in part by the effects of several temporary factors, including distortions of seasonal factors and a lull in mortgage refinancing. A renewed surge of mortgage refinancing began to bolster demand deposits and MMDAs in April, as mortgage servicers increased balances temporarily before making remittances to investors in mortgage-backed securities. The seasonal-factor distortions began to reverse that month as well. However, substantial shortfalls in individual nonwithheld tax payments relative to recent years produced an offsetting restraint to money growth in April, as the buildup of balances required to pay taxes was smaller than that incorporated into seasonal factors. Even excluding estimated effects of these special factors, however, underlying growth of money through the first four months of the year was far weaker than historical relationships would suggest.

Despite continued heavy inflows to bond and equity funds in May, the monetary aggregates surged, boosted in part by a reversal of the tax effects and an intensification of mortgage refinancing activity. However, the aggregates decelerated substantially in June, and by more than might be suggested by a waning of tax and mortgage refinancing effects.

Growth of Money and Debt

Percent

Measurement period	M1	M2	M3	Domestic nonfinancial debt	
				Total	Nonfederal
Year[1]					
1980	7.4	8.9	9.5	9.5	9.0
1981	5.4 (2.5[2])	9.3	12.3	10.0	9.7
1982	8.8	9.1	9.9	9.3	7.4
1983	10.4	12.2	9.9	11.4	8.8
1984	5.5	8.1	10.8	14.3	13.9
1985	12.0	8.7	7.6	13.8	13.3
1986	15.5	9.3	8.9	14.0	13.7
1987	6.3	4.3	5.8	10.1	10.4
1988	4.3	5.3	6.4	9.2	9.6
1989	.6	4.7	3.7	8.2	8.5
1990	4.3	4.0	1.8	6.8	5.9
1991	8.0	2.8	1.1	4.4	2.5
1992	14.3	1.8	.3	4.8	2.9
Half year (annual rate)[3]					
1993:H1	8.7	.1	−.7	5.1	3.3
Quarter (annual rate)[4]					
1993:Q1	6.6	−2.0	3.8	4.4	3.0
Q2	10.6	2.2	2.4	5.7	3.6
Fourth quarter 1992 average to June 1993 average (annual rate)[5]	9.5	.8	−.3	5.1	3.3

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 1992:Q4 to average for 1993:Q2 (for debt, estimated with data through May).

4. From average for preceding quarter to average for quarter indicated (for debt, estimated with data through May).

5. For debt, to May 1993 average.

In 1993, household portfolio adjustments differed somewhat from their previous pattern. In the past, the realignment of household wealth toward capital market investments had mainly involved shifts from money market mutual funds and small time deposit accounts. At the same time, outflows from those accounts had also gone into NOW and savings deposits, the interest rates on which were falling only slowly as market rates declined. This year, the sum of all these M2 balances has fallen at about the same rate as in 1992, but a slower runoff of small time deposits and money funds has been offset by a sharp deceleration in the growth of NOW and savings deposits. Catch up declines in interest rates on liquid deposits may account for part of their slower growth. Some nontransactions balances held in NOW and MMDA deposits have likely been shifted into bond and equity funds. It may be that some depositors who do not ordinarily shop for small rate advantages have been induced to make basic portfolio adjustments because of the historically low deposit interest rates and the increased ease of making investments in capital market instruments.

Partly as a result, narrow measures of money have decelerated this year, but their expansion has remained rapid. M1 has grown at a 9½ percent rate from the fourth quarter of 1992 through June, compared with 14¼ percent in 1992. Reserves, now held exclusively against transaction deposits, have grown at an 11 percent pace compared with 20 percent in 1992. The monetary base has slowed by much less, because of continued strong foreign demand for currency this year.

With reduced strength in its M1 component, and in savings and MMDAs, as well as continued runoffs of small time deposits and retail money funds, M2 has grown at only a ¾ percent annual rate from the fourth quarter of 1992 through June 1993, well below the lower end of its growth cone set in February. The FOMC monitored the behavior of M2 carefully over the first half of the year, but in light of actual and expected strength of velocity, the Committee determined that actions to boost M2 growth were not needed to achieve its underlying objectives for prices and the economy. The aggregate is near the lower arm of the revised annual growth cone established in July, and if velocity continues to increase substantially, M2 may well come in toward the lower end of the revised growth range for the year.

The non-M2 portion of M3 has declined this year at nearly the same pace as that of the previous two years. Large time deposits have continued to fall, and the halt in reductions in short-term rates has ended the rapid growth of institutional money funds, as their slower-adjusting yields have come down to their usual relationship to market interest rates. From the fourth quarter of 1992 through June, M3 fell at about a ¼ percent annual rate; it lies slightly below its revised annual growth cone. ■

Part 2

Records, Operations, and Organization

Record of Policy Actions of the Board of Governors

Regulation A (Extensions of Credit by Federal Reserve Banks)

December 16, 1993—Amendments

The Board approved amendments to Regulation A, effective January 30, 1994, to carry out a provision of the Federal Deposit Insurance Corporation Improvement Act of 1991 that set limits on Federal Reserve Bank credit.

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

Section 142 of the Federal Deposit Insurance Corporation Improvement Act of 1991 amended section 10B of the Federal Reserve Act to discourage advances to undercapitalized and critically undercapitalized insured depository institutions. This amendment provides that after December 19, 1993, the Board may be financially liable to the Federal Deposit Insurance Corporation (FDIC) for certain losses incurred by the FDIC's insurance funds. Specifically, the Board is liable for excess losses attributable to advances after the expiration of certain periods to undercapitalized insured depository institutions that are not viable and to critically undercapitalized insured depository institutions.

The Board approved amendments to Regulation A to place limitations on Federal Reserve Bank credit to undercapitalized and critically undercapitalized insured depository institutions; describe the calculation of amounts that may be payable to the Federal Deposit Insurance Corporation; define undercapitalized and critically undercapitalized insured depository institutions; clarify the term "viable" as it applies to an undercapitalized insured depository institution; and provide for assessments on the Federal Reserve Banks for amounts that the Board may be required to pay the Federal Deposit Insurance Corporation under section 142. The revised regulation will guide the Federal Reserve Banks in their dealings with undercapitalized and critically undercapitalized institutions and will advise those institutions and their banking supervisors of potential limitations on the availability of Federal Reserve Bank credit. The Board also approved several technical and stylistic changes to update and clarify the regulation.

Regulation B (Equal Credit Opportunity)

November 29, 1993—Amendments

The Board approved amendments to Regulation B to give credit applicants the right to receive a copy of their appraisal reports, effective December 14, 1993.

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

The Federal Deposit Insurance Corporation Improvement Act of 1991 provided credit applicants with a right to receive a copy of appraisal reports. The Board amended Regulation B to provide alternative methods of compliance with the law.

Under the amendments, creditors could automatically provide a copy of the appraisal report to each applicant for certain loans secured by dwellings or could provide a copy upon request, subject to certain other provisions in the rule.

For creditors who do not automatically provide a copy of appraisal reports, the regulation includes limits on when applicants may request (and creditors must provide) a copy of a report and a requirement that applicants be notified of the right to receive a copy. The amendments are effective on December 14, 1993, but compliance with the regulatory requirements is optional until June 14, 1994.

Regulation C (Home Mortgage Disclosure)

February 26, 1993—Amendments

The Board amended Regulation C to implement statutory requirements for disclosure of information, effective March 1, 1993.

Votes for this action: Messrs. Greenspan, Angell, LaWare, and Lindsey and Ms. Phillips. Absent and not voting: Messrs. Mullins and Kelley.

The Board amended Regulation C to implement statutory amendments requiring that lenders release disclosure statements earlier than they previously had been available and make their modified loan application register data publicly available. The revised rules apply to data collected for 1992.

Regulation D (Reserve Requirements of Depository Institutions)

November 15, 1993—Amendments

The Board amended Regulation D to increase the amount of transaction balances to which the lower reserve requirement applies.

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

Under the Monetary Control Act of 1980, depository institutions, Edge Act 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 amount. (Subsequently, the Board lowered the maximum reserve requirement to 10 percent.)

The act directs the Board to adjust annually the amount subject to the lower reserve requirement to reflect changes in nationwide transaction balances. By the beginning of 1993, that amount was $46.8 million. Recent increases in transaction balances warranted an increase of $5.1 million. The Board, therefore, amended Regulation D to increase to $51.9 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 institutions's reservable liabilities. The act also provides for annual adjustments to that exemption based on nationwide deposit growth. By the beginning of 1993, that amount had been increased to $3.8 million. Recent growth in deposits warranted an increase to $4 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 21, 1993, for institutions reporting weekly, and December 14, 1993, for institutions reporting quarterly.

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

Regulation K (International Banking Operations), *and*

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

May 26, 1993—Amendments

The Board amended Regulations H, K, and Y to adopt a uniform multiagency criminal referral form for domestic and foreign financial institutions operating in the United States, effective October 8, 1993.

Votes for this action: Messrs. Mullins, Angell, Kelley, and Lindsey and Ms. Phillips. Absent and not voting: Messrs. Greenspan and LaWare.

The Board adopted a final rule amending its Regulations H, K, and Y to require that all domestic and foreign banking organizations supervised by the Board, including state member banks, bank holding companies, Edge Act corporations, and certain U.S. branches and agencies of foreign banks, file criminal referrals on a broad range of suspected criminal activities.

Regulation H (Membership Requirements for State-Chartered Banks) *and*

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

April 20, 1993—Amendments

The Board approved amendments of Regulations H and Y to adopt as final its interim rule concerning the treatment of one- to four-family residential construction loans, effective April 26, 1993.

Votes for this action: Messrs. Greenspan, Angell, Kelley, and LaWare and Ms. Phillips. Absent and not voting: Messrs. Mullins and Lindsey.

The Board adopted as final its interim rule amending the risk-based capital guidelines for bank holding companies and state member banks to lower from 100 percent to 50 percent the risk weight assigned to certain loans to builders to finance the construction of presold residential (one- to four-family) properties. The rule implements section 618(a) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991.

Regulation O (Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks)

May 3, 1993—Amendments

The Board approved amendments to Regulation O to incorporate three exceptions to the regulation's insider lending limit, effective May 3, 1993.

Votes for this action: Messrs. Greenspan, Mullins, Angell, Kelley, and LaWare and Ms. Phillips. Absent and not voting: Mr. Lindsey.

The Housing and Community Development Act of 1992 authorizes the Board to adopt exceptions to the definition of "extension of credit" that pose minimal risk to the lending bank. The Board amended Regulation O to except from the aggregate lending limit extensions of credit secured by obligations of the United States or other obligations fully guaranteed as to principal and interest by the United States, extensions of credit to or secured by commitments or guarantees of a department or agency of the United States, and extensions of credit secured by a segregated deposit account with the bank.

Regulation DD (Truth in Savings) *and* **Regulation Q** (Interest on Deposits)

March 16, 1993—Amendments

The Board amended Regulation DD, effective March 21, 1993, and Regulation Q, effective June 21, 1993, to make certain changes required by the Housing and Community Development Act.

Votes for this action: Messrs. Greenspan, Mullins, and Angell and Ms. Phillips. Absent and not voting: Messrs. Kelley, LaWare, and Lindsey.

The Housing and Community Development Act of 1992 extended the mandatory date for compliance with the Truth in Savings Act by three months. The act also modified the advertising rules relating to signs on the premises of an institution and made a technical change in the provision dealing with notices required to be given to existing account holders. The Board amended Regulation DD to implement these changes. The Board also made two minor changes in the regulation and provided guidance on several issues that had been raised by institutions since publication of the regulation in September 1992.

In connection with this amendment, the Board also amended Regulation Q to delay by three months the deletion of rules governing the advertising of deposit accounts.

Rules of Procedure

September 1, 1993—Amendments

The Board approved an amendment to its Rules of Procedure to require that bank merger applicants publish notice of a proposed merger three times and made certain technical changes in the regulation, effective September 30, 1993.

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

The Bank Merger Act, section 18(c) of the Federal Deposit Insurance Act, requires that notice of merger applications be published at appropriate intervals during a period of at least thirty days. Since 1992, in an effort to reduce regulatory burden, the Board had required the publication of only one notice of a proposed merger. Because the act requires that notice of merger applications be published at appropriate intervals, the Board approved amendments to its Rules of Procedure to require that bank merger applicants publish notice of a proposed merger three times over a thirty-day period. The Board also approved certain other technical amendments to the regulation.

Ms. Phillips dissented from this action because she was concerned about the economic impact of publication of multiple notices. She would have supported the publication of two notices but felt that the publication of three notices would be excessive.

Rules Regarding Delegation of Authority

September 1, 1993—Amendment

The Board amended its Rules Regarding Delegation of Authority to delegate to its ethics officer (the Board's General Counsel) the authority to grant certain individual waivers under the federal conflicts of interest statute, effective September 1, 1993.

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

The Board delegated to the General Counsel the authority to grant individual waivers under the federal conflicts of interest statute in cases in which the employee's financial interest is not so substantial as to be likely to affect the integrity of the employee's services to the Board.

December 1, 1993—Amendment

The Board amended its Rules Regarding Delegation of Authority to delegate to the Director of the Division of Consumer and Community Affairs authority for determining inconsistencies between state laws and the federal Truth in Savings law.

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

The Board delegated to the Director of the Division of Consumer and Community Affairs the authority to determine whether a state law is inconsistent with (and, therefore, preempted by) the federal Truth in Savings Act and the Board's implementing regulation, Regulation DD. This authority matches the delegations already in place for the Truth in Lending Act, the Electronic Fund Transfer Act, the Equal Credit Opportunity Act, the Home Mortgage Disclosure Act, and the regulations implementing those statutes.

Rules Regarding Equal Opportunity

February 10, 1993—Interim Rules

The Board approved an interim rule revising its Rules Regarding Equal Opportunity, effective February 18, 1993.

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

The revised rules conform as closely as possible to a final regulation adopted by the Equal Employment Opportunity Commission governing the handling of complaints of discrimination in the federal sector.

Policy Statements and Other Actions

January 26, 1993—Securities Activities of Section 20 Subsidiaries of Bank Holding Companies

The Board approved an alternative method of adjusting the 10 percent revenue test for ineligible securities held by section 20 subsidiaries of bank holding companies, effective January 26, 1993.

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

The Board approved an alternative test to measure compliance with the 10 percent limit on the ineligible securities that could be held by section 20 subsidiaries of bank holding companies. Under the alternative test, revenue may be indexed to interest rate changes by comparing current interest rate changes for various portfolio durations with rates on corresponding durations in September 1989, when the 10 percent limit was first adopted. Messrs. Mullins and Angell thought that the indexed revenue test was unduly complex and burdensome.

March 8, 1993—Procedures for Processing Applications Filed by Foreign Banks

The Board adopted new procedures to be used in processing applications filed by foreign banks under the Foreign Bank Supervision Enhancement Act of 1991.

Votes for this action: Messrs. Greenspan, Mullins, Angell, Kelley, LaWare, and Lindsey. Absent and not voting: Ms. Phillips.

The Foreign Bank Supervision Enhancement Act of 1991 establishes uniform standards for all foreign banks entering the United States and requires that they meet financial, managerial, and operational standards equivalent to those required of U.S. banking corporations. A foreign bank may not establish a branch, agency, representative office, or commercial lending company without the advance approval of the Board.

The new procedures were designed to expedite the processing of applications and to reduce the burden on applicants. The procedures require simultaneous review of applications by staff members of the Board and the Reserve Banks, urge all foreign bank applicants to meet with such staff members before filing applications, require adherence to deadlines in requesting information during the acceptance process, establish new internal guidelines for processing applications after acceptance, and inform the public that information files on home country supervision and bank secrecy laws are maintained and available in the Board's Freedom of Information Office.

March 10, 1993—Interagency Policy Statement on Credit Availability

The Board approved issuance of an interagency policy statement on credit availability that would facilitate lending to creditworthy small and medium-sized businesses, effective March 10, 1993.

Votes for this action: Messrs. Greenspan, Mullins, Angell, Kelley, and LaWare and Ms. Phillips. Absent and not voting: Mr. Lindsey.

Problems with the availability of credit over the past few years have been especially significant for small and medium-sized businesses and farms. In response to a request by President Clinton, the Board, along with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision, issued an outline of a new program to help ensure that regulatory policies do not needlessly stand in the way of lending. The statement noted that loans to creditworthy borrowers should be made whenever possible as long as they are consistent with safe and sound banking practices.

March 15, 1993—Delegation of Authority

The Board delegated to the Commodity Futures Trading Commission the authority to determine margins on stock index futures contracts and options on those contracts, effective March 15, 1993.

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

The Futures Trading Practice Act of 1992 gave the Board authority to set margin requirements on stock index futures contracts and options on those contracts. The statute also allowed the Board to delegate any or all of its authority under this provision to the Commodity Futures Trading Commission. Contract markets must submit all rules, other than those relating to levels of margins, to the commission for approval. Because of the broad authority of the commission over contract markets and because margins are but one component of the risk-control systems used by contract markets, the Board concluded that the commission was the most appropriate entity to exercise the functions assigned to the Board. The Board delegated its authority under the statute to the Commodity Futures Trading Commission until further notice.

March 30, 1993—Interagency Loan Documentation Policy Statement

The Board approved issuance of an Interagency Policy Statement on Documentation Required for Loans to Small and Medium-Sized Businesses and Farms, effective March 30, 1993.

Votes for this action: Messrs. Greenspan, Mullins, Angell, Kelley, and Lindsey and Ms. Phillips. Absent and not voting: Mr. LaWare.

In connection with the Interagency Policy Statement on Credit Availability issued on March 10, 1993, the Board approved issuance of an interagency policy statement aimed at eliminating unnecessary and overly burdensome documentation for loans to small and medium-sized businesses and farms.

June 8, 1993—Interagency Policy Statements on Credit Availability

The Board approved issuance of five interagency policy statements on credit availability, effective June 10, 1993.

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

To implement the credit-availability program announced by the five banking agencies on March 10, 1993, the Board approved issuance of five interagency policy statements. The statements concerned the definition of "special mention" assets, avoidance of the use of liquidation values in the supervisory assessment of commercial real estate loans, restoration of partially charged-off loans to performing status, revision of reporting and examination guidance on sales of Other Real Estate Owned, and revision of the in-substance foreclosure reporting rules.

June 9, 1993—Interagency Policy Statement on Credit Availability

The Board approved issuance of an interagency policy statement on credit availability, effective June 10, 1993.

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

To implement the credit-availability program announced by the five banking agencies on March 10, 1993, the Board approved issuance of an interagency policy statement that outlines a program for coordinating examinations of insured depository institutions and inspections of their holding companies.

August 11, 1993—Interagency Policy Statement on the Closing of Branches

The Board approved issuance of an interagency policy statement on the closing of branches by depository institutions, effective September 21, 1993.

Votes for this action: Messrs. Greenspan, Mullins, Kelley, and LaWare and Ms. Phillips.

The Board approved issuance of a policy statement to implement section 228 of the Federal Deposit Insurance Corporation Improvement Act of 1991, which requires that insured depository institutions give ninety days advance written notice of the closing of any branch to its primary federal regulator and to branch customers, post a notice at the branch site at least thirty days before closing, and develop a policy on the closing of branches.

December 17, 1993—Risk-Based Capital Guidelines

The Board approved an amendment to its risk-based capital guidelines for state member banks and bank holding companies to permit them to lower the risk weight assigned to certain multifamily housing loans.

Votes for this action: Messrs. Greenspan, Mullins, Angell, Kelly, LaWare, and Lindsey and Ms. Phillips.

The Board amended its risk-based capital guidelines to lower from 100 percent to 50 percent the risk weight for certain multifamily housing loans meeting specified criteria. This amendment implements section 618(b) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991.

1993 Discount Rates

During 1993 the basic discount rate was left unchanged at 3 percent. the level established by the Board in early July 1992. Over the course of 1993, however, the Board approved numerous increases and decreases in the rates charged by the Reserve Banks for seasonal credit and for extended credit; rates for both types of credit are set on the basis of market-related formulas.

The reasons for Board decisions are reviewed below. Those 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 more fully in the Minutes of the Committee and in the Monetary Policy Reports to the Congress, which are printed elsewhere in this REPORT.

Basic Discount Rate

During the first quarter of 1993 the directors of ten Reserve Banks regularly proposed that the basic discount rate remain unchanged at 3 percent. The directors of the other two Banks requested reductions of ½ percentage point at various times during the quarter. The Board considered but took no action on these pending requests until late March. Data that became available during the first quarter indicated that the economic expansion had slowed markedly from a very rapid pace in the closing months of 1992, but the Board viewed policy as already stimulative and recent developments as pointing on the whole toward sustainable growth in economic activity. Moreover, advances in consumer and producer prices were larger in early 1993 than those recorded in the latter part of 1992.

Against this background, the Board on March 29 turned down a longstanding request from the Federal Reserve Bank of Cleveland to lower the basic discount rate from 3 percent to 2½ percent; a similar request from the Federal Reserve Bank of Boston had been withdrawn early in the year.

The economic expansion picked up some momentum during the spring, while broad measures of prices continued to suggest a deteriorating inflation picture. From mid-May to early August the Federal Reserve Bank of Richmond submitted recommendations to increase the basic discount rate from 3 percent to 3¼ percent as a means of signaling the System's concern about inflation. The Board took no action on this request, but in association with the unchanged policy posture of the Federal Open Market Committee, it supported the requests of the other eleven Banks to maintain the existing rate. In the Board's view, a steady monetary policy remained desirable and provided an appropriate balance between the risks of inflation and those of a faltering economic expansion. By summer a broad array of price and wage indicators suggested some moderation in the underlying rate of inflation, and the request of the Richmond Bank was withdrawn. No further recommendations to change the basic discount rate were received from Federal Reserve Banks over the balance of the year.

Structure of Discount Rates

The basic discount rate is the rate charged on loans to depository institutions for short-term adjustment credit, while flexible, market-related rates generally are charged on other types of credit. These flexible rates are changed periodically, subject to Board approval.

Under the seasonal program, loans may be provided for periods longer than those permitted under adjustment credit to assist smaller institutions in meeting regular needs arising from a clear pattern of intra-yearly movements in their deposits and loans. Since its introduction on January 9, 1992, the flexible rate charged on seasonal credit has been closely aligned with short-term market rates; it is never less than the basic rate applicable to adjustment credit.

A different flexible rate is charged on extended-credit loans, which are made to depository institutions that are under sustained liquidity pressure and are not able to obtain funds from other sources. The rate for extended credit is 50 basis points higher than the seasonal rate and is at least 50 basis points above the basic discount rate. 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 are not clearly 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 credit. At the end of 1993 the structure of discount rates was as follows: a basic rate of 3 percent for short-term adjustment credit, a rate of 3.10 percent for credit under the seasonal program, and a rate of 3.60 percent for extended credit. During 1993 the flexible rate on seasonal credit ranged from a high of 3.20 percent to a low of 3.00 percent, and that on extended credit ranged from a high of 3.70 percent to a low of 3.50 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 proposals on the discount rate include requests to renew the formulas for calculating the flexible rates on seasonal and extended credit. As shown below, the Board voted in late March to deny a request for a reduction in the basic rate, but other requests to change the rate were left pending and were withdrawn by the Reserve Banks as their evaluation of economic developments changed. Votes relating to the reestablishment of existing rates or for the updating of market-related rates under the seasonal and extended credit programs are not shown. All votes taken during 1993 on discount rates were unanimous.

On March 29, 1993, the Board disapproved an action taken on March 25 by the directors of the Federal Reserve Bank of Cleveland to reduce the basic discount rate from 3 percent to 2½ percent.

> Votes for this action: Messrs. Greenspan, Mullins, Angell, Kelley, LaWare, and Lindsey and Ms. Phillips. Votes against this action: None. ■

Minutes of Federal Open Market Committee Meetings

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

In the past, the policy record for each meeting was released simultaneously with, but separately from, the minutes, a few days after the next regularly scheduled meeting; only the policy record was subsequently published in the *Federal Reserve Bulletin* and in the ANNUAL REPORT. At its March 23, 1993, meeting, the Committee unanimously voted to merge the policy record with the minutes, beginning with the February 2–3 meeting. The merged document (hereafter, "the minutes") is published in the *Bulletin* and, for the meetings in 1993, in this REPORT.

The minutes of the meetings contain the votes on the policy decisions made at those meetings as well as a résumé of the discussions that led to 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.

Members of the Committee voting for a particular action may differ among themselves as to the reasons for their votes; in such cases, the range of their views is noted in the record. When members dissent from a decision, they are identified in the record along with a summary of the reasons for their dissent.

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, a Foreign Currency Directive, and Procedural Instructions with Respect to Foreign Currency Operations.

These policy instruments are shown below in the form in which they were in effect at the beginning of 1993. 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, 1993

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

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

(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 compara-

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

Domestic Policy Directive

In Effect January 1, 1993[1]

The information reviewed at this meeting suggests that economic activity has been rising appreciably in the current quarter. Total nonfarm payroll employment has increased slightly since September, and the average workweek has moved higher. The civilian unemployment rate fell further in November to 7.2 percent. Industrial production posted solid gains in October and November. Retail sales increased sharply in October and rose further in November. Residential construction activity appears to have increased from the third-quarter pace. Indicators of business fixed investment have been mixed recently, but on balance they suggest further growth. The nominal U.S. merchandise trade deficit narrowed somewhat in October from its average rate in the third quarter. Recent data on wages and prices suggest on balance a possible slowing in the trend toward lower inflation.

Changes in short-term interest rates have been mixed since the Committee meeting on November 17 while bond yields have edged lower. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies was essentially unchanged on balance over the intermeeting period.

Over the course of recent months, M2 has expanded at a moderate pace, while M3 has continued to expand at a very slow rate. More recently, both aggregates have weakened somewhat. Both appear to have grown at rates a little below the lower ends of the ranges established by the Committee for the year.

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 on June 30–July 1 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 1991 to the fourth quarter of 1992. The Committee anticipated that developments contributing to unusual velocity increases could persist in the second half of the year. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 4½ to 8½ percent for the year. For 1993, the Committee on a tentative basis set the same ranges as in 1992 for growth of the monetary aggregates and debt measured from the fourth quarter of 1992 to the fourth quarter of 1993. 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 or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with M2 growing at a rate of around 1½ percent and M3 about unchanged in the period from November through March.

Authorization for Foreign Currency Operations

In Effect January 1, 1993

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market

1. Adopted by the Committee at its meeting on December 22, 1992.

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 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, 1993

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

2. To achieve this end the System shall:

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

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

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

3. Transactions may also be undertaken:

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

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

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

4. System foreign currency operations shall be conducted:

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

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

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

Procedural Instructions with Respect to Foreign Currency Operations

In Effect January 1, 1993

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager for Foreign Operations, System Open Market Account, shall be guided by the following procedural understandings with respect to consultations and clearance with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

1. The Manager for Foreign Operations shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $300 million on any day or $600 million since the most recent regular meeting of the Committee.

B. Any operation that would result in a change on any day in the System's net position in a single foreign currency exceeding $150 million, or $300 million when the operation is associated with repayment of swap drawings.

C. Any operation that might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in 1.B.

D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

2. The Manager for Foreign Operations shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $1.5 billion since the most recent regular meeting of the Committee.

B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

3. The Manager for Foreign Operations shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System, and about any operations that are not of a routine character.

Meeting Held on February 2–3, 1993

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, February 2, 1993, at 2:30 p.m. and was continued on Wednesday, February 3, 1993, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Boehne
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. McTeer
Mr. Mullins
Ms. Phillips
Mr. Stern

Messrs. Broaddus, Jordan, Forrestal, and Parry, Alternate Members of the Federal Open Market Committee

Messrs. Hoenig, Melzer, and Syron, Presidents of the Federal Reserve Banks of Kansas City, St. Louis, and Boston respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary

Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Patrikis,[2] Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. R. Davis, Lang, Lindsey, Promisel, Rosenblum, Scheld, Siegman, Simpson, and Slifman, Associate Economists

Mr. McDonough, Manager of the System Open Market Account
Ms. Greene, Deputy Manager for Foreign Operations
Ms. Lovett,[3] Deputy Manager for Domestic Operations

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Stockton, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Assistant Director, Division of Monetary Affairs, Board of Governors
Mr. Brady,[4] Section Chief, Division of Monetary Affairs, Board of Governors
Mr. Rosine,[4] Senior Economist, Division of Research and Statistics, Board of Governors
Mr. Wiles,[5] Secretary of the Board, Office of the Secretary, Board of Governors
Mr. Winn,[5] Assistant to the Board, Office of Board Members, Board of Governors
Ms. Werneke,[5] Special Assistant to the Board, Office of Board Members, Board of Governors
Mr. Siciliano,[5] Special Assistant to the General Counsel, Legal Division, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Beebe, T. Davis, Dewald, Goodfriend, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Kansas City, St. Louis, Richmond, and Atlanta respectively

Mr. McNees, Vice President, Federal Reserve Bank of Boston
Mr. Gavin, Assistant Vice President, Federal Reserve Bank of Cleveland
Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis
Ms. Meulendyke, Manager, Open Market Operations, Federal Reserve Bank of New York

The Secretary reported that advices of the election of the Reserve Bank members and alternate members of the Federal Open Market Committee for the period commencing January 1, 1993, and ending December 31, 1993, had been received and that these individuals had executed their oaths of office. The elected members and alternate members were as follows:

E. Gerald Corrigan, President of the Federal Reserve Bank of New York, with James H. Oltman, First Vice President of the Federal Reserve Bank of New York, as alternate;
Edward G. Boehne, President of the Federal Reserve Bank of Philadelphia, with J. Alfred Broaddus, Jr., President of the Federal Reserve Bank of Richmond, as alternate;
Silas Keehn, President of the Federal Reserve Bank of Chicago, with Jerry L. Jordan, President of the Federal Reserve Bank of Cleveland, as alternate;
Robert D. McTeer, Jr., President of the Federal Reserve Bank of Dallas, with Robert P. Forrestal, President of the Federal Reserve Bank of Atlanta, as alternate;
Gary H. Stern, President of the Federal Reserve Bank of Minneapolis, with

2. Attended Wednesday session only.
3. Attended Tuesday session only.
4. Attended portion of meeting relating to the Committee's discussion of the economic outlook and its longer-run objectives for monetary and debt aggregates.
5. Attended portion of the meeting relating to the release of FOMC information to the public.

Robert T. Parry, President of the Federal Reserve Bank of San Francisco, as alternate.

By unanimous vote, the Committee elected the following officers of the Federal Open Market Committee to serve until the election of their successors at the first meeting of the Committee after December 31, 1993, with the understanding that in the event of the discontinuance of their official connection with the Board of Governors or with a Federal Reserve Bank, they would cease to have any official connection with the Federal Open Market Committee:

Alan Greenspan	Chairman
E. Gerald Corrigan	Vice Chairman
Donald L. Kohn	Secretary and Economist
Normand R.V. Bernard	Deputy Secretary
Joseph R. Coyne	Assistant Secretary
Gary P. Gillum	Assistant Secretary
J. Virgil Mattingly, Jr.	General Counsel
Ernest T. Patrikis	Deputy General Counsel
Michael J. Prell	Economist
Edwin M. Truman	Economist

Richard G. Davis, Richard W. Lang, David E. Lindsey, Larry J. Promisel, Arthur J. Rolnick, Harvey Rosenblum, Karl A. Scheld, Charles J. Siegman, Thomas D. Simpson, and Lawrence Slifman, Associate Economists

By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account until the adjournment of the first meeting of the Committee after December 31, 1993.

By unanimous vote, William J. McDonough, Margaret L. Greene, and Joan E. Lovett were selected to serve at the pleasure of the Committee in the capacities of Manager of the System Open Market Account, Deputy Manager for Foreign Operations, System Open Market Account, and Deputy Manager for Domestic Operations, System Open Market Account respectively, on the understanding that their selection was subject to their being satisfactory to the Federal Reserve Bank of New York.

Secretary's note: Advice subsequently was received that the selections indicated above were satisfactory to the board of directors of the Federal Reserve Bank of New York.

On January 15, 1993, the continuing rules, regulations, authorizations, and other instruments of the Committee listed below were distributed with the advice that, in accordance with procedures approved by the Committee, they were being called to the Committee's attention before the February 2–3 organization meeting to give members an opportunity to raise any questions they might have concerning them. Members were asked to indicate if they wished to have any of the instruments in question placed on the agenda for consideration at this meeting. No requests for substantive consideration were received.

At the meeting, the Committee voted unanimously to update the references to the Management of the System Open Market Account that were contained in the following: (1) Procedures for allocation of securities in the System Open Market Account and (2) Program for Security of FOMC Information. Apart from the indicated updating of titles, all of the instruments listed below remained in effect in their existing forms.

1. Procedures for allocation of securities in the System Open Market Account
2. Authority for the Chairman to appoint a Federal Reserve Bank as agent to operate the System Account in case the New York Bank is unable to function

3. Resolution of FOMC to provide for the continued operation of the Committee during an emergency; Resolution of FOMC authorizing certain actions by Federal Reserve Banks during an emergency
4. Resolution relating to examinations of the System Open Market Account
5. Guidelines for the conduct of System operations in federal agency issues
6. Regulation relating to Open Market Operations of Federal Reserve Banks
7. Program for Security of FOMC Information
8. Federal Open Market Committee Rules.

By unanimous vote, the Authorization for Domestic Open Market Operations, as shown below, was reaffirmed:

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

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

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

By unanimous vote, the Authorization for Foreign Currency Operations was amended to update the title of the Manager of the System Open Market Account. The Authorization, as amended, is shown below:

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

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

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

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

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

6. All operations undertaken pursuant to the preceding paragraphs shall be reported promptly to the Foreign Currency Subcommittee and the Committee. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in the absence of members of the Board serving on the Subcommittee, other Board Members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, his alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of the Manager of the System Open Market Account, 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(l) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

By unanimous vote, the Foreign Currency Directive, as shown below, was reaffirmed:

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

2. To achieve this end the System shall:

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

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

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

3. Transactions may also be undertaken:

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

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

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

4. System foreign currency operations shall be conducted:

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

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

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

By unanimous vote, the Procedural Instructions with respect to Foreign Currency Operations were amended to update the title of the Manager of the System Open Market Account. The Procedural Instructions, as amended, are shown below:

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager of the System Open Market Account ("Manager"), shall be guided by the following procedural understandings with respect to consultations and clearance with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $300 million on any day or $600 million since the most recent regular meeting of the Committee.

B. Any operation that would result in a change on any day in the System's net position in a single foreign currency exceeding $150 million, or $300 million when the operation is associated with repayment of swap drawings.

C. Any operation that might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in 1(B).

D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $1.5 billion since the most recent regular meeting of the Committee.

B. Any swap drawing proposed by a foreign bank exceeding the larger of

(i) $200 million or (ii) 15 percent of the size of the swap arrangement.

3. The Manager shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System, and about any operations that are not of a routine character.

The Report of Examination of the System Open Market Account, conducted by the Board's Division of Reserve Bank Operations and Payment Systems as of the close of business on July 31, 1992, was accepted.

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on December 22, 1992, were approved.

The Deputy Manager for Foreign Operations reported on developments in foreign exchange markets during the period December 22, 1992, through February 2, 1993. There were no System open market transactions in foreign currencies during this period, and thus no vote was required of the Committee.

The Manager of the System Open Market Account reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period December 22, 1992, through February 2, 1993. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic outlook, the ranges for the growth of money and debt in 1993, and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting indicated that economic activity rose appreciably further in the fourth quarter. Final demands were buoyed by strength in consumption, business spending for durable equipment, and residential construction. Manufacturing activity also increased considerably, and employment appeared to be on a modest upward trajectory, despite a continuing flow of announcements of layoffs by large corporations. Although recent data on wages and prices had been mixed, on balance they suggested that inflation was trending gradually lower.

Total nonfarm payroll employment registered a small increase in December for the fourth consecutive month. Service industries, notably business and health services, and retail trade accounted for nearly all of the rise in jobs. Manufacturing and construction payrolls changed little, and government employment fell as temporary election workers were dropped from payrolls. The civilian unemployment rate remained at 7.3 percent, almost ½ percentage point below its midyear peak but slightly above its level at the beginning of the year.

Industrial production advanced further in December and was up considerably over the fourth quarter as a whole. Motor vehicle assemblies rose sharply during the quarter; strong gains also were registered in business equipment, partly reflecting a further jump in output of computers, and in nondurable consumer goods. By contrast, the production of durable consumer goods other than motor vehicles was lower on balance after changing little over the third quarter, and the output of defense and space equipment remained on a downward trend. Total utilization of industrial capacity increased significantly in the fourth quarter and for the year as a whole.

Consumer spending was up substantially in the fourth quarter. Retail sales, after rising sharply in October and changing little in November, posted a further sizable increase in December. The largest sales gains in the fourth quarter were reported at automotive dealers and at building material and supply outlets, but most other types of retail stores also recorded higher sales. By contrast, consumer spending for services, as indicated by data on personal consumption expenditures, rose more slowly. Housing starts surged in December, with single family starts reaching their highest level in nearly three years and multifamily starts picking up slightly from the very low levels of October and November. Sales of new and existing homes remained on a strong upward trend in December.

Real outlays for business fixed investment apparently registered a notable gain in the fourth quarter, particularly for producers' durable equipment. Shipments of nondefense capital goods rose in November and December after changing little in October; for the quarter as a whole, shipments advanced substantially, with increases widespread by category. Business purchases of cars and trucks were up sharply in the fourth quarter, while nonresidential construction activity retraced a small part of a third-quarter decline.

Business inventories expanded moderately in November as a sizable drop in manufacturing inventories was more than offset by increases in wholesale and retail inventories. At the manufacturing level, the drawdown of stocks was associated with strong shipments of durable goods, and inventory-to-shipments ratios in most industries were at or near the bottom of their recent ranges. In the wholesale sector, sizable inventory increases were reported in November for a second straight month; most of the buildup was limited to machinery, motor vehicles, and miscellaneous nondurable goods. With stocks rising in line with sales since September, the stock-to-sales ratio in wholesaling remained at the low end of its range over the past year. Retail inventories increased moderately further in November; the inventory-to-sales ratio for the sector was slightly below its average for previous months of the year.

The nominal U.S. merchandise trade deficit widened slightly in November. For October and November together, however, the deficit narrowed a little from its average rate in the third quarter, as the value of exports rose more than the value of imports. Most of the increase in exports was in capital goods, both machinery and aircraft, and in consumer goods. Passenger cars accounted for a considerable part of the rise in imports, while the inflow of consumer goods eased from the very strong pace of the third quarter. Recent indicators suggested that economic activity had remained weak in the major foreign industrial countries and that unemployment rates had increased further in most of those countries. The recovery in Canada appeared to be continuing, but the downturn in western Germany and Japan evidently had persisted into the fourth quarter.

A small November decline in producer prices of finished goods was reversed in December, with a rebound in prices of finished foods outweighing a further drop in energy prices. For finished items other than food and energy, producer prices rose in December, but the advance followed six months of no change on balance; for 1992 as a whole, this measure of prices increased by a considerably smaller amount than in 1991. At the consumer level, the index for prices of nonfood, non-energy items edged higher in December after somewhat larger increases in the two preceding months. The rise in this index in 1992 was the smallest for any year since the early 1970s, when wage and price controls were in effect. Hourly compensation of private industry workers advanced a little more rapidly in the fourth quarter than in the two previous quarters, but the rise in total compensation over the year as a whole was considerably smaller than in 1991. The slowing of labor cost increases last year occurred in both the wages and benefits components.

At its meeting on December 22, 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 adjustments to policy during the intermeeting period. Accordingly, the directive indicated that 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 or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with expansion of M2 at an annual rate of about 1½ percent and with M3 remaining about unchanged on balance over the four-month period from November through March.

Open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions. Adjustment plus seasonal borrowing was well above expected levels in the first two full reserve maintenance periods in the intermeeting interval; borrowing was sizable over the long New Year's weekend and also later when unusually heavy Treasury tax receipts drained reserves from the banking system. The federal funds rate averaged close to expected levels over the intermeeting period. However, the rate was somewhat volatile in late December as a result of sizable swings in market factors affecting reserves and of shifting market anticipations regarding year-end pressures.

Most other short-term interest rates declined somewhat over the intermeeting period, in part reflecting the passing of year-end pressures. Intermediate- and long-term rates, including those on fixed-rate mortgages, also moved somewhat lower; the declines occurred in response to growing indications that any proposed near-term fiscal stimulus would be quite moderate and that the new Administration intended to recommend steps, possibly including new taxes, to lower the trajectory of the fiscal deficit appreciably over time. Broad indexes of stock prices exhibited mixed results over the intermeeting period: Indexes giving heavy weight to large companies changed little, while those primarily reflecting smaller companies rose significantly.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose on balance over the intermeeting period. Through early January, the dollar appreciated against both the yen and the mark, especially the latter, in response to actual and expected further declines in interest rates in Japan and Germany. Subsequently, the dollar's gains were partially erased as the prospects for near-term easing in Germany diminished somewhat and perceptions grew that fiscal initiatives in the United States would lower the deficit and reduce the chances that monetary policy might be tightened in the months ahead.

After expanding at a moderate pace over the course of earlier months, M2 contracted in December and January.

Some of the weakness reflected a slowdown in M1 growth associated with lower mortgage refinancing activity. Within M2's nontransactions component, the expansion of savings and money market deposit accounts slowed abruptly, perhaps owing in part to the wider spread that had developed during the fall between market rates and those paid on these accounts, as well as to the use of monies in these accounts to fund a step-up in consumer purchases and nonwithheld tax payments. In addition, the continued attractiveness to investors of bond and stock mutual funds might have contributed to a quickening of the runoff of holdings of money market mutual funds and to the persisting weakness in other M2 accounts. Appreciable declines in M3 in December and January reflected both the contraction in M2 and reduced needs by banks for managed liabilities at a time of weak overall credit demand. From the fourth quarter of 1991 to the fourth quarter of 1992, both M2 and M3 grew at rates somewhat below the lower ends of the Committee's annual ranges. Total domestic nonfinancial debt appeared to have expanded at the lower end of the Committee's monitoring range for 1992.

The staff projection prepared for this meeting suggested that economic activity would expand over the year ahead at a pace that would be sufficient to reduce gradually margins of unemployed labor and capital. Recent declines in long-term interest rates and more optimistic attitudes on the part of businesses and households were expected to support further solid gains in business fixed investment and in homebuying. Continuing progress in reducing debt service burdens and a gradual lessening of concerns regarding job security were projected to foster an expansion of consumer spending a shade faster than the growth in incomes. Export demand would be damped for some period of time by the appreciation of the dollar since mid-1992, but an anticipated pickup in growth abroad later this year would begin to counteract the effects of the higher dollar. Against the background of considerable uncertainties associated with still unannounced fiscal policy initiatives, the staff retained for this forecast the assumption contained in several previous forecasts that fiscal policy would remain mildly restrictive, largely because of declining defense outlays. The persisting slack in resource utilization over the forecast horizon was expected to be associated with some additional progress in reducing inflation.

In the Committee's discussion of current and prospective economic developments, the members were encouraged by the mounting evidence of appreciable momentum in the economic expansion. On the whole, recent developments tended to reinforce their forecasts of continuing growth at a moderate pace over the year ahead, especially in light of the improvement in business and consumer confidence. The impact of some retarding influences on the expansion, notably various balance sheet adjustment activities, appeared to be waning. In addition, while some major sectors of the economy such as defense spending and commercial construction remained weak, the economy was benefiting from considerable growth in consumer spending, from rising business expenditures for producer equipment, and from increasing outlays for housing. In one view, the recent behavior of commodity prices also tended to indicate some strengthening in the economy's expansion. Despite various indications of a more firmly established expansion, however, the members felt that the outlook remained subject to a good deal of uncertainty, and some commented that substantial deviations—in either direction—from their current forecasts could not be ruled out. It was noted in this connection that the specifics of the President's fiscal policy proposals were still unknown, and their reception by the public and the Congress would have a major influence on confidence, interest rates, and the performance of the economy. Other sources of uncertainty related to the outlook for further restructuring activities that involved cutbacks in operations and employment by many firms, and the prospective lending policies of banking institutions. With regard to the outlook for inflation, most of the members believed that some further progress toward stable prices was likely over the year ahead, given an economic outcome about in line with their forecasts of continued, albeit reduced, margins of unutilized or underutilized productive resources. Some members also referred to the extended period of relatively sluggish growth in the broad measures of money as a favorable indicator in the outlook for inflation.

In keeping 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 rate of unemployment, and inflation for 1993. The central tendencies of the forecasts pointed to slightly faster economic growth this year than currently seemed to have occurred in 1992. The anticipated rate of economic expansion would be at a pace that was rapid enough to reduce the rate of unemployment a little further. Nonetheless, with some slack in productive resources persisting, price and cost pressures would remain subdued and modest additional moderation in inflation was expected by most members. Measured from the fourth quarter of 1992 to the fourth quarter of 1993, the forecasts for growth of real GDP had a central tendency of 3 to 3¼ percent within a full range of 2½ to 4 percent. Projections of the civilian rate of unemployment in the fourth quarter of 1993 were concentrated in the upper half of a 6½ to 7 percent range. For the CPI, the central tendency of the forecasts for the period from the fourth quarter of 1992 to the fourth quarter of 1993 was centered on increases in a range of 2½ to 2¾ percent, and for nominal GDP the forecasts were clustered in a range of 5½ to 6 percent for the year.

In the course of the Committee's discussion of various factors underlying the outlook for economic activity, the members observed that on the whole the effects of a number of structural impediments to the expansion seemed to be diminishing as the financial condition of households, business firms, and financial institutions continued to improve. Household and business debt-service burdens had eased substantially, but it remained difficult to predict to what extent and for how long the ongoing balance sheet adjustments would continue to divert an unusual proportion of cash flows from spending to balance sheet repair. Improved profitability and new capital-market issuance had strengthened the capital positions of banking institutions, and in general they were now in a much better position to augment their lending activities. However, there were few indications thus far of any easing in terms or standards on business loans, and the depressed and uncertain values of commercial mortgages and real estate held in bank portfolios might continue to exert an inhibiting effect on the willingness of banks to lend. Another negative factor was the persistence of downsizing and other restructuring activities by numerous firms, notably large businesses. Such restructuring activities had not fully run their course as many firms continued to pare excess production capacity and to modernize production facilities to meet strong competition in domestic and foreign markets. The resulting layoffs had damped overall job growth.

Despite tepid job growth, retail sales had strengthened markedly during the closing months of 1992, and several members commented that such sales had continued to display surprising vigor in some parts of the country during the early weeks of 1993. Apart from the improvement in consumer sentiment, other favorable factors cited with regard to the outlook for consumer spending included lower debt-service burdens and the capital gains or enhanced cash flows now being realized as sales of homes picked up and mortgage refinancings again strengthened. Some members nonetheless expressed a degree of concern about the sustainability of the gains in consumer spending unless there were faster growth in employment and income to support such spending. Announcements by prominent firms of cutbacks in their workforces had continued into the new year, and while job gains at other firms, especially smaller ones, were contributing to modest net growth in overall employment, the publicity surrounding the persisting job cutbacks and a tendency for many new jobs to be lower-paying added an element of caution to the outlook for consumer expenditures. On balance, with the measured saving rate already at a low level, though an argument could be made that the actual rate was somewhat higher than indicated by the currently published data, consumer spending seemed likely to expand about in line with the growth in consumer incomes over the coming year.

The growth in consumer incomes in turn was likely to depend importantly on the expansion in business investment spending, and members cited a number of factors that were expected to provide a favorable setting for sustained momentum in such spending over the year ahead. These included the strengthening of final demands, the recent declines in intermediate- and long-term interest rates, the greater leeway for financial intermediaries to increase their lending to businesses, and a continuing desire by business firms to improve their operating efficiencies. Commercial construction activity, however, was likely to remain quite sluggish. There were indications that commercial real estate values had stabilized in a number of areas, but at low levels, and given the persistence of marked imbalances in numerous real estate markets that were the result of several years of overbuilding, a significant rebound in commercial building activity for the nation as a whole might well be several years away. The outlook for housing construction was much more promising. Against the background of a general upswing in consumer confidence and the improved balance sheets of many households, the declines that had occurred in mortgage interest rates had fostered a marked strengthening in the demand for single-family housing as evidenced by reports from many parts of the country as well as the overall statistics on housing. On the basis of these developments, the members anticipated a continuing impetus to the economic expansion from housing construction and from related industries over the year ahead. In addition, the current indications of generally lean business inventories, associated in part with strong final demands over the past several months, suggested that the prospects for further gains in overall spending were likely to stimulate efforts by business firms to build up inventories over the quarters ahead.

The increasing signs of slow growth or recession in a number of foreign nations represented a greater downside risk to the demand for U.S. exports than had been apparent earlier. It was noted, for example, that firms engaged in business activities abroad were reporting substantial deterioration in markets for U.S. goods in many foreign countries. Growth in U.S. exports might remain positive over the year ahead, but against the background of a relatively expansive U.S. economy and the dollar's recent appreciation, the value of exports might well fall increasingly short of that of imports with adverse effects on the growth of U.S. economic activity.

Turning to the outlook for fiscal policy, members were encouraged by the prospect that the President would soon propose a program that would produce substantial reductions in the federal deficit over the years ahead. Such a deficit-reduction program, if deemed credible, could result in lower intermediate- and long-term interest rates than would otherwise prevail—even before the program was enacted—with very positive implications for interest-sensitive expenditures. For the nearer term, the President was expected to announce some modest fiscal stimulus relative to what was currently in train. However, the specifics of the President's proposals were not yet known and there was little current basis on which to judge prospective public and congressional reactions. Members emphasized the critical need for long-term deficit reduction, and some expressed concern about the adverse effects on financial markets if fiscal stimulus measures were to be enacted for the short run without the assurance of further legislation to cut federal deficits over time.

With regard to the outlook for inflation, most of the members anticipated that the trend toward lower price and wage inflation would be sustained over the year ahead, and one member observed that the disinflationary momentum in the economy might well be underestimated. Favorable developments relating to the outlook for inflation included evidence of slowing increases in labor costs and continued aggressive efforts by many business firms to improve productivity and reduce costs in the face of intense competition from domestic and foreign producers. Indeed, anecdotal reports from around the country continued to suggest little or no upward pressure on prices in many regions. In addition, the behavior of interest rates in longer-term debt markets was consistent with spreading expectations of gradually diminishing inflation. Some members believed, however, that little or no further progress in reducing inflation was a more likely outcome in the year ahead, though none anticipated higher inflation. Some commodity price indexes had edged higher recently, apparently in response to growing demands related to strengthening activity in several sectors of the economy. Lumber prices in particular had risen considerably in conjunction with the uptrend in single-family housing construction and various constraints on lumber supplies. Some business contacts reported for the first time in a long while that they were experiencing or anticipated some upward pressure on their raw materials prices. Further, while most business contacts saw or anticipated little or no upward pressure on prices in their own industries, many continued to expect rising inflation more generally. The still relatively steep slope of the yield curve and its implications with regard to expectations of future increases in interest rates also suggested that investors remained concerned about the possibility of higher inflation over the longer run, even though such concerns might have abated somewhat recently and did not appear to extend to the next year or two. In general, however, the members viewed the inflation outlook with considerable optimism on the presumption of favorable fiscal and monetary policy developments.

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 of the monetary and debt aggregates in 1993 that it had established on a tentative basis at its meeting on June 30–July 1, 1992. The tentative ranges included expansion of 2½ to 6½ percent for M2 and 1 to 5 percent for M3, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The monitoring range for growth of total domestic nonfinancial debt had been set provisionally at 4½ to 8½ percent for 1993. All of these ranges were unchanged from those that the Committee had set for 1992 at its meeting in February of last year and had reaffirmed at midyear. When the provisional ranges for money growth were established, the Committee had noted that they were especially tentative and subject to revision in the latter part of 1992 or early 1993 owing to the considerable uncertainty about the evolving relationship of money to income.

In the event, the velocities of M2 and M3 had increased appreciably in the second half of 1992 and analysis of the factors behind this development suggested further increases in the year ahead. Consequently, in the Committee's discussion, which tended to focus on M2, all the members indicated that they could support a proposal to lower the tentative ranges for growth of the broad monetary aggregates by ½ percentage point for 1993. At the same time, a number of members indicated that they preferred somewhat different ranges including the retention of the tentative ranges, lowering the ranges by more than the proposal, and widening or narrowing them. All the members were in firm agreement that the purpose of the proposed reductions was not to signal or implement any change in monetary policy or to convey any intention to move away from the Committee's commitment to maximum sustainable economic expansion. Rather, the reductions were motivated by the persistence of marked shortfalls in the growth of M2 and M3 from their historical relationships with various measures of aggregate economic performance; those shortfalls appeared to be the technical result of forces that are altering the relationship between money and income. Members of the Committee urged that the Board's report to the Congress and the Chairman's accompanying testimony make clear the reasons for the unusual behavior of money and its consequences for the Committee's choice of ranges.

The deviations in monetary growth from historical norms reflected a number of developments whose relative importance and intensity had shifted to some extent over the course of recent years, but in general they had served to rechannel funds away from depository institutions, and the associated weakness in deposit growth had raised velocity—the ratio of nominal GDP to money. The result was the need for lower money growth than in the past to support a given rate of income growth. Among the developments that had tended to retard the relative growth of M2 and M3 was the unprecedented steepness of the yield curve that had prompted large shifts of funds by savers from M2 accounts to higher-yielding intermediate- and long-term assets. At the same time, credit growth at bank and thrift depository institutions had been weak, partly as a result of efforts by these institutions to improve capital and liquidity positions, and partly owing to weak demand. As a consequence, they also had maintained relatively low offering rates on deposits that had provided consumers with an incentive to reduce or hold down their deposit holdings in order to pay down relatively high-cost mortgages and other debts. In 1992, sluggish growth of M2 and M3 had been associated with a considerable acceleration in nominal spending. Indeed, despite growth of both M2 and M3 at rates below the Committee's ranges, the expansion of the economy had exceeded most forecasts.

The members generally anticipated that the intensity of these forces might diminish in 1993 as borrowers and lending institutions achieved more comfortable balance sheet positions. Nonetheless, the relative weakness in money growth was seen as likely to persist to a marked extent. The yield curve, while it had flattened a bit recently, was still expected to provide a considerable incentive for many savers to shift funds out of M2 assets, especially as relatively high-yielding time deposits continued to mature. In addition, banks were likely to remain generally unaggressive in bidding for deposits, in part because their substantial earlier acquisitions of securities would permit them to accommodate some of the anticipated growth in loan demand by selling securities or limiting purchases. In these circumstances, restrained money growth seemed likely to remain consistent with relative strength in the economic expansion.

The members recognized that the strength of the factors that were expected to continue to depress broad money growth in relation to income in 1993 was still subject to considerable uncertainty, and this implied the need for flexibility in assessing the implications of money growth relative to the Committee's ranges. Should the factors influencing the behavior of the broad aggregates persist in holding down money growth to the extent seen in 1992, expansion of M2 and M3 in the lower portion of their reduced ranges would be consistent with considerable further growth in nominal spending. Indeed, a shortfall from the reduced ranges could not be ruled out, and one member felt that the potential for such a development warranted consideration of a somewhat larger reduction in the M2 range; such a reduction also would signal more clearly the Committee's commitment to price stability. On the other hand, the upper portions of the reduced ranges would still accommodate an ample provision of liquidity to support further economic expansion even if the growth of money and of income were to move toward a historically more normal alignment and velocity were to slow from its high rate of increase. In one view, widening the tentative M2 range by reducing its lower limit while retaining its upper limit would help the Committee to convey its views regarding the potential for a continuing but acceptable sluggishness in M2 growth while leaving room for the possibility of faster M2 expansion should changing circumstances foster diminishing strength in velocity. Another member expressed a preference for narrowing the tentative range by lowering only its upper limit as a means of signaling the Committee's intent to resist both inflationary and recessionary developments. In light of the uncertainties that were involved, the informational content of the aggregates probably had diminished and in any event the Committee would need to continue to evaluate monetary growth developments in the context of a careful assessment of a wide variety of other financial, economic, and price developments. In this connection, one member observed that the uncertainties were of such a magnitude that, while plausible arguments could be made for a number of different ranges, retention of the tentative ranges would be appropriate in light of the Committee's willingness to review the ranges in the event that unanticipated developments were to unfold.

All of the members agreed that it would be desirable to retain the monitoring range of 4½ to 8½ percent that the Committee had established on a provisional basis for the growth of total domestic nonfinancial debt in 1993. The expansion in such debt had not been damped by special forces to the same extent as the broad monetary aggregates in 1992. Over the year ahead, growth in the federal debt was likely to remain substantial, and the expansion of debt in the nonfederal sectors was projected to accelerate somewhat given the continued improvement in borrower balance sheets and an anticipated increase in the willingness of financial institutions to lend as the economy continued to expand. Nonetheless, in the context of still cautious attitudes on the part of both borrowers and lenders, the growth of nonfederal debt probably would remain below that of nominal GDP in the year ahead.

At the conclusion of the Committee's discussion, all of the members indicated that they favored or could accept a technical downward adjustment of ½ percentage point in the tentative ranges for the broader monetary aggregates for 1993 to rates of 2 to 6 percent for M2 and ½ to 4½ percent for M3. It was agreed that there should be no change from the tentative range for total domestic nonfinancial debt. 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 growth and velocity behavior of the aggregates and ongoing economic and financial developments. Accordingly, by unanimous vote, the following longer-run policy for 1993 was approved by the Committee for inclusion in the domestic policy directive:

> 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 this meeting established ranges for growth of M2 and M3 of 2 to 6 percent and ½ to 4½ percent respectively, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The Committee expects that developments contributing to unusual velocity increases are likely to persist during the year. The monitoring range for growth of total domestic nonfinancial debt was set at 4½ to 8½ percent for the year. 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.

Turning to policy for the intermeeting period ahead, all of the members endorsed a proposal to maintain unchanged conditions in reserve markets, and all indicated that they could accept a directive that did not incorporate any presumption with regard to the likely direction of possible intermeeting adjustments to policy. While there was concern about the weakness in the monetary aggregates, the members generally agreed that recent economic developments tended to reinforce the view that monetary policy was on an appropriate course. The economy seemed to be on a stronger growth track than earlier in the expansion, and inflation remained quite subdued—only a bit above some estimates of price stability—and likely to moderate further in coming quarters in the view of most members. Some commented that a further easing move at this juncture might well have adverse effects on inflation sentiment and on interest rates in intermediate- and long-term debt markets. A few referred to the recent firming in some commodity prices and the consensus among private forecasters that inflation could drift higher over the next few years. In the view of one member, these developments might argue for a tilt in the directive toward possible restraint, but they did not call for an immediate tightening in reserve conditions.

A staff analysis prepared for this meeting suggested a resumption of some growth in the broad measures of money later in the first quarter but a decline in both M2 and M3 for the quarter as a whole. While part of the declines appeared to reflect difficulties with seasonal adjustments and the ebbing of special factors that previously had boosted growth, the uncertainties surrounding the behavior of these aggregates tended to reduce their role in current monetary policy. Nevertheless, there was concern about the persisting weakness in the broad aggregates, including the likelihood that they would fall well short of the Committee's new ranges over the first part of the year. Some members also noted that the growth of M1, while still fairly robust in December and January, was markedly below its pace over most of 1992. On the other hand, bank loans had increased in recent months, and the weakness in the monetary aggregates did not appear to reflect underlying softness in the economy. In these circumstances, a number of members believed that any effort to stimulate monetary growth under immediately prevailing economic conditions and market expectations might well prove to be counterproductive. An easing at this time could accelerate outflows from interest-sensitive M2 assets if the easing were seen as signaling a weakening of the System's anti-inflationary resolve and were to result in higher rates on intermediate- and long-term debt securities.

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 for, or acceptance of, a directive that did not include a presumption about the likely direction of any adjustment to policy over 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, the Committee decided that slightly greater or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with little change in the levels of M2 and M3 over the two-month period from January through March.

By unanimous vote, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting indicates that economic activity rose appreciably further in the fourth quarter. Total nonfarm payroll employment registered another small increase in December, and the civilian unemployment rate remained at 7.3 percent. Industrial production posted solid gains over the closing months of the year. Retail sales were up substantially in the fourth quarter, and residential construction activity increased sharply. Indicators of business fixed investment suggest a notable gain in recent months, particularly for producers' durable equipment. The nominal U.S. merchandise trade deficit narrowed slightly in October–November from its average rate in the third quarter. Recent data on wages and prices have been mixed but they continue to suggest on balance a trend toward lower inflation.

Interest rates have declined somewhat since the Committee meeting on December 22. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose on balance over the intermeeting period.

M2 appears to have contracted in December and January, after expanding at a moderate pace over the course of previous months; M3 is estimated to have declined appreciably in both months. From the fourth quarter of 1991 to the fourth quarter of 1992, both M2 and M3 grew at rates somewhat below the lower ends of the Committee's annual ranges for 1992. Total domestic nonfinancial debt appears to have expanded at the lower end of the Committee's monitoring range for the year.

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 this meeting established ranges for growth of M2 and M3 of 2 to 6 percent and ½ to 4½ percent respectively, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The Committee expects that developments contributing to unusual velocity increases are likely to persist during the year. The monitoring range for growth of total domestic nonfinancial debt was set at 4½ to 8½ percent for the year. 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 or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with little change in M2 and M3 over the period from January to March.

At this meeting the Committee discussed a preliminary report of a subcommittee that had been established to examine various issues relating to the release of information about Committee meetings and decisions. All of the members agreed that the Committee should keep the public as fully informed as possible about its monetary policy decisions and their rationale. Such information could reduce uncertainty about the stance of policy and about the factors the Committee takes into account in reaching its decisions. However, release of information should not be allowed to compromise the overriding objective of making and implementing the best possible decisions. In that regard, the Committee noted that its deliberative process requires a free flow of ideas, including the ability to advance or question hypotheses, to speculate on alternative outcomes, and to change opinions in response to the views expressed by other members. The members also needed to feel at liberty during meetings to use a wide array of information that is obtained on a confidential basis; at least some of that information would no longer be provided to the Committee if there were a risk of public disclosure. Moreover, the Committee wanted to give further consideration to the risk that the adoption of a different schedule for releasing information about policy decisions might have the effect, in difficult circumstances, of reducing its willingness to make needed policy adjustments promptly. No decisions were made at this meeting concerning various options for apprising the public more fully or promptly of the Committee's actions, and it was understood that the subcommittee would continue to study the matter.

It was agreed that the next meeting of the Committee would be held on Tuesday, March 23, 1993.

The meeting adjourned.

Donald L. Kohn
Secretary

Meeting Held on March 23, 1993

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, March 23, 1993, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Boehne
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. McTeer
Mr. Mullins
Ms. Phillips
Mr. Stern

Messrs. Broaddus, Jordan, Forrestal, and Parry, Alternate Members of the Federal Open Market Committee

Messrs. Hoenig, Melzer, and Syron, Presidents of the Federal Reserve Banks of Kansas City, St. Louis, and Boston respectively

Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Patrikis, Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. R. Davis, Lang, Lindsey, Rolnick, Rosenblum, Scheld, Siegman, Simpson, and Slifman, Associate Economists

Mr. McDonough, Manager of the System Open Market Account
Ms. Greene, Deputy Manager for Foreign Operations
Ms. Lovett, Deputy Manager for Domestic Operations
Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors[6]
Mr. Madigan, Assistant Director, Division of Monetary Affairs, Board of Governors
Mr. Hooper, Assistant Director, Division of International Finance, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Beebe, T. Davis, Dewald, Goodfriend, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Kansas City, St. Louis, Richmond, and Atlanta respectively

Ms. Browne, and Mr. Sniderman, Vice Presidents, Federal Reserve Banks of Boston and Cleveland respectively

Ms. Krieger, Manager, Open Market Operations, Federal Reserve Bank of New York

At the start of the meeting, the subcommittee established to review policies relating to the release of Committee information reported on its further deliberations and proposed a merging of the current "Minutes of Actions" and the "Record of Policy Actions" into a new document to be designated "Minutes of the Federal Open Market Committee

6. Attended actions portion of meeting relating to discussion of merging minutes of action and policy record into one document.

Meeting." Merging the two documents would put in convenient form all the information that is released pertaining to FOMC meetings, and the new document would be made public on the same schedule as its predecessor documents. The Committee members endorsed the subcommittee's proposal and by unanimous vote the Committee approved the "Minutes of the Federal Open Market Committee Meeting" held on February 2–3, 1993; this merged document was scheduled to be released on March 26, 1993.

The Manager of the System Open Market Account reported on developments in foreign exchange markets since the previous meeting on February 2–3, 1993. There were no System open market transactions in foreign currencies during this intermeeting period, and thus no vote was required of the Committee.

The Deputy Manager for Domestic Operations reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period February 3, 1993, through March 22, 1993. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic outlook and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting suggested that economic activity was expanding at a more moderate pace in the early months of 1993 after increasing substantially in the fourth quarter. Although outlays for business equipment apparently remained on a strong upward trajectory, sales of new homes had slackened and consumer spending was rising less rapidly. Indicators of production activity also were mixed: Industrial output had continued to post solid gains, but homebuilding had been less robust since year-end. Payroll employment had strengthened, and the unemployment rate had moved down further. Increases in wages had remained subdued in recent months, but advances in consumer and producer prices had been larger than those recorded in the latter part of 1992.

Total nonfarm payroll employment rose sharply in February, following generally small advances in previous months, and the length of the average workweek remained at the fourth-quarter level. The strong job gains in construction, services, and retail trade in February apparently reflected to some extent a partial reversal of the special factors that had depressed reported employment in these sectors in previous months. Since December, initial claims for unemployment insurance had fluctuated in a range that was consistent with further modest growth in employment. The civilian unemployment rate edged lower again in February, to 7.0 percent.

Industrial production continued to rise at a fairly brisk pace in January and February. Changes in mining and utilities were about offsetting on balance over the two months, but increases in manufacturing were fairly widespread. Although motor vehicle assemblies fell in February from a relatively high January level, the production of consumer durables and computers turned up sharply. In addition, increases in output were recorded in several other categories, including non-energy materials and construction supplies. Recent surveys indicated that new orders for durable goods increased further in February, and lean factory inventories coupled with reports of lengthening delivery times suggested further gains in industrial output in coming months. Total utilization of industrial capacity rose again in February.

Retail sales advanced in February after a fourth-quarter surge and a pause in January. Sales at automotive dealers weakened in February. However, there were sharp increases in sales of building materials and supplies, miscellaneous durable goods, and nondurable goods other than apparel. After registering sizable gains late last year, housing starts fell substantially in January and retraced only part of that decline in February. The slowdown was concentrated in single-family housing starts; multifamily starts were up in February from a historically low level in January. Although mortgage interest rates had dropped to the lowest levels in decades, sales of both new and existing homes turned down in January from their high December levels.

Incoming data on orders and shipments of nondefense capital goods suggested a further brisk advance in outlays for business equipment in coming months. In January, a decline in shipments of nondefense capital goods only partially reversed a large December rise, as a surge in shipments of computing equipment helped sustain the overall level. Shipments of complete civilian aircraft posted a solid gain in January. The increase appeared to be concentrated in sales to foreign purchasers; in the domestic airline industry, intense competition was forcing cutbacks of unprofitable routes and reductions in both the number of planes in service and orders for new planes. Shipments of durable equipment other than computers and aircraft fell in January to about the level of the fourth quarter. On the other hand, the January reading on new orders for these goods was well above the average for the fourth quarter, suggesting that additional advances in shipments might lie ahead. Nonresidential construction activity was down slightly further in January, reflecting persisting declines in office and industrial building in an environment of excess supply and some continuing, though perhaps lessening, downward pressure on the prices of such structures.

Business inventories appeared to have edged lower in January. In manufacturing, factory stocks were drawn down further, and most industries had relatively low stocks-to-shipments ratios. Among wholesalers, strong January sales pulled down inventories at many types of establishments; in numerous cases, a large accumulation of stocks in the fourth quarter was reversed. For the wholesale sector as a whole, the inventories-to-sales ratio in January was near the bottom of the range of the past two years. Retail inventories rose somewhat further in January after a large December increase. Stocks at automotive dealers accounted for all of the January accumulation. At retail stores other than auto dealers, the ratio of inventories-to-sales remained within the narrow range observed over the past year.

The nominal U.S. merchandise trade deficit widened slightly in January but was little changed from its average level in the fourth quarter. The value of both exports and imports dropped sharply in January from the December levels. The decline in imports was spread widely among major trade categories, but the decrease in exports largely reflected a reduction in shipments of aircraft after a strong December rise. Among the major foreign industrialized countries, the level of real activity contracted further in the fourth quarter in Japan, western Germany, and France; for the first quarter, the limited data available were generally weak for Japan and France but somewhat more mixed for western Germany. By contrast, economic activity appeared to be increasing in Canada and the United Kingdom.

Producer prices of finished goods were up in January and February after changing little over the fourth quarter. Producer prices of finished foods declined over the first two months of the year, but prices of finished energy products climbed rapidly, and prices of other finished items rose at a faster rate than in 1992. At the consumer level, price increases in January and February also were on the high side of the past year's advances. Food prices jumped in January and rose slightly further in February, while energy prices retraced most of a sharp January rise. Excluding food and energy items, consumer prices advanced at a substantially faster pace over the January–February period than in 1992. Increases in wages, as measured by average hourly earnings of production or nonsupervisory workers, remained subdued in recent months. The advance in average hourly earnings slowed in February, and the rise over the twelve months ended in February was considerably smaller than over the previous twelve-month period.

At its meeting on February 2–3, 1993, 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 adjustments to policy during the intermeeting period. Accordingly, the directive indicated that 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 or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with little change in the levels of M2 and M3 over the two-month period from January through March.

Open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions. Adjustment plus seasonal borrowing averaged only slightly above expected levels in the three full reserve maintenance periods in the intermeeting interval. For the period as a whole, the federal funds rate remained close to the 3 percent level that had prevailed in previous months.

Other short-term interest rates changed little over the intermeeting period, while long-term rates fell appreciably on balance. Bond markets rallied over most of the period, reflecting market assessments of improved prospects for significant reductions in the federal budget deficit in coming years and the consequences for overall spending. Prices of Treasury notes and bonds also were boosted by municipal defeasance activity and by perceptions of heightened prepayment risks in mortgage-backed securities. In early March, interest rates on long-term Treasury bonds and conventional fixed-rate mortgages reached their lowest levels since 1973, but some of the decline in bond and mortgage rates subsequently was reversed in response to increased apprehension about inflation. Equity prices generally responded favorably to the drop in long-term interest rates, but concerns about future changes in government policy toward a number of industries, including health care, led to lower prices in some segments of the equities market.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies fell on balance over the intermeeting period. The dollar depreciated through late February, partly in response to declines in U.S. long-term interest rates and incoming data that were seen as pointing to some slowing of the expansion in the United States. Subsequently, the dollar rebounded in the wake of unexpectedly strong U.S. employment statistics, disappointing inflation numbers, and further signs of weakening economic activity abroad. Near the end of the period, the dollar again dropped against the German mark and other European currencies, following a cut by the Bundesbank of its discount rate that apparently was less than market participants were expecting. On balance over the period, the dollar was marginally lower against the mark and other European currencies, but it declined substantially against the Japanese yen, reaching an all-time low.

M2 and M3 contracted in January and February. Part of the weakness apparently reflected temporary factors, such as distortions in seasonal adjustment factors and a lull in prepayments of mortgage-backed securities that reduced deposits held in association with this activity. More fundamentally, relatively attractive returns on capital market instruments continued to prompt households to shift large amounts of liquid balances into market investments, such as bond and stock mutual fund shares. In addition, banks continued to issue subordinated debt and equity to improve their balance sheets at a time when the expansion of bank credit was slowing noticeably; in particular, bank lending to businesses had been depressed by paydowns from the proceeds of heavy bond and stock issuance by nonfinancial corporations. Total domestic nonfinancial debt appeared to have expanded somewhat further in January.

The staff projection prepared for this meeting suggested that economic activity would grow over the year ahead at a pace that would foster a further gradual reduction in margins of unemployed labor and capital. The projection incorporated the essential elements of the fiscal proposals recently set forth by the Administration; the effects on aggregate demand, all other things equal, were expected to be small over the next several quarters. However, the appreciable declines in long-term interest rates that had occurred in recent months—evidently partly in response to anticipations of intermediate-term deficit reduction—were expected to support substantial additional gains in business and residential investment. Consumer spending would be bolstered by the progress already achieved in reducing debt-service burdens and by a gradual lessening of concerns regarding job security, although the higher personal income taxes now envisioned for upper-income taxpayers were expected to be an inhibiting factor. Increases in export demand would be limited in the near term by the continuing weakness in the economies of the major industrialized countries. The persisting slack in resource utilization was expected to be associated with a return to more subdued price increases after a spurt earlier this year.

In the Committee's discussion of current and prospective economic conditions, the members remained encouraged by recent developments that they viewed on the whole as tending to confirm their forecasts of sustained economic expansion, though at a pace appreciably below that now indicated for the fourth quarter of 1992. If realized, such economic growth would be associated over time with a further gradual decline in unemployment. While the expansion appeared to have generated some momentum, a number of factors were likely to limit its strength, including ongoing balance sheet and business restructuring activities, the outlook for a more restrictive federal budget, and continuing weakness in key foreign markets. At the same time, greatly reduced interest rates and much improved, if still vulnerable, business and consumer confidence were positive factors in the outlook. Some members cautioned that even though a moderate rate of economic growth could be viewed as the most likely outcome over the forecast horizon, the current expansion differed in important respects from earlier cyclical recoveries, and in light of the attendant uncertainties a considerably different result—in either direction—could not be ruled out. With regard to the outlook for inflation, the faster increases in consumer prices in recent months and a sharp upturn in the prices of certain producer materials tended to raise concerns, or at least a degree of unease, with regard to underlying inflation trends. While these developments might well prove to be an aberration rather than a signal of intensifying inflation, they did suggest the need to reassess the likelihood of a further decline in inflation and to be alert to further signs of a sustained upturn. For now, however, the favorable trends in underlying unit labor costs, which were associated in turn with ongoing gains in productivity and the absence of any firming in wage pressures, led many members to conclude that recent price developments did not provide persuasive evidence of a change in the inflation outlook.

Members continued to report somewhat uneven business conditions across the nation. Steady economic growth characterized many parts of the country, but business activity remained depressed in some areas and industries, notably those related to defense, aerospace, and nonresidential construction. While business sentiment was generally positive, many business contacts were uncertain about the outlook for demand in their own industries or the potential strength of the overall expansion, and recent fiscal policy developments appeared to have introduced a further note of caution. This uncertainty helped to account for the continuing reliance of numerous firms on overtime work to meet growing demand rather than incurring the considerable costs of adding new workers. Even so, an increasing number of contacts were reporting worker recalls or new hires. One member commented that job growth could be viewed both as a measure of business sentiment and as a necessary element in building or maintaining consumer confidence and thus helping to ensure an enduring economic expansion.

The quickening recovery during 1992, especially in the second half of the year, had received considerable impetus from consumer spending, and while growth in such spending could be expected to moderate from its pace in recent quarters, the consumer sector was viewed as likely to play a key role in sustaining the expansion this year. Many consumers had taken advantage of steep declines in interest rates to strengthen their balance sheets and reduce their debt-service burdens, and they were now in a much improved position to finance further growth in their expenditures. The members took note of recent indications of a decline in consumer confidence and of some softening in retail sales since early in the year. However, the latter appeared to be in part the result of recently adverse weather conditions in some major parts of the country, and consumer confidence was still much improved on balance since earlier in the recovery. Accordingly, recent developments were not seen in themselves as harbingers of a weakening consumer spending trend over the next several quarters.

Business spending on producers' durable equipment also was believed likely to continue to provide appreciable stimulus to the expansion, assuming that the much reduced interest rates and currently favorable business attitudes would be sustained and that proposed investment tax credit legislation eventually would be enacted. At the same time, business spending for nonresidential structures probably would continue to be held back by weakness in office construction stemming from widespread overcapacity. While office building activity was likely to be restrained for an extended period, members saw some positive signs that pointed to a degree of stabilization in this sector, including the leveling out or even a marginal pickup in rents and occupancy rates in some markets that previously had been severely depressed. A slow turnaround in other building activity was reported in some regions, notably for industrial and retail structures.

While the available data on starts of single-family houses in January and February were somewhat disappointing, the members felt that housing construction activity had held up relatively well thus far this year, after allowing for the adverse weather conditions that had retarded construction in some areas. The greatly reduced cost of mortgage financing pointed to continuing gains in housing construction despite a rise in costs associated with the sharp jump in lumber prices and a scarcity of finished building lots in some areas.

The members agreed that the prospects for overall spending on business capital goods and housing were vulnerable to shifts in attitudes that might be triggered, for example, by increases in market interest rates associated with an absence of progress in reducing the federal budget deficit. The outlook for a significant contraction in the federal deficit was subject to considerable uncertainty, especially in light of the still pending decisions to be made with regard to health care programs and their financing. The members recognized that the direct effects of appreciable deficit reduction would tend to constrain economic activity, as evidenced by the impact in many areas of the defense cutbacks that were already being implemented. Business contacts had expressed concerns about the potential effects on their industries and local markets of various provisions in the proposed legislation. Even so, a more encompassing assessment of the effects of deficit reduction needed to take account of its favorable implications for domestic interest rates. Moreover, insofar as the nearer-term outlook was concerned, the fiscal legislation now under consideration included new spending initiatives and an investment tax credit that were intended to provide some temporary stimulus to an economic expansion that, in the view of many observers, might still be in the process of gathering sustainable momentum. On balance, substantial deficit reduction in line with the currently proposed legislation was seen as likely to have a positive effect on business and consumer confidence, financial markets, and the longer-term health of the economy.

Several members observed that the outlook for exports had worsened as a result of weakening economic trends in a number of major industrialized nations. Members also commented on the uncertainties in the outlook for foreign trade associated with a variety of political risks abroad and the persisting protectionism that currently was highlighted by strong opposition to key trade agreements now under negotiation or under consideration for ratification. Anecdotal information from business contacts involved in export markets continued to suggest lagging foreign demand for many U.S. goods; however, backlogs for other products, such as labor-saving capital equipment, remained sizable.

The members devoted considerable attention to the discussion of various factors underlying the outlook for inflation. The consumer and producer price indexes had been less favorable in January and February than in the latter part of 1992. Also, prices of various industrial and construction materials had firmed since the start of the year in apparent response to rising production and, in some industries, to import or environmental restrictions. Anecdotal reports of increasing costs and prices had begun to appear with somewhat greater frequency in some areas, and pressures to widen profit margins reportedly were strong in a number of industries. In their evaluation of recent inflation developments, however, the members generally gave more weight to the behavior of unit labor costs, which indicated that much of the economy's underlying cost structure did not reflect any signs of a pickup in inflationary pressures. Moreover, from a financial perspective, extensions of credit and growth in overall nonfinancial sector debt were not consistent with an economy that was generating significant inflationary pressures, and the recent behavior of long-term debt markets suggested expectations of more subdued inflation. Against this background, the recent upturn in consumer and certain commodity prices might well represent a temporary development such as had occurred previously during the current cyclical upswing. In support of this view, members cited various fundamentals that seemed inconsistent with accelerating inflation, including the considerable slack in the utilization of labor and capital resources, strong competitive conditions in many markets, the absence of significant lengthening in supplier delivery schedules, and an extended period of weak expansion in the broader monetary aggregates that now encompassed some recent deceleration in M1. Nonetheless, the members acknowledged that recent price developments had raised a degree of unease in their minds, and their concerns would rise if the recent pace of price advances were sustained in the months immediately ahead. One member observed that a somewhat faster economic expansion than currently was expected by most members might well serve to intensify inflation pressures. While price developments were notably difficult to predict, most of the members concluded that the evidence at this point did not confirm a resurgence in inflationary pressures, and some commented that further modest disinflation remained a reasonable expectation for the next several quarters.

In the Committee's discussion of policy for the intermeeting period ahead, most of the members endorsed a proposal to maintain an unchanged degree of pressure on reserve positions, while two members supported an immediate move to tighten reserve conditions. In the majority view, the current degree of reserve pressure continued to represent a policy stance that was appropriately balanced in light of the opposing risks of a faltering economic expansion and a resurgence of inflation. Conditions in credit markets did not provide confirming evidence of the emergence of greater inflationary pressures and the need to restrain the growth in credit. Indeed, the continuation of balance sheet restructuring activities by financial institutions and the associated caution on the part of these institutions with regard to extending loans still appeared to be exerting a significantly inhibiting effect on the overall growth in spending and economic activity. Several members acknowledged that a policy of maintaining unchanged reserve conditions and an associated federal funds rate around current levels, which implied that real short-term rates were near zero or even slightly negative, could have inflationary consequences in the event of a strengthening of the expansion and a sustained pickup in credit demands. The Committee would need to remain alert to such a development. In present circumstances, however, an unchanged policy stance seemed most consistent with achieving sustained economic expansion in an environment of subdued inflation. The members who favored a prompt move toward restraint were persuaded that a steady policy incurred an unacceptable risk of halting the progress toward price stability and indeed of intensifying inflation as the current expansion matured. In this view, a policy tightening move at this point was likely to counter the need for more substantial and potentially disruptive tightening actions later.

In the course of the Committee discussion, the members took account of a staff analysis that pointed to a resumption of M2 and M3 growth over the months ahead. This analysis suggested that the temporary factors depressing the broader monetary aggregates likely would be reversing, but that the other influences causing a rechanneling of credit flows away from depository institutions and boosting the velocity of money undoubtedly would persist, though probably with diminishing force. Accordingly, the staff foresaw moderate growth of M2 and M3 that at midyear would leave these aggregates below the lower ends of the Committee's ranges for 1993. Under prevailing circumstances, such continuing weakness in the broader aggregates was not viewed as indicating inadequate monetary stimulus. Indeed, a number of members commented that other indicators suggested that current monetary policy was in fact quite accommodative as evidenced for example by low short-term interest rates, especially on an inflation-adjusted basis. Moreover, M1, reserves, and the monetary base had continued to expand in the first quarter, though at much reduced rates. One member commented that the slowdown in these narrower monetary measures, which he viewed as important indicators of the thrust of monetary policy, had favorable implications with regard to bringing inflation under control. The members agreed that the considerable uncertainty that continued to surround the outlook for broad money relative to spending implied that forming precise expectations for monetary growth over the months ahead was not feasible.

In the Committee's discussion of possible intermeeting adjustments to the degree of reserve pressure, members who favored an unchanged policy stance also expressed a preference for retaining the symmetry of the existing directive. Some observed that a policy change during the intermeeting period, if any, might well be in the direction of a tightening move. However, because there was no compelling case in the view of most members for such a move at this time and any intermeeting adjustment would be made in the light of emerging developments, a symmetric directive was warranted. In this connection, one member commented that, given the Committee's assessment of current economic and financial conditions, a tilt in the directive toward restraint would give a misleading indication of the Committee's current intentions. Members also noted that a change in policy, should one be called for by intermeeting developments, would represent a shift in the direction of policy and would be likely to have an especially pronounced impact on financial markets.

At the conclusion of the Committee's discussion, a majority of the members indicated that they favored a directive that called for maintaining the existing degree of pressure on reserve positions. These members also expressed a preference for a directive that did not include a presumption about the likely direction of any adjustment to policy 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, the Committee decided that slightly greater or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with a resumption of moderate growth in M2 and M3 over the second quarter.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that economic activity has increased at a more moderate pace in the early months of 1993 after expanding robustly in the fourth quarter. Total nonfarm payroll employment registered a sharp increase in February following generally small advances in previous months, and the civilian unemployment rate edged down further to 7.0 percent. Industrial production continued to post solid gains in January and February. Retail sales increased somewhat further over the first two months of the year after a fourth-quarter surge. Housing starts slipped in early 1993 after registering sizable gains late last year. Incoming data on orders and shipments of nondefense capital goods suggest a further brisk advance in outlays for business equipment, while nonresidential construction has remained soft. The nominal U.S. merchandise trade deficit was essentially unchanged in January from its average level in the fourth quarter, but both exports and imports were substantially lower. Increases in wages have remained subdued, but recent advances in consumer and producer prices have been larger than those recorded in the latter part of 1992.

Short-term interest rates have changed little since the Committee meeting in early February while bond yields have fallen appreciably on balance. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined on balance over the intermeeting period.

M2 and M3 contracted in January and February, apparently reflecting transitory factors and further shifts into market investments. Total domestic nonfinancial debt appears to have expanded somewhat further in January.

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 February established ranges for growth of M2 and M3 of 2 to 6 percent and ½ to 4½ percent respectively, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The Committee expects that developments contributing to unusual velocity increases are likely to persist during the year. The monitoring range for growth of total domestic nonfinancial debt was set at 4½ to 8½ percent for the year. 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 or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with a resumption of moderate growth in the broader monetary aggregates over the second quarter.

Votes for this action: Messrs. Greenspan, Corrigan, Boehne, Keehn, Kelley, LaWare, McTeer, Mullins, Ms. Phillips, and Mr. Stern. Votes against this action: Messrs. Angell and Lindsey.

Messrs. Angell and Lindsey indicated that their concerns about the outlook for inflation prompted them to favor an immediate move to tighten reserve conditions. In their view, such an action was desirable not only to arrest the possible emergence of greater inflation but especially to promote further disinflation. They were persuaded that monetary policy currently was overly accommodative as suggested by various indicators such as recent data on consumer and producer prices, the upswing in commodity prices, the low level of real short-term interest rates, and what in their judgment was a relatively depressed foreign exchange value of the dollar given the comparative strength of the U.S. economy and international interest rate trends. They noted that the current federal funds rate was probably not sustainable in the long term and that a tightening move at this time might well avoid the need for more sizable and potentially disruptive policy actions later.

Mr. Angell also emphasized the risks associated with any policy that did not firmly maintain a disinflationary trend. As he interpreted historical precedents, the typical result of a policy that tolerated some inflation was an eventual rise in inflation leading to permanently higher interest rates with adverse effects on economic activity. Indeed, he supported unpegging the federal funds rate to counter incipient price pressures showing through in commodity and finished goods prices. He believed that a clear signal of the Committee's commitment to price level stability would stabilize the price of gold along with the exchange value of the dollar and thereby provide a climate for further reductions in long- and intermediate-term interest rates. Such an approach to policy not only would assure a continuing disinflationary trend and eventual price stability, with very favorable implications for financial markets and economic growth, but it would in his view preclude an unsettling tendency for the debt markets to weaken every time newly available data appeared to suggest that economic growth was strengthening and that further monetary policy tightening actions therefore might be in the offing. In sum, such a policy would provide for the achievement of the Committee's objective of sustaining progress toward price stability, which he believed was necessary for maintaining recent higher labor productivity, a permanently higher saving rate, and a prolonged period of economic expansion.

It was agreed that the next meeting of the Committee would be held on Tuesday, May 18, 1993.

The meeting adjourned.

Normand Bernard
Deputy Secretary

Meeting Held on May 18, 1993

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, May 18, 1993, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell

Mr. Boehne
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. McTeer
Mr. Mullins
Ms. Phillips
Mr. Stern

Messrs. Broaddus, Jordan, Forrestal, and Parry, Alternate Members of the Federal Open Market Committee

Messrs. Hoenig, Melzer, and Syron, Presidents of the Federal Reserve Banks of Kansas City, St. Louis, and Boston respectively

Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist

Messrs. R. Davis, Lang, Lindsey, Promisel, Rolnick, Rosenblum, Scheld, Siegman, and Slifman, Associate Economists

Mr. McDonough, Manager of the System Open Market Account
Ms. Greene, Deputy Manager for Foreign Operations
Ms. Lovett, Deputy Manager for Domestic Operations
Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors
Mr. Stockton, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Hooper, Assistant Director, Division of International Finance, Board of Governors
Mr. Small,[7] Section Chief, Division of Monetary Affairs, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. T. Davis, Dewald, and Goodfriend, Senior Vice Presidents, Federal Reserve Banks of Kansas City, St. Louis, and Richmond respectively

Ms. Browne, Mr. Judd, and Mses. Rosenbaum and White, Vice Presidents, Federal Reserve Banks of Boston, San Francisco, Atlanta, and New York respectively

Mr. Eberts, Assistant Vice President, Federal Reserve Bank of Cleveland

By unanimous vote, the minutes for the meeting of the Federal Open Market Committee held on March 23, 1993, were approved.

The Deputy Manager for Foreign Operations reported on developments in foreign exchange markets and on System transactions in foreign currencies during the period March 23, 1993, through May 17, 1993. By unanimous vote, the Committee ratified these transactions.

The Manager of the System Open Market Account reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period March 23, 1993, through May 17, 1993. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic outlook and the implementation of monetary policy over the intermeeting period ahead. A sum-

7. Attended portion of meeting relating to a report on a study entitled "Operating Procedures and the Conduct of Monetary Policy: Conference Proceedings," edited by Marvin Goodfriend and David Small. This two-volume study has been designated Working Studies 1, Parts 1 and 2, of the Federal Reserve Board's Finance and Economic Discussion Series.

mary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting suggested that the pace of the economic expansion had slowed in recent months. Business outlays for durable equipment had remained strong, but consumer spending had been quite sluggish, reflecting limited gains in employment and real labor income and diminished optimism about near-term economic prospects. Additionally, U.S. exports continued to be constrained by the disappointing performance of the major foreign industrial economies. Available data indicated relatively modest growth in payroll employment and industrial production over recent months. Despite the considerable slack in the economy, increases in wages and prices had been appreciably larger thus far in 1993 than in the second half of last year.

Total nonfarm payroll employment rose only slightly on balance over March and April after registering sizable increases in the first two months of the year. Strong job gains in the services industry, notably in business and health services, were offset in considerable measure by job losses in manufacturing and construction in March and April. In manufacturing, reductions in payrolls were widespread, with particularly large declines at manufacturers of transportation equipment. Construction employment recovered only partially in April from the weather-related decline in March. The civilian unemployment rate remained at 7.0 percent.

Industrial production, after having posted solid gains in previous months, was little changed in March and April. Part of the recent sluggishness reflected a decline in utility output following a weather-related runup in February, but manufacturing output also grew more slowly. In the transportation industry, motor vehicle assemblies edged down and production of civilian aircraft remained weak over March and April. Elsewhere, the output of consumer goods other than motor vehicles was about unchanged, and the continuing strength in the computer industry contrasted with sluggish production of other types of business equipment. Total utilization of industrial capacity changed little over the two months.

Retail sales increased substantially in April, reversing the weather-related decline in March; automotive dealers reported large sales gains in April, and expenditures at other retail outlets retraced part of the March decrease. For the year to date, however, retail sales had been lackluster after the strong increases of the latter part of 1992. Housing starts picked up in April; both single-family and multifamily starts rebounded from weather-depressed March levels.

Business fixed investment advanced further during the first quarter of 1993, with another sizable rise in outlays for equipment outweighing continued weakness in nonresidential construction. Shipments of nondefense capital goods during the first quarter were paced by another sharp increase in shipments of office and computing equipment. By contrast, business spending for transportation equipment generally exhibited little strength; although sales of heavy trucks continued to trend up, outlays for complete aircraft apparently edged down further. Recent data on orders for nondefense capital goods other than aircraft suggested further expansion in business spending for equipment in the near term. Nonresidential construction activity was mixed in the first quarter. Office construction declined considerably further in response to the depressing effects of a continuing overhang of unoccupied space. On the other hand, building activity in the public utilities sector continued to trend up, and the construction of commercial structures other than office buildings increased for a second consecutive quarter.

Business inventories appeared to have risen in the first quarter. Manufacturing inventories expanded in both February and March after a series of declines that began early in the fall; much of the recent advance occurred in the durable goods sector, where shipments were strong, and the ratio of inventories to shipments fell for manufacturing as a whole. Wholesale inventories increased appreciably in March. However, the inventory-to-sales ratio for the sector moved up only slightly, and it remained near the low end of its range over the past two years. In the retail sector, available data indicated that inventories rose appreciably over January and February but that the inventory-to-sales ratio remained in the narrow range that had prevailed over the preceding year.

The nominal U.S. merchandise trade deficit in February was unchanged from its January level, reflecting little change in total exports and total imports. For January–February combined, however, the trade deficit was slightly below its average level for the fourth quarter, with both exports and imports down considerably from their fourth-quarter levels. Much of the drop in exports reflected a reversal of an earlier, largely transitory runup in aircraft and automotive products. The decline in imports was spread across all major trade categories; imports of aircraft and miscellaneous industrial supplies dropped appreciably, and imports of consumer goods fell further. Recent indicators pointed to further weakness in economic activity in continental Europe and Japan through the first quarter. Elsewhere, the recovery in the United Kingdom appeared to be firming, and growth continued at a modest pace in Canada.

Producer prices of finished goods rose more rapidly in March and April, partly as a result of sharp increases in the prices of finished energy goods in March and in the prices of finished foods in April. Excluding the food and energy components, producer prices advanced over the first four months of 1993 at a faster pace than in 1992. At the consumer level, the increase in prices of nonfood, non-energy items over the March–April period was smaller than the outsized change over the first two months of the year; nevertheless, averaging over the first four months of the year, the rate of increase in consumer prices was higher than in 1992. The deceleration of labor costs also appeared to have stalled in 1993. Average hourly earnings of production or nonsupervisory workers had grown more rapidly thus far this year than in 1992, and total hourly compensation of private industry workers rose at a faster pace in the first quarter of 1993 than in any quarter of last year.

At its meeting on March 23, 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 adjustments to policy during the intermeeting period. Accordingly, the directive indicated that 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 or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with a resumption of moderate growth in M2 and M3 over the second quarter.

Open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions. Expected levels of adjustment plus seasonal borrowing were raised during the period in anticipation of some increase in seasonal borrowing. Adjustment plus seasonal borrowing was near or a little above expected levels, except for a surge at the end of the first quarter, and the federal funds rate remained close to the 3 percent level that had prevailed for an extended period.

Short-term interest rates changed little over the period since the March meeting. Long-term rates rose considerably early in the period when a sharp increase in average hourly earnings and some upward pressure on commodity prices sparked fears among market participants of a buildup in inflation pressures. Subsequently, despite growing doubts about the fate of the deficit reduction program, bond yields declined in response to a series of more favorable readings on price behavior and to indications of a slowing of the economic expansion. Adverse news about consumer and producer prices rekindled inflation concerns late in the period, and bond rates once again moved higher. On balance, most long-term market rates rose somewhat over the period. Despite unexpectedly favorable earnings reports for many firms, major indexes of stock prices were narrowly mixed over the period.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined somewhat on balance over the intermeeting period. The dollar depreciated considerably more against the Japanese yen than against the German mark. A variety of factors contributed to the dollar's weakness, including indications of renewed sluggishness in U.S. economic activity, diminished prospects for a fiscal stimulus package, and market perceptions over much of the intermeeting period of limited official support for concerted actions to support the dollar against the yen. After falling to a historical low against the yen in late April, the dollar tended to stabilize following Treasury Secretary Bentsen's clarification of the Administration's exchange rate policy and intervention purchases of dollars against yen in a coordinated operation. Later in the period, the dollar rose somewhat against European currencies as the outlook for economic activity in Europe became more pessimistic.

M2 contracted slightly on balance over March and April, while M3 was unchanged over the two months; both monetary aggregates increased substantially in early May. Much of the weakness in M2 over the March–April period owed to a smaller volume of nonwithheld tax payments in April of this year that reduced the need for a buildup in deposits to fund these payments. Abstracting from this temporary depressant, weak underlying growth in M2 continued to reflect the relatively attractive returns available on capital market instruments such as bond and stock mutual funds, which experienced heavy inflows during the two-month period. Total domestic nonfinancial debt expanded somewhat further through March.

The staff projection prepared for this meeting suggested that economic activity would grow at a moderate pace and that such growth would foster a gradual reduction in margins of unemployed labor and capital. The projection continued to incorporate the essential elements of the Administration's fiscal package, excluding that portion of the short-run stimulus initiative that seemed unlikely to be enacted by the Congress. Although the outlook for fiscal policy now seemed somewhat more contractionary than earlier, the sizable declines in long-term interest rates that had occurred in recent months were expected to support substantial additional gains in business and residential investment. Moreover, the increasingly favorable financial environment associated with expected further easing of credit supply constraints and the ongoing strengthening of balance sheets would tend to buttress private spending on housing, consumer durables, and business equipment. Increases in export demand would be damped in the near term by the continuing weakness in the economies of the major industrialized countries. The persisting slack in resource utilization was expected to be associated with a return to more subdued price increases after a spurt earlier in the year.

In the Committee's discussion of current and prospective economic conditions, the members focused with some concern on the evidence of a slower economic expansion and a higher rate of inflation since late 1992. While recent indicators of economic activity were disappointing, the expansion nonetheless appeared to have sustainable momentum and the members generally viewed moderate growth in line with, or perhaps a bit below, their February forecasts as a reasonable expectation. At the same time, several emphasized that the outlook was subject to substantial uncertainty stemming to an important extent from the unsettled course of legislation aimed at reducing the federal deficit. Members expressed particular concern about the rise in various measures of inflation over the past several months. The increase seemed to reflect temporary factors and a worsening in inflationary expectations rather than any significant change in economic fundamentals. Accordingly, it was premature in the view of many members to conclude that the inflationary trend had tilted upward. Even so, higher inflation expectations, if sustained, would be detrimental to economic performance, and the risks of an uptrend in inflation clearly had increased.

In their review of business developments across the nation, members continued to report uneven conditions ranging from apparently moderate gains in some parts of the country to mixed or marginally declining activity in others. Business confidence had deteriorated in many areas and firms were trimming or putting on hold new or expanded spending programs pending a resolution of federal tax and spending proposals, including prospective health care reform, and the outcome of proposed tax legislation in some states as well. Cautious business attitudes were reflected in continuing efforts to constrain costs and to hold down or reduce employment levels, notably of permanent workers in light of the large nonwage costs associated with full-time workers. Accordingly, while some job growth was occurring, especially outside major firms and the defense sector, business firms generally appeared disposed to continue to meet increases in demand through overtime work and temporary workers, and members anticipated that such attitudes were likely to persist in the absence of a major improvement in business confidence.

As reflected in the available data for the national economy, anecdotal reports from around the country suggested generally lackluster retail sales over the first four months of the year. To an extent, this development probably involved some retrenchment in consumer spending following an unsustainable surge during the latter part of 1992. In some parts of the country, unusually severe weather conditions also had served to hold down retail sales earlier this year, and recovery from that slowdown had tended to be limited thus far, especially outside the automotive sector. Looking ahead, the members continued to anticipate that consumer spending would provide moderate support for a sustained economic expansion.

Despite the cautious business attitudes about the economic outlook, spending for business equipment had continued to help maintain the expansion. Encouraged in part by relatively low interest rates, receptive financial markets, and the more aggressive lending policies of some depository institutions, many firms were upgrading equipment to reduce costs and improve their product offerings. Concurrently, however, numerous firms reported that they were holding off on making major new investment commitments and in some cases were revising down earlier expansion plans in light of prevailing economic uncertainties, notably those generated by the current legislative debate about federal taxes and spending. Nonresidential construction remained uneven and on the whole relatively subdued across the nation. The construction of new office structures was likely to stay depressed in much of the country as overcapacity continued to be worked down, but members saw indications of some strengthening in industrial and commercial building activity and in public works projects in some areas.

Turning to the outlook for the nation's trade balance, some members referred to quite gloomy assessments from business contacts and other sources regarding current economic conditions in a number of major industrial nations and the associated prospect of little or no growth in U.S. exports to such countries. While total U.S. exports might continue to expand, reflecting sizable gains in some parts of the world, imports probably would grow at a somewhat faster pace, given moderate expansion in domestic demand in line with the members' expectations. At the same time, members expressed concern about the potential impact of growing protectionist sentiment on current trade negotiations and on the longer-run outlook for domestic industries and parts of the country that relied on foreign trade.

With regard to the inflation situation, members commented that it remained difficult to find a satisfactory explanation for the faster-than-projected increases in price measures thus far this year. Although temporary anomalies seemed to be involved, including measurement problems and special factors boosting some prices, higher inflation expectations also might have been playing a key role. The latter seemed to have intensified in the last month or two, perhaps as a result of growing concerns that significant deficit-reduction legislation might not be enacted. Strong competitive pressures in many markets, including competition from foreign producers, still appeared to be restraining or precluding price increases by many business firms, but efforts to raise prices seemed to be encountering somewhat less resistance recently than earlier in the economic expansion. Some price increases appeared to be associated with the earlier surge in demand, and in the case of one key industry higher prices had been facilitated by the implementation of import restrictions. The downtrend in labor compensation inflation also seemed to have stalled in recent months. Against this background, a considerable degree of uncertainty surrounded the outlook for inflation and the members differed to some extent with regard to the most likely outcome. A number of members, while they did not rule out the possibility of a more favorable result, stressed the risk that a faster rate of inflation might well tend to be sustained. Others gave more emphasis to the still considerable slack in labor and product markets and to the restrained growth in broad measures of money and credit. In this view, an inflation rate in the quarters ahead more in line with their earlier forecasts was still a reasonable expectation even though the average rate for the year as a whole was likely to be higher than they had forecast at the start of the year.

In the Committee's discussion of policy for the intermeeting period ahead, many of the members commented that recent price and wage developments were troubling but did not point persuasively at this juncture toward an extended period of higher inflation. In light of underlying economic and financial conditions, the upturn in inflation expectations and the somewhat quickened pace of inflation might well prove to be temporary. The economy was expanding, but the pace had slowed in recent months. On the other hand, the potential for a sustained increase in the rate of inflation could not be dismissed. Waiting too long to counter any emerging uptrend in inflation or further worsening in inflationary expectations would exacerbate inflationary pressures and require more substantial and more disruptive policy moves later. Indeed, in one view sensitive commodity prices and other key measures of inflation already indicated the need for a prompt move toward restraint, especially in the context of the Committee's objective of fostering progress toward price stability. However, the other members all supported a proposal to maintain an unchanged degree of pressure on reserve positions at this time.

In the course of the Committee's discussion, the members took account of a staff analysis that pointed to a considerable pickup in the growth of M2 and M3 over the months of May and June. Such strengthening, which appeared to have emerged in early May, was associated in part with the reversal of earlier tax-related distortions and with a surge in prepayments of mortgage-backed securities. Monetary growth was expected to revert to a more modest pace over subsequent months, and the members recognized that in any event the interpretion of monetary growth rates needed to be approached with considerable caution in a period when traditional relationships of such growth to aggregate measures of economic performance were not reliable. In present circumstances, M2 and M3 no longer seemed to be good barometers of underlying liquidity, which appeared to be ample. One member expressed the view that the relatively robust growth of M1 and reserves served as a better indicator of the thrust of monetary policy than did the broader monetary aggregates.

In the view of a majority of the members, wage and price developments over recent months were sufficiently worrisome to warrant positioning policy for a move toward restraint should signs of intensifying inflation continue to multiply. In addition to new information on prices and costs, such signs could include developments in markets affected by inflation psychology, such as those for bonds, foreign exchange, and sensitive commodities, all of which would need to be monitored carefully. These members supported a directive that incorporated a greater predilection to tighten than to ease over the intermeeting period. Given the special nature of current inflation concerns and attendant uncertainties, however, the Committee agreed with a proposal by the Chairman that an intermeeting consultation would be appropriate in the event that a tightening move were to be contemplated during this period. If a policy tightening action were not needed, an asymmetric directive would nonetheless underscore the Committee's concern about recent inflation readings and its judgment that a policy to encourage progress toward price stability would promote sustained economic growth. In the event that a tightening action became necessary, such action could help to moderate inflationary expectations, with positive implications over time for long-term interest rates and the performance of the economy. Monetary policy would still be stimulative after a modest tightening move in that such a move would leave short-term interest rates close to or even below their year-ago levels in real terms, given the interim rise in inflation.

Some members preferred to retain a directive that did not incorporate a presumption about the likely direction of a change in policy, if any, during the intermeeting period. They were concerned that adopting a biased directive might prove to be an overreaction to temporary factors and to a short-lived upturn in inflationary sentiment that was not warranted by underlying economic conditions. They noted that, if called for by intermeeting developments, a move toward restraint could be implemented from a symmetric directive. More fundamentally, they believed that the circumstances surrounding the recent performance of the economy and the uncertainties about price developments suggested the need for considerable caution before any policy tightening was implemented and that such a policy move should be carried out only in the light of information that pointed clearly to the emergence of higher inflation. Nonetheless, all but one of these members could accept an asymmetric directive on the understanding that the Committee would have a chance to discuss any possible policy action.

At the conclusion of the Committee's discussion, all but two of the members indicated that they preferred or could accept a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward possible firming of reserve conditions 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, the Committee decided that slightly greater reserve restraint would be acceptable or slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with appreciable growth in the broader monetary aggregates over the second quarter.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that the economic expansion has slowed in recent months. Total nonfarm payroll employment rose only slightly over March and April after registering sizable increases earlier in the year, and the civilian unemployment rate remained at 7.0 percent. Industrial production was little changed in March and April after posting solid gains in previous months. Retail sales increased substantially in April but were about unchanged on balance for the year to date. Housing starts picked up in April. Incoming data on orders and shipments of nondefense capital goods suggest a further brisk advance in outlays for business equipment, while nonresidential construction has remained soft. The nominal U.S. merchandise trade deficit in January–February was slightly below its average level in the fourth quarter. Increases in wages and prices have been appreciably larger this year than in the second half of 1992.

Short-term interest rates have changed little since the Committee meeting on March 23 while bond yields have risen somewhat. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined somewhat on balance over the intermeeting period.

After contracting during the first quarter, M2 was unchanged in April while M3 turned up; both aggregates increased substantially in early May. Total domestic nonfinancial debt expanded somewhat further through March.

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 February established ranges for growth of M2 and M3 of 2 to 6 percent and ½ to 4½ percent respectively, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The Committee expects that developments contributing to unusual velocity increases are likely to persist during the year. The monitoring range for growth of total domestic nonfinancial debt was set at 4½ to 8½ percent for the year. 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 would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with appreciable growth in the broader monetary aggregates over the second quarter.

Votes for this action: Messrs. Greenspan, Corrigan, Keehn, Kelley, LaWare, Lindsey, McTeer, Mullins, Ms. Phillips, and Mr. Stern. Votes against this action: Messrs. Angell and Boehne.

Mr. Angell dissented because he believed that the persisting indications of rising inflation and the related deterioration in inflationary psychology called for a prompt move to tighten monetary policy. In his view, low real interest rates, a very steep yield curve, a surprisingly weak exchange value of the dollar along with the confirming price behavior of inflation-sensitive commodities such as gold underscored the need for Committee action to signal the System's continuing commitment to the eventual achievement of price stability. In his opinion, progress toward lower inflation was not likely in 1993 and 1994 in the absence of a monetary policy that was sufficiently restrictive to check inflationary expectations. He added that history demonstrated that a monetary policy focused primarily on developments in the real economy ran the risk of waiting too long to counter a worsening in inflationary expectations and thus requiring more substantial and possibly more disruptive policy changes later.

Mr. Boehne supported a steady policy course, but he dissented because he objected to a directive that was biased toward tightening. Although recent developments suggested that inflation would be somewhat higher and real growth somewhat lower during the year than had been expected earlier, he did not believe recent data indicated a fundamental shift in the outlook for inflation or the economy. He was concerned that adopting a biased directive might prove to be an overreaction to temporary factors affecting the inflation rate and inflationary sentiment. In his view, underlying economic conditions did not point toward an extended period of higher inflation. While the pace of economic growth conceivably could quicken, it seemed just as likely that the tempo of business and consumer spending could diminish in the face of uncertainty about the stance of fiscal policy, particularly with regard to potential tax increases. Given these uncertainties, he had a strong preference for keeping an open mind about possible Committee action during the intermeeting period and, accordingly, favored a balanced policy directive.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, July 6–7, 1993.

The meeting adjourned at 1:50 p.m.

Normand Bernard
Deputy Secretary

Meeting Held on July 6–7, 1993

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, July 6, 1993, at 2:30 p.m. and continued on Wednesday, July 7, 1993, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Mullins[8]
Mr. Angell
Mr. Boehne
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. McTeer
Mr. Oltman[9]
Ms. Phillips
Mr. Stern

Messrs. Broaddus, Jordan, Forrestal, and Parry, Alternate Members of the Committee

Messrs. Hoenig, Melzer, and Syron, Presidents of the Federal Reserve Banks of Kansas City, St. Louis, and Boston respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Patrikis, Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. R. Davis, Lang, Lindsey, Promisel, Rolnick, Rosenblum, Scheld, Siegman, Simpson, and Slifman, Associate Economists

Mr. McDonough, Manager of the System Open Market Account
Ms. Greene, Deputy Manager for Foreign Operations
Ms. Lovett, Deputy Manager for Domestic Operations
Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors
Mr. Stockton, Associate Director, Division of Research and Statistics, Board of Governors
Ms. Danker, Assistant Director, Division of Monetary Affairs, Board of Governors
Messrs. Small,[10] and Whitesell,[11] Section Chiefs, Division of

8. Acting Vice Chairman in Mr. Corrigan's absence.

9. First Vice President, Federal Reserve Bank of New York, attending as alternate member for Mr. Corrigan.

10. Attended portion of meeting relating to a discussion of the uses of a broad monetary aggregate that includes bond and stock mutual funds.

11. Attended portion of meeting relating to the Committee's discussion of the economic outlook and its longer-run growth objectives for monetary and debt aggregates.

Monetary Affairs, Board of Governors
Ms. Kusko,[11] Senior Economist, Division of Research and Statistics, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Beebe, J. Davis, T. Davis, Goodfriend, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Cleveland, Kansas City, Richmond, and Atlanta respectively

Mr. McNees, Vice President, Federal Reserve Bank of Boston, Messrs. Coughlin and Guentner, Assistant Vice Presidents, Federal Reserve Banks of St. Louis and New York respectively

By unanimous vote, the minutes for the meeting of the Federal Open Market Committee held on May 18, 1993, were approved.

The Manager of the System Open Market Account reported on developments in foreign exchange markets and on System transactions in foreign currencies during the period May 18, 1993, through July 6, 1993. By unanimous vote, the Committee ratified these transactions.

The Deputy Manager for Domestic Operations reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period May 18, 1993, through July 6, 1993. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic outlook, the ranges for the growth of money and debt in 1993 and 1994, and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting provided a mixed reading on the economy, but on balance the available data suggested that the expansion had picked up somewhat during the second quarter from the very slow pace of the first quarter. Employment statistics, while tending to soften in June, pointed to considerable strength for the second quarter as a whole, although recent spending indicators suggested a much more moderate expansion. Consumer and producer price inflation slowed substantially in May, but prices had risen at a faster rate over the first five months of the year than over the second half of 1992.

Total nonfarm payroll employment changed little in June after registering substantial gains in April and May. For the second quarter as a whole, the increase in employment matched that of the first quarter. Manufacturing employment, which was about unchanged over the first quarter, declined somewhat in June for a third straight month. Construction payrolls edged lower after rising appreciably over the preceding two months, and job gains in the services industries were considerably smaller in June than those recorded earlier in the year. The civilian unemployment rate backed up to 7.0 percent in June.

Industrial production increased in May at the relatively subdued rate recorded in March and April; for June, the limited data available suggested a modest decline in output. In May, assemblies of motor vehicles declined after holding steady over the two previous months. Among other manufactured goods, the production of business equipment, led by computers and industrial equipment, recorded another brisk advance whereas the output of non-auto consumer goods continued to expand sluggishly. Total utilization of industrial capacity was unchanged in May for a third straight month.

Real personal consumption expenditures edged higher in May after a sizable rebound in April from weather-related weakness. On balance, however, consumer spending had increased only slightly thus far this year. Outlays for new cars and light trucks advanced in May to their highest level since January 1990 and apparently remained near that elevated level in June. In addition, spending for non-energy services had increased substantially in recent months. By contrast, energy consumption had fallen from the especially high levels of late winter, and outlays for nondurable goods in May were still below their fourth-quarter level. Housing starts increased in April and May from a depressed first-quarter pace, with most of the rise attributable to starts of single-family dwellings.

Shipments of nondefense capital goods in May retraced only a portion of a sizable April decline. However, for the two months combined, shipments of such goods were above the average for the first quarter and apparently remained on an upward trend that began early in 1992. The upward trajectory for spending on machinery and on electrical and communications equipment seemed to have reflected improved cash flows for the business sector and a declining cost of capital, and incoming data suggested that outlays for business equipment would increase further over the months ahead. Nonresidential construction activity was unchanged over the first quarter but picked up slightly on balance over April and May. Office building rose over the two months, while construction of non-office commercial structures was little changed and industrial building activity was down sharply.

Business inventories recorded another appreciable rise in April, and available data pointed to a further increase in May. In manufacturing, inventory accumulation stepped up in April and May after changing little in the first quarter; the ratio of stocks to shipments edged higher in each month and was only slightly above the very low level reached early in 1993. In the wholesale trade sector, inventories advanced at a slower rate in May than in April, and the inventory-to-sales ratio fell to the low end of the range for the past three years. The buildup of retail inventories slowed considerably in April, and with sales rebounding from the effect of March storms, the inventory-to-sales ratio declined for the retail sector. Nonetheless, the ratio still was near the high end of its range for the past several years.

The nominal U.S. merchandise trade deficit for April was unchanged from March, with both imports and exports declining slightly. However, the April deficit was substantially above the average for the first quarter, reflecting sizable increases in imports of capital goods, automotive products, consumer goods, and oil. The value of exports in April was only slightly above the first-quarter average. Recent indicators pointed to further weakness in economic activity in continental Europe thus far this year. By contrast, economic recovery appeared to be continuing in the United Kingdom and Canada. In Japan, economic activity was up appreciably in the first quarter, but available data suggested that this strength had not carried over to the second quarter.

Changes in producer and consumer prices were small in May following sizable increases earlier in the year. Producer prices of finished goods were unchanged in May, as declines in prices of finished consumer food and energy products offset small advances in prices of other finished goods. Excluding the food and energy components, producer prices had risen more rapidly thus far in 1993 than they had in the second half of 1992. At the consumer level, prices of items other than food and energy rose only slightly in May, but this measure of inflation also had risen faster this year than in the second half of last year. Labor costs likewise had evidenced a quickened pace of increases this year. Average hourly earnings of production or nonsupervisory workers rose substantially in May after edging lower in April, and these earnings had grown more rapidly over the first five months of 1993 than over the preceding six months.

At its meeting on May 18, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions but that included a tilt toward possible firming of reserve conditions during the intermeeting period. Accordingly, the directive indicated that 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 would be acceptable or slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with appreciable growth of the broader monetary aggregates over the second quarter.

Open market operations were directed toward maintaining the existing degree of pressure on reserve positions throughout the intermeeting period. Several upward adjustments were made to expected levels of adjustment plus seasonal borrowing during the period in anticipation of stepped-up demand for seasonal credit during the crop-growing season; borrowing averaged near expected levels over the period. The federal funds rate remained close to 3 percent over the period, although quarter-end pressures in money markets pushed the rate higher for a brief period at the end of June.

Other short-term interest rates also were little changed on balance over the period since the May meeting. Early in the period, unexpectedly robust employment data for May, coupled with media reports about the monetary policy stance adopted at the May meeting, led to some upward pressure on money market interest rates. Subsequently, however, this pressure abated in response to the release of data suggesting slower inflation and a somewhat weaker outlook for the economy. These developments along with the progress in the Congress toward adoption of a deficit-reduction package fostered a decline in bond yields; buoyed by the drop in yields, major indexes of stock prices rose over the intermeeting period in spite of disappointing second-quarter earnings reports by several major companies.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies increased on balance over the intermeeting period. After depreciating somewhat through the end of May, the dollar recovered in early June when U.S. money market interest rates moved higher. The dollar rose more strongly over the last half of June, principally in response to actual and expected monetary easing abroad. The rise in the dollar over the intermeeting interval reflected sizable appreciations against European currencies, especially the German mark. The dollar continued to fall against the Japanese yen through the middle of

June, in the process setting several new lows, before recovering a little over the remainder of the period.

After contracting during the first quarter, M2 and M3 expanded appreciably over the second quarter. Most of this growth, which was especially pronounced in May, reflected strength in M1 and occurred despite continued heavy outflows to bond and equity funds. The May surge resulted in part from a strong pickup in mortgage refinancing activity and a reversal of the depressing effect in April of relatively damped individual nonwithheld tax payments on the seasonally adjusted level of liquid deposits. The growth of the broader aggregates moderated substantially in June, and by more than might have been suggested by the waning of these mortgage and tax influences. For the year through June, growth of both M2 and M3 was below the lower ends of the ranges for 1993 that the Committee had established in February. This sluggishness reflected ongoing changes in asset preferences and financing patterns rather than restrictive financial conditions. The velocity of M2 was estimated to have increased at a rate of about 4½ percent over the first half of the year after a 4 percent rise in 1992. Total domestic nonfinancial debt expanded somewhat further through April.

The staff projection prepared for this meeting suggested moderate growth in economic activity and modest reductions in margins of unemployed labor and capital through 1994. The projection assumed the enactment of a federal budget bill that implied a moderately restrictive fiscal policy over the forecast horizon. As in earlier staff projections, lower interest rates were expected to support appreciable gains in interest-sensitive expenditures, including housing, consumer durables, and business equipment. Private spending also would be buttressed by a favorable financial environment associated with strengthened balance sheets and reduced debt burdens and by the apparently increasing willingness of banking institutions to make new loans. Export demand was likely to remain constrained over the near term by the weakness in the economies of several major industrial countries, but some improvement in foreign demand was anticipated later as those economies started to strengthen. The outlook for moderate growth and continuing slack in resource utilization suggested considerably more subdued price increases than had occurred in the early months of 1993.

In the Committee's discussion, the members generally agreed that ongoing economic developments remained consistent with moderate but sustained growth in economic activity. No sector of the economy seemed poised at this juncture to provide strong impetus to the expansion, but a promising basis for further growth was seen in the much improved financial condition of many households and business firms. Lower long-term interest rates, which had contributed to the improvement in balance sheets, were likely as well to bolster housing and business capital spending more directly. While the expansion now appeared to be firmly established, a number of members cautioned that it was subject to some downside risks, notably those associated with the still uncertain outlook for government budget and other policies. The possibility of higher taxes, associated with the deficit reduction legislation currently under consideration in the Congress and with the forthcoming proposals for national health care reform, was widely reported to be damping spending. With regard to the outlook for inflation, the most recent data on prices offered some encouragement that the earlier upturn in key measures of inflation might prove to be temporary, especially in the context of still ample margins of unutilized labor and other production resources. Even so, given generally held expectations among the public that inflation was not likely to decline and might in fact trend higher, many members concluded that for now the disinflationary trend might have been arrested or, at least, that further progress toward price stability would be quite difficult to achieve over the next several quarters.

In conformance with the usual practice at meetings when the Committee considers its longer-run objectives for growth of the monetary and debt aggregates, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members provided individual projections of growth in real and nominal GDP, the rate of unemployment, and the rate of inflation for the years 1993 and 1994. In light of the experience in the first half of the year, forecasts of real growth in 1993 had been revised down somewhat since February, while projections of inflation had been raised. The central tendency of the forecasts of the rate of expansion in real GDP in 1993 was now 2¼ to 2¾ percent for the year as a whole; for 1994, these projections had a central tendency of 2½ to 3¼ percent. With regard to the expansion of nominal GDP, the forecasts converged on growth rates of 5 to 5¾ percent for 1993 and 5 to 6½ percent for 1994. Given the projections of a moderate uptrend in economic activity and expectations of some further gains in labor productivity, the forecasts incorporated only a small decline in unemployment to rates of around 6¾ percent in the fourth quarter of 1993 and only slightly lower by the fourth quarter of 1994. For the rate of inflation, as measured by the CPI, the projections had a central tendency of 3 to 3¼ percent in 1993 and 3 to 3½ percent in 1994, reflecting little change in both years from the rate of inflation experienced in 1992.

Members commented that the improved prospects for significant reductions in the federal deficit had played an important role in fostering the declines in longer-term interest rates that had occurred since the latter part of 1992; the lower rates were having positive effects on spending decisions in a number of interest-sensitive sectors of the economy as well as on balance sheets more generally. At the same time, the prospects for higher taxes—accentuated by uncertainties about their size and incidence—were widely reported to be inhibiting spending decisions by business firms and might also be adding to cautious consumer attitudes. Some of the anecdotal evidence suggested that uncertainties associated with the potential impact of the still unannounced proposals for health care reform were making many businesses especially cautious, notably in their hiring decisions. Adding to the effects of anticipated federal legislation were concerns in various parts of the country about further cuts in defense spending and the impact of additional reductions in state and local expenditures or of increases in state and local taxes. Some members observed that the fiscal policy legislation before the Congress appeared to have generated a perhaps exaggerated degree of concern, and passage of this legislation might have a generally favorable effect on business and consumer sentiment.

Turning to the outlook for individual sectors of the economy, members referred to indications of an upturn in consumer spending in recent months, but they also noted that survey results and anecdotal reports still suggested generally cautious consumer attitudes. The prospects for increased taxes might be having some negative effect on consumer confidence, but consumers remained especially concerned about the outlook for jobs and incomes as defense cutbacks continued and many firms, notably larger business establishments, took further steps to restructure and downsize their operations. To an important extent the improvement in retail sales in the second quarter was associated with stronger sales of motor vehicles that, in the view of at least some members, appeared to reflect previously postponed replacement demand rather than a major shift in consumer attitudes. In any event, moderate growth in consumer spending was likely to be maintained in the context of the improved financial condition and the related reduction in debt-service burdens of many households. Further growth in overall employment, in line with that achieved in the first half of the year, would if it persisted provide important support toward sustaining the expansion of consumer spending and thus the growth of the economy more generally.

With regard to the outlook for business fixed investment, members reported that many firms were scaling back or putting on hold their capital spending plans pending a resolution of the business tax proposals under consideration in the Congress. Nonetheless, business spending for equipment still constituted a relatively robust sector of the economy, at least according to the data available to date. To a considerable extent, such spending reflected ongoing efforts to improve the quality of products and the efficiency of business operations while holding down the number of employees, and the members saw this trend as likely to continue. In general, other business capital spending had remained sluggish, although construction activity other than office building appeared to have picked up in parts of the country. The prospects for housing construction, though not ebullient, were viewed as more promising particularly in light of the declines in mortgage interest rates to relatively low levels. The improved financial position of many potential homebuyers also provided a basis for anticipating stronger housing markets. Despite these favorable factors, however, overall housing activity had improved only modestly in recent months as homebuyers tended to remain cautious, and at least in some areas housing developers continued to report that they were encountering difficulties in securing construction finance. On balance, housing construction seemed likely to provide some impetus to the expansion in coming quarters.

Relatively weak economic conditions in a number of foreign industrial countries were likely to continue to limit U.S. exports, which had declined since the end of 1992. Indeed, available data supplemented by reports from a variety of contacts suggested that business conditions had remained quite weak or had worsened in a number of foreign industrial nations. Even so, business contacts in some parts of the United States indicated that foreign demand for their products was still quite robust. Business activity abroad, which already was trending higher in a few industrial nations, was viewed as likely to strengthen more generally over the year ahead, with positive effects on overall U.S. exports.

Turning to the outlook for inflation, members commented that despite favorable readings recently, a wide range of price and wage data had suggested some acceleration in the rate of inflation during the early months of the year. To some extent, the indications of intensified inflation might have been the result of difficulties with seasonal adjustments or other temporary factors, but there were reports of some successful efforts by business firms to raise prices following the spurt in demand and the rise in capacity utilization toward the end of 1992. These price developments were disappointing and suggested to many members that the disinflationary trend might have been arrested, at least for now, though the economic fundamentals remained consistent with a resumption of some further downward movement in the rate of inflation. With regard to those fundamentals, many members saw significant, albeit diminished, slack in labor and product markets as likely to persist over the forecast horizon, given their current forecasts of moderate expansion in economic activity. Other favorable factors in the inflation outlook included efforts by businesses to hold down costs and increase productivity by restructuring their operations and investing in new, more productive equipment. Unfortunately, these favorable elements in the underlying economic situation seemed at odds with the apparently widely held view by the public that inflation would not diminish and indeed was likely to increase and that in any event current inflation levels were tolerable. Such expectations and attitudes would tend to temper the gains against inflation, if any, over the forecast horizon by their effects on the pricing and wage behavior of business firms and employees and the reactions of consumers toward rising prices. This inflationary climate underscored the importance of credible government policies—monetary, fiscal, trade, and regulatory—that encouraged reduced inflation over time.

In keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey–Hawkins Act), the Committee at this meeting reviewed the ranges for growth in the monetary and debt aggregates that it had established in February for 1993, and it decided on tentative ranges for growth in those aggregates in 1994. The current ranges for the period from the fourth quarter of 1992 to the fourth quarter of 1993 included expansion of 2 to 6 percent for M2 and ½ to 4½ percent for M3. A monitoring range for growth of total domestic nonfinancial debt had been set at 4½ to 8½ percent for 1993.

In the Committee's discussion, the members focused on the issue of whether or not to lower the ranges further. In February, the ranges for M2 and M3 had been reduced by ½ percentage point in the expectation that continuing rechanneling of credit demands and savings flows into securities markets and away from depository institutions would result in further increases in velocity, the ratio of nominal GDP to monetary measures such as M2 or M3. In fact, the strength of these forces was underestimated to some extent. Substantial increases occurred in the velocity of both M2 and M3, especially in the first quarter, that were reflected in weak bank credit and huge inflows into bond and stock mutual funds. In the circumstances, the expansion of both aggregates through midyear was below the lower ends of the reduced ranges established by the Committee for the year. According to a staff analysis, the developments boosting M2 and M3 velocity could be expected to persist over the balance of 1993. Such an outcome would imply monetary growth for the year as a whole slightly below the Committee's current ranges, even if the growth of nominal GDP picked up in the second half of the year as implied by the central tendency of the members' forecasts.

In light of this expectation, many of the members indicated their support of a proposal to lower the M2 and M3 ranges further for 1993 and on a tentative basis to retain the reduced ranges for 1994. It was emphasized during the discussion that the reductions were intended solely as technical adjustments to reflect expected increases in velocity and that the lower ranges did not imply any tightening of monetary policy. Rather, the reductions in the ranges would serve to align them with monetary growth rates that were more likely to be associated with a satisfactory economic performance. Indeed, M2 and M3 growth consistent with most members' forecasts might still leave the expansion of those aggregates near the lower ends of their reduced ranges for the year; at the same time, the probability of a surge in monetary growth to levels above the new ranges appeared remote. In this connection, some members commented that the uncertainties surrounding the behavior of M2 and M3 might well persist for some time. The value of these aggregates in guiding policy seemed to have diminished in 1992 and 1993, and the Committee needed to continue to rely on its evaluation of a broad array of other financial and economic developments in its assessment of an appropriate course for monetary policy. The members did not rule out the possibility that a more normal or predictable relationship between money and economic activity might be restored once the current process of balance sheet adjustments was completed, the yield curve flattened, and some stabilization in the intermediation function of depository institutions emerged. In the view of a few members, moreover, the lower range proposed for M2 might in fact be more consistent with the rate of monetary growth that would be needed over the long term to sustain price stability and satisfactory economic expansion, if the earlier relationships between broad money growth and economic performance were to reemerge.

Many of these members commented that the considerations underlying the desirability of a technical adjustment to the ranges for this year applied to 1994 as well, and they therefore supported extending the reduced ranges to 1994 on a tentative basis subject to review early next year. Monetary growth outcomes somewhat higher within these ranges might be anticipated in association with the somewhat faster economic growth and essentially unchanged rate of inflation that most members had forecast for next year.

Several members indicated that while they could accept reductions in the 1993 ranges, they nonetheless preferred to retain the existing ranges. One reason given for this preference was that the prospective performance of the broad monetary aggregates in relation to developments in the economy was not sufficiently understood to warrant the specification of new ranges. Indeed, a change might be misinterpreted as implying more knowledge about velocity relationships than the Committee in fact possessed and could set up expectations that the Committee would put greater and, depending on emerging circumstances, perhaps undesirable emphasis on achieving monetary growth within the new ranges. Moreover, to the extent that some observers interpreted the ranges as the Committee's proxies for presumed nominal GDP objectives, an erroneous conclusion could be reached that the Committee had decided on a reduced target level of nominal GDP even though the Committee had not in fact framed its objectives in terms of GDP targets. On balance, while these members did not view this choice as a matter of great consequence in current circumstances, they concluded that it was marginally preferable to retain the ranges for this year, and if necessary, to accept and explain the reasons for a shortfall once the latter were more clearly established. The members who preferred to retain the current ranges agreed that there were plausible arguments on both sides of this issue and they could accept a proposal to reduce the ranges for both 1993 and 1994.

In light of the limited reliance that the members felt they could place on the behavior of the current monetary aggregates, the Committee at this meeting reviewed the possible advantages of a newly constructed measure of money. This measure involved the addition of bond and stock mutual funds to M2 as currently defined. There were indications that the shares of such funds had become closer substitutes for M2, and large portfolio shifts into such funds seemed to account for much of the weakness in M2 and its uncertain relationship to income and the longer-run behavior of prices. After examining the properties of this measure and reviewing its past behavior in relation to key indicators of economic performance, the members concluded that it would not enhance the formulation or implementation of monetary policy, at least at this point. However, the members agreed that mutual funds flows should continue to be monitored for their effects on M2 and that the relevant data should be made available to outside analysts.

At the conclusion of its discussion, the Committee voted to lower the M2 range that it had established in February by an additional 1 percentage point and to reduce the M3 range by another ½ percentage point, bringing the M2 range to 1 to 5 percent and that for M3 to 0 to 4 percent for 1993. The Committee also voted to reduce the annual monitoring range for growth of total domestic nonfinancial debt by ½ percentage point to 4 to 8 percent. The members anticipated that this debt aggregate would continue to grow at a rate that was roughly in line with that of nominal GDP. The Committee approved the following statement for inclusion in its domestic policy directive.

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 this meeting lowered the ranges it had established in February for growth of M2 and M3 to ranges of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The Committee anticipated that developments contributing to unusual velocity increases would persist over the balance of the year and that money growth within these lower ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt also was lowered to 4 to 8 percent for the year.

Votes for this action: Messrs. Greenspan, Mullins, Angell, Boehne, Keehn, Kelley, LaWare, Lindsey, McTeer, Oltman, Ms. Phillips, and Mr. Stern. Votes against this action: None. Absent: Mr. Corrigan. (Mr. Oltman voted as alternate for Mr. Corrigan.)

For the year 1994, the Committee approved provisional ranges that were unchanged from the reduced levels for 1993. Accordingly, the Committee voted to incorporate the following statement regarding the 1994 ranges in its domestic policy directive.

For 1994, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1993 to the fourth quarter of 1994, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the monitoring range for growth of total domestic nonfinancial debt at 4 to 8 percent for 1994. 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, Mullins, Angell, Boehne, Keehn, Kelley, LaWare, Lindsey, McTeer, Oltman, Ms. Phillips, and Mr. Stern. Votes against this action: None. Absent: Mr. Corrigan. (Mr. Oltman voted as alternate for Mr. Corrigan.)

In the Committee's discussion of policy for the period until the next meeting, most of the members indicated that they saw little or no reason to change monetary policy in either direction. The most recent information on the performance of the economy was mixed, and this together with questions about the course of fiscal policy contributed to considerable uncertainty about the outlook. Even so, the members felt that the evidence pointed on the whole to a sustained rate of economic expansion. The latest price statistics provided some encouragement that the apparent intensification of inflation in earlier months of the year might have abated. For now, therefore, nearly all the members saw the balance of factors bearing on the course of economic activity and the outlook for inflation as calling for an unchanged degree of pressure on reserve positions.

According to a staff analysis prepared for this meeting, the growth of M2 could be expected to slow markedly in the months ahead from its pace over the second quarter. The projected deceleration was mainly associated with some unwinding of the second-quarter bulge in mortgage refinancings along with further heavy inflows to bond and stock mutual funds. The expansion of M3 appeared likely to be held down by weaker bank credit extensions as alternative sources of funds in the capital markets attracted more borrowers. On balance, modest growth of both M2 and M3 would keep them close to the lower ends of their downward-revised ranges through September.

Some members cautioned that despite the very sluggish behavior of the broad measures of money thus far this year, monetary policy was relatively expansive as evidenced by a variety of other indicators including the growth in narrow measures of money and reserves and the very low levels of money market interest rates. Indeed, in the view of several members, in a period characterized by indications of some worsening in inflationary expectations, a policy course that maintained steady conditions in reserve markets could be said to have become more accommodative as the federal funds rate, in real terms after adjustment for expected inflation, moved down from an already low level. Accordingly, while current monetary policy seemed likely to support further economic expansion, the Committee needed to remain alert to the potential for intensifying inflation. At some point the current policy stance could well begin to foster greater price pressures. One member urged a prompt move toward restraint, given the prospect in his view that further progress toward price stability was unlikely with the current, quite stimulative, stance of monetary policy.

A majority of the members, taking account of the current stance of monetary policy, favored a proposal to retain the bias toward possible tightening that the Committee had adopted at the May meeting. In this connection, some commented that while the need for any policy adjustment during the period ahead seemed somewhat remote, the next policy move was more likely to be in the direction of some firming than toward easing. Other members suggested that a symmetrical directive might be more consistent with current economic conditions and the related outlook for a steady policy course over the near term. These members agreed, however, that a return to symmetry so soon after the adoption of a directive that was biased toward restraint could convey a misleading impression that recent developments had increased the Committee's concerns about the sustainability of the expansion or that the Committee had become less committed to a disinflationary policy course. Accordingly, these members indicated that they could support an asymmetric directive at this point. Several members observed that a number of key economic measures were scheduled for release during the intermeeting period and that the data in question should provide a firmer basis for evaluating the performance of the economy and a desirable course for monetary policy.

At the conclusion of the Committee's discussion, all but one of the members indicated that they preferred or found acceptable a directive that called for maintaining the existing degree of pressure on reserve positions and that retained a bias toward possible firming of reserve conditions 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, the Committee decided that slightly greater reserve restraint would be acceptable or slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with modest growth in the broader monetary aggregates over the third quarter.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that the economic expansion has picked up somewhat in recent months from the very slow pace of the first quarter. Total nonfarm payroll employment changed little in June after registering substantial gains in April and May, and the civilian unemployment rate edged up to 7.0 percent in June. Industrial production has changed little on balance over the last few months. Real consumer expenditures edged higher in May after a sizable rise in April but have increased only slightly thus far this year. Housing starts turned up in April from a depressed first-quarter pace and rose somewhat further in May. Incoming data suggest a continued brisk advance in outlays for business equipment, while nonresidential construction has remained soft. The nominal U.S. merchandise trade deficit was about unchanged in April but substantially larger than its average rate in the first quarter. Consumer and producer prices were about unchanged in May, but for the year to date inflation has been more rapid than in the second half of 1992.

Short-term interest rates have changed little since the Committee meeting on May 18 while bond yields have declined somewhat. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies increased on balance over the intermeeting period.

After contracting during the first quarter, M2 and M3 expanded appreciably over the second quarter. For the year through June, growth of the two aggregates was below the lower ends of the ranges established by the Committee for 1993. Total domestic nonfinancial debt expanded somewhat further through April.

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 this meeting lowered the ranges it had established in February for growth of M2 and M3 to ranges of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The

Committee anticipated that developments contributing to unusual velocity increases would persist over the balance of the year and that money growth within these lower ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt also was lowered to 4 to 8 percent for the year. For 1994, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1993 to the fourth quarter of 1994, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the monitoring range for growth of total domestic nonfinancial debt at 4 to 8 percent for 1994. 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 would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with modest growth in the broader monetary aggregates over the third quarter.

Votes for this action: Messrs. Greenspan, Mullins, Boehne, Keehn, Kelley, LaWare, Lindsey, McTeer, Oltman, Ms. Phillips, and Mr. Stern. Vote against this action: Mr. Angell. Absent: Mr. Corrigan. (Mr. Oltman voted as alternate for Mr. Corrigan.)

Mr. Angell dissented because he favored a prompt move to tighten policy. In his view, monetary policy was overly expansive at this point as evidenced by what he viewed as excessive liquidity in financial markets, the negative level of real short-term interest rates, and the disappointing lack of progress toward lower inflation this year. Given indications of worsening inflationary expectations, such as the substantial rise in the price of gold, as well as projections of an increase in inflation, a policy that led to a steady federal funds rate in fact implied a further easing of an already stimulative monetary policy. In these circumstances, a tightening of policy would not involve any significant risk to the expansion but would foster changes in financial conditions and the outlook for inflation that would be more consistent with renewed progress toward price stability in 1994 and later. Declining inflation around the world and a stronger trend of productivity growth in the United States, among other factors, were providing a favorable environment for further disinflation, but those developments needed to be supported and validated by appropriate monetary policy action.

At this meeting, the Committee reviewed its practices with regard to the release of information to the public. This review was undertaken in response to media reports of the purported results of the May meeting before the Committee had made public any information about that meeting. In its discussion, the Committee reaffirmed its long-standing rules governing the confidentiality of FOMC information, including the schedule that calls for releasing the minutes of a Committee meeting, along with an explanation of the Committee's decisions, a few days after the next meeting. These rules are designed to safeguard the Committee's flexibility to make needed adjustments to policy and also to provide adequate time to prepare a full report of the context and rationale for its decisions. Committee members emphasized the potential for inadvertent leaks of information in the course of general conversations with representatives of the news media or others concerning the members' views about economic developments or monetary policy. The members agreed that particular care needed to be taken for some period before and after each of its meetings.

It was agreed that the next meeting of the Committee would be held on Tuesday, August 17, 1993.

The meeting adjourned at 12:25 p.m. on Wednesday, July 7, 1993.

Donald L. Kohn
Secretary

Meeting Held on August 17, 1993

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, August 17, 1993, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Angell
Mr. Boehne
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. McTeer
Mr. Mullins
Ms. Phillips
Mr. Stern

Messrs. Broaddus, Jordan, Forrestal, and Parry, Alternate Members of the Federal Open Market Committee

Messrs. Hoenig, Melzer, and Syron, Presidents of the Federal Reserve Banks of Kansas City, St. Louis, and Boston respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Patrikis, Deputy General Counsel
Mr. Prell, Economist

Messrs. R. Davis, Promisel, Rosenblum, Scheld, Siegman, Simpson, and Slifman, Associate Economists

Ms. Greene, Deputy Manager for Foreign Operations
Ms. Lovett, Deputy Manager for Domestic Operations

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors
Mr. Stockton, Associate Director, Division of Research and Statistics, Board of Governors
Ms. Johnson, Assistant Director, Division of International Finance, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Beebe, J. Davis, T. Davis, Dewald, Goodfriend, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Cleveland, Kansas City, St. Louis, Richmond, and Atlanta respectively

Messrs. McNees, Meyer, and Miller, Vice Presidents, Federal Reserve Banks of Boston, Philadelphia, and Minneapolis respectively

Ms. Meulendyke, Manager, Open Market Operations, Federal Reserve Bank of New York

By unanimous vote, the minutes for the meeting of the Federal Open Market Committee held on July 6–7, 1993, were approved.

Secretary's Note: Advice had been received of the election of William J. McDonough by the Board of Directors of the

Federal Reserve Bank of New York as a member of the Federal Open Market Committee for the period commencing July 19, 1993, and ending December 31, 1993, and that he had executed his oath of office.

By unanimous vote, the Committee elected William J. McDonough as Vice Chairman of the Committee to serve until the first meeting of the Committee after December 31, 1993.

The Deputy Manager for Foreign Operations reported on developments in foreign exchange markets during the period since the July meeting. There were no System open market transactions in foreign currencies during this period, and thus no vote was required of the Committee.

The Deputy Manager for Domestic Operations reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period July 7, 1993, through August 16, 1993. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting suggested that economic activity was expanding at a moderate pace. The limited data available on spending in the third quarter presented a mixed picture but on balance pointed to continued expansion in consumption, business fixed investment, and homebuilding. Employment remained on an uptrend, and industrial production recently had firmed somewhat. After rising at a faster rate in the early part of the year, consumer prices had changed little and producer prices had fallen in recent months.

Total nonfarm payroll employment, after a small gain in June, expanded in July at a rate close to its average advance in earlier months of the year. The services industries, led by business services, provided half of the July increase. Elsewhere, considerable hiring was evident in wholesale and retail trade, and construction employment moved up after a small decline in June. In manufacturing, more jobs were lost, although at a slower rate than earlier in the year. The civilian unemployment rate dropped to 6.8 percent in July.

Industrial production recovered in July from small declines in May and June. Manufacturing output rose in spite of a sizable cutback in motor vehicle assemblies; utility production registered a strong weather-related gain; and mining output declined further. Within manufacturing, the production of consumer durable goods other than automobiles and trucks rebounded in July, and the output of business equipment advanced further. Total utilization of industrial capacity edged higher in July, reflecting a substantial gain at electric utilities; utilization of manufacturing capacity was unchanged.

Retail sales increased slightly further in July after a sizable rise in the second quarter. Spending on automobiles was down in July for a second straight month, but sales were strong at apparel, furniture and appliance, and general merchandise stores. Total housing starts, depressed by wet weather and floods in some areas of the country, were down somewhat in July; however, permit issuance moved up, suggesting that homebuilding activity remained in a mild uptrend. In addition, consumer surveys indicated that attitudes toward home-buying continued to be strongly positive during July, and builders' assessments of home sales improved substantially.

Business fixed investment increased in the second quarter at about the rapid pace of the first quarter. Spending for equipment remained strong, with solid increases in purchases of motor vehicles, computers, and a wide range of machinery and equipment. However, outlays for aircraft declined in the second quarter, retracing some of the substantial first-quarter rise. The limited information available for the third quarter pointed to some slowing of the growth of spending for equipment. In the second quarter, nonresidential building activity posted its largest advance in three years. Expenditures were up across a broad array of categories, with investment in institutional and public utilities structures being particularly strong.

Business inventories expanded moderately during the second quarter, and inventory accumulation was broadly in line with sales over the first half of the year. In manufacturing, stocks edged lower in June, reflecting a further decline in inventories held by aircraft producers. Outside of the aircraft industry, inventory changes were mixed. For manufacturing as a whole, the ratio of inventories to shipments fell in June to one of the lowest levels in recent years. In the wholesale trade sector, inventories expanded modestly in June, and with sales lower, the inventory-to-sales ratio for the sector increased slightly. Retail inventories, after changing little in May, rose slightly more than sales in June, and the stocks-to-sales ratio for the retail sector remained near the high end of its range for the past several years.

The nominal U.S. merchandise trade deficit was considerably smaller in May than the deficits recorded in March and April; however, the deficit for April and May combined was larger than the average rate for the first quarter. The value of exports rose slightly in May; increases in sales abroad of industrial supplies, machinery, and consumer goods offset declines in agricultural products, civilian aircraft, and motor vehicles and parts. A drop in the value of imports was spread across a wide range of products, particularly automotive products, consumer goods, and oil. The economic performance of the major foreign industrial countries was mixed in the second quarter. Output continued to decline in western Germany, and economic activity in Japan appeared to have stalled after modest growth in the first quarter. In contrast, economic recovery continued in Canada and the United Kingdom.

Producer prices of finished goods declined in July for a second consecutive month. Prices of finished foods edged lower, and prices of finished energy goods, particularly gasoline and fuel oil, fell significantly; excluding the food and energy components, producer prices edged up in July and to that point in the year had risen at a slightly lower rate than was recorded in 1992. At the consumer level, prices for nonfood, nonenergy items were up slightly in both June and July and for the year to date had increased a little more slowly than last year. Hourly compensation for private industry workers rose in the second quarter at about the rate seen last year. Average hourly earnings of production or nonsupervisory workers were unchanged on balance over June and July, but for the year through July these earnings had increased at the same pace as in 1992.

At its meeting on July 6–7, 1993, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that retained a tilt toward possible firming of reserve conditions during the intermeeting period. Accordingly, the directive indicated that 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 would be acceptable or slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with modest growth of the broader monetary aggregates over the third quarter.

Throughout the intermeeting period, open market operations were directed toward maintaining the existing degree of pressure on reserve positions. Two upward adjustments were made to expected levels of adjustment plus seasonal borrowing in anticipation of further increases in demand for seasonal credit. Borrowing averaged close to expected levels over most of the intermeeting interval, and the federal funds rate remained near 3 percent.

Money market interest rates were little changed on balance over the intermeeting period, while rates on intermediate-term U.S. Treasury obligations and on fixed-rate mortgages dropped slightly. Yields on long-term Treasury and corporate bonds were down by more, with the rate on the thirty-year Treasury bond falling below 6½ percent. Many market interest rates moved higher after Chairman Greenspan's congressional testimony on July 20, which was perceived by market participants as suggesting a greater likelihood of some tightening of monetary policy in the future. Subsequently, interest rates generally retreated in reaction to incoming economic data indicating subdued inflation pressures and to the passage of the deficit-reduction legislation. Major indexes of stock prices increased somewhat over the intermeeting period.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies was about unchanged on balance over the intermeeting period. The dollar strengthened slightly against the German mark, but it rose by significantly more against most other European currencies in the Exchange Rate Mechanism in the aftermath of a widening of the margins within which participating currencies are allowed to fluctuate relative to each other. The widening, which was in response to massive selling pressures on the French franc and several other currencies, followed sharp increases in short-term interest rates in the affected countries. With exchange market participants continuing to focus on Japan's trade surplus, the dollar fell substantially against the yen.

M2 expanded only slightly in July after growing appreciably over the second quarter. The continued strength of inflows to bond and stock mutual funds suggested that households were still realigning their portfolios toward assets outside the monetary aggregates. Through July, M2 was estimated to have grown at a rate close to the lower end of the Committee's range for the year. M3 contracted slightly in June and July, owing in part to a substantial drop in institution-only money market mutual funds, whose returns had not kept pace with the increase in money market rates in late spring. In addition, depository institutions placed greater reliance on various nondeposit sources of funds, including the issuance of equity and subordinated debt. Through July, M3 had declined a little and was slightly below its annual range. Total domestic nonfinancial debt had expanded at a moderate

rate in recent months, and for the year through June was estimated to have increased at a rate in the lower half of the Committee's monitoring range.

The staff projection prepared for this meeting suggested moderate growth in economic activity and modest reductions in margins of unemployed labor and capital through next year. The fiscal restraint stemming from the recent legislation and uncertainty about other government policies would act as a drag on the economy. On the other hand, lower interest rates were expected to contribute to further gains in spending on consumer durables, housing, and business fixed investment. Continued expansion also would be supported by further improvements in the availability of credit, a small boost to production over the next several quarters associated with rebuilding activity in areas of the Midwest affected by the recent floods, and a pickup in foreign demand resulting from some strengthening in economic activity abroad. The projected slack in labor and product markets, coupled with some tempering of inflation expectations, was expected to foster modest further reductions in wage and price inflation.

In the Committee's discussion of prospective economic conditions, members commented that recent developments had not materially altered the outlook for moderate and sustained growth in economic activity. Despite widespread indications of pessimistic consumer and business attitudes, overall consumer spending and business investment appeared to be reasonably well maintained. Likewise, the outlook for increased fiscal restraint associated with the recently enacted deficit-reduction legislation needed to be weighed against the favorable effects on spending of reduced interest rates in intermediate- and long-term debt markets, the improved balance sheets of consumers and businesses, and the indications of a somewhat better availability of loans from financial intermediaries. In an environment of moderate economic growth, the fundamentals bearing on the outlook for inflation were consistent with further disinflation, and the members drew some encouragement from consumer and producer price developments in recent months. Several cautioned, however, that recent price measures probably overstated the reduction in inflation, just as the surge in prices earlier in the year seemed to have overstated the underlying inflation trend. Members also referred to the persistence of inflationary expectations among business executives and consumers. Thus, while the rise in inflation appeared to have been arrested, any further progress toward price stability was likely to be limited over the quarters ahead.

Business contacts and other sources of information suggested little change since the July meeting in the pace or composition of economic activity in different parts of the country. Descriptions of economic performance varied from slow to moderate growth in most regions, though business activity probably continued to weaken in some major areas such as California. Despite sustained, if not ebullient, growth in sales to consumers and the relative strength in business investment spending in the first half of this year, business sentiment was widely described as cautious or negative even in some regions whose economies were outperforming the nation as a whole. According to business contacts, the recent enactment of deficit-reduction legislation had tended to mitigate concerns about the size of future federal deficits, but business executives were now focusing on the implications of higher taxes and many were expressing apprehension about further though still unannounced tax increases that might be associated with health care reform. Business sentiment and sales also were being affected adversely in many areas by cutbacks in defense contracts and closings of military installations and by the weakness in foreign demand for some products.

With regard to developments and prospects in key sectors of the economy, members noted that despite further survey indications of eroding consumer confidence, consumer expenditures had strengthened in recent months after a pause earlier in the year. The pickup had featured rising sales of motor vehicles, and while the latter had slipped recently, a number of special factors such as shortages of popular models at the end of the model year and the effects of flooding in some parts of the Midwest suggested the need to withhold judgment on any downward shift in the underlying demand for motor vehicles. Tourism was reported to have strengthened considerably in many areas this summer, though there were major exceptions. As had been true for an extended period, consumer attitudes continued to be inhibited by concerns about employment opportunities, especially given further reductions in defense spending, the ongoing restructuring and related downsizing of many business operations, and the continuing efforts by business firms to limit the number of their permanent employees in order to hold down the rising costs of health care and other nonwage worker benefits. Members noted, however, that the growth in employment thus far this year, while tending to involve many low-paying jobs, had greatly exceeded the rate of expansion in 1992. In the view of at least some members, appreciable further growth was likely as business firms found it increasingly difficult in an expanding economy to meet growing demands through outsourcing, temporary workers, and overtime work. Some members also noted that the newly legislated taxes on higher incomes would tend to curtail some consumer spending. The timing of that effect was uncertain; tax liabilities had already risen, but some payments on the added tax liabilities were not due until April of 1994 and 1995.

Members anticipated that building activity, notably housing construction, would provide some stimulus to the expansion. Although indicators of housing activity were somewhat mixed for the nation as a whole, sales of new and existing homes were brisk in many regions and even sales of second homes were reported to be improving in some areas. Prospective homebuyers continued to exercise considerable caution, but reductions in mortgage rates and generally improved affordability pointed to rising housing sales and construction over the quarters ahead. In the nonresidential sector, there was growing evidence of some strengthening in the construction of commercial and institutional structures, but overcapacity was likely to depress the construction of new office buildings for an extended period in most parts of the country. In some areas, infrastructure and other rebuilding associated with the recent floods was likely to stimulate some construction activity later this year.

With regard to the external sector of the economy, the members again noted a somewhat mixed picture. Exporters from some parts of the country continued to report relatively brisk sales abroad, but many domestic producers were expressing concerns about weak markets in key foreign nations. Against the background of more stimulative economic policies in a number of those countries, some overall strengthening in the major foreign economies was viewed as a reasonable expectation, but the overall growth in exports was likely to lag the anticipated expansion in imports over the projection horizon. The North American Free Trade Agreement now under consideration in the Congress was a topic of active discussion among business contacts, and the uncertain outcome of that treaty was a matter of concern in several parts of the country.

Members observed that the more favorable performance of key measures of prices in recent months had tended to relieve earlier concerns about a possible worsening in inflation. However, because the recent price indexes probably overstated the improvement in the trend rate of inflation, it was too early to determine whether they pointed to renewed disinflation. In any event, a number of fundamental factors appeared to have favorable implications for the inflation outlook, notably the prospect that some slack in labor and capital resources would persist in the context of projections that pointed to a relatively moderate rate of economic expansion. Members continued to cite reports from numerous business firms regarding their inability to raise prices because of the highly competitive markets in which those firms had to operate. Many business contacts also referred to the absence of significant increases—and indeed to occasional decreases—in the costs of their outside purchases. Oil price developments in world markets and the ongoing competition from foreign producers also were cited as favorable elements in the outlook for inflation. On the negative side, adverse weather conditions in recent months including severe floods in the Midwest appeared to have fostered some upward pressure on food prices, and higher taxes would raise gasoline prices in the fourth quarter. Perhaps of greater significance, business contacts and surveys of households indicated persisting expectations that inflation would rise at some point. In this connection, however, passage of the federal deficit-reduction legislation and the Committee's reaffirmation in its directive and in congressional testimony of its commitment to price stability seemed to have had a constructive effect on attitudes in financial markets and on long-term interest rates, and these developments could prove to be harbingers of more favorable inflation attitudes more generally.

In the Committee's discussion of policy for the intermeeting period ahead, the members agreed that recent developments pointed to the desirability of a steady policy course. While economic growth did not seem particularly robust, neither was it clear that a disinflationary trend had been reestablished. Many members observed that real short-term interest rates were at very low levels, indeed slightly negative by some calculations, and while real intermediate- and long-term interest rates were higher, it was apparent that monetary policy was in an accommodative posture. This conclusion was seen as reinforcing the view that monetary policy probably would have to move in the direction of restraint at some point to resist any incipient tendency for inflationary pressures to intensify. For now, the relatively slow economic expansion in the first half of the year, the fiscal restraint associated with the deficit-reduction legislation, other obstacles to economic growth, and the encouraging inflation statistics for recent months argued against any near-term policy adjustment.

Moreover, there was no compelling evidence that current monetary policy was fostering credit flows usually associated with speculative excesses or impending increases in price pressures. Growth in the broad measures of money and in the debt of nonfinancial sectors remained fairly damped despite indications of greater willingness to supply credit by banks, other financial intermediaries, and investors in securities markets. With regard to the monetary aggregates, low short-term interest rates undoubtedly were contributing to large shifts of funds from depository institutions, notably from components of M2 and M3 to stock and bond mutual funds and to other financial instruments, and thus to the sluggish behavior of the broad measures of money. In this connection, a staff analysis pointed to continuing slow growth in M2 over the near term and, on the assumption of little or no change in the degree of pressure on reserve positions, to growth for the year at a rate around the lower end of the Committee's range. Growth in M3 was likely to fall marginally below the Committee's range for the year. On the other hand, growth in M1 and various reserve measures was expected to remain relatively robust.

Turning to possible adjustments to policy during the intermeeting period ahead, the members endorsed a proposal to return to an unbiased intermeeting instruction that did not incorporate any presumption with regard to the direction of possible intermeeting policy changes. The members agreed that the probability of an intermeeting policy adjustment was relatively remote. Incoming data on economic activity and prices had reduced concerns that inflation and inflationary expectations might be worsening. The Committee retained its fundamental objectives of fostering economic expansion at a sustainable pace that was consistent with further progress over time toward stable prices. However, it now appeared less likely than at the time of the May and July meetings that the Committee needed to bias its consideration of responses to incoming information in the intermeeting period toward possible tightening in order to achieve those objectives. One member, while agreeing that a tightening move would not be appropriate under current circumstances, nonetheless believed that monetary policy had been overly stimulative for some time and that the Committee should move toward restraint at the first favorable opportunity.

At the conclusion of the Committee's discussion, all the members expressed a preference for a directive that called for maintaining the existing degree of pressure on reserve positions. They also indicated their support of a directive that did not include a presumption about the likely direction of any adjustment to policy 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, the Committee decided that slightly greater or slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with modest growth in M2 and little net change in M3 over the balance of the third quarter.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that economic activity is expanding at a moderate pace. Total nonfarm payroll employment increased in July at a rate close to its average advance in earlier months of the year, and the civilian unemployment rate declined to 6.8 percent. Industrial production turned up in July after posting small declines in May and June. Retail sales edged higher in July following a sizable rise in the second quarter. Housing starts were down somewhat in July, but permits moved up. Available indicators point to continued expansion in business capital spending. The nominal U.S. merchandise trade deficit declined in May, but for April and May combined it was larger than its average rate in the first quarter. After rising at a faster rate in the early part of the year, consumer prices have changed little and producer prices have fallen in recent months.

Short- and intermediate-term interest rates have changed little since the Committee meeting on July 6–7, while yields on long-term Treasury and corporate bonds have declined somewhat. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies was about unchanged on balance over the intermeeting period.

After expanding appreciably over the second quarter, M2 increased slightly further in July and M3 declined. For the year through July, M2 is estimated to have grown at a rate close to the lower end of the Committee's range for the year, and M3 at a rate slightly below its range. Total domestic nonfinancial debt has expanded at a moderate rate in recent months, and for the year through June it is estimated to have increased at a rate in the lower half of the Committee's monitoring range.

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 lowered the ranges it had established in February for growth of M2 and M3 to ranges of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The Committee anticipated that developments contributing to unusual velocity increases would persist over the balance of the year and that money growth within these lower ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt also was lowered to 4 to 8 percent for the year. For 1994, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1993 to the fourth quarter of 1994, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the monitoring range for growth of total domestic nonfinancial debt at 4 to 8 percent for 1994. 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 or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with modest growth in M2 and little net change in M3 over the balance of the third quarter.

Votes for this action: Messrs. Greenspan, McDonough, Angell, Boehne, Keehn, Kelley, LaWare, Lindsey, McTeer, Mullins, Ms. Phillips, and Mr. Stern. Votes against this action: None.

Donald L. Kohn
Secretary

Meeting Held on September 21, 1993

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, September 21, 1993, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Angell
Mr. Boehne
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. McTeer
Mr. Mullins

Ms. Phillips
Mr. Stern

Messrs. Broaddus, Jordan, Forrestal, and Parry, Alternate Members of the Federal Open Market Committee

Messrs. Hoenig, Melzer, and Syron, Presidents of the Federal Reserve Banks of Kansas City, St. Louis, and Boston respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Patrikis, Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. R. Davis, Lang, Lindsey, Promisel, Rolnick, Rosenblum, Scheld, Siegman, Simpson, and Slifman, Associate Economists

Mr. Fisher, Manager for Foreign Operations, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors
Mr. Stockton, Associate Director, Division of Research and Statistics, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Ms. Browne, Messrs. T. Davis, Dewald, and Goodfriend, Senior Vice Presidents, Federal Reserve Banks of Boston, Kansas City, St. Louis, and Richmond respectively

Messrs. Judd, King, and Ms. White, Vice Presidents, Federal Reserve Banks of San Francisco, Atlanta, and New York respectively

Mr. Gavin, Assistant Vice President, Federal Reserve Bank of Cleveland
Ms. Krieger, Manager, Open Market Operations, Federal Reserve Bank of New York

By unanimous vote, the minutes for the meeting of the Federal Open Market Committee held on August 17, 1993, were approved.

By unanimous vote, Joan E. Lovett and Peter R. Fisher were selected to serve at the pleasure of the Committee in the capacities of Manager for Domestic Operations, System Open Market Account, and Manager for Foreign Operations, System Open Market Account respectively, on the understanding that their selection was subject to their being satisfactory to the Federal Reserve Bank of New York.

Secretary's Note: Advice subsequently was received that the selections indicated above were satisfactory to the Federal Reserve Bank of New York.

The Manager for Foreign Operations reported on developments in foreign exchange markets and on System transactions in foreign currencies during the period August 17, 1993, through September 20, 1993. By unanimous vote, the Committee ratified these transactions.

Ms. Betsy B. White, Vice President for Domestic Operations of the Federal Reserve Bank of New York, reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period August 17, 1993, through September 20, 1993. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook and the formulation of monetary policy for the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed by the Committee at this meeting suggested that economic activity, adjusted for the temporary depressing effects of the flood in the Midwest, was continuing to expand at a moderate pace. Consumer spending was up, and business purchases of durable equipment had recorded further healthy gains. On the other hand, housing activity had shown a muted response to the declines in mortgage rates that had occurred through the spring, and gains in manufacturing output and in employment had been limited in recent months. After rising at an accelerated rate in the early part of the year, consumer prices had increased more slowly in recent months and producer prices had fallen.

Total nonfarm payroll employment edged lower in August after a sizable gain in July. Hiring in the service-producing sectors, especially in health and business services, was down in August from the pace of recent months, and more jobs were lost in manufacturing. Construction employment also moved lower, retracing part of the July increase. On the other hand, the average workweek rose to a relatively high level in August, and as a result, aggregate hours worked by production or nonsupervisory workers were significantly above the second-quarter average. The civilian unemployment rate declined to 6.7 percent.

Industrial production posted a further moderate gain in August. Manufacturing output more than accounted for the increase, as strikes damped mining production and utilities output was unchanged following large gains in earlier months. Within manufacturing, the output of motor vehicles and parts was unchanged. Excluding the motor vehicle component, another sharp gain in computers and related electronic components boosted the production of business equipment, while the output of consumer goods declined as a result of a retrenchment in appliance production following the advance posted in July. Total utilization of manufacturing capacity edged up again in August.

Total retail sales were little changed in real terms in July and August. Despite the recent sluggishness, however, real spending for goods in July and August was appreciably above the level in the second quarter. In addition, real expenditures for services had grown rapidly in July; this reflected both high energy consumption associated with unusually hot weather and robust spending for other services. The persistence of hot weather through August suggested that spending on energy services continued at a high level for that month. After a slight decline in July, housing starts rose substantially in August. Single-family starts accounted for all of the August increase, as multifamily starts fell further and continued to hover around their thirty-year low.

Growth in real business fixed investment appeared to be slowing in the third quarter from the robust pace earlier in the year. Shipments of nondefense capital goods dropped substantially in July, with all of the decline occurring in the volatile aircraft component. For capital goods other than aircraft and parts, shipments again moved higher in July; while the demand for computing equipment strengthened after dropping off somewhat in the second quarter, shipments of other types of durable equipment softened. In addition, heavy-truck sales were off substantially in July after advancing steadily since late 1992, and fleet sales of light vehicles were down in July and August. Investment in nonresidential structures posted its largest advance in three years in the second quarter. However, construction activity fell in July in reflection of a sharp decline in the construction of commercial structures other than offices.

Business inventories contracted sharply in July after changing little in June. The bulk of the July decline occurred in the retail sector and reflected drawdowns in inventories at automobile dealerships. Non-auto retail inventories edged down in July; with sales flat, the ratio of non-auto inventories to sales remained near the high end of the range for the past several years. In the wholesale trade sector, stocks were trimmed somewhat further in July, but the inventory-to-sales ratio remained at the midpoint of its range over the past three years. Manufacturing stocks were unchanged in July after a small reduction in June. With shipments down in July owing to weak shipments of aircraft and motor vehicles, the stocks-to-sales ratio rebounded but was still at a low level.

The nominal U.S. merchandise trade deficit decreased in July, but it remained essentially unchanged from its average rate in the second quarter. The value of exports edged lower in July, while the value of imports fell by more, retracing nearly all of the sizable June rise. The decline in imports was primarily in automotive products, consumer goods, and oil. The performance of the major foreign industrial economies continued to present a mixed picture. Economic activity in Japan, after increasing slightly in the first quarter, evidenced renewed weakness in the second quarter that apparently persisted into the third quarter. In western Germany, real output rose in the second quarter, but much of the gain apparently stemmed from unintended inventory accumulation. In France and Italy, economic activity appeared to have leveled out in the second quarter after declining earlier. By contrast, both the United Kingdom and Canada recorded further modest gains in economic activity.

Producer prices of finished goods fell sharply further in August; higher prices for consumer foods were more than offset by lower prices for the energy and the nonfood, non-energy components of the index. For finished goods other than food and energy, producer prices increased over the twelve months ended in August by a considerably smaller amount than in the previous twelve-month period. Consumer prices rose a little faster in August than in July, with an increase in food prices counterbalancing a decline in prices of consumer energy goods. For nonfood, non-energy items, consumer prices advanced over the twelve months ended in August by an amount comparable to that recorded for the twelve months ended in August 1992. Average hourly earnings of production or nonsupervisory workers were up in August after little change on balance in June and July; the rise reflected in part overtime earnings in manufacturing. Over the twelve months ended in August, this measure of earnings increased by about the same amount as in the previous twelve-month period.

At its meeting on August 17, 1993, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that, in contrast to the two previous directives, did not include a tilt toward possible firming of reserve conditions during the intermeeting period. Accordingly, the directive indicated that 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 or slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with modest growth of M2 and little net change in M3 over the balance of the third quarter.

Open market operations were directed during the intermeeting period toward maintaining the existing degree of pressure on reserve positions. The federal funds rate remained close to 3 percent over the period, while adjustment plus seasonal borrowing averaged somewhat above anticipated levels, reflecting demand for adjustment credit by banks experiencing temporary technnical difficulties.

Other short-term interest rates were little changed on balance over the intermeeting period, while yields on intermediate- and long-term debt obligations declined somewhat. The drop in longer-term yields appeared to be associated with incoming data indicating continuing sluggishness in economic activity and the more favorable performance of broad measures of prices. Major indexes of stock prices increased somewhat further over the intermeeting period, evidently reflecting lower bond yields and heavy inflows to stock mutual funds.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies depreciated on balance over the intermeeting period. Much of the dollar's decline reflected the strength of the mark and other European currencies, which was related in part to the unexpectedly slow pace of monetary easing in Germany and other European countries. Against the yen, the dollar rebounded early in the intermeeting period from the historical low that occurred around the time of the Committee's August meeting. The dollar was buoyed by joint central bank sales of yen against the dollar and by the accompanying public statement from the U.S. Treasury that was seen by market participants as signaling a new attitude toward any further appreciation of the yen. On September 21, the dollar rose sharply on news that President Yeltsin had dissolved the Russian Parliament.

Growth of M2 continued at a slow rate in August. The sluggishness in this aggregate, which occurred despite further rapid expansion in its M1 component, apparently reflected ongoing efforts by households to shift funds away from depository accounts in search of better returns. M3 turned up after declining in June and July; however, expansion of this aggregate continued to be held down by declines in institution-only money market funds. For the year through August, M2 and M3 were estimated to have grown at rates close to the lower ends of the Committee's ranges for the year. Total domestic nonfinancial debt had expanded moderately in recent months, and for the year through July it was estimated to have increased at a rate in the lower half of the Committee's monitoring range.

The staff projection prepared for this meeting suggested moderate growth in economic activity and limited reductions in margins of unemployed labor and capital through next year. Fiscal restraint, uncertainty about other government policies, and slow growth of foreign industrial economies over the near term would act as a constraint on the economy. However, improving balance-sheet positions and credit supply conditions were lifting an unusual constraint on spending, and the lower interest rates would encourage further increases in consumer spending, housing construction, and business fixed investment. The continued slack in labor and product markets, coupled with some tempering of inflation expectations, was expected to foster further reductions in wage and price inflation.

In the Committee's discussion of current and prospective economic conditions, members commented that recent developments had not altered their outlook for moderate and sustained expansion in economic activity. The members acknowledged that the interpretation of ongoing developments presented some unusual problems, notably the difficulty of reconciling the appreciable growth in employment thus far this year with the slow expansion in measured output; the associated drop in measured productivity was especially surprising in light of the business drive toward more efficient operations. Moreover, the economic outlook clearly remained subject to a variety of uncertainties, including potential developments abroad that were especially difficult to predict. Nonetheless, while temporary factors were likely to depress third-quarter expansion, the members saw little in the current statistical or anecdotal reports on the domestic economy that pointed to the likelihood of a significant deviation from a moderate growth trend. It was noted in this connection that the inhibiting effects of increased fiscal restraint and expected further weakness in net exports needed to be weighed against the favorable effects on interest-sensitive spending of considerably reduced intermediate- and long-term interest rates and the much improved financial condition of many business firms and households. With regard to the outlook for inflation, some members suggested that the prospects for continued slack in resource utilization were consistent with a disinflationary trend, but the disparate factors bearing on the outlook for inflation as well as the swings in price performance experienced in recent quarters argued for caution in assessing the future course of inflation.

In their review of developments around the nation, members commented that business conditions remained uneven across local areas and industries, but they characterized general economic activity in most regions as ranging from little change to moderate growth since midsummer. However, business conditions continued to be quite weak in some areas, notably in California, and business sentiment appeared to have remained cautious in much of the nation. One member emphasized uneven conditions of a different kind. Relatively disadvantaged members of the population, often living in inner cities, had high and rising expectations about their economic prospects. At the same time, however, some traditional paths of upward mobility were being cut back, such as the military and civil service within the government and office jobs more generally. In addition, regulations aimed at correcting some problems in financial institutions—such as real estate appraisal and downpayment requirements—were having unintended adverse effects on lower-income businesses and households, and other proposals aimed at promoting minority lending were in danger of promising more than they could deliver. An apparently widening gap between economic realities and aspirations might not have measurable implications for the macroeconomic outlook over short periods of time, but they reflected a worrisome trend in terms of the longer-run health of the economy.

In other comments, members referred to a number of financial developments that had favorable implications for sustained economic expansion. Business firms and consumers had made substantial progress in strengthening their balance sheets, and while the process of adjusting balance sheets evidently was still under way, the material improvement accomplished thus far had diminished financial risks and constraints on spending. Banking institutions had bolstered their capital positions and were in a better position to accommodate increases in loan demand. Bond and stock markets had exhibited considerable strength. In this connection, however, a few members commented on the apparently growing concern in financial markets that current equity prices were high relative to earnings and dividends. A correction in U.S. equity markets could trigger cumulative selling, especially by mutual funds, which had garnered substantial new investors, some of whom might not fully appreciate the risks of their new assets relative to deposits. On the positive side, there were good reasons for optimism on the trajectory of business profits in an environment of low inflation and moderate growth. Moreover, some managers of mutual funds reportedly were taking steps to strengthen the liquidity of their portfolios, and members reported on efforts to improve individual investor awareness of the risks of equity investments.

During their review of the prospective performance of key sectors of the economy, members gave somewhat mixed reports on retail sales in recent weeks, but they generally anticipated that consumer spending would provide continued if not strong support to sustained economic expansion. As had been true for an extended period, consumer attitudes remained hesitant in the context of concerns about employment and income prospects and, in the case of many consumers with higher incomes, increased income tax liabilities. Some members expressed the view that more vigorous growth in employment might well occur as the expansion matured, and such a development would be likely to have a favorable effect on consumer attitudes and spending.

Cautious attitudes also appeared to have held back housing demand and construction activity despite declines in mortgage interest rates. The combination of some further declines in mortgage interest rates recently and a tendency for house prices to stabilize or even to firm in some markets seemed to have induced appreciable and widespread strengthening in demand for single-family housing. Indeed, despite persisting weakness in some areas, housing markets were described as quite strong in many parts of the country, and the overall improvement in housing activity might not be captured in the latest statistics. Other construction activity appeared on the whole to have bottomed out and might have begun to trend higher. Anecdotal reports suggested a pickup in the volume of commercial property transactions, though apparently not yet in the prices of commercial properties in most areas, and rising construction outlays were anticipated for commercial, industrial, and institutional facilities as economic activity continued to expand. Office construction was likely to remain generally depressed as excess capacity continued to be absorbed, but such construction might not decline further. Members also anticipated appreciable further growth in business spending for equipment, notably for the purpose of enhancing productivity in an environment of strong competitive pressures; concurrently, spending to expand capacity seemed likely to remain relatively limited unless consumer spending gathered more momentum in coming quarters than was now anticipated. On balance, business fixed investment was expected to continue to provide considerable support to the economic expansion.

The passage of deficit-reduction legislation in July implied increased fiscal restraint but also appeared to have improved confidence in financial markets and in the business community more generally regarding the ability of the federal government to enact needed legislation. At the same time, the new taxes stemming from that legislation and a greater focus on the potential for further legislation, notably health care reform and its implications for mandated business costs, were a key factor in sustaining cautious attitudes among business executives. Members also referred to the constraining effects in many areas, and on the economy more generally, of current and prospective cutbacks in defense expenditures, spending curbs by state and local governments, and the outlook for further tax increases by many of these governments.

The prospects for net exports also were cited as a negative factor in the economic outlook. Expectations of persisting weakness in some major foreign economies implied relatively limited growth in U.S. exports in a period when moderate expansion in this country was likely to foster somewhat more rapid increases in U.S. imports. Some members also commented that the controversial NAFTA legislation under consideration in the Congress continued to dominate business discussions in parts of the country. It was suggested that whatever its eventual benefits for the three nations immediately involved might be, a defeat of that legislation could prove to be a setback for the GATT negotiations with dislocative implications for world trade.

Many members referred to the more favorable price developments that had occurred since the early part of the year when key measures of inflation had surged. While it was premature to conclude that a distinct disinflationary trend had been reestablished, the members generally agreed that price pressures were likely to remain subdued given their projections of some continuing slack in resource utilization. Favorable developments tending to support that conclusion included the persistence of intensely competitive conditions in most markets for goods around the country. The costs of materials purchased by business firms generally were reported to be rising only slowly, if at all. There were indications of fairly tight labor markets in some areas, but wage pressures remained limited even in those markets. At the same time, the costs of worker benefits continued to rise fairly rapidly and many business contacts were expressing concern about the possibility of further mandated cost increases related to the health care reform legislation. For the next several months, relatively rapid increases in food prices associated with weather-related crop losses and an increase in the excise tax on gasoline would tend to boost consumer prices. On balance, these developments were not seen as inconsistent with longer-run progress toward price stability, though the inflation outlook remained subject to considerable uncertainty.

In the Committee's discussion of policy for the intermeeting period ahead, all of the members agreed that recent economic and financial developments pointed to the desirability of an unchanged policy stance. The members recognized that neither the pace of the economic expansion nor the uncertain progress toward price stability reflected a wholly satisfactory economic performance, but at this point the present posture of monetary policy continued to offer the best promise in their view of promoting sustained economic growth in the context of subdued if not declining inflation.

From the perspective of a variety of financial measures, the current monetary policy continued to be quite accommodative. Short-term interest rates were low, indeed close to zero after adjustment for inflation, and there had been appreciable further declines in longer-term interest rates. Growth of M2 remained slow, but it had picked up since earlier in the year, and M3 had expanded in August, albeit at a sluggish rate, after declining in previous months. One member observed that growth in M2, adjusted to include certain stock and bond mutual funds, was estimated to have accelerated since early spring to a fairly healthy pace. Narrow measures of money and reserves, though subject to a variety of influences, were growing at rates that suggested an ample provision of liquidity to the economy.

In considering possible adjustments to policy during the intermeeting period, all of the members endorsed a proposal to retain a symmetrical directive. While current economic uncertainties were mirrored in uncertainties about the future course of monetary policy, the members agreed that developments in the period until the next meeting in mid-November were not likely to call for any adjustment to policy. Beyond the nearer term, however, both the timing and, in the view of at least some members, the direction of the next policy change could not be foreseen at this time. While they did not see convincing evidence that monetary policy was overly stimulative at this point, some members were concerned that the current stance, as reflected in short-term interest rates, was quite accommodative and probably would need to be firmed at some point. These members stressed the need to remain especially alert to potential inflationary developments against the background of persisting inflationary expectations and uncertain progress toward price stability. Other members, while sharing this concern to an extent, gave some weight to the possibility that the expansion might remain quite sluggish for a period; under the circumstances, they foresaw the need to maintain an accommodative policy posture and could not rule out the possibility that the next policy move might have to be toward greater monetary stimulus.

At the conclusion of the Committee's discussion, all the members indicated their support of 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 adjustment to policy 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, the Committee decided that slightly greater or slightly lesser reserve restraint might be acceptable during the intermeeting period. According to a staff analysis, the reserve conditions contemplated at this meeting were expected to be consistent with modest growth in M2 and M3 over the balance of the year.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that economic activity is continuing to expand at a moderate pace. Total nonfarm payroll employment edged down in August after a sizable gain in July, but the average workweek rose to a relatively high level and the civilian unemployment rate declined to 6.7 percent. Industrial production has advanced moderately over recent months. Retail sales changed little in real terms in July and August after increasing appreciably in the second quarter. Housing starts were down slightly in July but rose substantially in August. Available indicators suggest a slowing in the expansion of business capital spending from a robust pace earlier in the year. The nominal U.S. merchandise trade deficit was about unchanged in July from its average rate in the second quarter. After rising at an accelerated rate in the early part of the year, consumer prices have increased more slowly and producer prices have fallen in recent months.

Short-term interest rates have changed little since the Committee meeting on August 17, while yields on intermediate and long-term debt obligations have declined somewhat. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies depreciated substantially over the intermeeting period.

M2 continued to expand at a slow rate in August, while M3 turned up after declining in June and July. For the year through August, M2 and M3 are estimated to have grown at rates close to the lower end of the Committee's ranges for the year. Total domestic nonfinancial debt has expanded at a moderate rate in recent months, and for the year through July it is estimated to have increased at a rate in the lower half of the Committee's monitoring range.

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 lowered the ranges it had established in February for growth of M2 and M3 to ranges of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The Committee anticipated that developments contributing to unusual velocity increases would persist over the balance of the year and that money growth within these lower ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt also was lowered to 4 to 8 percent for the year. For 1994, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1993 to the fourth quarter of 1994, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the monitoring range for growth of total domestic nonfinancial debt at 4 to 8 percent for 1994. 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 or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with modest growth in M2 and M3 over the balance of the year.

> Votes for this action: Messrs. Greenspan, McDonough, Angell, Boehne, Keehn, Kelley, LaWare, Lindsey, McTeer, Mullins, Ms. Phillips, and Mr. Stern. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, November 16, 1993.

The meeting adjourned at 12:35 p.m.

During the intermeeting period, available members participated in three telephone conference calls to discuss issues relating to the release of information about discussions at Federal Open Market Committee meetings. These calls were prompted by hearings on such issues that were held by the House Committee on Banking, Finance, and Urban Affairs. The discussions took into account information that unedited transcripts for meetings since early 1976 were maintained by the FOMC secretariat at the Board of Governors. The members did not reach any decisions on these matters during these conferences. In the course of two further telephone conferences during the intermeeting period, the Committee reviewed economic and financial developments affecting Mexico and discussed various contingencies that might involve the Federal Reserve.

Donald L. Kohn
Secretary

Meeting Held on November 16, 1993

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, November 16, 1993, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Angell
Mr. Boehne
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. McTeer
Mr. Mullins
Ms. Phillips
Mr. Stern

Messrs. Broaddus, Jordan, Forrestal, and Parry, Alternate Members of the Federal Open Market Committee

Messrs. Hoenig, Melzer, and Syron, Presidents of the Federal Reserve Banks of Kansas City, St. Louis, and Boston respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Patrikis, Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. R. Davis, Lang, Lindsey, Promisel, Rolnick, Rosenblum, Scheld, Siegman, Simpson, and Slifman, Associate Economists

Ms. Lovett, Manager for Domestic Operations, System Open Market Account
Mr. Fisher, Manager for Foreign Operations, System Open Market Account

Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors[12]
Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors
Mr. Stockton, Associate Director, Division of Research and Statistics, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Beebe, Ms. Browne, Messrs. J. Davis, T. Davis, Dewald, Goodfriend, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Boston, Cleveland, Kansas City, St. Louis, Richmond, and Atlanta respectively

Mr. Guentner, Assistant Vice President, Federal Reserve Bank of New York

By unanimous vote, the minutes for the meeting of the Federal Open Market

12. Attended portion of meeting on the review of FOMC practices with regard to recording and transcribing FOMC meeting discussions and the release of information about such discussions.

Committee held on September 21, 1993, were approved.

The Report of Examination of the System Open Market Account, conducted by the Board's Division of Reserve Bank Operations and Payment Systems as of the close of business on April 30, 1993, was accepted.

The Manager for Foreign Operations reported on developments in foreign exchange markets during the period since the September meeting. There were no open market transactions in foreign currencies for the System account during this period, and thus no vote was required of the Committee.

By unanimous vote, the Committee authorized the renewal for further periods of one year of the System's reciprocal currency ("swap") arrangements with foreign central banks and the Bank for International Settlements. The amounts and maturity dates of these arrangements are indicated in the table that follows:

Foreign bank	Amounts (millions of dollars equivalent)	Term (months)	Maturity dates
Austrian National Bank	250	12	12/04/93
Bank of England	3,000	"	12/04/93
Bank of Japan	5,000	"	12/04/93
Bank of Mexico	700	"	12/04/93
Bank of Norway	250	"	12/04/93
Bank of Sweden	300	"	12/04/93
Swiss National Bank	4,000		12/04/93
Bank for International Settlements			
Swiss francs	600		12/04/93
Other authorized European currencies	1,250		12/04/93
National Bank of Belgium	1,000		12/18/93
Bank of Canada	2,000		12/28/93
National Bank of Denmark	250		12/28/93
Bank of France	2,000		12/28/93
German Federal Bank	6,000	"	12/28/93
Bank of Italy	3,000	"	12/28/93
Netherlands Bank	500	"	12/28/93

The Manager for Domestic Operations reported on developments in domestic financial markets and on System open market transactions in U.S. government securities and federal agency obligations during the period September 21, 1993, through November 15, 1993. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook and the formulation of monetary policy for the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting suggested some strengthening in the expansion of economic activity in recent months. Consumer spending had picked up; housing activity was quickening; and business spending for durable equipment had continued to trend higher, though at a reduced pace. Industrial production, particularly manufacturing, and employment had posted solid gains. At the same time, inflation had remained muted, with consumer prices increasing moderately on balance in recent months and producer prices falling.

Total nonfarm payroll employment rose appreciably in September and October after declining slightly in August. Although job gains were widespread in October, a large part of the increase was in various business services, notably temporary employment agencies. In other categories, construction employment registered its largest monthly rise since last spring, and jobs in manufacturing increased after seven months of declines. The civilian unemployment rate edged up to 6.8 percent in October.

Industrial production rose sharply in October, with manufacturing more than accounting for the increase. Part of the gain in manufacturing reflected a further rebound in the output of motor vehicles and parts. Aside from motor vehicles, however, the production of business equipment was lifted by another surge in office and computing equipment, and the output of consumer goods was boosted by strength in furniture and appliances. Utilization of total industrial capacity rose in October, reaching a level last seen in the fourth quarter of 1992.

Nominal retail sales were up substantially in October after changing little in September. Sales in October were boosted by a turnaround in spending at automobile dealerships and by a surge at building materials and supply stores. Sales at other types of retail outlets were mixed. Purchases at general merchandise stores were brisk. However, sales at apparel outlets and at furniture and appliance stores edged down after rising strongly for several months, and the increase in spending at gasoline stations entirely reflected the effects of the new federal gasoline tax on pump prices. Housing activity strengthened further in the third quarter. Starts of single-family homes in August and September were at their highest levels in almost five years; starts of multifamily units also picked up in September, although construction activity in this sector remained at a very low level. Sales of new and existing homes moved up further in the third quarter and were especially strong in September.

Real business capital spending increased in the third quarter at a considerably slower pace than earlier in the year. The slowdown largely reflected a smaller rise in spending for producers' durable equipment, as reduced outlays for aircraft and motor vehicles more than offset continued strong gains in spending for computing equipment and other capital goods. Nonresidential construction was down slightly in the third quarter after a sizable advance over the first half of the year. Office and industrial building activity appeared to have bottomed out, but high vacancy rates and declining property values continued to limit new construction.

Business inventories climbed significantly further in September; for the third quarter as a whole, however, stocks were accumulated at a somewhat slower pace than in the first half of the year. At the retail level, inventories rebounded in September after declining on balance over July and August. The ratio of inventories to sales for retailing edged up in September but remained near the low end of its range over the past year. Inventory accumulation in the wholesale sector slowed in September after rising substantially in August; the inventory-to-sales ratio for this sector was unchanged at the midpoint of its range over the past several years. In manufacturing, stocks dropped in September after changing little over the two previous months; with factory shipments up, the stocks-to-shipments ratio for manufacturing as a whole fell in September to its lowest level in recent years.

The nominal U.S. merchandise trade deficit declined further in August, but for July and August combined the deficit was about the same as its average rate for the second quarter. The value of both exports and imports was slightly lower in July–August than in the second quarter. The decline in the value of exports primarily reflected shortfalls in shipments of aircraft and automotive products, and the drop in imports was associated with reduced imports of oil and automotive products. Available data indicated that the performance of the major foreign industrial economies continued to be mixed. Economic activity appeared to have remained weak in Japan in the third quarter and to have stagnated in western Germany after increasing moderately in the second quarter. On the other hand, the recessions in France and Italy seemed to have bottomed out, and the economies of Canada and the United Kingdom to have recovered somewhat further.

Producer prices for finished goods fell in October, retracing the small increase in September; excluding the effects of higher prices for finished foods and energy goods, producer prices were down over the September–October period. Over the twelve-month period ended in October, producer prices for nonfood, non-energy finished goods were fractionally higher on balance, the lowest yearly increase on record for this index, which was introduced in 1973. Consumer prices rose in October after being unchanged in September, with the increase partly reflecting the effect of the implementation of the new federal gasoline tax. For nonfood, non-energy consumer items, the rise in consumer prices over the twelve months ended in October was considerably smaller than the rise over the comparable period ended in October 1992. Labor compensation costs did not show a comparable downtrend. The increase in hourly compensation for private industry workers in the third quarter was about the same as in the second quarter. For the twelve months ended in September, hourly compensation advanced slightly faster than over the comparable year-earlier period.

At its meeting on September 21, 1993, 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 adjustment to policy during the intermeeting period. Accordingly, the directive indicated that 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 or slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with modest growth of M2 and M3 over the balance of the year.

Open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions. Adjustment plus seasonal borrowing averaged somewhat above anticipated levels as a result of increased demands for adjustment credit associated with quarter-end pressures in financial markets and an unexpected swing in the Treasury balance. The federal funds rate remained close to 3 percent over the period.

Most other interest rates were up somewhat over the period since the Committee's September meeting. Treasury bill rates rose in part because of the Treasury's need to rely more heavily on bill issuance in a quarter containing a reduced schedule for auctioning long-term debt. Intermediate- and long-term yields fell in the weeks following the September meeting and reached twenty-year lows. These declines were more than reversed subsequently, however, when investors interpreted incoming data as suggesting stronger economic growth and credit demands over the intermediate term and a somewhat greater likelihood of some tightening of monetary policy. Most indexes of stock market prices posted robust gains early in the intermeeting period, but these gains subsequently were pared back as interest rates moved higher.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies appreciated over the intermeeting period. The strengthening of the dollar, and the associated rise in U.S. long-term interest rates relative to foreign rates, reflected both more optimistic expectations for growth in the United States and more pessimistic assessments for the course of economic activity in continental Europe and Japan.

M2 registered a relatively strong advance in September, but growth slowed again in October. The September pickup partly reflected an unexpected surge in the volatile overnight repurchase agreement (RP) component of M2. M1 also was strong, but the total of time and savings deposits continued to decline, apparently in large part because of the persisting allure of capital market instruments. Growth of M3 strengthened somewhat more than M2 over the two months, reflecting a run-up in institution-only money market funds. For the year through October, M2 and M3 were estimated to have grown at rates a little above the lower ends of the Committee's ranges for the year. Total domestic nonfinancial debt expanded at a moderate rate in recent months, and for the year through September it was estimated to have increased at a rate in the lower half of the Committee's monitoring range.

The staff projection prepared for this meeting suggested that economic activity, after advancing relatively strongly in the fourth quarter, would expand moderately next year, about in line with the potential rate of economic growth over time, and thus would be associated with limited, if any, further reductions in margins of unemployed labor and capital. Consumer spending, which had buoyed growth recently, was expected to expand at the same pace as incomes over the year ahead. In addition, fiscal restraint and uncertainty about other government policies would continue to inhibit the expansion, and a sluggish acceleration in foreign industrial economies pointed to only modest improvement in export demand. However, improving balance sheet positions and credit supply conditions were lifting an unusual constraint on spending, and the lower interest rates would encourage further increases in business fixed investment and housing construction. The continued slack in labor and product markets, coupled with some tempering of inflation expectations, was expected to foster further reductions in wage and price inflation.

In the Committee's discussion of the economic outlook, members commented that the economic data and anecdotal reports received since the September meeting had tended to reinforce their earlier forecasts that moderate economic expansion would be sustained. After a sluggish performance in the first half of the year, overall economic activity had picked up somewhat more in the third quarter than most members had anticipated, and available indicators of spending and production pointed to relatively robust economic growth in the current quarter. Looking ahead to 1994, the members expected the expansion to slow somewhat from its apparent pace over the closing months of this year. Fluctuations in the rate of quarterly GDP growth undoubtedly would occur, but the economy over the year ahead was thought likely to continue on a trend of moderate expansion averaging close to the economy's long-run potential or somewhat higher. Most members saw the probability of a sharp deviation in either direction from their current forecasts as relatively remote, though a number also believed that any deviation was more likely to be in the direction of somewhat stronger rather than weaker growth. In general, members expected core inflation to change little or to edge lower next year, but a few saw some danger of marginally higher inflation.

In their assessment of developments underlying the economic outlook, members referred to indications in many areas of some strengthening in business conditions and in related business sentiment, though economic activity clearly remained sluggish or even depressed in some parts of the country and overall business attitudes could still be described as cautious. Current financial conditions, including the strength in equity markets, reduced intermediate- and long-term interest rates, and an apparently improving availability of business credit from financial institutions, provided a favorable backdrop for further economic expansion. Moreover, businesses and households had made substantial progress in improving their financial positions. These factors were seen as reducing downside risks to the expansion. At the same time, while there were signs of significant firming in the economic expansion, a number of members observed that at this point they did not see the usual indications of any near-term intensification of inflationary pressures such as general increases in commodity prices, lengthening delivery lead times along with efforts to increase inventories, and strong growth of credit. Indeed, the risks of an overheated and inflationary expansion in the near term seemed quite limited in light of various constraints on the economy such as those associated with a restrictive fiscal policy and the continuing weakness in key export markets.

With regard to the outlook for specific sectors of the economy, a step-up in consumer spending, notably for motor vehicles and housing-related durable goods, had contributed substantially to the strengthening of the economic expansion. Indications of improving consumer confidence, reflected in turn in the growing optimism expressed by business contacts regarding the outlook for holiday sales, should help to sustain relatively ebullient consumer spending through the year-end. Contacts in the motor vehicles industry also appeared to be relatively optimistic about the prospects for sales of the new models. The outlook for the consumer sector also was subject to some constraining influences. Growth in consumer spending had tended to exceed the expansion in consumer incomes, and a number of members questioned the extent to which the acceleration in such spending was likely to extend into the new year. The saving rate already was near the low end of its historic range, at least on the basis of current estimates, and was unlikely to decline significantly, if at all. Much would depend on consumers' outlook for employment and incomes. Growing demands should eventually be translated into faster employment gains, but at this point business firms continued to resist adding to their workforces despite increasing sales and many firms were still announcing workforce reductions. While net gains in employment, including growth associated with increases in self-employment and new business formations, were continuing, expansion in jobs and consumer incomes probably would be at a moderate pace over the year ahead. Against this background, members generally expected moderate growth in consumer spending to be maintained, but they did not see such spending as likely to give extra impetus to growth in economic activity in 1994.

The members anticipated appreciable further expansion in business investment spending, especially in the context of reduced interest rates, improved business balance sheets, and ongoing efforts to improve productivity. Growth in spending for business equipment probably would continue at a relatively vigorous pace, though perhaps somewhat below the growth rates experienced in recent quarters, and other investment activity seemed poised to pick up. In this connection, several members reported that vacancy rates in commercial office buildings were declining in some areas and while this development was not yet being translated into appreciable new construction, investment funds appeared to be flowing more freely into commercial real estate. Clear indications of strengthening were observed in housing construction in many parts of the country and the outlook for such building activity seemed promising in the context of reduced mortgage rates and improving consumer sentiment.

Fiscal policy developments, including the effects on business attitudes of the uncertainties surrounding health care reform legislation, were likely to continue to inhibit the expansion over the year ahead. Some members again emphasized the negative effects that the ongoing retrenchment in defense spending was having on local economies as well as on the economy more generally. On the taxation side, the rise in tax liabilities on higher incomes could have an especially pronounced effect during the early months of next year, given the retroactive inclusion of 1993 incomes subject to the new tax, but some members noted that the increased tax payments probably had been widely anticipated and the negative implications for the economy might well be less than many observers expected. Nonetheless, the overall posture of fiscal policy and associated business concerns about the cost implications of possible future legislation were likely to be an important factor tending to limit the strength of the expansion.

Net exports were seen as another constraining factor in the performance of the economy next year. On the import side, even moderate expansion in domestic economic activity was likely to stimulate appreciable further growth in U.S. demands for foreign goods. At the same time, the prospects for exports to a number of major industrial countries were not promising, at least for the nearer term, given lagging economies in Europe and Japan. In this connection, a number of members referred to reports of weak export demand for specific U.S. products and also noted that an extended coal mining strike had cut supplies of coal available for export and had induced some domestic firms to turn to imports to help fill their requirements. On the other hand, some markets for U.S. exports, notably those in a number of East Asian nations and some Latin American countries, were likely to continue to experience considerable growth, thereby mitigating an otherwise fairly gloomy outlook for exports.

With regard to the outlook for inflation over the year ahead, views did not vary greatly among the members. They ranged from expectations of some limited progress toward price stability to forecasts of a marginal increase in the core rate of inflation. Members who anticipated a relatively favorable inflation performance tended to underscore the likely persistence of appreciable slack in labor and other production resources on the assumption that growth in overall economic activity would remain on a moderate trend in line with their forecasts. Some also pointed to the absence of inflationary pressures in most commodity markets, the persistence of intense competition in local markets across the nation, and the outlook for relatively subdued increases in labor costs in part because of ongoing improvements in productivity. Other members gave more emphasis to the possibility that the economic expansion next year, especially if it turned out on the high side of the range encompassing the members' current projections, was more likely to be associated with some upward pressures on costs and prices. In this connection, relatively rapid growth in economic activity, should it persist into the early part of next year, probably would trigger attempts to raise prices and wages somewhat more rapidly even in the context of some continuing slack in overall capacity and labor utilization. At this point, however, there were no significant indications of accelerating inflation, and business contacts around the nation did not currently see or seem to anticipate increasing inflationary pressures.

In the Committee's discussion of policy for the intermeeting period ahead, the members generally agreed that despite various indications of a pickup in economic growth, the underlying economic situation and the outlook for inflation had not changed sufficiently to warrant an adjustment in monetary policy. Looking beyond the intermeeting period, however, several members commented that the Committee might well have to consider the need to move from the currently stimulative stance of monetary policy toward a more neutral policy posture, should concerns about rising inflationary pressures begin to be realized. The members recognized the desirability of taking early action to arrest incipient inflationary pressures before they gathered strength, especially given the Committee's commitment not just to resist greater inflation but to foster sustained progress toward price stability. In appropriate circumstances, a prompt policy move also might allay market concerns about inflation with favorable implications for longer-term interest rates and the performance of interest-sensitive sectors of the economy. The members acknowledged that current measures of inflation and anecdotal reports from around the nation did not on the whole suggest an intensification of inflation at this point. Moreover, the Committee had to be wary of misleading signals that were inherent in the saw-tooth pattern of typical economic expansions, and it needed to avoid a policy move that would incur an unnecessary risk to the expansion, given uncertainties about the degree to which recent strength in spending would persist.

Most of the members concluded that on balance current economic conditions warranted a steady policy course and, in light of prevailing uncertainties, that it would be premature to anticipate any particular policy change or its timing. As a consequence, the members also concluded that the currently unbiased instruction in the directive relating to the direction of possible intermeeting policy changes should be retained; in any case, significant changes in the outlook requiring policy action were viewed as unlikely in the relatively short period until the next scheduled meeting on December 21. One member expressed the differing view that a less accommodative policy would be more consistent over time with the Committee's desire to foster sustained economic expansion and progress toward price stability. However, this member also felt that a policy tightening move at this time might be seen as a response to a stronger economy, rather than an action that clearly was intended to underscore the Committee's commitment to price stability and therefore would elicit a favorable response in intermediate- and long-term debt markets.

With regard to financial developments bearing on the economic outlook and the potential need to adjust monetary policy, members observed that the broader money and credit aggregates had strengthened somewhat since earlier in the year, though to still relatively moderate growth rates. Moreover, much of the acceleration in M2 and M3 could be attributed to special or temporary factors, and according to a staff analysis growth in these aggregates was likely to revert to relatively slow rates in coming months, assuming unchanged reserve conditions. At the same time, growth in M1 and reserves had remained comparatively rapid and in one view such growth might well be indicative of an overly stimulative monetary policy that would promote more inflation over time or at least prove inconsistent with further disinflation.

At the conclusion of the Committee's discussion, all the members indicated their support of 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 adjustment to policy 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, the Committee decided that slightly greater or slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with modest growth in M2 and M3 over coming months.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests some strengthening in the expansion of economic activity in recent months. Total nonfarm payroll employment rose appreciably in September and October, while the civilian unemployment rate edged up to 6.8 percent in October. Industrial production increased sharply in October, partly reflecting a continuing rebound in the output of motor vehicles. Retail sales were up substantially in October after changing little in September. Housing activity picked up further in the third quarter. The expansion of business capital spending has slowed from a robust pace earlier in the year. The nominal U.S. merchandise trade deficit in July–August was about unchanged from its average rate in the second quarter. Consumer prices have increased moderately on balance in recent months and producer prices have fallen.

Most interest rates have increased somewhat since the Committee meeting on September 21. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies appreciated over the intermeeting period.

Growth of M2 picked up slightly on balance in September and October, while M3 strengthened to a somewhat greater extent over the two months. For the year through October, M2 and M3 are estimated to have grown at rates a little above the lower end of the Committee's ranges for the year. Total domestic nonfinancial debt has expanded at a moderate rate in recent months, and for the year through August it is estimated to have increased at a rate in the lower half of the Committee's monitoring range.

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 lowered the ranges it had established in February for growth of M2 and M3 to ranges of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The Committee anticipated that developments contributing to unusual velocity increases would persist over the balance of the year and that money growth within these lower ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt also was lowered to 4 to 8 percent for the year. For 1994, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1993 to the fourth quarter of 1994, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the monitoring range for growth of total domestic nonfinancial debt at 4 to 8 percent for 1994. 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 or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with modest growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Angell, Boehne, Keehn, Kelley, LaWare, Lindsey, McTeer, Mullins, Ms. Phillips, and Mr. Stern. Votes against this action: None.

The Committee approved a temporary increase of $3 billion, to a level of $11 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 21, 1993.

Votes for this action: Messrs. Greenspan, McDonough, Angell, Boehne, Keehn, Kelley, LaWare, Lindsey, McTeer, Mullins, Ms. Phillips, and Mr. Stern. Votes against this action: None.

Release of Information about FOMC Meetings

At this meeting the Committee considered a number of alternatives for releasing detailed information on its deliberations at past and future meetings. Members emphasized that the most important consideration was the preservation of a deliberative process that would enable the Committee to arrive at the best possible monetary policy decisions. Premature release of detailed information, such as transcripts, would sharply curtail the Committee's ability to freely discuss evolving economic and financial trends and alternative policy responses. Moreover, if full transcripts were subject to release before many years had passed, much vital information obtained in confidence could not be discussed in meetings and in any event probably would not be made available by foreign central banks, business firms, and other sources.

The information for all past meetings and many of the intermeeting telephone consultations was contained in unedited transcripts that had been preserved by the FOMC Secretariat since March 1976. Virtually all the tapes from which these transcripts were typed had been reused to record subsequent meetings, and very few tapes currently existed for meetings before September 1993.

In the course of the Committee's discussion, members observed that the purpose of the transcripts had been to assist the FOMC Secretariat in the preparation of minutes that reported the economic and monetary policy discussions and were released after the next meeting. As a result, the transcripts for past meetings had never been edited nor had they been checked by meeting participants for accuracy. It was clear from even a casual perusal that at times the transcripts failed for various reasons to convey an intelligible account of members' comments, and on occasion they even misstated the views that had been expressed. Moreover, most participants at these meetings had not been aware until recently that the transcripts had been preserved and that they could at some point be made public. Their release at this time would represent a sharp break with past practice and would raise an issue of fairness to participants at earlier meetings of the Committee.

The members generally agreed that their reservations about releasing the transcripts could be mitigated through appropriate safeguards such as withholding particularly sensitive materials and providing for a considerable lapse of time after Committee meetings. They noted in this connection that, while there was no legal requirement to prepare transcripts, the substance of existing transcripts needed to be preserved in accordance with the Federal Records Act. With regard to the manner in which the information might be made public, the Committee considered several alternatives including making available the unedited transcripts themselves, or lightly edited versions of the transcripts, or Memoranda of Discussion comparable to those prepared for meetings before late March 1976. The members expressed varying preferences among these alternatives. Some proposed that marginal notations be included with raw or edited transcripts to provide staff explanations or interpretations of unclear or evidently mistranscribed comments. It was understood that preparation of edited transcripts and especially Memoranda of Discussion would require a considerable amount of time and effort before they would be ready for public release. A majority favored the release of lightly edited transcripts that would retain all substantive comments but would allow for grammatical corrections, the smoothing of some sentences to facilitate the understanding, and the correction of obvious transcription errors. The editing would be patterned after that done for congressional hearings; importantly, no changes would be made in the substance or the intent of the speakers. Before release to the public, particularly sensitive materials would be redacted in accordance with the provisions of the Freedom of Information Act. The Committee agreed that the FOMC Secretariat should be given responsibility for the editing process and that the Committee itself would not undertake to review these transcripts. It was noted in this respect that many former members of the Committee were no longer available to review their comments and that in any event the passage of time would make it impossible for members to recall precisely what they had said or to verify many of their comments. Accordingly, the edited transcripts could not be regarded as official records of the Committee.

With respect to the interval between a meeting and release of a lightly edited transcript, all of the Committee members were concerned that the absence of a substantial lag would seriously harm the Committee's ongoing deliberative process. Many also commented that the absence of a substantial lag would be unfair to meeting participants who had been unaware that their remarks would be released and were unable to review the transcripts for accuracy. Various members argued for lags that ranged from three years to ten years or more, but a majority felt that a five-year lag was necessary to prevent harm to the Committee's ongoing deliberations. The other members indicated that a five-year lag was acceptable because it represented a reasonable balance among the various considerations.

At the conclusion of this discussion, the members agreed unanimously to authorize the preparation of lightly edited transcripts of past meetings and available telephone conferences since late March 1976 and to release such transcripts to the public five years after the meetings, subject to the redaction of especially sensitive materials as authorized by the Freedom of Information Act. It was understood that the transcripts for the meetings held during 1988 would be edited on a priority basis and released as soon as possible. Providing copies of unedited transcripts for all past meetings and available conference calls to the Chairman or staff of the House Banking Committee in response to a request was not approved by the Committee.

The members reviewed various options for the release of information about the Committee's deliberations at future meetings. These options included continuing the preparation of the minutes in their current form, which members regarded as providing a complete account of the substance of the Committee's deliberations. Some urged that consideration be given to supplementing the minutes with the prompt release after each meeting of information about Committee decisions. Among other options considered were an expanded version of the current minutes and the release, after an appropriate lag, of a lightly edited transcript or a Memorandum of Discussion for each meeting. The members concluded that the complexity of the issues reflected in these alternatives warranted further review by the Committee and accordingly a decision was deferred. It was agreed that the Committee would continue its discussion of these issues at a special meeting during December.

Donald L. Kohn
Secretary

Meeting Held on December 21, 1993

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, December 21, 1993, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Angell
Mr. Boehne
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. McTeer
Mr. Mullins
Ms. Phillips
Mr. Stern

Messrs. Broaddus, Jordan, Forrestal, and Parry, Alternate Members of the Federal Open Market Committee

Messrs. Hoenig, Melzer, and Syron, Presidents of the Federal Reserve Banks of Kansas City, St. Louis, and Boston respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Patrikis, Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. R. Davis, Lang, Lindsey, Promisel, Rolnick, Rosenblum, Scheld, Siegman, Simpson, and Slifman, Associate Economists

Ms. Lovett, Manager for Domestic Operations, System Open Market Account
Mr. Fisher, Manager for Foreign Operations, System Open Market Account

Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors[13]
Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors
Mr. Stockton, Associate Director, Division of Research and Statistics, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Ms. Pianalto, First Vice President, Federal Reserve Bank of Cleveland

Messrs. Beebe, T. Davis, Goodfriend, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Kansas City, Richmond, and Atlanta respectively

Mr. McNees, Vice President, Federal Reserve Bank of Boston

Ms. Meulendyke and Mr. Thornton, Assistant Vice Presidents, Federal Reserve Banks of New York and St. Louis respectively

By unanimous vote, the minutes for the meeting of the Federal Open Market Committee held on November 16, 1993, were approved.

By unanimous vote, responsibility for making decisions on appeals of denials by the Secretary of the Committee for access to Committee records was delegated under the provisions of 271.4(d) of the Committee's Rules Regarding Availability of Information to Mr. Mullins and, in his absence, to Ms. Phillips.

The Manager for Foreign Operations reported on developments in foreign exchange markets during the period since the November meeting. There were no System open market transactions in foreign currencies during this period, and thus no vote was required of the Committee.

The Manager for Domestic Operations reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period November 16, 1993, through December 20, 1993. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting suggested that economic activity had recorded a strong advance in recent months. Consumer spending had picked up, and business purchases of durable equipment had remained on a marked upward trend. Residential construction was rising rapidly, and nonresidential construction had turned up from depressed levels. Industrial production had been boosted by developments in the motor vehicle industry, and employment had continued to post solid gains. Most indexes of prices pointed to little change in inflation trends despite the recent acceleration of economic activity.

Total nonfarm payroll employment rose appreciably further in November. Another substantial increase in jobs was recorded in the services industries, notably in health and business services. Construction employment was up significantly further after registering modest

13. Attended part of the meeting.

gains on balance over the first three quarters of 1993. In manufacturing, there were back-to-back increases in jobs in October and November following seven consecutive monthly declines, and both overtime hours and the average workweek remained at a high level. Most of the November expansion in factory jobs occurred in the motor vehicle and capital goods industries. The civilian unemployment rate fell considerably in November, to 6.4 percent.

Industrial production increased sharply in October and November. Manufacturing accounted for all the gain over the two months, with the rise partly reflecting a continuing rebound in the production of motor vehicles and parts. Elsewhere in manufacturing, strong advances were recorded in the output of computers and non-auto durable consumer goods. The sharp expansion in production was associated with substantial increases in the rate of utilization of industrial capacity in October and November.

Retail sales were up moderately in November after a large advance in October. Motor vehicle sales surged in October and remained at the higher level in November, apparently reflecting in part favorable financing terms, small price increases—adjusted for quality improvements—on 1994 models, and generous incentives on pickup trucks from some manufacturers. Sales of apparel, furniture and appliances, and other durable goods also were strong on balance over October and November. Housing starts rose substantially in November; starts of single-family units reached their highest level since early 1987, but starts of multifamily units edged lower. Sales of both new and existing homes remained robust in October.

Business spending for durable equipment apparently continued to rise rapidly. Among nondefense capital goods other than aircraft, shipments of computers and other durable equipment were significantly higher in October than in the third quarter. In addition, the demand for heavy trucks remained strong, and the brisk sales of light vehicles in October and November likely were the result in part of a step-up in spending by businesses. Nonresidential construction activity increased again in October: Office building declined further and industrial construction retraced part of a sizable September gain, but outlays for institutional, public utilities, and non-office commercial structures continued to move higher.

Business inventories were little changed in October, with reductions in manufacturing and wholesale stocks nearly offsetting increases at the retail level. A moderate further decline in manufacturers' inventories in October was concentrated among producers of aircraft and parts, where stocks have been contracting for more than two years; the stocks-to-shipments ratio for manufacturing as a whole fell to its lowest level in recent years. In the wholesale sector, inventories declined in October after changing little in September, and the ratio of inventories to sales remained in the middle of its range over the past several years. At the retail level, stocks increased considerably further; with sales expanding vigorously, however, the ratio of stocks to sales edged lower, and this ratio also was in the middle of its range over the past several years.

The nominal U.S. merchandise trade deficit for October was about unchanged from its September level and its average rate for the third quarter. The value of both exports and imports increased in October. Exports of automotive products rose strongly, and exports of aircraft rebounded from a September downturn. The advance in imports was spread across all major categories. Economic activity in the major foreign industrial countries expanded moderately in the third quarter; however, available data suggested that output in Japan and Germany might decline in the current quarter, with a depressing effect on growth for these industrial countries as a group.

Broad indexes of consumer and producer prices pointed to little change in inflation trends, although prices of some commodities and industrial materials had firmed recently. Producer prices of finished goods were unchanged in November after declining in October and over the third quarter. In November, a large drop in the prices of finished energy goods offset a rebound in the prices of other finished goods. Producer prices for nonfood, non-energy finished goods were about unchanged over the twelve months ended in November. At the consumer level, prices of items other than food and energy advanced moderately in November; the twelve-month increase in this price measure was a little smaller than the rise over the comparable period ended in November 1992. Average hourly earnings edged up in November; for the twelve months ended in November, these earnings were up a smaller amount than over the preceding year.

At its meeting on November 16, 1993, 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 adjustment to policy during the intermeeting period. Accordingly, the directive indicated that 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 or slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with modest growth of M2 and M3 over coming months.

Open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions. Adjustment plus seasonal borrowing averaged somewhat less than anticipated levels, reflecting very light amounts of adjustment borrowing over most of the period, and the federal funds rate remained close to 3 percent.

While most short-term interest rates changed little over the intermeeting period, signs of stronger economic growth and the firming of some commodity prices tended to push up longer-term interest rates, although that pressure was offset to some extent by declines in oil prices. Taken as a whole, incoming economic data were seen by market participants as increasing the odds of a tightening of monetary policy at some point but not necessarily in the very near term. Most indexes of stock prices fell slightly over the intermeeting period, but the strong performance of a few firms boosted the Dow Jones Industrial Average to a new high near the end of the period.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies was about unchanged on balance over the intermeeting period. The dollar appreciated against the yen in response to incoming data suggesting weakness in the Japanese economy and heightened prospects for further monetary easing by the Bank of Japan. Even though interest rates eased in Europe as central banks lowered their money-market intervention rates, the dollar was little changed against the German mark and declined somewhat against other European currencies.

Growth of M2 and M3 strengthened appreciably in November; both aggregates had risen at somewhat faster rates since late summer than earlier in the year. M1 growth remained brisk in November, and money funds included in M2 apparently benefited from a slowdown in inflows to bond funds in the wake of the earlier decline in bond prices. The pickup in M3 growth reflected a surge in term Eurodollar deposits as well as faster growth of M2. For the year through November, M2 and M3 were estimated to have grown at rates somewhat above the lower end of the Committee's ranges for the year. Total domestic nonfinancial debt had expanded moderately in recent months, and for the year through November it was estimated to have increased at a rate in the lower half of the Committee's monitoring range.

The staff forecast prepared for this meeting suggested that, after a strong fourth-quarter advance, the economy would expand at a more moderate rate in 1994. Consumer spending was projected to decelerate to a rate more in line with the growth of disposable income. Business fixed investment was expected to advance briskly, although not quite as rapidly as in 1993, and further gains in homebuilding activity likely would be concentrated in the first half of the year. Exports were projected to strengthen somewhat, bolstered by a modest pickup in foreign economic growth. Fiscal restraint was expected to exert a substantial drag on spending, through both falling government defense purchases and higher taxes. In light of the limited margins of slack in labor and product markets, the ongoing expansion was projected to be associated with only a slight further reduction in inflation.

In the Committee's discussion of current and prospective economic developments, members referred to widespread indications, both statistical and anecdotal, of a marked strengthening in economic activity and much improved business and consumer confidence in recent months. The rate of economic growth could be expected to moderate during the early months of 1994 from what currently appeared to be an unsustainable pace, but the members viewed the extent of such moderation as a key uncertainty in the outlook. A number of members observed that a sharp slowing of the expansion early next year, similar to the slowdown after the surge in activity during the closing months of 1992, could not be ruled out. However, most saw the gains in the economy as more solidly based than earlier in the expansion, and they generally expected the economy to settle into a pattern of moderate growth over coming quarters at a trend rate close to or somewhat above the economy's long-run potential. With regard to the outlook for inflation, the members saw little evidence in available measures of prices and wages or in other indicators that any significant change might already have occurred in underlying inflation trends. Nonetheless, views varied somewhat with regard to the outlook and ranged from expectations of some modest further decline in the core rate of inflation to concerns about the possibility of some acceleration in the context of diminishing margins of unemployed production resources and an accommodative monetary policy as reflected in low real short-term interest rates and continued rapid growth in narrow measures of money and reserves.

In their comments about developments across the nation, members observed that economic conditions clearly had strengthened in many regions and that the better conditions had fostered appreciable improvement in business and consumer sentiment in most parts of the country. The members recognized that the economic expansion was still quite subdued in many local areas and that economic activity remained depressed in some parts of the country such as southern California. The overall strength of the economy was fueled to an important extent by interest-sensitive spending on producer and consumer durables and housing and tended to confirm the durability of the expansion. Gains in such spending were not likely to be sustained at their recent rates, but the cash flow and income that such expenditures had generated were likely to foster further economic growth, especially in the context of generally supportive conditions in financial and credit markets. The members acknowledged that a number of factors continued to constrain the expansion, including ongoing though less pervasive balance-sheet rebuilding, business restructuring and downsizing activities, and the downtrend in defense spending. On balance, however, current developments did not point to a marked deviation from the moderate growth trend in economic activity that had been experienced over the past two years, though in the view of a number of members, the odds on somewhat stronger growth were greater than they had been earlier in the expansion.

With regard to the outlook for key sectors of the economy, consumer expenditures were seen as likely to continue to provide vital support to the expansion even though increases in consumer spending were not likely to be maintained at recent rates. Members noted that the improved consumer confidence and increased spending were reflected in a somewhat greater willingness to incur debt, at least in the context of reduced interest rates. Some members cautioned, however, that growth in consumer expenditures had exceeded gains in incomes for an extended period, insofar as could be judged from available data, and an already low saving rate seemed likely to limit the potential growth in such spending. Moreover, the negative impact of increased tax rates on high incomes seemed likely to be felt especially during the first half of 1994, though the extent of that impact on consumer spending remained uncertain. On the positive side, members cited a number of developments that would tend to bolster overall consumer expenditures, including lower energy costs, reduced income taxes for many individuals stemming from indexing, and lower interest charges on various kinds of debt. More generally, the rise in consumer confidence seemed to be related to perceptions of improving employment opportunities despite continuing announcements of sizable workforce reductions by some large firms.

The members expected growth in real business investment to remain robust in 1994 but to decelerate somewhat from the rapid rate of expansion over the past year. Continuing increases in business sales and low financing costs along with ongoing efforts to improve productivity were likely to remain conducive to substantial further growth in overall spending for business equipment despite persisting weakness in aerospace and defense-related industries. Nonresidential construction activity, including commercial and industrial building and infrastructure construction, displayed signs of considerable strength in some parts of the country; and declining vacancy rates pointed to a leveling out or even a pickup in nonresidential building construction in a number of other areas. Some expansion in inventories seemed likely over the forecast horizon to accommodate the continuing growth in overall demands. In this connection, members noted that a rise in inventories probably contributed to the expansion in production in recent months since the latter could not be explained entirely by the strength of final demand, and a buildup of motor vehicle stocks in late 1993 was likely to continue into the early part of 1994.

The housing sector was expected to remain a source of considerable economic stimulus during the early months of 1994, both directly and indirectly in terms of the favorable effects on purchases of home furnishings. Some members commented that the increases in housing starts experienced over the closing months of this year might not be sustainable; even so, housing construction, especially in the single-family sector, should be relatively well maintained given the likelihood that homeownership would remain comparatively affordable in the context of growing incomes, favorable mortgage rates, and limited pressures on the prices of new homes.

With respect to fiscal policy, members referred to the prospects for further cutbacks in defense spending that probably would continue to be offset only in part by growth in federal government purchases of other goods and services. However, net reductions in government purchases were expected to diminish over the projection horizon. Likewise, adverse effects on spending of the rise in tax rates on higher incomes would tend to be concentrated in the first half of 1994, and the impact on spending over the months ahead might well be relatively limited because many taxpayers probably had anticipated the higher taxes and had taken measures to mitigate or spread out their effects or would meet new tax obligations partly out of savings. Proposed health care reform legislation would exert a restraining effect on the economy, should it be enacted, owing to mandated cost increases on employers. If this form of financing were adopted, however, the legislation might have little, or perhaps even a favorable, effect on the federal deficit.

The external sector of the economy also appeared likely to have a moderating effect on domestic economic activity over the year ahead. The economies of key foreign industrial nations and thus U.S. exports to those nations were projected to grow only gradually, while the expansion of U.S. imports was likely to remain relatively robust on the basis of current expectations for domestic economic activity. In the view of at least some members, however, stimulative economic policies in a number of foreign countries might well lead to stronger economic performances and to greater demand for U.S. goods and services than many observers currently anticipated. In any event, the members generally agreed that the outlook for developments abroad remained a source of particular uncertainty for the domestic economy.

Members commented that there were few indications of any change in inflationary trends in broad measures of prices and wages despite the surge in economic activity in recent months and associated increases in capacity utilization rates. One important sign of growing inflationary pressures, rising lead times for deliveries of materials, had not emerged. Some members noted that although capacity usage rates were approaching or had reached levels that in the past had tended to signal the onset of rising inflation, the growth of competition stemming from the internationalization of numerous markets suggested that old capacity benchmarks might no longer apply and, especially in the context of excess capacity in many foreign economies, the potential inflationary effects of strong domestic demand pressures might remain subdued for some period of time. In keeping with these assessments, members again reported on the absence of inflationary cost pressures in local areas across the country and on persisting comments by business contacts regarding their inability to raise prices to achieve more satisfactory or customary profit margins. Business executives continued to look to improvements in productivity to maintain or increase their margins, and there were numerous reports of considerable success in implementing productivity gains. Price developments in commodity markets presented a mixed picture; higher food prices stemming from weather conditions earlier in the year had had an adverse effect on broad measures of prices, but the drop in energy prices had favorable implications for the near-term inflation outlook.

It also was noted that rising inflationary pressures often were accompanied by a pickup in credit demands, and there was no evidence of any surge in such demands. However, the expansion of overall nonfinancial debt had strengthened to a degree. Moreover, in the view of some members, the rise in long-term interest rates and in gold prices might well have been caused in part by heightened inflation concerns. Members also cited scattered examples of greater price pressures, notably the prices of lumber and some other building materials and of related efforts to pass on the added costs through higher prices on new homes in some areas. Despite the absence of any general indication of rising inflation, a number of members expressed concern about the potential for increasing inflationary pressures in the economy and saw a need to monitor possible future sources of inflation with special care over the period ahead, especially in light of the considerable lags between monetary policy actions and their effects on prices.

In the Committee's discussion of monetary policy for the period until the next scheduled meeting in early February, a majority of the members endorsed a proposal to maintain unchanged conditions in reserve markets and to retain the currently unbiased instruction in the directive concerning possible intermeeting adjustments to policy. Looking forward, many of the members commented that the Committee probably would have to firm reserve conditions at some point to adjust monetary policy from its currently quite accommodative stance to a more neutral position, and that such a policy move might have to be made sooner rather than later to contain inflation and continue to provide a sound basis for sustained economic expansion. Monetary conditions had been eased to their current degree of accommodation in the 1990–92 period in the context of balance sheet restructuring and other unusual forces that were holding down spending. Since the latter part of 1992, however, downside risks to the expansion had diminished considerably as financial conditions became more supportive of economic activity. Borrowers and lenders had strengthened their financial positions substantially and were less reluctant to use and extend credit. Moreover, the low level of real short-term interest rates and in the view of some members the continued rapid growth of reserves or increases in a variety of commodity prices provided evidence of a quite accommodative monetary policy. Overstaying such a policy would incur an increasing risk of fostering greater inflationary pressures that in turn would undermine the sustainability of the expansion. For now, however, a majority believed that the risks remained at an acceptable level, given the remaining slack in the economy and the lack of near-term inflation pressures. Waiting for further developments before making any policy move was warranted in light of the uncertainties surrounding the outlook, notably with regard to the extent of the moderation in economic growth expected early next year. If the economy settled into a pattern of growth about in line with its potential, the chances of greater inflation pressures down the road would be reduced and the need for a near-term policy adjustment would be less pressing, though it would still be required at some point.

Two members expressed a strong preference for a prompt move toward a firmer policy stance to forestall inflation pressures. A number of others commented that the decision was a close call, including two who had a marginal preference for tightening policy at this time but who could accept a delay in light of the uncertainties that were involved.

Members who could support an unchanged policy stance also indicated their acceptance of a directive that was not biased in either direction with regard to possible adjustments in the degree of reserve pressure during the intermeeting period. Some observed that while the flow of economic reports during this period was likely to underscore the marked strengthening of the economy, those reports mainly would cover developments in the fourth quarter, and from a monetary policy perspective the members were more interested in knowing something about the extent of the follow-through strength early in the new year. Moreover, the members recognized that any tightening move would represent a turn in policy that might well have a greater-than-usual effect on financial markets. This prospect argued for taking such an action at a meeting, with the benefit of a full Committee review of the implications for future growth and inflation pressures of a wide variety of emerging developments—including those in money, credit, and financial markets—rather than an intermeeting action based on an asymmetric directive. In the view of one member, a tightening action over the coming intermeeting period would incur an undue risk of an exaggerated response in financial markets, given the likelihood of thin trading markets around year-end; and since a policy move should be postponed, a symmetrical directive seemed appropriate.

At the conclusion of the Committee's discussion, all but two members indicated that they could support 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 adjustment to policy 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, the Committee decided that slightly greater or slightly lesser reserve restraint might be acceptable during the intermeeting period. According to a staff analysis, the reserve conditions contemplated at this meeting would be consistent with moderate growth in M2 and M3 over the months ahead.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests a strong advance in economic activity in recent months. Total nonfarm payroll employment rose appreciably further in November, and the civilian unemployment rate fell considerably to 6.4 percent. Industrial production increased sharply in October and November, partly reflecting a continuing rebound in the output of motor vehicles. Retail sales were up moderately in November after a large increase in October. Housing starts advanced substantially in November. Business equipment expenditures have been rising rapidly, and nonresidential construction has turned up from depressed levels. The nominal U.S. merchandise trade deficit in October was about unchanged from its average rate in the third quarter. Broad indexes of consumer and producer prices suggest little change in inflation trends, although prices of some raw materials have increased recently.

Short-term interest rates have changed little, while intermediate- and long-term rates have risen slightly since the Committee meeting on November 16. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies is about unchanged on balance over the intermeeting period.

Growth of M2 and M3 strengthened in November, and both aggregates have risen at somewhat faster rates since late summer than earlier in the year. For the year through November, M2 and M3 are estimated to have grown at rates somewhat above the lower end of the Committee's ranges for the year. Total domestic nonfinancial debt has expanded at a moderate rate in recent months, and for the year through November it is estimated to have increased at a rate in the lower half of the Committee's monitoring range.

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 lowered the ranges it had established in February for growth of M2 and M3 to ranges of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1992 to the fourth quarter of 1993. The Committee anticipated that developments contributing to unusual velocity increases would persist over the balance of the year and that money growth within these lower ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt also was lowered to 4 to 8 percent for the year. For 1994, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1993 to the fourth quarter of 1994, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the monitoring range for growth of total domestic nonfinancial debt at 4 to 8 percent for 1994. 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 or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Keehn, Kelley, LaWare, McTeer, Mullins, Ms. Phillips, and Mr. Stern. Votes against this action: Messrs. Angell and Lindsey.

Messrs. Angell and Lindsey dissented because they believed that monetary policy was overly accommodative and needed to be adjusted promptly toward a more neutral stance to counter potential inflationary pressures in the economy. They referred to the long lags with which monetary policy exerts its effects on inflation and the consequent need to adjust monetary policy on a timely basis to foster the Committee's long-run objective of stable prices. They understood the difficulty of finding the appropriate circumstances for tightening actions so as to avoid unintended interpretations and repercussions in financial markets. In their judgment, economic and financial conditions were unlikely to be more favorable later and waiting risked undesirable inflationary consequences.

Mr. Angell also stressed that the Committee should focus more directly on forward-looking indicators such as the price of gold and the estimate of the natural rate of interest provided by the yield on five-year Treasury notes. He favored an immediate increase of 50 basis points in the federal funds rate, which would enable the Committee to observe how the market adjusted the price of gold to the changed opportunity cost of holding gold. He believed that if bond market participants concluded that the Committee was using the price of gold to target the price level, five-year and ten-year interest rates would then be significantly lower than if the Committee's tightening was a belated response to a worsening outlook for inflation. He emphasized that the objective of monetary policy clearly should be stable money, which produces stable prices and an ongoing optimal and stable economic growth path.

Mr. Lindsey commented further that a modest policy move now would appropriately signal the Committee's concern about the potential for inflation. Such an action would begin the process of moving policy away from what he perceived as an unsustainable stance. He also noted that foreign competition had been restraining pressures on domestic prices, and the policy course he had in mind would continue to help in that regard by supporting the foreign exchange value of the dollar.

Request for Access to Conference Call Record

At this meeting the Committee considered a request from Mr. Henry B. Gonzalez, Chairman of the House Committee on Banking, Finance, and Urban Affairs, for access by his staff to the tape recording and transcript of the Committee's telephone conference on October 15, 1993. The main purpose of the conference call was to discuss what position the Committee should take on the release of material about its deliberations that are contained in historical files of meeting transcripts; the issue undoubtedly would be raised in the near future, probably during upcoming testimony before Chairman Gonzalez' Committee scheduled for October 19, 1993.

Chairman Gonzalez had indicated that he was investigating the possibility that Committee members had conspired during the conference call to hide information from the House Banking Committee. The accusation was wholly without merit, but at this stage the Committee could fully vindicate itself only by making the tape and transcript available to congressional staff for their review.

Such a step would be taken with considerable reluctance. The recording in question did not contain a discussion of monetary policy, but it did involve Committee deliberations, which are protected from public disclosure by the Freedom of Information Act. Some members expressed concern that granting access to this material could be viewed as setting a precedent for the premature release of other tapes and transcripts, with adverse effects on the Committee's deliberations. However, the Committee's General Counsel expressed the opinion that the Committee could make an exception for this transcript without prejudicing its ability to withhold deliberative or other privileged materials in other transcripts under the Freedom of Information Act. The members agreed with a proposal from the Chairman that the staff of Chairman Gonzalez and of certain other Banking Committee members be allowed to listen to the tape recording of the October 15 conference call. The review would be conducted at the offices of the Board of Governors, and the congressional staff members would be asked to keep confidential the information to be made available to them. The members indicated that it should be made clear that access to the tape in question was being undertaken solely to dispel the unfounded allegations regarding the Committee's actions. The Committee already had decided to make public, with a five-year lag, lightly edited versions of all the transcripts currently in the possession of the FOMC Secretariat. These transcripts as edited will include all the deliberative materials except for highly sensitive information that can continue to be withheld under the provisions of the Freedom of Information Act.

It was agreed that the next meeting of the Committee would be held on Thursday–Friday, February 3–4, 1994.

The meeting adjourned at 1:30 p.m.

Donald L. Kohn
Secretary

Consumer and Community Affairs

Concerns about possible discrimination in mortgage lending and access to credit by minorities and low-income households continued to receive special attention from the Division of Consumer and Community Affairs in 1993. A new process to reform the Community Reinvestment Act dominated Board and interagency activities during the latter half of the year. This CRA initiative was a response to a directive from President Clinton to the regulatory agencies to reform the law by developing new regulations, supervisory procedures, and standards for assessing financial institution performance.

This chapter presents the efforts of the Board to address these concerns and to promote fair lending. It summarizes the Board's actions to enforce existing federal consumer protection laws. It also discusses the community affairs program of the Board and the Reserve Banks; reports on the examination of institutions for compliance with consumer laws—by the Federal Reserve and by other regulatory agencies—and on the System's handling of consumer complaints; details the activities of the Board's Consumer Advisory Council; and reports on congressional testimony on consumer affairs issues.

Regulatory Matters

The Board took these actions with regard to consumer affairs regulations:

- Amended Regulation B (Equal Credit Opportunity) to clarify when credit applicants have a right to receive copies of appraisal reports on residential property. The amendments require notice by creditors that do not routinely provide appraisals. The regulation also provides alternative methods for compliance with the law.
- Amended Regulation C (Home Mortgage Disclosure) to require that financial institutions make available to the public an edited version of the loan register data they file under the Home Mortgage Disclosure Act. The amendment also requires that institutions release their disclosure statement within three business days, instead of thirty days, after receiving it from their supervisory agencies.
- Adopted a supervisory statement announcing a series of steps designed to help ease financial stress on borrowers in areas affected by flooding in the Midwest. The Board also temporarily amended Regulation Z (Truth in Lending) to make it easier for borrowers in flood-affected areas to waive the right to cancel certain home-secured loans and thus to gain ready access to the loan proceeds.
- Issued for comment a proposal to extend the provisions of Regulation E (Electronic Fund Transfers) to electronic benefit transfer (EBT) programs established by government agencies. Under these programs, the agencies issue access cards and personal identification numbers that recipients use to obtain government benefits.
- Amended Regulation DD (Truth in Savings) to extend by three months the mandatory date for compliance with the requirements of the Truth in Savings Act and make certain other technical changes. The Board also issued proposed amendments to Regulation DD; under these revisions the annual per-

centage yield would reflect not only the effect of compounding of interest but also the time value of money for consumers who receive interest payments during the term of the account.

- Announced plans to review Regulation M (Consumer Leasing) to determine whether it can be simplified and clarified to carry out more effectively the purposes of the Consumer Leasing Act.
- Revised the commentary to Regulation Z (Truth in Lending) to address issues such as the interaction between the Truth in Lending rules on the terms on which banks can demand repayment of loans and the other federal rules dealing with credit extended to executive officers of depository institutions; the revisions provide greater flexibility in complying with disclosure requirements.

Regulation B (Equal Credit Opportunity)

In December the Board revised Regulation B to implement statutory amendments contained in the Federal Deposit Insurance Corporation Improvement Act of 1991. The amendments give credit applicants the right to receive copies of appraisal reports on residential property. The regulation sets alternative ways of complying with the law. Creditors may automatically give a copy of an appraisal report to all applicants for certain dwelling-secured loans, or they may give a copy to applicants upon request. For creditors that do not routinely provide the reports, the regulation sets limits on when applicants may request (and creditors must provide) the appraisal reports, and requires that applicants be notified of their right to receive the report. These rules cover applications for credit to be secured by a lien on a residential structure containing one to four family units.

Regulation C (Home Mortgage Disclosure)

In March the Board amended Regulation C to expand public access to the data collected under the Home Mortgage Disclosure Act (HMDA) and to require earlier release. These amendments, which took effect in 1993, apply to the HMDA data for 1992 and subsequent years; they implement provisions contained in the Housing and Community Development Act of 1992. Lenders must make a copy of their loan application register available to the public upon request; they must first delete certain items—the loan or application number, the date of application, and the date of the action taken—to protect the privacy of applicants and borrowers. Covered lenders will now make disclosure statements available to the public within three business days, instead of thirty days, after receiving the statements from supervisory agencies.

To assist covered institutions in complying with the regulation, the Board distributed a revised version of *A Guide to HMDA Reporting, Getting It Right,* issued by the Federal Financial Institutions Examination Council. The comprehensive guide discusses the law's requirements, coverage, and management responsibilities; it also gives detailed directions for gathering data and step-by-step instructions for completing the reporting form.

Regulation Z (Truth in Lending)

In July the Board adopted a supervisory statement that encouraged financial institutions to work constructively with borrowers harmed by the flooding in the Midwest. The disruption caused by the heavy floods placed many financial pressures on businesses and individuals, in some cases adversely affecting their ability to repay loans in accordance with the original terms and conditions. The statement suggested that lenders would find it more prudent to ease credit terms to help borrowers restore their financial strength, consistent with sound banking practices, and to restructure debt or extend repayment terms for existing borrowers.

The Board waived appraisal regulations for transactions related to real estate affected by the flooding. The Board also adopted a temporary amendment to Regulation Z to make it easier for borrowers in the major disaster areas to waive their right to cancel certain home-secured loans and thereby gain ready access to loan funds.

Regulation E (Electronic Fund Transfers)

In February the Board issued a proposal to revise Regulation E to cover electronic benefit transfer (EBT) programs established by federal, state, or local government agencies. The types of transfers covered by Regulation E include transfers initiated through an automated teller machine, point-of-sale terminal, automated clearinghouse, telephone bill-payment system, or home banking program. EBT programs involve the issuance of plastic access cards and personal identification numbers to recipients of government benefits such as food stamps, Aid to Families with Dependent Children, and Supplemental Security Income. Recipients gain access to benefits through automated teller machines and point-of-sale terminals.

The proposal would primarily affect government agencies that administer EBT programs and would affect only indirectly most depository institutions and other private sector entities. The Board proposed certain limited modifications; in particular, periodic account statements would not be required provided certain conditions are met, such as giving the benefits recipient information about the balance remaining in the account. The Board expected to take final action early in 1994.

Regulation DD (Truth in Savings)

In March the Board amended Regulation DD to carry out changes made to the Truth in Savings Act by the Housing and Community Development Act of 1992. The law extended the mandatory date for compliance by three months, giving institutions until June 21, 1993, to comply. The law also modified the advertising rules relating to signs on the premises of an institution and made a technical change to the provision dealing with notices to be given to existing account holders.

In November the Board issued a proposal to revise Regulation DD. Under the proposed revisions, the annual percentage yield would reflect not only the effect of compounding but also the time value of money for consumers who receive interest payments during the term of the account.

In December the Board issued a consumer pamphlet entitled *Making Sense of Savings*. It describes various types of deposit accounts available as well as the account features that consumers should compare, and it helps consumers understand the disclosures they receive.

Regulation M (Consumer Leasing)

The Board published an advance notice of proposed rulemaking, announcing a review of Regulation M pursuant to the Board's policy of periodically reviewing its regulations. The Consumer Leasing Act requires lessors to provide disclosures about consumer lease transactions. The Board plans to review the regulation to determine whether it can be simplified and clarified to better achieve the purposes of the act without diminishing consumer protections.

Interpretations

In 1993 the Board continued to offer legal interpretations and guidance on Regulation Z (Truth in Lending) through an official staff commentary. The purpose of the commentary is to help financial institutions and others apply the regulation to specific situations, and it is updated periodically to address significant questions that arise.

In April the Board revised the commentary to address the interaction between the Truth in Lending rules on demand features and other federal rules dealing with credit extended to executive officers of depository institutions. The revisions provide greater flexibility in complying with the disclosure requirements under Regulation Z in these transactions. Other revisions clarify the disclosure rules for security interests and offer creditors alternative methods of disclosing security interests in rescindable transactions.

As part of an ongoing commitment to assist the public by providing interpretations of the Board's regulations, the division's attorneys responded to more than 14,000 telephone requests in 1993.

HMDA Data

The Home Mortgage Disclosure Act (HMDA) requires covered mortgage lenders in metropolitan areas to disclose data regarding home purchase and home improvement loans, including refinancings. Depository institutions and mortgage companies generally are covered if they are located in metropolitan areas and have assets of more than $10 million. Beginning January 1, 1993, independent mortgage companies with lower assets are covered if they originated 100 or more home purchase loans in the preceding calendar year. This new rule on coverage implements a statutory amendment contained in the Federal Deposit Insurance Corporation Improvement Act that directed the Board to set a new exemption standard for mortgage companies comparable to the asset test for depository institutions.

Covered lenders collect and submit to their supervisory agency geographic information about the property involved in a loan or a loan application. They also report information about the disposition of applications and, in most cases, about the race or national origin, income, and sex of applicants and borrowers. The Board processes the data and prepares disclosure statements on behalf of the Department of Housing and Urban Development and member agencies of the FFIEC—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.

The FFIEC prepared almost 29,000 disclosure statements for the more than 9,000 lenders that reported HMDA data for 1992. In August 1993, individual institutions made these disclosure statements public. The FFIEC also prepared aggregate reports that contained data for all lenders in a given metropolitan area; these reports became available in October 1993 at a central depository in each of the nation's 341 metropolitan areas.

In November the Board appeared before the Senate Committee on Banking, Housing, and Urban Affairs and presented analyses based on national aggregates of the HMDA data. The 1992 data continue to show rates of credit denial that are higher for black and Hispanic loan applicants than for Asian and white applicants, even when applicants are in the same income bracket. For neighborhoods, the rate of loan denial generally increased with an increase in the proportion of minority residents.

Income is the one financial characteristic of applicants collected under HMDA, and analysis shows that income levels account for some, but not all, of the variations in loan disposition rates among racial groups: Even after controlling for income, the categories show that white applicants for conventional home loans in all income groups had lower rates of denial than black or Hispanic applicants did.

The data collected under HMDA do not include the wide range of financial and property-related factors that lenders consider in evaluating loan applications. Consequently, the data alone do not provide a sufficient basis for determining whether a lender is discriminating unlawfully. But when the data are combined with other information available to the agencies, they are an important tool for enforcement.

In evaluating compliance with fair lending laws, bank examiners assess mortgage decisions in the context of the lending institution's underwriting standards. They look at a sample of approved and denied applications and check whether an institution, in applying its lending criteria, has implemented standards consistently and fairly, particularly in its treatment of minority applicants. When examiners find apparent exceptions, they seek to determine whether differences in the decision to grant or deny credit have a legitimate basis or whether they suggest discriminatory treatment that warrants further investigation. Access to all of a lender's files on loan applications and to related information enables the agencies to overcome many of the limitations of the HMDA data regarding the assessment of applicant creditworthiness and of property characteristics.

During 1993 the supervisory agencies began using a new computer-based system that helps examiners analyze HMDA data more effectively and efficiently. The system, which the Board developed in consultation with the other agencies, enables examiners to design and obtain specialized HMDA reports that provide a more complete picture of an institution's mortgage lending record than was readily available in the past. To facilitate use of the HMDA analysis system by the other agencies, the Board conducted four interagency training sessions for examiners.

In recent months the Federal Reserve System also has been testing a new fair lending examination tool for examinations of large-volume mortgage lenders. The use of this tool, which begins with an analysis of HMDA Loan/Application Register (LAR) data, employs statistical techniques to determine the significance of race in a bank's lending decisions. Examiners supplement their analysis of HMDA LAR data with other information related to the bank's credit decisions drawn from actual loan files. The analysis of this additional information enables examiners to identify specific loan files for further review and discussions of credit decisions with bank management.

Other Uses of HMDA Data

The expanded HMDA data are being used to address a variety of public policy issues. In response to a directive in the Housing and Community Development Act of 1992, the Board used the 1992 data to assess the risks and returns associated with community development lending in low-income, minority, and distressed neighborhoods as compared with lending elsewhere.[1] The analysis suggested that no significant, consistent relationship exists between profitability and variables describing the income or racial or ethnic composition of a neighborhood. The study found evidence suggesting that FHA-insured loans and loans purchased by the Federal Home Loan Mortgage Corporation (Freddie Mac) had somewhat higher default rates among borrowers in low-income neighborhoods.

Lenders covered by HMDA are required to identify secondary-market purchasers by type of entity. As a consequence, the expanded HMDA data provide new opportunities to profile the characteristics both of the borrowers whose loans are purchased by secondary-market entities and of the neighborhoods in which those borrowers reside.[2]

The Department of Housing and Urban Development (HUD) uses the expanded HMDA data as an important database in carrying out its statutory responsibilities to oversee the housing activities of Freddie Mac and the Federal National Mortgage Association (Fannie Mae). The information can be used to help assess the success of efforts made by government-sponsored entities like Fannie Mae and Freddie Mac in attaining goals established by HUD for supporting loans to benefit low- and moderate-income families and to finance mortgages on properties in central cities.

HMDA data are also being used extensively as one component of fair lending examinations conducted by HUD's Office of Fair Housing and Equal Opportunity and by the Office of Lender Activities in the Office of Housing. The data assist in targeting lenders for further investigation; the data are also used in HUD's investigation of specific allegations of lending discrimination filed with HUD or with certain state or local agencies. HMDA data are also being used as part of a large-scale investigation in three metropolitan areas where HUD is testing fair lending compliance. In connection with these efforts, HUD sponsored a major conference on HMDA and fair lending in May 1993.

Community Affairs

During 1993 the Federal Reserve System's Community Affairs programs focused on community development, reinvestment, and fair lending and developed programs to facilitate constructive responses beneficial to banks and their communities. Increased resources devoted by the Board and the Reserve Banks enabled the System to respond to public concerns about possible discrimination in lending and bank participation in community development and reinvestment.

Helping financial institutions and communities address fair lending issues had high priority during 1993. Fair lending and the techniques banks can use to ensure equal access to credit was a focus of the educational programs of the Reserve Banks, which included training workshops, seminars, and major conferences. Concurrently, the Reserve Banks developed new publications and educational materials to assist bankers and others to better understand and respond to fair lending concerns.

1. Board of Governors of the Federal Reserve System, *Report to the Congress on Community Development Lending by Depository Institutions* (Board of Governors, October 1993).

2. See the discussion of data on the secondary market in Glenn B. Canner, Wayne Passmore, and Dolores S. Smith, "Residential Lending to Low-Income and Minority Families: Evidence from the 1992 HMDA Data," *Federal Reserve Bulletin*, vol. 80 (February 1994), pp. 79–108.

The Boston Reserve Bank developed *Closing the Gap: A Guide to Equal Opportunity Lending,* a publication highlighting various techniques that banks can use to help combat possible discrimination in lending and to ensure equitable treatment for loan applicants. In conjunction with state bankers associations throughout New England, the Boston Reserve Bank conducted statewide antidiscrimination workshops based on the publication. Community Affairs programs at the other Federal Reserve Banks distributed more than 50,000 copies of *Closing the Gap* to bankers and to community and civil rights groups throughout the country.

The Board, with the Federal Reserve Bank of Richmond, sponsored a meeting of Washington, D.C., bankers to discuss options for improving the fair lending programs of financial institutions. For bankers and representatives of community organizations, the Reserve Banks of Kansas City, San Francisco, and Dallas conducted multiple sessions of seminars with a focus on fair lending issues and antidiscrimination initiatives.

Promoting greater awareness of community development and reinvestment opportunities for bankers and their communities was another major focus of the System's Community Affairs program. The System sponsored six regional roundtables with representatives of depository institutions, nonprofit lending organizations, multibank loan consortia, and other intermediaries to gain more insight into the risks and profitability of community development lending and to further the Board's congressionally mandated study of such lending.[3]

The Board and the Reserve Banks responded to numerous requests for information and assistance from bankers and others interested in community development investments by banks and bank holding companies. The Board revised and published its *Directory of Bank Holding Company Community Development Corporations.* The Board also worked to address policy issues concerning the community development investment authority of state member banks.

The Federal Reserve Bank of Philadelphia published *Community Reinvestment Advocates,* a compilation of profiles on the performance of financial institution programs designed to meet the credit needs of low- and moderate-income borrowers; featured programs include those of individual financial institutions, multilender consortia, nonprofit lenders, and other community development finance partnerships and intermediaries.

The Reserve Banks of St. Louis, Atlanta, Richmond, Kansas City, and San Francisco sponsored training programs on the Community Reinvestment Act for bank directors and executive officers. The Reserve Banks of Boston, Cleveland, Atlanta, Chicago, Kansas City, Dallas, and San Francisco sponsored and conducted workshops and major conferences on affordable housing, community development finance, small business, and rural development. Overall, during 1993 the Reserve Banks' Community Affairs programs sponsored or cosponsored more than 175 conferences, seminars, and informational meetings on fair lending, community development, and reinvestment topics. Staff members of the Board and of the Reserve Banks made more than 300 presentations at other conferences, seminars, and meetings sponsored by banking, governmental, business, and community organizations.

As part of the System's ongoing outreach efforts, several Reserve Banks

3. Board of Governors, *Report to the Congress on Community Development Lending.*

published profiles of targeted communities, identifying their reinvestment needs and resources and the reinvestment opportunities for bankers. These profiles often helped stimulate collaboration among local financial institutions and community and business organizations by identifying community credit needs and possible community development finance programs to respond to those needs. The Richmond Reserve Bank issued profiles highlighting community development organizations and resources in Richmond and Lynchburg, Virginia, and the San Francisco Bank published a comprehensive community profile for Las Vegas, Nevada. The St. Louis Reserve Bank published a profile on Evansville, Indiana.

During 1993, Community Affairs programs at the Reserve Banks were increasingly in demand to provide technical assistance to bankers, community organizations, and others on community development and reinvestment issues. Unlike educational and training programs, technical assistance is aimed at helping develop specific program responses to recognized needs or, in many cases, to assist individual institutions in strengthening their CRA programs.

For example, the Federal Reserve Bank of Atlanta, working extensively with Minority Business Development centers and local financial institutions, helped develop large-scale loan programs to assist minority businesses in Orlando, Florida, and Nashville, Tennessee. The Richmond Reserve Bank completed a three-year effort to assist the West Virginia Bankers Association and the state banking commission in forming a statewide multibank community development corporation that will focus on small business development. The Chicago Reserve Bank provided technical assistance on CRA and community development finance options to help several banks strengthen their CRA programs.

Community Affairs programs also expanded the reach of their newsletters, which typically feature information on community development lending programs and related CRA, HMDA, and fair lending issues. The Federal Reserve Bank of Kansas City published the inaugural issue of its *Community Reinvestment* newsletter, bringing to ten the number of Reserve Banks that now publish such newsletters. The newsletters reach more than 48,000 representatives of financial institutions, community organizations, local government agencies, and other interested parties.

The Board intensified its support during 1993 for the Federal Reserve System's supervisory responsibilities, particularly those involving CRA and fair lending. The Board conducted a one-week course on advanced CRA examination techniques for compliance examiners, and it continued to instruct consumer compliance examiners in the conduct of community contacts and in bank involvement in community development finance. The Board also significantly expanded its training on affordable housing and community development project finance for commercial examiners. For example, the Board conducted five half-day training sessions on community development finance for senior commercial examiners.

FFIEC and Other Interagency Activities

The Federal Financial Institutions Examination Council (FFIEC) is the interagency coordinating body charged with developing uniform examination principles, standards, and report forms. During 1993, its activities and the joint efforts of its member agencies focused intensively on fair lending and CRA initiatives. Through improved data analyses, examiner training, and more effective coordination efforts, the agencies continued to strengthen their capacity to enforce fair lending laws.

In May the Chairman of the Federal Reserve Board and the heads of each of the other financial regulators issued a joint letter stressing the agencies' concerns about discriminatory treatment in the credit application process. The agencies reaffirmed their ongoing efforts to refine and improve the fair lending examination process. They urged financial institutions to be creative in designing fair lending programs, and suggested positive actions that institutions could take to ensure that minority applicants are not discouraged from seeking credit and that they are treated equitably during the application process.

In June the agencies issued an "Interagency Policy Statement on Fair Lending Initiatives" that outlined ongoing antidiscrimination projects and initiatives being considered. These measures include expanded training for examiners; fair lending seminars to make top-level financial industry executives aware of practices that may result in inequitable treatment of applicants; development of new methods of discrimination detection; procedures that govern referrals of possible discrimination cases to the Department of Justice; and program improvements to ensure that complaints involving discrimination are handled effectively.

The agencies continued to work with HUD to ensure proper disposition of consumer complaints involving violations of the Fair Housing Act. Representatives of the FFIEC's member agencies and HUD held discussions in August and November on the implementation of a memorandum of understanding that took effect in June 1992. The memorandum sets out procedures to facilitate cooperation between HUD and the other agencies in complaint investigation and to minimize duplication of effort.

In September the FFIEC received a consultant's report with recommendations for improving fair lending examination procedures. The report covered pre-examination planning, onsite examinations, and procedures suggested for cases in which enforcement action is indicated. The FFIEC member agencies anticipated implementing key recommendations in 1994.

In March the FFIEC sponsored its first national interagency conference on consumer compliance. The conference explored key examination issues and updated senior compliance examiners from each of the agencies on current and prospective developments in consumer banking law and regulation. Sessions covered community reinvestment, HMDA, fair lending, real estate appraisals, trends in community development lending by banks, the Truth in Savings regulation, and common regulatory problems with adjustable rate mortgages. Speakers included recognized leaders from the industry and senior staff members from the supervisory agencies and other federal agencies.

Economic Effects of the Electronic Fund Transfer Act

In keeping with statutory requirements, the Board monitors the effect of the Electronic Fund Transfer Act on the compliance costs and consumer benefits related to EFT services. In 1993 there were no new requirements or changes in the regulation, but because of continued growth in the availability and use of EFT services, the economic effects of the act increased.

The act covers a large number of consumer accounts and financial institutions. In 1993, about three-fourths of all households in the United States had one or more EFT features on accounts at financial institutions, and about two-thirds of all banks and thrift institutions offered EFT services. Automated teller machines (ATMs) are the most widely used EFT service in the United States. Most of the nation's depository institutions offer consumers access to ATMs, and more than half of all households currently have ATM access cards. ATM services have become more widely available with the continuing expansion of shared networks. Almost all ATM terminals in operation today participate in one or more shared networks. The monthly average number of ATM transactions increased about 6 percent, from 605 million in 1992 to 642 million in 1993. During the same period the number of installed ATMs rose about 9 percent.

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 more than half of social security payments and about two-thirds of federal salary and retirement payments made by direct deposit. Although direct deposit in the private sector is less common, it has grown substantially in recent years.

Point of sale (POS) systems account for a small share of all EFT transactions, but their use grew rapidly in 1993. The number of transactions on POS systems rose 43 percent, to 36.4 million a month, and the number of POS terminals rose 68 percent, to 196,000.

The incremental costs associated with the EFT act are difficult to quantify because no one knows how industry practices would have evolved in the absence of statutory requirements. The benefits of the law are also difficult to measure because they cannot be isolated from consumer protections that are provided even in the absence of regulation. The available evidence provides no indication of serious consumer problems with electronic transactions. In 1993, about 90 percent of depository institutions examined by federal agencies were in full compliance with Regulation E. Statistics indicate that the institutions that are not in full compliance with the regulation generally had fewer than five violations. The violations primarily involved the failure to provide disclosures to consumers.

The Board's database of consumer complaints and inquiries is another source of information on potential problems. In 1993, fifty of the complaints processed involved electronic transactions. The System forwarded thirty-three complaints that did not involve state member banks to other agencies for resolution. Of the remaining seventeen complaints, one involved a possible violation of the act or regulation.

In February 1993 the Board published for comment a proposal to expand coverage of Regulation E to the electronic benefit transfer (EBT) programs of government agencies. The Board expressed the view that recipients of electronic benefit transfers were entitled to the same protections as consumers who obtain EFT services from financial institutions. Because EBT programs have not yet extended much beyond the pilot-program stage, the potential benefits of the proposal are difficult to measure.

The costs of operating EBT programs are currently about the same as those of paper-based systems. The expansion of EBT programs could be expected to result in lower per-unit costs through scale economies. The regulatory cost that most concerns government agencies that administer benefit programs is the cost of Regulation E liability rules, which limit the consumer's liability if the consumer reports promptly when a debit card is lost or stolen. The one EBT pilot program that operates under Regulation E liability rules has recorded loss rates no greater than those of financial instituitions for electronic fund transfers and lower than those of paper-based food stamp programs and Aid to Families with Dependent Children. If the limited available evidence on the costs of Regulation E to financial institutions can be a guide, ongoing costs of the regulation seem unlikely to greatly inhibit growth of EBT programs.

Compliance Examinations

Since 1977 the Federal Reserve System has maintained a specialized examination program to ensure compliance by state member banks with consumer protection laws. The consumer compliance examination program is under the general direction of the Board's Division of Consumer and Community Affairs and consists of a consumer affairs unit within each Federal Reserve Bank's examination department. The Compliance Section of the Board's Division of Consumer and Community Affairs is responsible for reviewing and coordinating compliance activities, providing Reserve Banks with the information and assistance they need, and ensuring that the Reserve Banks take a uniform approach to compliance examinations.

The Federal Deposit Insurance Corporation Improvement Act of 1991 expanded the Board's enforcement authority to include certain types of foreign banking organizations.[4] The System began conducting compliance examinations of foreign banking organizations in the first quarter of 1992. The scope of these examinations typically includes the Equal Credit Opportunity Act, the Home Mortgage Disclosure Act, the Truth in Lending Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the Electronic Fund Transfer Act, the Federal Trade Commission Act, and the Expedited Funds Availability Act. The degree to which foreign banking organizations conduct activities covered by these laws and regulations varies, but often these institutions conduct far fewer such activities than a typical state member bank does.

During the 1993 reporting period, from July 1, 1992, to June 30, 1993, Federal Reserve examiners conducted 951 examinations for compliance with the consumer laws: 644 for state member banks and 307 for foreign banking organizations.

An important aspect of the Federal Reserve's compliance program is examiner training for CRA, fair lending, and consumer compliance. New examiners attend the Board's three-week basic consumer compliance school, while examiners with eighteen to twenty-four months of field experience attend the Board's week-long advanced compliance school and the one-week class on advanced techniques for CRA examinations. In addition, examiners receive training in the HMDA data analysis system.

A resident examiner program complements the Board's schools and provides Federal Reserve examiners with an opportunity to get a System perspective by working at the Board for several weeks; examiners observe how the division works, how policies are developed, and how the Board interacts with the other agencies that supervise financial institutions. Examiner training is supple-

4. The Federal Reserve System is responsible for enforcing consumer laws for state-chartered agencies and state-chartered uninsured branches of foreign banks, commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25(a) of the Federal Reserve Act (Edge Act and agreement corporations).

mented by the Reserve Banks through regular departmental staff meetings and through special training sessions such as the FFIEC's 1993 senior examiner conference.

During calendar year 1993 the Federal Reserve System conducted two basic consumer compliance schools for 69 students, two advanced consumer compliance schools for 39 students, four HMDA data analysis system training sessions for 270 students, and one advanced CRA examination techniques class for 25 students. Twenty examiners participated in the resident examiner program.

New classes are incorporated into the System's training program when needed. For instance, Board and System staff began working on a fair lending school for System examiners during 1993. The first sessions will be held in 1994.

The Board monitors the various aspects of state member banks' compliance examination records through data collected on the Consumer Affairs Report of Examination Systems. During 1993 the Board expanded its computer systems to better track detailed information on violations of Regulation B and the Fair Housing Act.

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 Equal Credit Opportunity Act, the Electronic Fund Transfer Act, the Truth in Lending Act, and the Expedited Funds Availability Act improved from 1992 levels while compliance with the Consumer Leasing Act remained essentially unchanged. This section summarizes these data for the reporting period of July 1, 1992, to June 30, 1993.[5]

Equal Credit Opportunity Act (Regulation B)

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 the level of compliance with the Equal Credit Opportunity Act (ECOA) increased from 57 percent in the 1992 reporting period to 61 percent during 1992.[6] The four agencies that were able to provide the frequency of violations (the Board, the NCUA, the OCC, and the OTS) reported that, as in 1992, 77 percent of the institutions examined that were not in full compliance with Regulation B had between one and five violations (the lowest frequency category). 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
- Follow the prescribed form of the ECOA notice

5. Not all the federal agencies that regulate financial institutions use the same method to compile compliance data. However, the data support the general conclusions presented here.

6. 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.

• Request information for monitoring purposes about race or national origin, sex, marital status, and age on credit applications primarily for the purchase or refinancing of a primary dwelling

• Note information for monitoring purposes on the basis of visual observation or surname if applicants choose not to provide it.

The Board issued four written agreements and one cease-and-desist order involving violations of Regulation B. Civil money penalties were assessed in connection with Regulation B violations found at one bank. The OTS issued six supervisory agreements.

The Federal Trade Commission (FTC) continued its enforcement efforts under the ECOA. The FTC worked with other government agencies and with creditor and consumer organizations to increase awareness of, and compliance with, the ECOA. In 1993 the FTC, in cooperation with the American Bar Association, issued a new consumer brochure entitled *Credit and Divorce.*

The Farm Credit Administration (FCA) reported a satisfactory level of compliance with the ECOA. The total number of violations found as a result of examinations and enforcement activities decreased 35 percent from 1992 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 reported that 90 percent of examined institutions were in full compliance with Regulation E, up from 85 percent in 1992. The following five rules were the most frequently violated provisions of Regulation E:

• Provide a notice of the procedures for resolving alleged errors at least once each calendar year

• Provide, in a timely manner, a written statement outlining the terms and conditions of the electronic fund transfer service

• Provide a summary of consumers' liability for unauthorized transfers

• Provide a statement with all information required for each monthly cycle in which an electronic transfer occurred

• Investigate and resolve alleged errors promptly.

The OTS issued two supervisory agreements involving violations of Regulation E. The Board issued one written agreement; civil money penalties were assessed at one bank.

The Federal Trade Commission reported ongoing litigation with one telemarketing company that allegedly failed to obtain written authorization from consumers for preauthorized transfers.

Consumer Leasing (Regulation M)

The five financial regulatory agencies reported finding substantial compliance with Regulation M, which implements the Consumer Leasing Act. As in the 1992 reporting period, 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 adhere to specific disclosure requirements in the regulation.

The Federal Trade Commission issued one consent order during the reporting period. That consent order involved the failure to provide advertising disclosures required by Regulations Z and M.

Truth in Lending Act (Regulation Z)

The five regulatory agencies that supervise financial institutions reported that, on average, 49 percent of examined institutions were in full compliance with Regulation Z, up from 44 percent in 1992. The Board, the FDIC, and the OTS showed increases in compliance, the OCC reported a slight decline, and the NCUA reported no change. The agencies able to provide the frequency of violations (the Board, the NCUA, the OCC, and the OTS) reported that 62 percent of the financial institutions not in full compliance had between one and five violations, an improvement from the 57 percent reported for 1992.

The most frequent violations of Regulation Z observed by the five regulatory agencies involved the failure to accurately disclose the finance charge, the annual percentage rate, the amount financed, and the number, amounts, and timing of payments scheduled to repay the obligation; and the failure to provide Truth in Lending disclosures that accurately reflected the terms of the legal obligation.

The Board issued three written agreements and one cease-and-desist order involving violations of Regulation Z; civil money penalties were assessed at one bank. The OTS issued thirteen supervisory agreements, one cease-and-desist order, and one notice of charges. Under the interagency enforcement policy on Regulation Z, a total of 426 institutions supervised by the Board, the FDIC, the OCC, or the OTS refunded \$5.9 million on 28,786 accounts in 1993. In 1992, roughly \$4.1 million had been refunded on 23,967 accounts.

The Federal Trade Commission issued a final consent order in a case involving the failure to provide advertising disclosures required by Regulations Z and M. The FTC also issued a final consent order against a mortgage lender that prohibited the lender from misrepresenting the terms or nature of lock-in agreements offered to consumers in residential mortgage transactions.

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 issued a new publication entitled *Secured Credit Card Marketing Scams* and updated its publication entitled *Refinancing Your Home.*

Other agencies found that the institutions they supervise had a satisfactory level of compliance with Regulation Z. The Department of Transportation reported that its investigation of consumer inquiries about foreign and domestic carriers resulted in the initiation of formal enforcement proceedings against a travel agency and a charter operator. The department initiated the proceedings after finding violations that involved credit practices with regard to required refunds on air charters. The Farm Credit Administration (FCA) reported that violations decreased 11 percent from the 1992 reporting period, and that no formal enforcement actions were taken as a result of the agency's examinations and enforcement activities. The Packers and Stockyards Administration of the Department of Agriculture received no complaints, initiated no enforcement actions, and indicated its belief that the individuals and firms it regulates are in substantial compliance with Regulation Z.

Community Reinvestment Act (Regulation BB)

The Community Reinvestment Act 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.

For enforcing and fostering better bank performance under the CRA, the Federal Reserve System maintains a three-part program:

- Examinations of institutions to assess compliance
- Dissemination of information on community development techniques to bankers and to the public through community affairs offices at the Reserve Banks
- CRA analyses in processing applications from bank and bank holding companies.

Federal Reserve examiners review performance in fair lending, community revitalization, and other relevant areas to assess CRA compliance. During the 1993 reporting period (July 1, 1992, through June 30, 1993), they conducted 627 examinations.[7] When appropriate, examiners suggested ways to improve CRA performance.

During the 1993 reporting period, 96 banks received "outstanding" CRA ratings, 485 received "satisfactory" ratings, 40 received "needs to improve" ratings, and 6 received "substantial noncompliance" ratings. The Board issued four written agreements and, in the case of one bank, a notice of charges.

7. The foreign banking organizations supervised by the Federal Reserve System are not subject to CRA.

CRA Reform

A new CRA reform process, initiated at the direction of President Clinton, dominated interagency activities during the latter half of 1993. In July the President asked the four supervisory agencies with CRA responsibilities (the Board, the FDIC, the OCC, and the OTS) to reform the implementation of the CRA by developing new regulations, supervisory procedures, and standards for assessing financial institutions' CRA performance. The President also directed the agencies to consult with community groups and with the banking and thrift industries during the reform process.

In August and September the agencies held seven public hearings to solicit the views of the public and of financial institutions across the country on specific ways in which the CRA regulations could be revised to facilitate improved performance by institutions while reducing their regulatory burdens. Hearings were held in Washington, D.C.; San Antonio; Los Angeles; Albuquerque; New York City; Chicago; and Henderson, North Carolina. More than 250 witnesses representing financial institutions, community and civil rights groups, government agencies, small businesses, and the general public presented their views. Many others submitted written statements to the agencies.

After taking into consideration the President's directive, the results of the hearings process, and their own experience in administering the current CRA assessment system, the Board and the other agencies jointly proposed CRA regulations, which they published concurrently in December. The agencies anticipated issuing final regulations in 1994.

The proposed regulations would provide more direct guidance to financial instutions on the nature and extent of their CRA responsibilities and the means by which their obligations will be assessed and enforced. The proposal seeks to emphasize performance rather than process, to provide greater predictability and consistency in examinations, and to reduce the compliance burden on some institutions. Specifically, the proposal would do the following:

- Create a new quantitative system for assessing CRA performance, which would include measurements for lending, services, and investments
- Require institutions to collect additional data for small business, small farm, and certain consumer loans
- Allow for alternative bases of evaluation to try to minimize the regulatory burden on institutions
- Establish a new approach to enforcement that would subject institutions to full enforcement actions based solely on their CRA rating.

Expedited Funds Availability Act (Regulation CC)

The five financial regulatory agencies reported that the level of compliance with Regulation CC improved during the 1993 reporting period: 74.1 percent of examined institutions were in full compliance with the act, compared with 69 percent in 1992. 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, 90 percent had between one and five violations. The most frequently violated provisions of Regulation CC were the following:

- Provide next-day availability as required for certain items
- Provide two-day availability for local checks
- Train employees adequately and provide procedures to ensure compliance
- Follow the prescribed procedures for exceptions involving large deposits
- Provide fifth-day availability for nonlocal checks.

The OTS issued one supervisory agreement involving violations of Regulation CC. The Board issued two written agreements and one cease-and-desist order and assessed civil money penalties against one bank.

Applications

During 1993, ninety-eight of the applications from banks and bank holding companies that the Federal Reserve reviewed and acted on involved adverse CRA ratings or CRA protests. This compares with fifty-nine applications in 1992.[8]

Among the ninety-eight applications acted on in 1993, forty-five were protested on CRA grounds; forty raised adverse CRA rating issues; and thirteen involved both protests and adverse CRA rating issues. In comparison, the previous year's fifty-nine applications involved twenty that were protested based on CRA grounds, thirty-one that raised CRA rating issues, and eight that involved adverse CRA rating issues and protests.

8. Fifteen applications were pending at year-end 1993. Statistics for 1992 have been recalculated from those in last year's REPORT to reflect only applications acted on during 1992.

The Board denied two applications on CRA grounds. In February it denied the application of Farmers & Merchants Bank of Long Beach (California) to establish a new branch and invest in bank premises because of chronic deficiencies in the bank's regulatory compliance and CRA performance efforts. In May the Board denied the application of First Colonial Bankshares Corporation (Chicago) to acquire all the voting shares of Hi-Bancorp, Inc. (Highwood, Illinois) and GNP Bancorp, Inc. (Mundelein, Illinois). First Colonial's third largest subsidiary bank (which represented approximately 10 percent of consolidated assets) had received two consecutive CRA ratings of "needs to improve." There also had been allegations of discriminatory lending practices and of the failure to address adequately the credit needs of the subsidiary bank's delineated community.

In November, by a vote of three to three, the Board did not approve the application of Shawmut National Corporation (Hartford and Boston) to acquire New Dartmouth Bank (Manchester, New Hampshire). The three Board members voting against the acquisition cited concerns about Shawmut's compliance with the Equal Credit Opportunity Act and the Home Mortgage Disclosure Act.

The Board approved two applications, with dissents from Governor Lindsey that were based on consumer-related issues. One, involving the application of First Interstate Bancorp (Los Angeles) to acquire Cal Rep Bancorp, Inc. (Bakersfield, California), was approved in November. Governor Lindsey believed that the lead bank's performance in mortgage lending and in community outreach efforts to low- to moderate-income and minority neighborhoods was deficient. In the second application, approved in December, Fleet Bank of New York (Albany) proposed to acquire twenty-nine branches of Chemical Bank (New York City). Governor Lindsey based his dissent on managerial concerns related to Fleet's compliance with consumer credit protection laws.

Complaints about State Member Banks

The Federal Reserve investigates complaints against state member banks, and

Consumer Complaints to the Federal Reserve System Regarding State Member Banks and Other Institutions, by Subject, 1993

Subject	State member banks	Other institutions[1]	Total
Regulation B (Equal Credit Opportunity)	93	67	160
Regulation E (Electronic Fund Transfers)	17	33	50
Regulation Q (Interest on Deposits)	19	22	41
Regulation Z (Truth in Lending)	100	197	297
Regulation BB (Community Reinvestment)	2	4	6
Regulation CC (Expedited Funds Availability)	19	32	51
Fair Credit Reporting Act	20	90	110
Fair Debt Collection Practices Act	5	15	20
Fair Housing Act	4	0	4
Flood Insurance	2	0	2
Real Estate Settlement Procedures Act	1	3	4
Unregulated practices	823	894	1,717
Total	**1,105**	**1,357**	**2,462**

1. Complaints against these institutions were referred to the appropriate regulatory agencies.

forwards to appropriate enforcement agencies complaints that involve other creditors or businesses. In 1993 the Federal Reserve received 2,462 complaints: 2,120 by mail, 327 by telephone, and 15 in person. The Federal Reserve investigated and resolved the 1,105 complaints that were against state member banks (see preceding table). The System also received 1,976 oral and written inquiries about consumer credit and banking policies and practices. In responding to these complaints and inquiries, the Board and Federal Reserve Banks gave specific explanations of laws, regulations, and banking practices and provided relevant printed materials on the general issues.

A second table summarizes the nature and resolution of the 1,105 complaints against state member banks. About 63 percent involved loan functions: 10 percent alleged discrimination on a prohibited basis, and 53 percent concerned credit denial on nonprohibited bases (such as length of residency) and other unregulated lending practices (such as release or use of credit information). Approximately 24 percent involved disputes about interest on

Consumer Complaints to the Federal Reserve System, by Function and Resolution, 1993

Type of complaint and resolution	Total	Loans		Deposits	Electronic fund transfers	Trust services	Other
		Discrimination	Other				
Complaints about state member banks, by type							
Insufficient information[1]	22	1	11	9	0	0	1
Information furnished to complainant[2]	134	5	88	24	0	3	14
Bank legally correct							
No reimbursement or accommodation	465	62	222	114	9	12	46
Reimbursement or accommodation—goodwill[3]	156	12	100	31	2	0	11
Bank error							
No reimbursement	49	3	29	10	0	0	7
Reimbursement	89	2	51	27	1	1	7
Factual dispute[4]	44	1	19	19	2	1	2
Possible bank violation[5]	14	2	6	0	1	1	4
Matter in litigation[6]	15	1	3	8	0	2	1
Customer error	20	0	12	8	0	0	0
Pending, December 31	97	10	46	19	2	2	18
Total, state member banks	1,105	99	587	269	17	22	111
Percent	100	9	53	24	2	2	10
Complaints referred to other agencies	1,357	81	772	293	33	16	162
Total	**2,462**	**180**	**1,359**	**562**	**50**	**38**	**273**

1. The staff was 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.

deposits and general deposit account practices. The remaining 13 percent concerned disputes about electronic fund transfers, trust services, and other miscellaneous bank practices.

In March 1993 the President issued an Interagency Policy Statement on Credit Availability, which requires agencies to review their programs to ensure that complaints are carefully scrutinized and handled in a timely manner, particularly complaints involving discriminatory lending practices.

In response the Federal Reserve reviewed its complaint investigation program and took actions during 1993 to strengthen and improve it, particularly with respect to complaints alleging illegal credit discrimination. These actions included implementing new policies and procedures to ensure thorough analysis and prompt investigation of discrimination complaints, and developing special analysis reports from the Board's automated data system.

Under a new program, staff members from the consumer complaint sections of the Reserve Banks began working for several weeks in the consumer complaint section of the Board at various times during the year to become familiar with operations in Washington; staff members from ten Reserve Banks participated during the year.

In November 1993 the first annual Consumer Complaint Officers and Managers Conference was held at the Board to discuss issues, policy matters, and procedures related to the function.

In addition, an interagency work group met regularly at the Board in 1993 to identify and develop ideas to improve consumer access to the agencies and improve the ability of the agencies to handle consumer concerns about the financial services area. In December 1993 the work group submitted four initiatives for consideration by the FFIEC Consumer Compliance Task Force: creating an interagency toll-free number dedicated to fielding discrimination complaints from consumers; developing a joint brochure on consumers' rights under the fair lending laws; establishing toll-free numbers at each FFIEC agency for receiving complaints and inquiries; and improving the exchange of complaint data among the agencies.

During 1993 the Federal Reserve continued to refer to the Department of Housing and Urban Development complaints alleging violations of the Fair Housing Act as required by a memorandum of understanding between HUD and the federal bank regulatory agencies that became effective in June 1992. The memorandum encourages cooperation and coordination between HUD and the bank regulatory agencies in the investigation of these complaints. In 1993 the Federal Reserve referred fourteen complaints about state member banks to HUD. The Federal Reserve's investigations of thirteen of these complaints revealed no evidence of illegal discrimination; one complaint remained pending at year-end.

The memorandum of understanding requires HUD and the agencies to meet at least annually to discuss issues relating to its implementation. The first meeting was held in August 1993, and a second meeting was held in November.

Unregulated Practices

In 1993 the Board continued to monitor, under section 18(f) of the Federal Trade Commission Act, complaints about banking practices that are not subject to existing regulations to focus on those that may be unfair or deceptive. Two categories each accounted for 7 percent or less of the 1,717 complaints: denial of credit applications based on credit history (122) and other miscellaneous complaints (54). Each of these categories accounts for a small number (5 percent or less) of all consumer complaints received by the System.

Many of the complaints about credit denials based on credit history indicate that applicants underestimated the importance lenders give to a poor credit history or a lack of borrowing experience when assessing the applicant's creditworthiness. Complaints in the miscellaneous category covered a wide range of issues such as bank fees and services; tactics lenders employed to collect late payments or outstanding debts; or a lender's failure to close on a mortgage loan by the agreed settlement date.

Consumer Advisory Council

The Consumer Advisory Council 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, and state and local government. Council meetings are open to the public. During 1993 the council considered a variety of topics including impediments to the availability of small business credit, community development banks, secured credit cards, and models for economic development.

In March the council discussed issues related to the Community Reinvestment Act, including safe harbors for banks rated "outstanding" to provide protection against protests on applications. The council also recommended that the current number of CRA ratings be increased from four to five, with the "satisfactory" rating replaced by two ratings: "good" and "adequate." The three other ratings ("outstanding," "needs to improve," and "substantial noncompliance") would remain unchanged. The council adopted the recommendation unanimously.

In June the council's Community Affairs and Housing Committee reported on the Administration's proposal to create a Community Development Bank and Credit Fund to help finance community development financial institutions (CDFIs); CDFIs include traditional depository institutions and community development corporations. The proposal specified, and the committee endorsed, four purposes of the proposal:

- Support institutions whose primary mission is community development
- Recognize the important role private money will play in the success of CDFIs and the importance of CRA credit in attracting private investment in CDFIs
- Recognize the diversity of local CDFIs, which range from unions to loan funds to commercial banks specializing in development lending
- Apportion funds to CDFIs based on their performance in meeting local community needs, for example, by making loans and leveraging private money.

In the context of the proposed reform of the CRA, the council's Bank Regulation Committee in October identified thirteen elements as key to any CRA reform proposal. Six elements pertained to CRA activities by banks. The committee believed that evidence of willful discrimination should result automatically in a CRA rating of "substantial noncompliance" and that significant statistical imbalances in institutional lending patterns should result in a rating of less than "satisfactory." The committee supported a system in which banks developed a CRA business plan with quantifiable performance measures against which their performance would later be measured by the regulators.

The committee also believed that regulators should determine the value of such a plan based in part on the amount of community outreach by the bank, with performance assessed on the "depth and breadth" of performance on market share and variety of services offered. In the case of specialty or wholesale banks, the committee believed that assessment of CRA performance should be based on the value of their targeted initiatives in low- and moderate-income and minority communities.

The remaining elements pertained to the regulators. The committee recommended that regulators meet regularly with community groups, provide advance public notice of CRA examinations, and provide feedback from community groups to the institutions. Members also favored making CRA public evaluations available at central data depositories, where the HMDA data are currently available. The committee recommended that the four agencies should provide training and basic experience for their examiners in all aspects of the examination process; create a tiered structure for CRA examinations that contains more cost-effective requirements for small community banks; and create a five-tiered system of CRA ratings.

Roundtable discussions, known as the Members Forum and held at each council meeting, gave council members the opportunity through the year to offer their views on visible signs of an economic recovery within their industries or local economies. During the year, the council also considered "secured" credit cards (with credit lines fully backed by consumer deposits) and discussed actions that could reduce the regulatory burden associated with the Board's consumer protection rules.

Testimony and Legislative Recommendations

The Board testified on matters relating to the 1992 HMDA data, the status of the Community Reinvestment Act, bank-related community development corporations and other types of community development equity investments, the Home Ownership and Equity Protection Act of 1993, the Small Business Loan Securitization and Secondary Market Enhancement Act, the challenges that face banks in meeting the service and credit needs of low-income and minority communities, and the Community Development Secondary Market Development Act.

Credit Discrimination in Mortgage Lending

In February the Board testified before the Senate Committee on Banking, Housing, and Urban Affairs on credit discrimination in mortgage lending on its own behalf and on behalf of the FFIEC. The Board noted the implementation of a system that has increased the agencies' ability to analyze HMDA data for purposes of fair lending and CRA enforcement; cooperation with the Justice Department to target banks for fair lending examinations when HMDA data suggest disparate treatment by the banks of minority mortgage loan applicants; the referral of consumer complaints alleging violations of the Fair Housing Act to HUD and to the Department of Justice; formal enforcement actions, including assessment of civil money penalties, to enforce compliance with consumer protection laws, including the prohibitions against credit discrimination based on marital status, age and race; and the denial by the Board of three applications in the past two years primarily because of poor CRA performance.

In September the Board testified before the House Committee on Banking, Finance and Urban Affairs about the challenges that face banks in meeting the service and credit needs of low-income and minority communities. The hearing was held in Prince George's County, a Maryland suburb of Washington, D.C.

In November the Board testified before the Senate Committee on Banking, Housing, and Urban Affairs on the results of the 1992 HMDA data, the Board's fair lending enforcement efforts, and its examination process.

Community Reinvestment Act

In February the Board testified before the House Committee on Banking, Finance and Urban Affairs concerning the status of CRA. The Board discussed several issues relating to the act, including supervisory agency roles and actions, examination improvements, expanded educational and technical assistance, effects on applications, and discrimination and home mortgage lending.

In October the Board testified before the House Committee on Banking, Finance and Urban Affairs on current efforts of the agencies to strengthen and improve the administration of CRA.

Other Testimony

In February the Board testified before the House Committee on Banking, Finance and Urban Affairs about the Board's perspective on bank-related community development corporations (CDCs) and other types of community development equity investments. The Board's testimony focused on the role of banks in community development, the special role for CDCs, legal and regulatory issues, characteristics of CDCs, and types of community development investments.

In May the Board testified before the Senate Committee on Banking, Housing, and Urban Affairs concerning the Home Ownership and Equity Protection Act of 1993. The bill would amend the Truth in Lending Act to require additional disclosures to consumers who take out "high-cost mortgages" on their homes and would restrict the terms of such mortgages.

In September the Board testified before the Senate Committee on Banking, Housing, and Urban Affairs on the Small Business Loan Securitization and Secondary Market Enhancement Act (S.384), which sought to increase the availability of credit to small businesses by facilitating the securitization of small business loans. The Board's testimony was generally supportive of the legislation.

Recommendations of Other Agencies

Each year the Board asks the agencies with enforcement responsibilities under Regulations B, E, M, Z, and CC for recommendations of changes to the regulations or the underlying statutes. They had no recommendations in 1993. ■

Litigation

During 1993 the Board of Governors was named in twenty-two lawsuits, compared with seventeen in 1992. Fourteen new lawsuits were filed in 1993, none of which raised questions under the Bank Holding Company Act. As of December 31, 1993, seventeen cases were pending.

Bank Holding Company Act—Review of Board Actions

In *State of Idaho, Department of Finance v. Board of Governors,* No. 92-70107 (9th Circuit, filed February 24, 1992), petitioner sought review of a Board order determining, in accordance with *Synovus v. Board of Governors,* 952 F.2d 426 (D.C. Circuit, 1991), that no application is required for a bank holding company to relocate its subsidiary bank across state lines. On June 4, 1993, the Court of Appeals denied the petition for review (994 F.2d 1441).

Litigation under the Financial Institutions Supervisory Act

In *Board of Governors v. Ghaith R. Pharaon,* No. 91-CIV-6250 (S.D. New York, filed September 17, 1991), the Board sought to freeze the assets of an individual pending administrative adjudication of a civil money penalty assessment by the Board. On September 17, 1991, the court issued an order temporarily restraining the transfer or disposition of the individual's assets. The order has been extended by agreement.

In *CBC, Inc. v. Board of Governors,* No. 92-9572 (10th Circuit, filed December 2, 1992), petitioners sought review of a civil money penalty assessment against a bank holding company and three of its officers, directors, and shareholders for failure to comply with reporting requirements. The Board's order was affirmed by the Court of Appeals on November 30, 1993.

First National Bank of Bellaire v. Board of Governors, No. H-93-1708 (S.D. Texas, filed June 8, 1993), is an action to enjoin possible enforcement actions by the Board of Governors and other bank regulatory agencies. The case is pending.

Board of Governors v. Oppegard, No. 93-3706 (8th Circuit, filed November 1, 1993), is an appeal of a District Court order ordering appellant Oppegard to comply with a prior order requiring compliance with a Board civil money penalty order. The case is pending.

Board of Governors v. DLG Financial Corp., Nos. 93-2944 and 94-20013 (5th Circuit, filed December 14 and December 31, 1993), is an appeal from orders, obtained by the Board, that freeze appellants' assets pending administrative adjudication of civil money penalty assessments by the Board. In a related case, *DLG Financial Corp. v. Board of Governors,* No. 94-10078 (5th Circuit, filed January 20, 1994), appellants appeal the District Court dismissal of their action to enjoin the Board and the Federal Reserve Bank of Dallas from taking certain enforcement actions, and for money damages on a variety of tort and contract theories.

In addition, in a case in which the records are sealed pursuant to a court order, a former officer of a foreign bank appeals a suspension order that the

Board issued against him. The case has been stayed.

Other Actions

In *Fields v. Board of Governors,* No. 3:91CV069 (N.D. Ohio, filed February 5, 1991), the plaintiff appealed the Board's denial of a request under the Freedom of Information Act. On June 23, 1992, the Board's motion for summary judgment was granted in part, and its motion to dismiss was denied. On January 15, 1993, the action was dismissed.

In *In re Subpoena Served Upon the Board of Governors of the Federal Reserve System,* Nos. 91–5427, 91–5428 (D.C. Circuit, filed December 27, 1991), the Board appealed an order of the U.S. District Court requiring the Board and the Office of the Comptroller of the Currency to comply with a subpoena for the production of confidential examination material to a private litigant. The subpoena was issued in a shareholder derivative suit against the Fleet/Norstar Financial Group. On June 26, 1992, the Court of Appeals affirmed the District Court order in part, but it held that the bank examination privilege was not waived by the agencies' provision of examination materials to the examined institution. The case was remanded for further consideration of the privilege issue (967 F.2d 630). On August 6, 1992, the District Court ordered the matter held in abeyance pending settlement of the underlying action.

In *Zemel v. Board of Governors,* No. 92–1057 (D. District of Columbia, filed May 4, 1992), the plaintiff alleges discriminatory practices under the Age Discrimination in Employment Act. The case is pending.

In re Subpoena Duces Tecum, Misc. No. 92–0375 (D. District of Columbia, filed August 25, 1992), is another subpoena enforcement case in which plaintiffs seek bank examination reports and other supervisory material in connection with a shareholder derivative suit. On February 25, 1993, the District Court denied enforcement and upheld the claim of privilege by the Board and the Federal Deposit Insurance Corporation. The case was appealed, and on December 28, 1993, the Court of Appeals for the D.C. Circuit remanded the matter to the District Court for further findings on the privilege issue. The case is pending.

In *U.S. Check v. Board of Governors,* No. 92–2892 (D. District of Columbia, filed December 30, 1992), plaintiff sought review of the denial of its request under the Freedom of Information Act. The case was dismissed by stipulation on November 9, 1993.

In *Sisti v. Board of Governors,* No. 93–0033 (D. District of Columbia, filed January 6, 1993), the plaintiff challenged a Board staff interpretation with respect to margin accounts. The Board's motion to dismiss was granted on May 13, 1993, and on October 14, 1993, dismissal was summarily affirmed by the Court of Appeals for the District of Columbia Circuit.

In *Adams v. Greenspan,* No. 93–0167 (D. District of Columbia, filed January 27, 1993), the plaintiff, a former employee, alleges a violation of the Civil Rights Act of 1964 and the Rehabilitation Act of 1973 concerning termination of employment. The case is pending.

In *Amann v. Prudential Home Mortgage Co., et al.,* No. 93–10320 WD (D. Massachusetts, filed February 12, 1993), plaintiff alleges fraud and breach of contract arising out of a home mortgage. The case is pending.

In *Ezell v. Federal Reserve Board,* No. 93–0361 (D. District of Columbia, filed February 19, 1993), plaintiff sought damages for personal injuries arising from a motor vehicle collision. The case was dismissed on the Board's motion on July 30, 1993.

In *Bennett v. Greenspan,* No. 93–1813, (D. District of Columbia, filed April 20, 1993), plaintiff alleges employment discrimination. The case is pending.

In *Kubany v. Board of Governors, et al.,* No. 93–1428 (D. District of Columbia, filed July 9, 1993), the plaintiff challenges a Board determination under the Freedom of Information Act. The case is pending.

In re Subpoena Duces Tecum, Misc. No. 93–261 (D. District of Columbia, filed August 17, 1993), is a subpoena enforcement case in which plaintiffs seek examination and other supervisory material in connection with a shareholder derivative action against a bank holding company. The case is pending.

Richardson v. Board of Governors, et al., No. 93–C836A (D. Utah, filed August 30, 1993), is an action for damages and injunctive relief against the Board and other parties for alleged constitutional and statutory violations caused by issuance of Federal Reserve notes. The case is pending. A similar case filed in Utah state courts, *Scott v. Board of Governors,* No. 930905843CV (District Court, Salt Lake County, Utah, filed October 8, 1993), is also pending. ■

Legislation Enacted

The 1993 federal legislation that directly affects the Federal Reserve System or the institutions it regulates includes the Government Securities Act Amendments of 1993, the North American Free Trade Agreement Implementation Act, the Omnibus Budget Reconciliation Act of 1993, an act relating to unclaimed insured deposits, and the Depository Institutions Disaster Relief Act of 1993.

Government Securities Act Amendments of 1993

The Government Securities Act Amendments of 1933, Public Law 103–202, was enacted on December 17, 1993. Title I augments the scope of regulation of the government securities market, and title II relates to the auction procedure.

Title I

Title I amends the government securities provisions of the Securities Exchange Act of 1934 to extend the rulemaking authority of the Department of the Treasury, require transaction records and large position reporting, prohibit fraud and manipulation, regulate sales practices, require disclosure by government securities dealers and brokers that are not financial institutions if their accounts are not insured by the Securities Investor Protection Corporation, and obtain studies and reports on the act's success in furthering transparency.

Under the Government Securities Act of 1986, Treasury had authority to write rules related to capital adequacy, financial responsibility, recordkeeping, reports, audits, customer protection, securities custody requirements, and transfer and control of government securities subject to repurchase agreements. The 1993 amendments extend this authority, which had expired October 1, 1991, and make it permanent.

The amendments also require every government securities dealer and broker to furnish on request sufficient transaction records for the Securities and Exchange Commission (SEC) to reconstruct trading in a government security under investigation. The SEC, however, may not request information not otherwise required by law or customary business practice, must consult with the appropriate regulator on information to be requested, and may not obtain examination reports.

In addition, the SEC is not to request of government securities dealers or brokers information obtainable from the Federal Reserve Bank of New York. Requested information is to be furnished to the SEC directly, to the New York Reserve Bank, or to the appropriate regulatory agency. The Board is the appropriate regulatory agency for state member banks; for foreign banks, their commercial lending companies, state agencies, and uninsured state branches; for foreign branches or affiliates of national banks; and for Edge Act corporations.

The 1993 amendments authorize Treasury to adopt rules requiring holders of large positions in to-be-issued or recently issued government securities to file reports enabling Treasury to monitor the impact of such concentrations of position and authorize the SEC to enforce the provisions of title I. Treasury, however, must take into account the need for market liquidity and efficiency and the cost to taxpayers of funding the federal debt. Large positions include any position that would allow its holder to manipulate the supply, price, or cost of financing of an issue or the portion thereof available for active trading. Treasury may also impose recordkeeping requirements to ensure that such holders can comply with these reporting requirements and may exempt any person or class of person from them. The reports are to be filed with the New York Reserve Bank as agent for Treasury, and the Reserve Bank is to provide them to the SEC. The reports are confidential for Freedom of Information Act purposes, but congressional requests, legitimate requests from other agencies, and court orders are to be fulfilled.

The 1993 amendments subject government securities dealers and brokers to the prohibitions in the Securities Exchange Act of 1934 on manipulative activities (including fictitious quotations) to effect or induce a government securities trade if the activities involve use of the mails or other instrumentalities of interstate commerce. The SEC must consult with Treasury before adopting rules under this provision, but Treasury does not have a veto over such rules.

The amendments also grant rulemaking authority over sales practices to the appropriate regulatory agencies and registered securities associations. For financial institutions, which include banks, foreign banks, and savings institutions, these agencies may adopt rules to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade. For government securities dealers and brokers, the amendments remove prior limitations on the ability of registered securities associations to adopt rules applicable to government securities, subject to SEC approval. The appropriate regulatory agencies and the SEC are to consult with Treasury before adopting or approving such rules; but they may implement them, even if Treasury believes the rules would adversely affect liquidity or impose burdens on competition, if they find them necessary.

Although the amendments are generally limited to secondary market trading and specifically do not apply to the issuance of government securities, these provisions would apply to any resale by a dealer even if part of the initial distribution. In addition, in a separate provision, the amendments prohibit false or misleading written statements or omissions by any government securities dealer or broker or any other bidder in connection with any bid or purchase related to any issuance of government securities.

Under the Government Securities Act of 1986, all government securities dealers and brokers that are not financial institutions and not already registered with the SEC as broker–dealers in other securities are required to register with the SEC as government securities dealers or brokers. Title I of the amendments requires any such government securities dealer or broker that is not a member of the Securities Investor Protection Corporation to follow such rules as the SEC shall prescribe to assure disclosure to its customers that their accounts are not covered.

The amendments change somewhat the Board's jurisdiction with respect to government securities dealers and brokers. Previously the Board was the appropriate regulatory agency for all state branches of foreign banks; under title I, the Board is the agency for uninsured state branches of foreign banks, and the FDIC becomes the agency for insured state branches. The Board also becomes the regulatory agency for foreign branches and affiliates of U.S. banks, including agreement corporations, and for Edge Act corporations; previously the SEC had supervisory responsibility for their government securities activities.

Title I requires Treasury, the Board, and the SEC to evaluate in a joint study the regulations promulgated under the amendments for their effectiveness and impact on market efficiency and liquidity. The study must also evaluate the effectiveness of surveillance and enforcement and the extent to which they are affected by the availability of automated, time-sequenced trade data. The three agencies must make recommendations to the Congress by March 31, 1998, concerning the regulation of dealers, the dissemination of quotation and trade information, and the prevention of abusive sales practices.

Also with a view to promoting transparency, title I makes changes in the annual report the SEC sends to the Congress under the 1934 act. The SEC report is to annually review the steps taken to promote the timely, nondiscriminatory dissemination of quotation and transactions data and make recommendations to assure the availability of high-bid and low-offer price and size information.

Finally, in consultation with the SEC, Treasury is to study the continuing need for, and consequences of, a separate regulatory system for government dealers registered with the SEC and report its recommendations to the Congress within eighteen months of enactment.

Title II

Title II requires, among other things, the Secretary of the Treasury to notify the Congress of any significant modification to Treasury auction procedures, requires modification of the system to accept computer-generated tenders, and prohibits discrimination by the Secretary among government dealers. It also requires that meetings of the Treasury Borrowing Advisory Committee of the Public Securities Association be open to the public but permits closed meetings at the recommendation of Treasury, prohibits members from discussing closed meetings except with other members or Treasury personnel, and prohibits the committee or its members from giving gratuities to employees of Treasury or the Federal Reserve System.

North American Free Trade Agreement Implementation Act

The North American Free Trade Agreement Implementation Act, Public Law 103–182, was enacted on December 8, 1993. It implements the North American Free Trade Agreement (NAFTA), but only to the extent consistent with prior laws of the United States.

The parties to NAFTA are the United States, Canada, and Mexico. Its financial services chapter covers financial institutions, investment in such institutions, and cross-border trade in financial services. The chapter generally requires each party to grant both national treatment and most-favored-nation treatment to financial service providers and investors of the other parties.

NAFTA's provisions do not apply to existing federal, state, or provincial measures that are identified and set forth (reserved) in the Annex to NAFTA. In addition, each party may adopt reasonable new prudential measures, including measures to protect consumers of financial services, to maintain the soundness, integrity, and financial responsibility of financial market participants, and to ensure the integrity and stability of the financial system.

No U.S. banking laws were changed by NAFTA; statutes and other measures that do not conform to U.S. obligations under NAFTA were reserved. Thus, Canandian and Mexican banks in the U.S. will continue to be subject to existing U.S. laws and regulations. The United States will allow certain Mexican financial groups a period of five years from the date each became subject to U.S. law to conform their existing U.S. securities activities to U.S. legal requirements; this provision will be implemented through administrative action by the Board under section 4(a)(2) of the Bank Holding Company Act. Subject to market share restrictions during a six-year transition period, Mexico will allow U.S. and Canadian banks to establish and operate banking and certain other financial services subsidiaries.

Omnibus Budget Reconciliation Act of 1993

The Omnibus Budget Reconciliation Act of 1993, Public Law 103–66, was enacted on August 10, 1993. Title III creates a national depositor preference and requires the transfer of certain Federal Reserve surpluses.

For insured depository institutions for which a receiver is appointed, section 3001 of the act amends the Federal Deposit Insurance Act to require that depositors be paid after secured claims and after the administrative expenses of the receiver but before any general or senior liability. Previously, when distributing the assets of a failed national bank or a state bank in a state without a depositor preference law, the Federal Deposit Insurance Corporation (FDIC) or the Resolution Trust Corporation as receiver paid depositors on a pro rata basis with general or senior creditors. Depositor preference may reduce the FDIC's losses because the FDIC as insurer is subrogated to the claims of insured depositors; but depositor preference also subordinates depositors at foreign branches and other general or senior creditors including sellers of federal funds and counterparties in off-balance-sheet transactions such as derivatives transactions. This provision supersedes inconsistent state laws, including those in the many states with depositor preference laws, to the extent of any inconsistency; the FDIC will determine, subject to judicial review, whether any such inconsistency exists.

Section 3002 amends section 7 of the Federal Reserve Act to require transfers from the surplus funds of the Reserve Banks to the Board and thence to Treasury. These transfers will amount to $106 million in fiscal 1997 and $107 million in fiscal 1998, in addition to all surplus in excess of 3 percent of the paid-in capital and surplus of the member banks. Previously, all surplus in excess of such 3 percent was so transferred by the Reserve Banks pursuant to Board policy, while the 3 percent was retained by the Reserve Banks for capital purposes. Reserve Banks are prohibited from replenishing their reserve funds by the amount of any such additional transfer during fiscal years 1997 and 1998.

Unclaimed Insured Deposits

An Act to Amend the Federal Deposit Insurance Act to Improve Procedures for Treating Unclaimed Insured Deposits, Public Law 103–44, was enacted June 28, 1993. Within thirty days of initiation of payment by the FDIC to insured depositors of an institution in default, the FDIC must, under section 1 of the act, notify insured depositors, at the last known address on the institution's records, that they must claim payment from the FDIC or the transferee institution. The FDIC must send a second notice to depositors who have not claimed their deposits within fifteen months of the FDIC's initiation of payment.

After eighteen months, the transferee shall refund any unclaimed deposits to the FDIC and be relieved of liability; such deposits shall be distributed to the depositors' states of residence for custody, except that federal deposits shall be given to Treasury. If the deposit remains unclaimed for ten years, it becomes the property of the FDIC.

Depository Institutions Disaster Relief Act of 1993

The Depository Institutions Disaster Relief Act of 1993, Public Law 103–76, enacted on August 12, 1993, permits the Board to make exceptions to the Truth in Lending and Expedited Funds Availability acts within major disaster areas, including those eligible because of the 1993 flooding of the Mississippi River. The permission to make exceptions lasts 240 days from enactment and the exceptions must expire by October 1, 1994.

Bank regulatory agencies may also allow federally insured depository institutions that are located in disaster areas to subtract deposits attributable to qualified insurance proceeds from their assets in calculating leverage limits for capital adequacy purposes; the institutions must have been adequately capitalized before the disaster, and the exception must expire by April 1, 1995.

In order to facilitate recovery from a major disaster, bank regulatory agencies may also suspend certain administrative law provisions, including requirements for notice or hearing or time limits with respect to agency action, and for publication to establish branches. The act requires Treasury to report within eighteen months on how the bank regulatory agencies used their authority under the act and whether it should be extended. ■

Banking Supervision and Regulation

Economic conditions in 1993 were generally favorable for the banking industry. Earnings for the industry substantially exceeded the record of 1992, largely as a result of further improvements in asset quality and the continuation of historically wide net interest margins. The industry also made further progress in expanding its fee-based income, reflecting increased sales of mutual funds and continued growth of transactions in derivative instruments (futures, forwards and options contracts and swap agreements). Earnings were also bolstered by profits obtained from foreign exchange and securities trading activities and by relatively large gains on sales of securities from investment portfolios.

The number of commercial bank failures in the country declined again, to forty-one, the lowest level since 1983, and at year-end the number of problem banks and the volume of assets held by these banks were down substantially from the levels of the previous year. The equity capital of the industry grew to its highest level relative to assets since 1963, primarily through the retention of a large portion of the year's strong earnings.

Despite the industry's general strength, pockets of weakness persisted, particularly in Southern California and New England, where many banks continued to have asset quality problems. The majority of commercial bank failures for 1993 occurred in these areas.

One important effect of the recent solid performance of banks has been the alleviation of difficulties faced by some creditworthy borrowers, particularly small businesses, in obtaining bank loans. In addition, the Federal Reserve and the other federal banking agencies continued their programs, begun in late 1991, to reduce regulatory impediments to the availability of credit. By the end of the year, reports seemed to suggest that banks generally were seeking to promote growth in loans to both business and household borrowers and were, to some extent, relaxing their credit standards.

During 1993, the substantial and growing involvement of banks and other financial firms in derivative markets attracted considerable attention. The Federal Reserve responded to a number of inquiries from the Congress concerning the involvement of banking institutions in derivative markets. It also issued guidance to examiners and field tested a comprehensive trading activities manual setting forth procedures for evaluating a banking organization's derivatives and trading activities.

The growth in mutual funds sales by banks raised concerns that customers may not understand that mutual funds are not federally insured deposits. In June the Board issued a supervisory letter to state member banks on this issue, and, shortly after the end of the year, the Board in coordination with the other federal banking agencies issued guidance on mutual funds.

Risk-based capital standards, based upon a framework adopted internationally in 1989, were fully phased-in at the start of 1993. In addition, the Federal Reserve, along with other banking agencies, took steps to augment and strengthen the risk-based standards during 1993 in the areas of market risk and interest rate risk. The Board also addressed rules on risk contained in the Federal Deposit Insurance Corporation Improvement Act of 1991 and continued the process of implementing title II of that law, the Foreign Bank Supervision Enhancement Act of 1991.

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 overseeing 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.[1] 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, securities clearing activities, and securities underwriting and dealing through special subsidiaries.

The Federal Reserve is also responsible for the supervision of (1) all Edge Act and agreement corporations, (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.[2] The Foreign Bank Supervision Enhancement Act of 1991 increased the Federal Reserves's authority over the establishment, examination, and termination of branches, agencies, commercial lending subsidiaries, and representative offices of foreign banks in the United States.

The Federal Reserve also exercises important regulatory influence over the entry into, and the structure of, the U.S. banking system through its administration of the Bank Holding Company Act, the Bank Merger Act for state member banks, and the Change in Bank Control Act for bank holding companies and state member banks. Also, the Federal Reserve is responsible for imposing margin requirements on securities transactions. In carrying out these responsibilities, 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, visitations, and inspections and off-site surveillance and monitoring, and it undertakes 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.

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1. The Board's Division of Consumer and Community Affairs is responsible for 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.

2. Edge Act corporations are chartered by the Federal Reserve, and agreement corporations are chartered by the states, to provide all segments of the U.S. economy with a means of financing international trade, especially exports.

Examinations of state member banks, of branches and agencies of foreign banks, and of Edge Act and agreement corporations, as well as 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 1993, 972 state-chartered banks belonged to the Federal Reserve System, an increase of 15 from the year-end 1992. These banks represented about 9 percent of all insured commercial banks and held about 19 percent of all insured commercial bank assets.

Federal Reserve guidelines call for state member banks to be examined annually by either a Reserve Bank or state banking agency. Large or troubled banks must be examined annually by a Reserve Bank.[3]

In conformance with Federal Reserve guidelines and the requirements of the Federal Deposit Insurance Corporation Improvement Act of 1991, all state member banks were examined at least once in 1993. Altogether, the Reserve Banks conducted 773 examinations (some of them jointly with the state agencies), and state banking departments conducted 284 independent examinations. Also, in conformance with Federal Reserve guidelines, Reserve Bank officials held 244 meetings with directors of large state member banks and those state member banks that displayed significant weaknesses.

3. Beginning in 1994, the Federal Deposit Insurance Corporation Improvement Act of 1991 will require full-scope, on-site examinations during each twelve-month period for all depository institutions except well-capitalized and well-managed banks (CAMEL 1 rating), which may be examined every eighteen months.

Bank Holding Companies

At the end of 1993 the number of bank holding companies was 6,111, a decline of 237 from the preceding year. These organizations controlled about 8,100 insured commercial banks that held approximately 90 percent of the assets of all insured commercial banks in the United States.

Federal Reserve guidelines call for annual inspections of large bank holding companies and smaller companies with significant nonbank assets. Small companies (those with assets of less than \$150 million) that do not appear to have problems are selected for inspection on a sample basis; medium-sized companies (\$150 million to \$500 million in assets) that do not appear to have 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 refer to the examination reports of the federal and state banking authorities that have primary responsibility for the supervision of these banks. In 1993, the Federal Reserve inspected 1,922 bank holding companies. Altogether, Federal Reserve examiners conducted 2,146 inspections and state examiners conducted 63 independent inspections. The assignment of examiners to work on industry problems and major mergers and acquisitions in 1993 required that inspections of 50 bank holding companies be deferred to 1994. During 1993, Reserve Bank officials held 465 meetings with the boards of directors of bank holding companies to discuss supervisory concerns.

Enforcement Actions, Civil Money Penalties, and Significant Criminal Referrals

In 1993 the Federal Reserve Banks recommended, and members of the Board's staff initiated and worked on, 179 formal enforcement cases involving 468 separate actions such as written agreements, cease-and-desist orders, removal and prohibition orders, and civil money penalties. Of these, 65 cases involving 138 actions were completed by year-end. Of particular note was the completion of several actions relating to the Board's extensive investigation of matters involving the Bank of Credit and Commerce International; these actions included orders requiring restitution of $188 million and the assessment of more than $45 million in fines. The Board assessed a $400,000 fine against a foreign bank for its failure to maintain adequate Bank Secrecy Act compliance procedures.

All final enforcement actions issued by the Board of Governors and all written agreements executed by the Federal Reserve Banks in 1993 are available to the public. In addition to formal enforcement actions, the Federal Reserve Banks initiated and worked on 261 informal enforcement actions and completed 221 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 1993 the staff of the Division of Banking Supervision and Regulation forwarded 539 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 of banks regarding electronic data processing, fiduciary activities, government securities dealing and brokering, municipal securities dealing, securities clearing, and securities underwriting and dealing through subsidiaries. The Federal Reserve also reviews state member banks and bank holding companies that act as transfer agents.

Electronic Data Processing

Under the Interagency EDP Examination Program, the Federal Reserve examines the electronic data processing activities of state member banks, U.S. branches and agencies of foreign banks, Edge Act and agreement corporations and independent data centers that provide EDP services to these institutions. The Federal Reserve conducted 457 on-site EDP reviews in 1992. The Federal Reserve also was the agency-in-charge for 3 examinations of 18 large independent providers of data services; these examinations were coordinated and conducted with the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

Fiduciary Activities

The Federal Reserve has supervisory responsibility for institutions that hold more than $4.3 trillion of discretionary and nondiscretionary assets in various fiduciary capacities. This group of institutions includes 304 state-chartered member banks and trust companies and 61 nonmember trust 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. These examinations include (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 1993, Federal Reserve examiners conducted 177 on-site trust examinations of state member banks and trust companies engaged in fiduciary activities. The institutions examined in 1993 held approximately $1 trillion in fiduciary assets.

Government Securities Dealers and Brokers

The Federal Reserve is responsible for examining the activities of state member banks and foreign banks that are government securities dealers and brokers for compliance with the Government Securities Act of 1986 and regulations of the Department of the Treasury. Forty-three state member banks, five state branches of foreign banks, and one state agency of a foreign bank have notified the Board that they are currently government securities dealers or brokers that are not exempt from Treasury's regulations. During 1993 the Federal Reserve conducted twenty-two examinations of broker–dealer activities in government securities at state member banks and foreign banks.

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 securities dealers or as clearing agencies. The Board supervises forty-six banks that act as municipal securities dealers and three clearing agencies that act as custodians of securities involved in transactions settled by bookkeeping entries. In 1993 the Federal Reserve examined all three of the clearing agencies and nineteen of the banks that deal in municipal securities.

Securities Subsidiaries of Bank Holding Companies

The Banking Act of 1933, commonly known as the Glass–Steagall Act, prohibits, in section 20, 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 section 20 of the Glass–Steagall Act and with 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 increased in September 1989 to 10 percent. In January 1993 the Board adopted an optional indexed revenue test for calculating the 10 percent limit that reflects the changes in the level and structure of interest rates since 1989.

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 received comparable authority for equities.

At year-end 1993, thirty-one bank holding companies had so-called section 20 subsidiaries authorized to underwrite and deal in ineligible securities. Of these, nine could underwrite any debt or equity security; four could underwrite any debt security; and eighteen could underwrite only the limited types of debt securities approved by the Board in 1987. The Federal Reserve uses specialized procedures for reviewing operations of these securities subsidiaries; it conducted twenty-nine such inspections in 1993.

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 1993, Federal Reserve examiners conducted on-site examinations at 63 of the 182 banks and bank holding companies registered as transfer agents with the Board.

Surveillance and Monitoring

The Federal Reserve monitors the financial condition and performance of individual banking organizations and the banking system as a whole to identify areas of supervisory concern. Automated screening systems are used to identify organizations with poor or deteriorating financial profiles and to identify adverse trends affecting the banking system. Information from these systems is then used in decisions to allocate examination resources or take other appropriate supervisory actions. Among the automated systems used by the Federal Reserve to monitor banking organizations is the System to Estimate Examination Ratings (SEER), which is used to track the overall financial condition of individual organizations. SEER statistically estimates an institution's supervisory rating based on its quarterly Report of Condition and Income (Call Report). A number of supplementary screening systems are used to monitor specific areas of supervisory interest. Another automated system tracks examinations and inspections and summarizes examination results and supervisory actions.

To assist supervisory staff in evaluating individual bank holding companies, the Federal Reserve produces and distributes the quarterly Bank Holding Company Performance Report, which provides detailed financial information on the condition and performance of each bank holding company. The Federal Reserve also produces several aggregate reports on the national and regional performance and condition of the banking industry.

Automated monitoring systems rely heavily on the information in regulatory reports filed by banking organizations. To ensure the timeliness and accuracy of the reports, the Federal Reserve maintains the Regulatory Reports Monitoring System to track domestic and foreign banking organizations that file late or inaccurately.

International Activities

The Federal Reserve is responsible for supervising the international activities of various entities.

Edge Act 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 state-chartered company that enters into an agreement with the Board not to exercise any power that is impermissible for an Edge Act corporation. In 1993 the Federal Reserve examined all eighty-seven Edge Act and agreement corporations, which held about $31 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 1993 the Federal Reserve conducted full-scope and targeted-scope examinations of twelve foreign branches of state member banks and forty foreign 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 they took place; when appropriate, the examinations were coordinated with the Office of the Comptroller of the Currency. Also, examiners made 16 visitations to overseas offices to obtain current financial and operating information and, in some instances, to evaluate their compliance with corrective measures or test-check their adherence to safe and sound practice.

U.S. Activities of Foreign Banks

Foreign banks continue to be significant participants in the U.S. banking system. As of year-end 1993, 295 foreign banks from 61 countries operated 481 state-licensed branches and agencies, of which 33 are insured by the Federal Deposit Insurance Corporation. These foreign banks also operated 73 branches and agencies licensed by the Office of the Comptroller of the Currency, of which 8 have FDIC insurance. Foreign banks also operated 245 representative offices and directly owned 16 Edge Act corporations and 8 commercial lending companies. In addition, foreign banks held an equity interest of at least 25 percent in 88 U.S. commercial banks. Altogether, these U.S. offices of foreign banks control approximately 22 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, representative offices, Edge Act corporations, banks, and certain nonbanking companies. The Federal Reserve conducted or participated with state and federal regulatory authorities in the examination of 784 such offices during 1993.

Before the December 1991 passage of the Foreign Bank Supervision Enhancement Act of 1991 (FBSEA), the Federal Reserve had residual authority to examine all branches, agencies, and commercial lending subsidiaries of foreign banks in the United States. The International Banking Act of 1978 instructed the Federal Reserve to use, to the extent possible, the examination reports of other state and federal regulators. FBSEA amended the International Banking Act and increased the Federal Reserve's authority with respect to these foreign bank operations, including representative offices. The Federal Reserve has acted to ensure that all state and federally licensed branches and agencies receive an on-site examination at least once during each twelve-month period. These examinations are coordinated with other state and federal regulators to eliminate duplication whenever possible. FBSEA requires Federal Reserve approval to establish foreign bank branches, agencies, commercial lending subsidiaries, and representative offices in the United States.

In 1993, applications by twelve banks from eight foreign countries were approved to establish branches, agencies, and representative offices.

Charging for Examinations of U.S. Offices of Foreign Banks

In December 1993 the Board published for comment a proposal to implement provisions of FBSEA that require the Board to charge foreign banks for the cost of examinations of their branches, agencies, and representative offices in the United States. This notice of proposed rulemaking asked specifically for public comment regarding the methods developed by the Board for assessing the cost of examinations against foreign banks. The Board also sought comment on whether implementation of this provision of FBSEA was consistent with the policy of national treatment established in the International Banking Act of 1978.

Examination Manual

In 1993 the federal bank regulatory agencies began developing a comprehensive interagency manual for examiners of individual branches and agencies of foreign banking organizations. The goal is to complete the manual in early 1994 and also make it available to foreign banking organizations and other interested parties. Some of the policy concepts that are being incorporated in the examination manual are part of a larger group of policy initiatives seeking to enhance the overall supervision of the U.S. operations of foreign banking organizations in accordance with FBSEA.

Representative Offices

FBSEA gave the Board supervisory responsibility, including examination authority, over the activities of representative offices of foreign banks. As of year-end 1993, 245 representative offices of foreign banks were registered with the Federal Reserve System. In order to determine the various activities undertaken by these offices, the Board issued a policy directive to examine all registered representative offices by year-end 1993. The findings from these examinations will assist the Board in finalizing an ongoing supervisory and regulatory program for representative offices.

Technical Assistance

In 1993 the System provided staff on a number of technical assistance missions and training sessions on bank supervisory matters to numerous central banks in Russia, Eastern Europe, and Latin America.

Supervisory Policy

During 1993 the Federal Reserve undertook several initiatives in supervisory and regulatory policy related to the continuing implementation of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). Other initiatives included guidance on the use of and examination of derivatives and amendments to the Board's risk-based capital guidelines and other rules and policies.

FDICIA

The major Board actions of 1993 to implement FDICIA as it relates to supervisory policy covered the following sections of the act:

Section 132. On November 18 the federal banking agencies issued an interagency notice of proposed rulemaking requesting public comment on safety and soundness standards with regard to operations and management, asset quality, earnings, stock valuation, and compensation. The proposal prescribes standards specific enough to identify emerging operational and managerial problems and to require submission of a compliance plan before those problems become serious. The proposed standards generally establish the ends that proper operations and management should achieve, leaving the means to each institution. A final rulemaking is expected in 1994.

Section 305. On September 14 the federal banking agencies issued an interagency notice of proposed rulemaking, requesting comment on the incorporation of interest rate risk into the risk-based capital framework. A final rulemaking is expected in 1994.

Trading Activities Guidance

Trading in derivatives and cash investments is becoming increasingly important to the overall risk profile and profitability of certain banking organizations. Accordingly, the Federal Reserve has given examiners guidance on the issue in a supervision letter and through the development and field testing of a Capital Markets and Trading Activities Manual. The supervisory letter, issued on December 22, highlights the key considerations in examining the risk management and internal controls of trading activities in both cash and derivative instruments. The Capital Markets and Trading Activities Manual codifies existing practices and addresses these topics in significant detail. The manual outlines procedures for evaluating the trading function's organizational structure and front- and back-office operations and systems; approaches to market and credit risk measurement; and overall risk management.

Risk-Based Capital Standards

The risk-based capital standards, phased in over a four-year period, became fully effective at the end of 1992. Consequently, 1993 was the first full year that banking organizations were expected to maintain capital equal to at least 8 percent of risk-adjusted assets. The risk-based capital standards were developed by the Board, in conjunction with the FDIC and the OCC, to implement the Basle Accord, which was proposed by the Basle Committee on Banking Regulations and Supervisory Practices (Basle Supervisors' Committee) and endorsed by the central bank governors of the Group of 10 (G-10) countries in July 1988.

Amendments

During 1993 the Board adopted amendments to its risk-based capital guidelines in the following areas:

Intangible assets. The Board adopted an amendment to provide guidance on the types and amounts of intangible assets that may be included in tier 1 capital. The amendment incorporates limits and discounts on includable intangible assets in a manner that is consistent with the requirements of section 475 of FDICIA and achieves uniformity in the banking agencies' capital treatment of intangible assets.

Presold one- to four-family residential construction loans. The Board adopted a final rule amending the risk-based capital guidelines to lower the risk weight from 100 percent to 50 percent for presold one- to four-family residential construction loans that meet certain criteria. This action was mandated by section 618(a) of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 (RTCRRIA).

Multifamily housing loans. The Board adopted a final rule, effective December 31, 1993, lowering the risk weight from 100 percent to 50 percent for qualifying multifamily housing loans and securities backed by such loans that meet certain criteria. This amendment was mandated by section 618(b) of RTCRRIA and also fulfills the requirements of section 305(b)(1)(B) of FDICIA, which requires the agencies to revise their capital standards to ensure that the treatment of multifamily housing loans reflects their actual risk.

Proposals

The Board in 1993 issued for public comment several proposals regarding risk-based capital:

Interest rate risk. Section 305 of FDICIA requires the bank regulatory agencies to incorporate interest rate in risk the risk-based capital framework. Accordingly, in September 1993 the Board issued a proposal for incorporating interest rate risk into the assessment of capital adequacy. The proposal would impose additional capital requirements on institutions having interest rate risk in excess of a defined threshold level. The proposal outlines the use of a reporting exemption test, an option for institutions to use internal models to measure interest rate risk and two alternative methods, one quantitative and one qualitative, for determining the additional capital, if any, an institution may be required to have for interest rate risk. The approach taken in the proposal seeks to balance the regulatory burden associated with more precise measures of interest rate risk and the commercial banking industry's favorable experience in adapting to changing rate environments.

Securities accounting. In December 1993 the Board issued a proposed rule seeking public comment on the inclusion in tier 1 capital of net unrealized holding gains and losses on securities available for sale. This rule was proposed in light of the recently adopted Financial Accounting Standards Board (FASB) Statement No. 115, "Accounting for Certain Investents in Debt and Equity Securities." A final rule is expected in 1994.

Recourse. In December 1993 the Board approved a recommendation from the Federal Financial Institutions Examination Council that its members issue a proposed rulemaking, together with an advance notice of proposed rulemaking, requesting comment on various recourse issues. The proposed rulemaking would lower the capital requirement for assets sold with low levels of recourse. The advance notice of proposed rulemaking outlines an approach to the capital treatment of structured-finance transactions that would take into account various levels of recourse exposure.

Risk-based capital. The Board has been working with banking supervisors of the other G-10 countries to broaden the scope of the international risk-based capital framework. The Board released for public comment in May 1993 a consultative paper developed by the Basle Supervisors' Committee. The paper contained proposals to incorporate interest rate risk, market risk, and netting into the Basle Accord. The comment period for the consultative paper ended on December 31, 1993.

Real Estate Appraisals

On June 4, 1993 the Board and the other banking agencies issued for public comment an interagency proposal to revise their appraisal regulations. This proposal was initiated as part of an interagency effort to increase credit availability, especially for small and medium-sized businesses, by reducing regulatory impediments to lending consistent with safe and sound banking practices. The proposed amendments would increase to $250,000 the threshold level at or below which appraisals are not required, expand and clarify existing exemptions to appraisal requirements, and identify additional circumstances when appraisals are not required. The Board received more than 2,000 letters on the proposal.

As a result of the comments, the Board and the other agencies reopened the public record on the proposal on November 10, 1993, and placed into the public file supplemental information that relates to the proposed increase in the appraisal threshold. The Board received more than 2,000 additional letters on this supplemental information. The Board is expected to consider in the first quarter of 1994 a final rule to amend the appraisal regulation.

In July 1993 the Board in conjunction with the other federal banking agencies issued an order granting relief from certain real estate appraisal requirements for financial institutions affected by the flooding in the Midwest. The Board acted under provisions of the Depository Institutions Disaster Relief Act of 1992.

Credit Availability

The Federal Reserve continued to work in a number of policy and supervisory areas to ease problems related to the availability of bank credit. The policy changes that were implemented included reducing unnecessary documentation requirements for loans to small- and medium-sized businesses and small farms, improving regulatory treatment related to in-substance foreclosures, and permitting certain partially performing loans to be placed on accrual status. The agencies also conformed with generally accepted accounting principles the regulatory reporting requirements for sales of other real estate owned; reaffirmed that examiners should review commercial real estate loans in a consistent, prudent, and balanced manner; and developed a common definition for "Special Mention" assets that separates these loans from loans warranting adverse classification.

Interagency Coordination

The Federal Reserve together with the FDIC, the OCC, and the OTS adopted a Uniform Core Report of Examination in 1993. This report will be used by each agency for its reports of examination of financial institutions. Each agency is scheduled to implement the report during 1994 and the use of a common report by each agency will significantly reduce the burden on institutions that are subject to examination by different agencies. Furthermore, the agencies issued guidelines to coordinate the supervision and examination of banking organizations in order to minimize the disruptions and burdens associated with the examination process, and provided guidance on fair lending initiatives. The Federal Reserve also reiterated its long-standing policy for resolving differences between bankers and examiners regarding examination findings.

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 1993 the Federal Reserve conducted a variety of schools and seminars, and Federal Reserve staff members participated in several courses offered by, or co-sponsored with, other agencies, as shown in the accompanying table. One new school was added to the curriculum during the year, a senior level continuing education seminar for EDP examiners.

In 1993 the Federal Reserve trained 3,045 persons in System schools, 1,291 in schools sponsored by the Federal Financial Institutions Examination Council (FFIEC), and 145 in other schools, for a total of 4,481 students, including 230 representatives from foreign central banks. The number of student days of training in 1993 was 26,938, compared with 20,555 in 1992.

The Federal Reserve System also gave scholarship assistance to the states for training their examiners in Federal

Training Programs for Banking Supervision and Regulation, 1993

Program	Number of sessions	
	Total	Regional
Schools or seminars conducted by the Federal Reserve		
ETS I, Introduction to examinations	14	5
ETS II, Financial institution analysis	17	8
ETS III, Loan analysis	17	13
ETS IV, Bank management	9	1
Effective writing for banking supervision staff	26	26
Management skills	12	9
Conducting meetings with management	17	17
Abbreviated cash flow seminar	2	2
Real estate lending seminar	6	2
Senior lending seminar	5	1
Senior forum for current banking and regulatory issues	3	...
Bank operations	6	5
Bank holding company applications	2	...
Bank holding company inspection	8	6
Basic entry-level trust	1	...
Advanced trust	1	...
Consumer compliance examination I	2	...
Consumer compliance examination II	2	...
Advanced CRA examination techniques	1	...
Advanced EDP examination	1	...
EDP continuing education	1	...
Section 20 securities seminar	1	...
Securities activities and interest rate risk	3	3
Seminar for senior supervisors of foreign central banks[1]	3	2
Other agencies conducting courses[2]		
Federal Financial Institutions Examination Council	78	15
Federal Deposit Insurance Corporation or 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. Co-sponsored by the Federal Reserve, Federal Deposit Insurance Corporation, Office of Thrift Supervision, Office of the Comptroller of the Currency, and the Resolution Trust Corporation.

Reserve and FFIEC schools. Through this program, 537 state examiners were trained; 276 in Federal Reserve courses, 239 in FFIEC programs, and 22 in other courses.

During 1993 the Federal Reserve continued to integrate its core supervision schools with those of the FDIC. This effort began in 1992 with the integrating of the curriculum for the first two schools attended by newly hired examination and inspection staff. The pilot session of the joint Loan Analysis School, sequentially the third school, was held in July 1993, and ten sessions of the joint schools were offered during the remainder of the year.

During 1993 the Federal Reserve trained examiners on capital markets topics using a variety of forums. Such training focused on issues related to interest rate risk, investment activities, financial derivatives and mortgage securities. One effort involved the development of separate training modules on these topics that are to be offered to examiners throughout the Federal Reserve System during 1994. Other efforts included seminars for capital markets specialists on examining internal interest rate risk models and on the concepts underlying the Basle proposals regarding market risk. These seminars were tailored to provide the specialists with the resources and materials to train staff members at their respective Reserve Banks and to enable them to provide supplemental examination support when special issues arise.

In addition, the Federal Reserve has revised and updated both the Commercial Bank Examination Manual and the Bank Holding Company Supervision Manual. The revised manuals reflect certian provisions of FDICIA as well as the Federal Reserve's current practices in examining banks and holding companies.

Federal Financial Institutions Examination Council

In December 1993 the Federal Reserve and the other bank regulatory agencies issued, under the auspices of the FFIEC, a joint policy statement that provides comprehensive guidance on the maintenance of an allowance for loan and lease losses (ALLL) and an effective loan review system.[4] The policy statement discusses the nature and purpose of the ALLL, defines an adequate ALLL, and covers the responsibilities of the board of directors, the institution's management, and the examiner. The policy statement emphasizes that it is the responsibility of the board of directors and management of each institution to maintain the ALLL at an adequate level. The policy statement also discusses the analysis of the loan and lease portfolio, factors to consider in estimating credit losses, and the characteristics of an effective loan review system.

In response to an FFIEC recommendation, the Federal Reserve Board on February 11, 1993, issued for public comment a proposal to amend its capital guidelines for deferred tax assets. The proposed rule would limit the amount of deferred tax assets that can be included in capital. The FFIEC's recommendation and the Board's proposal were issued in response to FASB Statement 109, "Accounting for Income Taxes," issued in February 1992. Final action on the rule will be considered when all of the other federal banking agencies have completed their comment process.

In addition, on April 16, 1993 the FFIEC issued optional worksheets to

4. 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.

assist smaller banks in the implementation of FASB Statement 109 for purposes of the Call Reports, which are filed quarterly by all insured commercial banks. Banks can use these worksheets to determine the amount of income taxes they should show in the Call Report.

The FFIEC also approved a number of revisions to the Call Report. These modifications, effective as of the March 31, 1994, reporting date, cover the following items: the reporting of securities in the Call Report as required by FASB Statement 115, "Accounting for Certain Investments in Debt and Equity Securities;" sales of mutual funds and annuities and their related income; the original maturity of other borrowed money; the disclosure of "Depository Institution Investment Contracts" for deposit assessment purposes; and trading account assets and liabilities to reflect ongoing developments in the trading area. In addition, changes were made to collect information about past due derivatives, to provide instructional guidance on the offsetting of amounts associated with derivative contracts, and to set forth instructional clarifications regarding loans to small businesses and small farms. Furthermore, the revisions include deleting certain items related to loan sales and purchases and certain items related to taxable securities and debt securities held for sale.

On April 14, 1993, the FFIEC issued for public comment proposals for certain fair value disclosure requirements mandated by section 121 of FDICIA. The FFIEC received more than 180 comment letters during the comment period. The proposal provided a method for disclosing fair values of assets and liabilities that is similar to that set forth in FASB Statement 107, "Disclosure about Fair Values of Financial Instruments." These disclosures would be required annually by financial institutions that are required to submit audited financial statements to the federal banking agencies under FDICIA section 112. In addition, the FFIEC requested comment on whether it was "feasible and practicable" to include these fair value disclosures in certain other regulatory reports and on a quarterly basis. The FFIEC continues to study the responses received on the proposal and expects to issue a final rule in the first half of 1994o for disclosure of fair values of assets and.

In 1993 the FFIEC implemented a supplement to the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (FFIEC 002) to obtain improved data for supervisory purposes and for the analysis of U.S. credit and deposit flows in connection with international indebtedness.

Regulation of the U.S. Banking Structure

The Board administers the Bank Holding Company Act, the Bank Merger Act for state member banks, and the Change in Bank Control Act for bank holding companies and state member banks. In doing so, the Federal Reserve acts on a variety of proposals that directly or indirectly affect the structure of U.S. banking at the local, regional, and national levels. The Board also has primary responsibility for regulating the international operations of domestic banking organizations and the overall U.S. banking operations of foreign banks, whether conducted directly through a branch or agency or indirectly through a subsidiary commercial lending company. 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 such as 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 1993 the Federal Reserve acted on 1,180 bank holding company and related applications. The Federal Reserve approved 282 proposals to organize bank holding companies and denied 2; approved 111 proposals to merge existing bank holding companies; approved 326 bank acquisitions by existing bank holding companies and denied 3; approved 432 requests by existing companies to acquire nonbank firms engaged in activities closely related to banking and denied 1; and approved 23 other applications. Data on these and related bank holding company decisions are shown in the accompanying table.

Bank Merger Act

The Bank Merger Act requires that all proposed 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.

Bank Holding Company Decisions by the Federal Reserve, Domestic Applications, 1993

Proposal	Direct action by the Board of Governors		Action under authority delegated by the Board of Governors					Total
			Director of the Division of Banking Supervision and Regulation		Office of the Secretary	Federal Reserve Banks		
	Approved	Denied	Approved	Denied	Approved	Approved	Permitted	
Formation of holding company	19	2	0	0	4	259	0	284
Merger of holding company	19	0	0	0	16	76	0	111
Retention of bank	0	0	0	0	0	0	0	0
Acquisition								
Bank	41	3	0	0	19	266	0	329
Nonbank	115	1	0	0	37	149	131	433
Bank service corporation	0	0	0	0	0	0	2	2
Other	1	0	20	0	0	0	0	21
Total	**195**	**6**	**20**	**0**	**76**	**750**	**133**	**1,180**

During 1993 the Federal Reserve approved ninety-seven merger applications. As required by law, each merger is described in this REPORT (in table 16 of the Statistical Tables section).

When the FDIC, the OCC, or the OTS 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 882 reports on competitive factors to the other federal banking agencies in 1993.

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 1993 the Federal Reserve acted on 192 proposed changes in control of state member banks and bank holding companies.

Public Notice of Federal Reserve Decisions

Each decision by the Federal Reserve that involves a bank holding company, bank merger, change in control, or international banking proposal is effected by an order or announcement. Orders state the decision along with the essential facts of the application and the basis for the decision; announcements state only the decision. All orders and announcements are released immediately to the public; they are subsequently reported in the Board's weekly H.2 statistical release and in the monthly *Federal Reserve Bulletin.* The H.2 release also contains the announcement of applications and notices received by the Federal Reserve but not yet acted on.

Timely Processing of Applications

The Federal Reserve maintains target dates and procedures for the processing of applications filed under the Bank Holding Company Act, the Bank Merger Act, and the Change in Bank Control Act. 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 sixty days; during 1993, 91 percent of the decisions met this standard.

Delegation of Applications

Historically, 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 permits staff members at both the Board and the Reserve Banks to work more efficiently by removing routine cases from the Board's agenda.

In 1993, 83 percent of the applications processed were acted on under delegated authority. The Board continued its efforts during the year to streamline its processing procedures. In particular, the Board permitted the Reserve Banks to act on more applications by bank holding companies to initiate or expand their futures commission merchant activities.

Board Policy Decisions and Developments in Bank-Related and Nonbanking Activities

In January 1993 the Board approved an indexed revenue test as an alternative to the 10 percent revenue limit applicable to the ineligible securities activities of section 20 subsidiaries of bank holding companies. This modification was effective immediately and applied to all section 20 subsidiaries. It did not in any other way affect the authorizations to engage in securities underwriting and dealing granted by the Board in its previous section 20 orders and was subject to the Board's continuing authority to reexamine limitations on such activities.

In 1993 the Board approved an application by a foreign bank to clear futures transactions that generally were executed by other pre-approved execution groups. In addition, the Board approved applications by a foreign bank and by a U.S. bank holding company to act as a futures commission merchant (FCM) for unaffiliated customers in executing and clearing, and clearing without executing, certain futures, and certain options on futures, on nonfinancial commodities. Previously, the Board had limited its consideration of FCM activities to futures and options on futures on financial commodites (such as bullion and coin) and other financial instruments.

During the year, the Board also permitted one bank holding company to offer career counseling services to unaffiliated parties and another bank holding company to provide inventory inspection services on a stand-alone basis. In addition, the Board approved a proposal by a bank holding company to provide administrative services to mutual funds and closed-end funds.

Three rulemakings were under consideration at year-end. One proposal would ease the restrictions on the underwriting and dealing activities of bank holding companies to permit certain joint marketing efforts and common management officials. A second proposal would 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. A third rulemaking would permit bank holding companies to engage in real estate investment activities within certain limits.

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 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 larger purchases may undermine the financial condition of a bank holding company and its bank subsidiaries. The Federal Reserve may object to stock repurchases by holding companies that fail to meet certain standards, including the Board's capital guidelines. In 1993 the Federal Reserve reviewed sevety-one proposed stock repurchases by bank holding companies, all of which were acted on by the Reserve Banks on behalf of the Board.

International Activities of U.S. Banking Organizations

The Board has several statutory responsibilities in supervising the international operations of U.S. banking organizations. The Board must provide authorization and regulation of foreign branches of member banks; of overseas investments by member banks, Edge 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.

Foreign Branches of Member Banks

Under provisions of the Federal Reserve Act and of the Board's Regulation K (International Banking Operations), member banks must obtain 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 1993 the Board approved the opening of three foreign branches.

By the end of 1993, 114 member banks were operating 739 branches in foreign countries and overseas areas of the United States; 84 national banks were operating 640 of these branches, and 30 state member banks were operating the remaining 99 branches. In addition, 18 nonmember banks were operating 36 branches in foreign countries.

Edge Act Corporations and Agreement Corporations

Under sections 25 and 25(a) of the Federal Reserve Act, Edge Act 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.

In 1993 the Federal Reserve approved two new agreement corporations. At year-end, there were eighty-seven Edge Act and agreement corporations, which together had thirty-six domestic branches. Effective January 1, 1993, the Board, in line with the latest revision to Regulation K, requires each Edge Act corporation that is "engaged in banking" to maintain a minimum ratio of qualifying total capital to weighted risk assets of 10 percent.

Foreign Investments

Under authority of the Federal Reserve Act and the Bank Holding Company Act, U.S. banking organizations may engage in activities overseas with the authorization of the Board. 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. Since 1982 the Federal Reserve has acted affirmatively on notifications by 48 bank holding companies to establish export trading companies.

Enforcement of Other Laws and Regulations

The Board is also responsible for the enforcement of various 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 Currency and Foreign Transactions Reporting Act (the Bank Secrecy Act) was originally proposed as a means by which to identify and track proceeds of illegal activity by creating and maintaining records of various financial transactions that otherwise would not be identifiable. More recently, the Bank Secrecy Act has been regarded as a tool in the fight against money laundering. The records required by the Bank Secrecy Act provide useful data for aiding in the detection of unlawful activity as well as for determining the safety and soundness of financial institutions. The Federal Reserve monitors compliance with the requirements of the Bank Secrecy Act by the institutions it supervises.

During 1993 the Federal Reserve tested new Bank Secrecy Act examination procedures during its regularly scheduled Bank Secrecy Act examinations of financial institutions under its supervision. Some examinations resulted in the issuance of cease and desist orders and the assessment of civil money penalties for failure to comply with the requirements of the Bank Secrecy Act.

The Federal Reserve also appointed a representative to the Bank Secrecy Act Advisory Council, a committee created under recent legislation to propose additional anti-money-laundering measures to be taken under the Bank Secrecy Act: created a Special Investigations and Examinations Section to, among other things, assist in the investigation of money laundering activities; and designated staff members at each Reserve Bank to assist examiners in reviewing compliance procedures under the Bank

Secrecy Act during regularly scheduled examinations.

During 1993 the Federal Reserve also provided assistance to law enforcement agencies conducting criminal investigations under the Bank Secrecy Act.

Securities Regulation

Under the Securities Exchange Act of 1934 the Board is responsible for regulating credit in certain transactions involving the purchase or carrying of securities. 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 Board's securities credit regulations. The Securities and Exchange Commission, the National Association of Securities Dealers, and the national securities exchanges examine brokers and dealers for compliance with Regulation T. The federal banking agencies examine banks under their respective jurisdictions for compliance with Regulation U. The compliance of other lenders with Regulation G is examined by the Board, the Farm Credit Administration, the National Credit Union Administration, and the OTS, according to the jurisdiction involved. At the end of 1993, 677 lenders were registered under Regulation G, and 377 came under the Board's supervision. Of these 377, the Federal Reserve regularly inspects 229 either biennially or triennially, according to the type of credit they extend. The others are exempted from periodic on-site inspections by the Federal Reserve but are monitored through the filing of periodic regulatory reports. During 1993, Federal Reserve examiners inspected 67 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 1993 the OTC list was revised in February, May, August, and November. The November OTC list contained 3,545 stocks.

Pursuant to a 1990 amendment to Regulation T, the Board publishes a list of foreign stocks that are eligible for margin treatment at broker–dealers on the same basis as domestic margin securities. In 1993 the foreign list was revised in February, May, August, and November. The November foreign list contained 299 stocks.

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 one new agreement in 1993.

In 1993 the Securities Regulation Section of the Board's Division of Banking Supervision and Regulation issued 53 interpretations of the margin regulations. Those that presented sufficiently important or novel issues were published in the *Securities Credit Transactions Handbook,* which is part of the Federal Reserve Regulatory Service. These interpretations serve as a guide to the margin regulations.

Financial Disclosure by State Member Banks

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 1993, forty-two 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 in each quarterly Call Report all extensions of credit made by the bank to its executive officers since the date of the bank's previous report. The accompanying table summarizes this information.

Federal Reserve Membership

At the end of 1993, 4,338 banks were members of the Federal Reserve System, a decrease of 281 from the previous year-end. Member banks operated 35,564 branches on December 31, 1993, a net increase of 95 for the year.

Member banks accounted for 39 percent of all commercial banks in the United States and for 67 percent of all commercial banking offices; the figures for year-end 1992 were 39 percent of banks and 66 percent of banking offices. ■

Loans by State Member Banks to their Executive Officers, 1992–93

Period	Number	Amount (dollars)	Range of interest rates charged (percent)
1992			
October 1–December 31	704	18,286,000	4.0–19.8
1993			
January 1–March 31	611	18,324,000	3.0–21.0
April 1–June 30	752	25,072,000	3.9–21.0
July 1–September 30	760	20,705,000	3.0–21.0

SOURCE. Call Report.

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.

During 1993 the Board took a variety of actions to reduce the regulatory burden on supervised institutions; among these actions were changes to Regulation O to ease compliance for some small banks and the start of a review of Regulation M under the Board's program of periodic reviews of its regulations.

Loans to Officers, Directors, and Principal Shareholders

Under the Federal Deposit Insurance Corporation Improvement Act of 1991, a bank's total lending to insiders cannot exceed 100 percent of its unimpaired capital and surplus. The statute authorizes the Board, however, to establish a higher limit for banks with less than $100 million in deposits if the Board determines that the exception is "important to avoid constricting the availability of credit in small communities or to attract directors to such banks." Through an interim rule in May 1992, the Board allowed banks with deposits under $100 million to extend credit of up to 200 percent of capital and surplus if the bank's board of directors adopted a resolution certifying that the bank meets the statute's criteria for the exception. Shortly after the end of 1993, after a period of public comment, the Board made the interim rule permanent.

During September the Board issued for comment (and, shortly after the end of the year, adopted) some additional amendments to Regulation O to reduce the burden and complexity of the regulation. The amendments clarified the "tangible economic benefit" rule, adopted certain exceptions to the lending limit for insiders, permitted banks to follow alternative record keeping procedures, and narrowed the definition of "extension of credit."

Consumer Leasing

In November the Board issued for comment an advance notice of proposed rulemaking concerning review of Regulation M. The purpose of periodic reviews is to determine whether the regulation in question can be eliminated, simplified, or modified to ease any burdens of compliance it may impose. The advance notice was to give the leasing industry, consumer interest groups, state and federal regulators, and other interested parties the opportunity to comment on revisions to the regulations that might be beneficial (with or without corresponding statutory changes). The notice indicated that the Board would be considering some specific areas, but it asked for public comment on these and any other issues which the Board should consider in preparing a more detailed proposal for comment in 1994. ■

Federal Reserve Banks

In 1993 the Federal Reserve Banks continued a variety of programs to improve the payment services they provide to depository institutions. The Banks also began to prepare for the January 1994 implementation of the same-day settlement amendments to Regulation CC, which were approved by the Board of Governors in 1992. Under same-day settlement, private collecting institutions will be able to present checks directly to payor institutions and to demand settlement in same-day funds. Many institutions currently using intermediaries, such as the Reserve Banks, to collect checks are expected to begin presenting checks directly to payor institutions.

The Reserve Banks made substantial progress during the year in consolidating their mainframe data processing operations. The objectives of consolidation are greater reliability and security, increased control of payment system risk in a national banking environment, and improved efficiency. The Federal Reserve Automation Services (FRAS) organization substantially completed establishment of the three designated data centers at the head offices of the Richmond and Dallas Banks and the East Rutherford (New Jersey) Operations Center of the New York Bank. The Philadelphia, Richmond, Atlanta, St. Louis, Kansas City, Dallas, and San Francisco Banks moved their funds transfer and book-entry securities transfer applications to the data centers in 1993. In addition, the Richmond, Atlanta, Kansas City, and Dallas Banks completed the move of all other mainframe workloads to the data centers.

Work continued on new centralized applications software that will support the Reserve Banks' operations in the consolidated environment. During 1993 all twelve Banks began using the new daylight overdraft reporting and pricing system and two Banks implemented the new integrated accounting system. In addition, development of the new funds transfer and account balance monitoring applications was substantially completed, and work continued on development of the new automated clearinghouse and book-entry securities transfer applications.

During 1993 the Reserve Banks began implementing the System's new national communications network, Fednet. When it is fully implemented in 1995, Fednet will replace the current FRCS-80 backbone network and the twelve District networks with a single unified network that will provide a standard level of service throughout the System. Fednet is designed to improve reliability, security, and disaster recovery capabilities for the Reserve Banks and the depository institutions that use Federal Reserve services. The majority of Fednet's telecommunications circuits and circuit switching infrastructure were deployed in 1993; depository institutions will begin using the new network in 1994.

Developments in Federal Reserve Services

The Monetary Control Act of 1980 requires the Federal Reserve System to establish fees that, over the long run, recover all direct and indirect costs of providing services to depository institutions, plus imputed costs that reflect the taxes that would have been paid and the return on capital that would have been earned had the services been provided by a private firm. These imputed costs are referred to as the private sector adjustment factor (PSAF). In 1993, income from priced services totaled $945.1 million and costs totaled $906.8 million, resulting in net revenue of $38.3 million and a recovery rate of 104.2 percent of expenses, including the PSAF but before the cumulative effect of a change in accounting principle. The one-time charge for the cumulative effect on prior years of the retroactive application of the accrual method of postretirement benefits resulted in a net loss of $33.1 million. In 1992, the System had net income of $26.6 million and recovered 105.1 percent of its total expenses, including the PSAF.[1]

Check Collection

The Federal Reserve's operating expenses and imputed costs for commercial check services in 1993 totaled $555.0 million (see the second pro forma income statement for priced services, at the end of this chapter). Income from check operations totaled $583.2 million and other income (net of expenses) amounted to $13.7 million, for income after imputed costs of $28.3 million. The Reserve Banks handled 19.0 billion checks, a decrease of 0.2 percent from 1992 volume.

During the year, the Board approved several changes to the check services provided by the Reserve Banks. In June, after extensive analysis of comments from the public, the Board adopted new Federal Reserve Bank check services designed to facilitate implementation of the same-day settlement provisions of Regulation CC. Specifically, a paying bank may now designate a Federal Reserve office as the place at which private sector banks may present checks to it. In addition, the Reserve Banks will provide information services to paying banks, enabling them to continue to provide timely cash-management information to their corporate customers. In November, the Board approved, subject to additional staff analysis and public comment, volume-based pricing for certain check deposit products and payor bank services in two Districts. Volume-based pricing offers lower per-item fees to high-volume users, allowing those users to realize, through the fees they pay, the cost efficiencies that can be achieved in handling a large volume of transactions. Also during the year, the Board approved adjustments to deposit deadlines at several Reserve Banks as the Banks continued their efforts to enhance funds availability for depositors.

During 1993 the Federal Reserve continued to encourage the development and use of electronic mechanisms to enhance or replace paper check processing. Furthering this effort, all Reserve Banks will offer basic electronic check presentment and local truncation services in 1994. Nearly 248 million checks were presented to payor banks for settlement electronically during 1993, an increase of approximately 60 percent over the 1992 level. One Bank instituted a fully electronic check collection service that permits collecting banks to deposit, in electronic form, checks destined for paying banks that currently use the Reserve Bank's truncation services. The Federal Reserve also continued to develop and test medium-speed and high-speed imaging technologies. One District introduced the first

1. See the pro forma statements at the end of this chapter. *Income* is the sum of income from services and investment income. *Cost* is the sum of operating 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.

Federal Reserve check service that applies imaging technology. The service allows a paying bank that uses truncation or other electronic check presentment services to obtain check images for its information-processing needs. Testing of intra- and inter-District transmission of requests for adjustment of check transactions via Fedline also continued, and several Districts have begun to implement this service.

Automated Clearinghouse

In 1993 the operating expenses and imputed costs of providing commercial automated clearinghouse (ACH) services totaled $65.0 million. Income from operations was $58.9 million and other income was $1.2 million, resulting in a loss after imputed expenses of $6.2 million. The Reserve Banks processed 1,545 million commercial transactions during the year, an increase of 16.5 percent over 1992 volume.

By mid-1993 all depository institutions that originate or receive commercial transactions through the Federal Reserve Banks had established electronic connections. By the end of 1993 only 660 depository institutions that receive only government transactions were not connected electronically. The Department of the Treasury is requiring that all these institutions establish electronic connections by July 1, 1994.

The conversion of all users of commercial ACH services to electronic connections enabled the Reserve Banks to improve their ACH services significantly during 1993. On October 1, 1993, the Banks added two processing exchanges each day, enhancing the flexibility of the ACH services for institutions that originate transactions. The increase in the number of times during the day that ACH transactions may be deposited should make the service attractive for more types of payments than previously. The new processing exchanges also permit depository institutions to decrease the interval between the origination of ACH transactions and the time they are available to receiving depository institutions.

Funds Transfer

The operating expenses and imputed costs of providing funds transfer services in 1993 totaled $75.3 million. Income from operations was $88.4 million and other income was $1.8 million, resulting in income after imputed expenses of $13.1 million. The number of Fedwire funds transfers originated increased 2.0 percent over the 1992 volume, to 71.2 million transfers.[2]

In July 1993 the Board announced a delay in taking final action on its proposal to change the opening time for the Fedwire funds transfer system from 8:30 a.m. to 6:30 a.m. Eastern time. Commenters raised a number of complex issues concerning the proposal, questioned whether expanded operating hours would reduce risk, and requested that the Federal Reserve share its long-term plans regarding Fedwire operating hours with the public. As a result, the Board's staff began a thorough study of the issues raised by extending Fedwire operating hours and the associated public policy concerns.

In August 1993 the Board and the Department of the Treasury jointly requested public comment on a proposal to impose recordkeeping requirements for certain wire transfers sent by financial institutions. The proposal was developed to implement revisions to the Bank Secrecy Act as required by the Annunzio–Wylie Anti–Money Launder-

2. Transfers originated include 69.7 million value transfers and 1.5 million nonvalue transfers.

ing Act of 1992 and is intended to facilitate investigations of money laundering. In response to commenters' concerns about implementing the required changes by year-end 1993, Treasury in December announced that the proposed implementation would be delayed until it could complete a review of its anti-money laundering programs. Final action is expected in 1994.

In November 1993 the Board requested public comment on a proposal to expand the Fedwire funds transfer format and adopt a more comprehensive set of data elements by late 1996. The change would facilitate compliance with regulations proposed by Treasury to include, with each transfer, complete name and address information for all parties to the transfer. The proposed format would also be more consistent with the formats used for other large-value funds transfer systems. Comments are expected in early 1994.

Net Settlement

The Federal Reserve provides net settlement services to four national, and numerous local, private sector clearing arrangements. These arrangements enable participants to settle their net positions either via Fedwire funds transfers using special settlement accounts at the Federal Reserve or via accounting entries to their settling participants' reserve or clearing accounts at the Federal Reserve.

Two of the national arrangements, the Clearing House Interbank Payments System and the Participants Trust Company, process and net large-dollar transactions associated, respectively, with interbank funds transfers and with payments related to the settlement of mortgage-backed securities transactions. The other two national arrangements, Visa and Chexs, process and net small-dollar transactions associated, respectively, with automated clearinghouse and check payments. The majority of local arrangements are check clearinghouses.

In 1993 the Reserve Banks processed about 600,000 net settlement entries for local netting arrangements; the value of these entries was about $600 billion.

Securities and Fiscal Agency Services

The Federal Reserve provides book-entry securities account maintenance and transfer services for debt issues of the U.S. Treasury and of certain federally sponsored agencies, such as the Federal Home Loan Mortgage Corporation and the Student Loan Marketing Association. Only the services related to federal agency securities are priced by the Federal Reserve. In 1993, operating expenses and imputed costs totaled $11.8 million and income was $14.2 million, for income after imputed expenses of $2.4 million. The Federal Reserve processed 3.7 million transfers of government agency securities during the year, a 10.4 percent increase over 1992 volume.

Eight Federal Reserve Banks currently offer purchases and sales services to depository institutions. Under the program, the Banks will purchase or sell, on the secondary market, securities that are book-entry-eligible at the Federal Reserve. Because of declining demand and other factors, the Board in November 1993 decided to consolidate this service at the Federal Reserve Bank of Chicago. Consolidation will provide an opportunity to reduce cost with little, if any, effect on the services offered.

The Federal Reserve continues to operate Treasury Direct, the book-entry securities safekeeping system for individuals who invest in Treasury securities and use the Treasury Department as custodian. Treasury Direct has grown to more than 1.2 million accounts with a total par value of more than $60 billion. During 1993 the Reserve Banks processed 311,756 applications to purchase securities, issued almost 5.2 million Treasury Direct payments to investors, and handled more than 1.2 million telephone, walk-in, and written inquiries from Treasury Direct account holders.

Early in 1993 the Federal Reserve Bank of New York began using its recently developed Treasury Automated Auction Processing System (TAAPS). TAAPS enables bidders that have an electronic connection to a Federal Reserve Bank to submit bids for new issues of Treasury securities electronically instead of on paper and facilitates the Federal Reserve's review of the bids.

In 1993 the Federal Reserve System printed more than 89 million savings bonds, representing over-the-counter, payroll, and other types of savings bond purchases. By the end of the year, eight Federal Reserve Districts had consolidated their savings bond operations at one of five consolidation sites: the Buffalo Branch of the New York Bank, the Pittsburgh Branch of the Cleveland Bank, and the Richmond, Minneapolis, and Kansas City Banks. The remaining four Districts will consolidate their savings bond operations at one of these sites within two years.

The Federal Reserve Banks of Minneapolis, St. Louis, and Atlanta are participating in a test of an Electronic Federal Tax Deposit (EFTD) system, a nationwide system to collect federal business and individual tax payments electronically. EFTD was designed by the Treasury Department's Internal Revenue Service and Financial Management Service to automate the tax collection system further and to reduce paper handling.

Noncash Collection and Definitive Securities Safekeeping

The operating expenses and imputed costs of providing definitive safekeeping services in 1993 totaled $3.9 million. Income was $1.5 million, for a loss, after imputed expenses, of $2.4 million. In keeping with the Board's 1992 decision to discontinue definitive safekeeping services, the Reserve Banks ceased providing these services at the end of 1993. The operating loss largely reflects the costs of withdrawing from the service.

The operating expenses and imputed costs of providing the noncash collection service in 1993 totaled $5.6 million and income was $4.8 million, resulting in a loss after imputed expenses of $0.7 million. The number of noncash collection items processed decreased 37.7 percent, to 1.0 million items.

Because of declining volumes, the Reserve Banks in 1993 consolidated their noncash collection operations at four sites. By the end of 1994, noncash collection transactions will be processed at only three sites—the Cleveland and Chicago Banks and the Jacksonville Branch of the Atlanta Bank. In November 1993 the Board approved the use of a volume-based pricing structure for the noncash collection service, which is designed to reduce the burden on low-volume users resulting from the fee increases necessary for Reserve Banks to recover costs while transaction volume continues to decline.

Currency and Coin

In 1993, income from priced cash services was $6.3 million and the cost of providing the service was $6.2 million, for income after imputed expenses of $0.1 million. Only three Federal Reserve offices—the Minneapolis Bank, its

Helena Branch, and the Pittsburgh Branch of the Cleveland Bank—continued to arrange transportation of cash by armored carrier; the Cleveland Bank and the Branches in the San Francisco District discontinued the service during the year. Two Districts provided coin wrapping services, offices in two Districts provided nonstandard packaging of currency, and offices in two Districts offered nonstandard frequency of access to services; all are priced services.

The Reserve Banks continued to work closely with Treasury and other agencies to deter counterfeiting and laundering of U.S. currency. One important aspect of these efforts was the distribution of $10 through $100 notes that incorporate two new features, a security thread and microprinting, to discourage photocopied counterfeits. The security-enhanced notes account for 17 percent of all notes now in circulation. Distribution of a new series $5 note with these same security features is scheduled for 1994.

In 1993 the Reserve Banks installed twenty-five ISS 3000 currency processing machines. Over the next four years an additional 133 processors will be installed to improve efficiency and enhance currency processing capabilities.

Float

Federal Reserve float increased to a daily average of $821 million in 1993, up from $417 million in 1992. The costs of Federal Reserve float associated with priced services are recovered each year through fees for priced services.

Examinations

The Federal Reserve Act, section 21, requires the Board of Governors to "order an examination of each Federal Reserve Bank" at least once a year. The responsibility is assigned to the Board's Division of Reserve Bank Operations and Payment Systems. In 1993 the Board also engaged two certified public accounting (CPA) firms to examine two of the twelve Federal Reserve Banks. The findings of all examinations are reported to the management and directors of the respective Banks and to the Board of Governors.

To assess conformance with policies established by the Federal Open Market Committee (FOMC), the Division of Reserve Bank Operations and Payment Systems also 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. All 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 1993 and 1992.

Income was $18,914 million in 1993 and $20,235 million in 1992. Expenses in 1993 totaled $1,798 million ($1,475 million in operating expenses, $183 million in earnings credits granted to depository institutions, and $140 million in assessments for expenditures by the Board of Governors). The cost of currency was $356 million. Revenue from financial services was $757 million.

The profit and loss account showed a net loss of $201 million. The loss was a result primarily of the initial accrual of postretirement employee benefits required by the adoption of Statement of Financial Accounting Standards (SFAS) No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions." This accrual was partially offset by realized and unrealized gains on assets denominated in foreign currencies and gains on the sales of securities from the System Open Market Account portfolio. Statutory dividends to member banks totaled $195 million, $23 million more than in 1992. The rise reflected an increase in the capital and surplus of member banks and a consequent increase in the paid-in capital stock of the Reserve Banks.

Payments to the U.S. Treasury in the form of interest on Federal Reserve notes totaled $15,987 million, compared with $16,774 million in 1992. The payments consist of all net income after the deduction of dividends and 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 1993 and table 7 shows a condensed statement for each Bank for 1914–93. A detailed account of the assessments and expenditures of the Board of Governors appears in the next section, Board of Governors Financial Statements.

Holdings of Securities and Loans

Average daily holdings of securities and loans by the Reserve Banks during 1993 were $320,528 million, an increase of $37,424 million over 1992 (see accompanying table). From 1992 to 1993, holdings of U.S. government securities increased $37,420 million and loans increased $4 million.

The average rate of interest on holdings of U.S. government securities decreased from 6.13 percent in 1992 to 5.27 percent in 1993, and the average rate of interest on loans decreased from 3.43 percent to 3.08 percent.

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 1990–93.

Income, Expenses, and Distribution of Net Earnings of Federal Reserve Banks, 1993 and 1992[1]

Millions of dollars

Item	1993	1992
Current income	18,914	20,235
Current expenses	1,658	1,475
Operating expenses[2]	1,475	1,298
Earnings credits granted	183	177
Current net income	17,256	18,760
Net addition to (deduction from, –) current net income	–201	–959
Cost of unreimbursed services to Treasury	29	29
Assessments by the Board of Governors	496	424
For expenditures of Board	140	129
For cost of currency	356	295
Net income before payments to Treasury	16,530	17,348
Dividends paid	195	172
Payments to Treasury (interest on Federal Reserve notes)	15,987	16,774
Transferred to surplus	348	402

1. Details may not sum to totals because of rounding.
2. Includes a net periodic credit for pension costs of $131 million in 1993 and $141 million in 1992.

Federal Reserve Bank Premises

In 1993 the New York Reserve Bank completed the relocation of its staff and operations to its new East Rutherford Operations Center, and the Dallas Bank completed its move to its new head office building. In addition, modifications to accommodate the new Federal Reserve Automation Services organization at the three consolidated processing sites—the East Rutherford Operations Center and the Richmond and Dallas Banks—were completed.

The design activities for the new headquarters building for the Minneapolis Bank and renovation of the headquarters building of the Cleveland Bank continued during 1993.

The Board approved projects to renovate the cash departments at several Reserve Banks in preparation for installation of new currency-processing equipment. Also approved were multiyear renovation programs for the San Francisco Bank's Seattle and Portland Branches.

Table 8, in the Statistical Tables chapter, shows the cost and book values of premises owned and occupied by the Federal Reserve Banks and the cost of other real estate owned by the Banks.

Securities and Loans of Federal Reserve Banks, 1991–93

Millions of dollars, except as noted

Item and year	Total	U.S. government securities[1]	Loans[2]
Average daily holdings[3]			
1991	256,929	256,559	370
1992	283,104	282,927	177
1993	320,528	320,347	181
Earnings			
1991	19,283	19,262	21
1992	17,342	17,336	6
1993	16,896	16,891	6
Average interest rate (percent)			
1991	7.51	7.51	5.73
1992	6.13	6.13	3.43
1993	5.27	5.27	3.08

1. Includes federal agency obligations.
2. Does not include indebtedness assumed by FDIC.
3. Based on holdings at opening of business.

Pro Forma Balance Sheet for Priced Services, December 31, 1993 and 1992[1]

Millions of dollars

Item	1993		1992	
Short-term assets[2]				
Imputed reserve requirement on clearing balances	749.8		699.2	
Investment in marketable securities	5,498.2		5,127.8	
Receivables	67.4		66.6	
Materials and supplies	9.9		6.5	
Prepaid expenses	17.2		12.3	
Items in process of collection	3,458.6		4,062.4	
Total short-term assets		9,801.1		9,974.7
Long-term assets[3]				
Premises	385.4		378.5	
Furniture and equipment	211.2		176.2	
Leases and leasehold improvements	18.0		51.3	
Prepaid pension costs	179.9		141.7	
Total long-term assets		794.4		747.6
Total assets		**10,595.5**		**10,722.4**
Short-term liabilities				
Clearing balances and balances arising from early credit of uncollected items	7,039.0		8,820.7	
Deferred-availability items	2,667.6		1,068.8	
Short-term debt	94.5		85.3	
Total short-term liabilities		9,801.1		9,974.7
Long-term liabilities				
Obligations under capital leases	1.2		1.2	
Long-term debt	195.0		192.3	
Postretirement benefits obligation	121.2		...	
Total long-term liabilities		317.4		193.5
Total liabilities		**10,118.5**		**10,168.3**
Equity		477.0		554.1
Total liabilities and equity[4]		**10,595.5**		**10,722.4**

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 1993 the Reserve Banks recognized a credit to expenses of $54.6 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.

Pro Forma Income Statement for Federal Reserve Priced Services, Calendar Years 1993 and 1992[1]

Millions of dollars

Item	1993		1992	
Income from services provided to depository institutions[2]		757.3		758.4
Operating expenses[3]		633.4		606.1
Income from operations		123.9		152.3
Imputed costs[4]				
Interest on float	10.6		14.5	
Interest on debt	21.3		19.8	
Sales taxes	12.2		11.2	
FDIC insurance	18.0	62.0	8.9	54.4
Income from operations after imputed costs		61.9		97.9
Other income and expenses[5]				
Investment income	187.8		180.2	
Earnings credits	170.6	17.2	177.8	2.4
Income before income taxes		79.1		100.3
Imputed income taxes[6]		23.3		29.5
Income before cumulative effect of a change in accounting principle	55.8			
Cumulative effect on prior years of retroactive application of accrual method of postretirement benefits (net of $29.9 million tax)[7]	−71.4			
Net income		**−15.6**		**70.8**
MEMO: Targeted return on equity[8]		17.5		24.9

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

2. Income from 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 $2.3 million in 1993 and $1.9 million in 1992. 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 1993 in millions of dollars:

Total float	641.1
Unrecovered float	8.6
Float subject to recovery	632.5
Sources of recovery of float	
Income on clearing balances	63.2
As-of adjustments	291.7
Direct charges	134.9
Per-item fees	142.7

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 1993.

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. Effective January 1, 1993, the Reserve Banks implemented Financial Accounting Standards Board Statement No. 106, Employers' Accounting for Postretirement Benefits Other than Pensions. Accordingly, in 1993 the Reserve Banks recognized a one-time cumulative charge of $101.3 million to reflect the retroactive application of this change in accounting principle.

8. 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. This amount is adjusted to reflect the deferral of $7.4 million and $1.1 million respectively for 1993 and 1992 automation consolidation, an amount that the Reserve Banks plan to recover, along with a finance charge, by the end of 1999.

Pro Forma Income Statement for Federal Reserve Priced Services, by Service, 1993[1]

Millions of dollars

Item	Total	Commercial check collection	Funds transfer and net settlement	Commercial ACH	Definitive safekeeping	Noncash collection	Book-entry securities	Cash services
Income from services	757.3	583.2	88.4	58.9	1.5	4.8	14.2	6.3
Operating expenses	633.4	504.4	69.1	59.8	3.9	5.5	11.8	6.2
Income from operations	123.9	78.9	19.3	−1.0	−2.4	−.6	2.4	.1
Imputed costs[2]	62.0	50.6	6.2	5.2	.0	.1	.0	.0
Income from operations after imputed costs	61.9	28.3	13.1	−6.2	−2.4	−.7	2.4	.1
Other income and expenses, net[3]	17.2	13.7	1.8	1.2	.0	.1	.3	.1
Income before income taxes	79.1	42.0	14.9	−4.9	−2.4	−.6	2.6	.2

1. Details may not sum to totals because of rounding. The amortization of the initial effect of implementing FASB 87 is reported only in the "Total" column of this table and has not been allocated to individual priced services, whereas the portion of the credit related to 1993 has been allocated (see pro forma balance sheet, note 3). 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 1993, 1992, and 1991[1]

Thousands of items, except as noted

Service	1993	1992	1991	Percent change 1992–93	Percent change 1991–92
Funds transfers	71,199	69,803	66,921	2.0	4.3
Commercial ACH	1,544,848	1,326,632	1,119,073	16.5	18.5
Commercial checks	19,008,808	19,052,928	18,742,950	−.2	1.7
Securities transfers	3,604	3,266	2,800	10.4	16.6
Definitive safekeeping	17	41	57	−58.5	−28.1
Noncash collection	1,020	1,636	2,243	−37.7	−27.1
Cash transportation	65	282	338	−77.0	−16.6

1. Activity is defined as follows: for funds transfers, 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.

Income and Expenses for Locally Priced Federal Reserve Services, by District, 1993[1]
Millions of dollars

District	Total revenue	Operating expense	Float expense	Total expense	Net revenue
	Commercial check collection				
Boston	34.3	32.1	.6	32.7	1.6
New York	69.7	62.5	1.6	64.1	5.6
Philadelphia	31.9	27.4	1.0	28.4	3.5
Cleveland	32.4	28.0	1.1	29.1	3.3
Richmond	55.2	48.4	.7	49.1	6.1
Atlanta	77.8	67.7	1.2	68.9	8.9
Chicago	79.5	66.4	1.1	67.5	12.0
St. Louis	24.1	20.8	.8	21.6	2.5
Minneapolis	32.2	27.7	.2	27.9	4.3
Kansas City	37.0	31.8	.9	32.7	4.3
Dallas	43.1	34.5	1.1	35.6	7.5
San Francisco	65.9	55.6	.2	55.8	10.1
System total	**583.1**	**502.9**	**10.5**	**513.4**	**69.7**
	Definitive safekeeping				
Boston	.1	.3	*	.3	−.2
New York	.1	.2	*	.2	−.1
Philadelphia	.1	.4	*	.4	−.3
Cleveland	.2	.5	*	.5	−.3
Richmond	.1	.2	*	.2	−.1
Atlanta	.2	.3	*	.3	−.1
Chicago	.4	.7	*	.7	−.3
St. Louis	.1	.1	*	.1	.0
Minneapolis	.1	.1	*	.1	.0
Kansas City	.1	.5	*	.5	−.4
Dallas	.1	.2	*	.2	−.1
San Francisco	.0	.0	.0	.0	.0
System total	**1.6**	**3.5**	**.0**	**3.5**	**−1.9**

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.

Income and Expenses for Locally Priced Federal Reserve Services—Continued

Millions of dollars

District	Total revenue	Operating expense	Float expense	Total expense	Net revenue
	Noncash collection				
Boston	.1	.1	*	.1	.0
New York	1.5	1.5	*	1.5	.0
Philadelphia	.1	*	*	.0	.1
Cleveland	.9	.7	*	.7	.2
Richmond	*	*	*	*	*
Atlanta	1.4	1.8	*	1.8	–.4
Chicago	.7	.5	*	.5	.2
St. Louis	.2	.3	*	.3	–.1
Minneapolis	.0	*	*	*	*
Kansas City	.0	*	*	.0	.0
Dallas	*	*	*	.0	.0
San Francisco	.0	.0	.0	.0	.0
System total	**4.9**	**4.9**	**.0**	**4.9**	**.0**
	Cash services				
Boston	*	...	...	*	*
New York	.0	...	...	.0	*
Philadelphia	.0	...	...	.0	.0
Cleveland	1.9	...	...	1.9	.0
Richmond	.0	...	...	*	.0
Atlanta	.0	...	...	.0	.0
Chicago	.4	...	...	.4	.0
St. Louis	.1	...	...	.1	.0
Minneapolis	2.9	...	...	2.7	.2
Kansas City	.6	...	...	.5	.1
Dallas	*	...	...	*	*
San Francisco	.4	...	...	.5	–.1
System total	**6.3**	...	...	**6.1**	**.2**

Board of Governors Financial Statements

The financial statements of the Board were audited by Price Waterhouse, independent public accountants, for 1993.

Report of Independent Accountants

To the Board of Governors of the
Federal Reserve System

In our opinion, the accompanying balance sheet and the related statements of revenues and expenses and fund balance and of cash flows present fairly, in all material respects, the financial position of the Board of Governors of the Federal Reserve System (the Board) at December 31, 1993, and the results of its operations and its cash flows for the year in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Board's management; our responsibility is to express an opinion on these statements based on our audit. We conducted our audit of these statements in accordance with generally accepted auditing standards and the financial audit standards in *Government Auditing Standards* issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for the opinion expressed above. The financial statements of the Board of Governors of the Federal Reserve System for the year ended December 31, 1992, were audited by other independent accountants whose report dated February 12, 1993, expressed an unqualified opinion on those statements.

As discussed in Note 1 to the financial statements, the Board implemented Statement of Financial Accounting Standard No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* effective January 1, 1993.

Price Waterhouse

Washington, D.C.
February 18, 1994

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BALANCE SHEET

	As of December 31, 1993	1992
ASSETS		
CURRENT ASSETS		
Cash	$12,186,714	$ 9,853,172
Accounts receivable	1,555,026	2,543,876
Prepaid expenses and other assets	1,130,894	1,462,101
Total current assets	14,872,634	13,859,149
PROPERTY, BUILDINGS, AND EQUIPMENT, NET (Note 4)	50,121,444	48,968,026
Total assets	$64,994,078	$62,827,175
LIABILITIES AND FUND BALANCE		
CURRENT LIABILITIES		
Accounts payable	$ 5,308,176	$ 5,311,460
Accrued payroll and related taxes	2,718,512	1,978,051
Accrued annual leave	5,871,643	5,612,406
Unearned revenues and other liabilities	1,504,663	1,366,877
Total current liabilities	15,402,994	14,268,794
ACCUMULATED POSTRETIREMENT BENEFIT OBLIGATION (Note 3)	15,880,742	—
FUND BALANCE	33,710,342	48,558,381
Total liabilities and fund balance	$64,994,078	$62,827,175

The accompanying notes are an integral part of these statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENT OF REVENUES AND EXPENSES AND FUND BALANCE

	For the years ended December 31, 1993	1992
Board Operating Revenues		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures	$140,465,600	$128,955,300
Other revenues (Note 5)	5,452,588	6,795,747
Total operating revenues	145,918,188	135,751,047
Board Operating Expenses		
Salaries	90,339,090	81,981,637
Retirement and insurance contributions	14,945,349	13,106,634
Depreciation and net losses on disposals	7,124,330	6,079,387
Contractual services and professional fees	5,811,359	7,527,562
Travel	4,718,069	3,953,838
Postage and supplies	4,207,146	3,687,785
Utilities	3,744,162	3,607,431
Repairs and maintenance	3,684,542	3,757,815
Software	2,878,660	2,751,537
Printing and binding	2,374,942	2,089,901
Equipment and facilities rental	2,287,576	873,672
Other expenses (Note 5)	3,584,471	3,573,879
Total operating expenses	145,699,696	132,991,078
Board Operating Revenues Over Expenses	218,492	2,759,969
Issuance and Redemption of Federal Reserve Notes		
Assessments levied on Federal Reserve Banks for currency costs	355,947,291	295,400,650
Expenses for currency printing, issuance, retirement, and shipping	355,947,291	295,400,650
Currency Assessments Over (Under) Expenses	—	—
Total Revenues Over Expenses Before Effect of Change in Accounting for Postretirement Benefits	218,492	2,759,969
Less: Effect on prior years (to December 31, 1992) of change in accounting for postretirement benefits (Note 3)	15,066,531	—
Total Revenues (Under) Over Expenses	(14,848,039)	2,757,969
Fund Balance, Beginning of year	48,558,381	45,798,412
Fund Balance, End of year	$ 33,710,342	$ 48,558,381

The accompanying notes are an integral part of these statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENT OF CASH FLOWS

Increase (Decrease) in Cash

	For the years ended December 31, 1993	1992
CASH FLOWS FROM OPERATING ACTIVITIES		
Board operating revenues (under) over expenses	$(14,848,039)	$2,759,969
Adjustments to reconcile operating revenues (under) over expenses to net cash provided by operating activities:		
Effect of change in accounting for postretirement benefits	15,066,531	—
Depreciation and net losses on disposals	7,124,330	6,079,387
Increase in accrued postretirement benefits	814,211	—
Decrease (Increase) in accounts receivable, and prepaid expenses and other assets	1,320,057	(2,000,125)
Increase in accrued annual leave	259,237	555,041
(Decrease) Increase in accounts payable	(3,284)	1,702,068
Increase in payroll payable	740,461	857,719
Increase in unearned revenue and other liabilities	137,786	109,435
Net cash provided by operating activities	10,611,290	10,063,494
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from disposals of furniture and equipment	3,723	15,104
Capital expenditures	(8,281,471)	(4,723,564)
Net cash used in investing activities	(8,277,748)	(4,708,460)
NET INCREASE IN CASH	2,333,542	5,355,034
CASH BALANCE, Beginning of year	9,853,172	4,498,138
CASH BALANCE, End of year	$ 12,186,714	$ 9,853,172

The accompanying notes are an integral part of these statements.

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 costs 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 4 to 10 years for furniture and equipment and from 10 to 50 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.

Accounting Change—Effective January 1, 1993, the Board adopted Statement of Financial Accounting Standards No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions (FAS 106), using the immediate recognition method. Under this accounting method, the Board records the cost of these benefits during the employee's years of service rather than the previous pay-as-you-go method. Consistent with this method of implementation option allowed in FAS 106, prior year financial statements have not been restated.

Reclassification—Certain prior year amounts have been reclassified to conform with current year presentation.

(2) RETIREMENT BENEFITS

Substantially all of the Board's employees participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan). The System's Plan is a multiemployer plan which covers employees of the Federal Reserve Banks, the Board, and the Plan Administrative Office. Employees of the Board who entered on duty prior to 1984 are covered by a contributory defined benefits program under the Plan. Employees of the Board who entered on duty after 1983 are covered by a non-contributory defined benefits program under the Plan. Contributions to the System's Plan are actuarially determined and funded by participating employers at amounts prescribed by the Plan's administrator. Based on actuarial calculations, it was determined that employer funding contributions were not required for the years 1993 and 1992, and the Board was not assessed a contribution for these years. Excess Plan assets will continue to fund future years' contributions. The Board is not accountable for the assets of this plan.

A relatively small number of Board employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). The Board matches employee contributions to these plans. These defined benefits plans are administered by the Office of Personnel Management. The Board's contributions to these plans totalled $867,600 and $898,000 in 1993 and 1992, respectively. The Board has no liability for future payments to retirees under these programs, and it is not accountable for the assets of the plans.

(3) OTHER BENEFIT PLANS

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 $3,831,700 in 1993 and $3,419,000 in 1992.

The Board also provides certain defined benefit health and life insurance for its active employees and retirees under Federal and Board sponsored programs. As discussed in Note 1, the Board adopted Statement of Financial Accounting Standards No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions (FAS 106), effective January 1, 1993. The Board elected to immediately recognize the accumulated postretirement benefit obligation upon adoption of FAS 106; as of January 1, 1993, the Board recorded an accumulated postretirement benefit obligation of $15,066,531. The net periodic postretirement benefit cost for 1993 included the following components:

Service cost (benefits attributed to employee services during the year)	$ 248,662
Interest cost on accumulated postretirement benefit obligation	1,181,104
Net periodic postretirement benefit cost	$1,429,766

Since postretirement benefit costs for the year ended December 31, 1992, were recorded on the cash basis, the amount recognized as expense in 1992 is not comparable with the current year. Although postretirement benefits are recorded using the accrual basis of accounting in accordance with FAS 106, the Board's current policy is to fund the cost of these benefits on a pay-as-you-go basis.

The FAS 106 accumulated postretirement benefit obligation at December 31, 1993, is comprised of:

Retirees	$ 9,971,023
Fully eligible active plan participants	2,297,911
Other active plan participants	5,092,539
	17,361,473
Unrecognized net loss	(1,480,731)
Liability for accumulated postretirement benefit obligation	$15,880,742

The liability for the accumulated postretirement benefit obligation and the net periodic expense was determined using an 8-percent discount rate. Unrecognized losses of $1,480,731 result from applying a discount rate of 7 percent as of December 31, 1993. Under FAS 106, the Board may have to record some of these unrecognized losses in operations in future years. The assumed health care cost trend rate for measuring the increase in costs from 1993 to 1994 was 12.5 percent for those under age 65, and 11 percent for those over age 65. These rates were assumed to gradually decline to an ultimate rate of 6.4 percent in the year 2004 for the purpose of calculating the January 1, 1993, transition amount and the 1993 expense, and to 6.0 percent in 2004 for the purpose of calculating the December 31, 1993, accumulated postretirement benefit obligation. The effect of a 1-percent increase in the assumed health care cost trend rate would increase the accumulated postretirement benefit obligation by $1,947,400 at December 31, 1993, and the net periodic benefit cost by $173,400 for the year. The assumed salary trend rate for measuring the increase in postretirement benefits related to life insurance was 4 percent.

The above accumulated postretirement benefit obligation is related to the Board sponsored health benefits and life insurance programs. The Board has no liability for future payments to employees who continue coverage under the federally sponsored programs upon retiring. Contributions for active employees participating in federally sponsored programs totalled $3,353,200 and $1,149,700 in 1993 and 1992, respectively.

(4) 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,	
	1993	1992
Land and improvements	$ 1,301,314	$ 1,301,314
Buildings	64,891,700	63,856,738
Furniture and equipment	43,055,132	38,550,995
	109,248,146	103,709,047
Less accumulated depreciation	59,126,702	54,741,021
Total property, buildings, and equipment	$ 50,121,444	$ 48,968,026

(5) OTHER REVENUES AND OTHER EXPENSES

The following are summaries of the components of Other Revenues and Other Expenses.

	For the years ended December 31,	
	1993	1992
Other Revenues		
Data processing revenue	$3,152,492	$2,737,073
Subscription revenue	1,579,653	1,537,013
Reimbursement of regulatory investigation costs	—	1,500,000
Reimbursable services to other agencies	319,938	471,590
Miscellaneous	400,505	550,071
Total other revenues	$5,452,588	$6,795,747
Other Expenses		
Cafeteria operations, net	$ 740,900	$ 765,478
Tuition, registration, and membership fees	1,015,507	866,965
Subsidies and contributions	768,186	735,835
Miscellaneous	1,059,878	1,205,601
Total other expenses	$3,584,471	$3,573,879

(6) 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, 1993, are as follows:

1994	$ 2,985,900
1995	3,179,900
1996	3,212,000
1997	3,194,500
1998	1,390,000
after 1998	5,947,200
	$19,909,500

Rental expenses under these operating leases were $1,927,600 and $644,600 in 1993 and 1992, respectively.

(7) FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

The Board is one of the five member agencies of the Federal Financial Institutions Examination Council (the "Council"). During 1993 and 1992, the Board paid $371,200 and $324,300, respectively, in assessments for operating expenses of the Council. These amounts are included in subsidies and contributions for 1993 and 1992. During 1993 and 1992, the Board paid $124,500 and $92,000, respectively, for office space sub-leased from the Council. ■

Statistical Tables

1. Detailed Statement of Condition of All Federal Reserve Banks Combined, December 31, 1993[1]

Thousands of dollars

ASSETS				
Gold certificate account				11,053,286
Special drawing rights certificate account				8,018,000
Coin				372,129
Loans and securities				
Loans to depository institutions			93,975	
Federal agency obligations				
Bought outright			4,638,425	
Held under repurchase agreement			1,025,000	
U.S. Treasury securities				
Bought outright				
Bills	160,367,594			
Notes	132,076,127			
Bonds	39,571,572			
Total bought outright		332,015,293		
Held under repurchase agreement		12,187,000		
Total securities			344,202,293	
Total loans and securities				349,959,693
Items in process of collection				
Transit items			5,980,549	
Other items in process of collection			1,192,782	
Total items in process of collection				7,173,331
Bank premises				
Land			156,810	
Buildings (including vaults)	872,266			
Building machinery and equipment	228,729			
Construction account	61,110			
Total bank premises		1,162,105		
Less depreciation allowance		263,731	898,374	
Bank premises, net				1,055,184
Other assets				
Furniture and equipment		1,057,335		
Less depreciation		608,399		
Total furniture and equipment, net			448,935	
Denominated in foreign currencies[2]			22,339,560	
Interest accrued			3,406,080	
Premium on securities			5,086,337	
Overdrafts			25,271	
Prepaid expenses			643,300	
Suspense account			37,753	
Real estate acquired for banking-house purposes			27,769	
Other			323,883	
Total other assets				32,338,887
Total assets				409,970,511

Continued

LIABILITIES		
Federal Reserve Notes		
Outstanding (issued to Federal Reserve Banks)	409,264,572	
Less held by Federal Reserve Banks	65,339,274	
Total Federal Reserve notes, net		**343,925,298**
Deposits		
Depository institutions		**34,951,224**
U.S. Treasury, general account		**14,809,011**
Foreign, official accounts		**386,345**
Other deposits		
Officers' and certified checks	23,255	
International organizations	111,905	
Other[3]	261,403	
Total other deposits		**396,563**
Deferred credit items		**6,210,168**
Other liabilities		
Discount on securities	1,837,782	
Sundry items payable	68,370	
Suspense account	10,378	
All other	572,851	
Total other liabilities		**2,489,380**
Total liabilities		**403,167,988**
CAPITAL ACCOUNTS		
Capital paid in		**3,401,261**
Surplus		**3,401,261**
Other capital accounts[4]		**0**
Total liabilities and capital accounts		**409,970,511**

1. Amounts in boldface type indicate items in the Board's weekly statement of condition of the Federal Reserve Banks.
2. Of this amount $10,447.8 million was invested in securities issued by foreign governments, and the balance was invested with foreign central banks and the Bank for International Settlements.
3. In closing out the other capital accounts at year-end, the Reserve Bank earnings that are payable to the Treasury are included in this account pending payment.
4. During the year, includes undistributed net income, which is closed out on December 31.

2. Statement of Condition of Each Federal Reserve Bank, December 31, 1993 and 1992

Millions of dollars[1]

Item	Total 1993	Total 1992	Boston 1993	Boston 1992
Assets				
Gold certificate account	11,053	11,056	660	705
Special drawing rights certificate account	8,018	8,018	511	511
Coin	372	446	10	19
Loans				
To depository institutions	94	675	4	0
Other	0	0	0	0
Acceptances held under repurchase agreements	0	0	0	0
Federal agency obligations				
Bought outright	4,638	5,413	274	346
Held under repurchase agreements	1,025	631	0	0
U.S. Treasury securities				
Bought outright[2]	332,015	295,011	19,592	18,843
Held under repurchase agreements	12,187	7,463	0	0
Total loans and securities	349,960	309,192	19,870	19,189
Items in process of collection	7,173	8,911	353	634
Bank premises	1,055	1,026	91	90
Other assets				
Denominated in foreign currencies[3]	22,339	21,514	793	794
All other	10,000	7,738	460	376
Interdistrict Settlement Account	0	0	−2,195	−1,634
Total assets	**409,971**	**367,901**	**20,553**	**20,683**
Liabilities				
Federal Reserve notes	343,925	314,208	17,254	18,572
Deposits				
Depository institutions	34,951	32,079	2,555	1,442
U.S. Treasury, general account	14,809	7,492	0	0
Foreign, official accounts	386	206	5	5
Other	397	372	15	21
Total deposits	50,543	40,148	2,575	1,468
Deferred credit items	6,210	5,561	326	311
Other liabilities and accrued dividends[4]	2,489	1,876	152	115
Total liabilities	**403,168**	**361,793**	**20,307**	**20,466**
Capital Accounts				
Capital paid in	3,401	3,054	123	108
Surplus	3,401	3,054	123	108
Other capital accounts	0	0	0	0
Total liabilities and capital accounts	**409,971**	**367,901**	**20,553**	**20,683**
Federal Reserve Note Statement				
Federal Reserve notes outstanding (issued to Bank)	409,265	363,479	19,706	21,432
Less: Held by Bank	65,339	49,271	2,452	2,860
Federal Reserve notes, net	**343,925**	**314,208**	**17,254**	**18,572**
Collateral for Federal Reserve notes				
Gold certificate account	11,053	11,056	...	...
Special drawing rights certificate account	8,018	8,018	...	...
Other eligible assets	0	0	...	...
U.S. Treasury and federal agency securities	324,854	295,134	...	...
Total collateral	**343,925**	**314,208**	...	...

2.—Continued

New York		Philadelphia		Cleveland		Richmond	
1993	1992	1993	1992	1993	1992	1993	1992
3,753	4,042	399	347	701	658	899	941
2,808	2,808	303	303	556	556	652	652
11	13	15	24	21	26	67	95
9	0	8	592	0	0	65	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
1,602	2,106	176	165	312	341	362	423
1,025	631	0	0	0	0	0	0
114,654	114,769	12,583	8,979	22,303	18,569	25,898	23,068
12,187	7,463	0	0	0	0	0	0
129,477	124,969	12,766	2,736	22,614	18,909	26,325	23,492
789	1,352	445	538	275	442	502	760
140	137	47	45	37	36	139	128
6,474	6,258	858	852	1,289	1,308	1,537	1,383
4,529	3,421	306	199	512	375	835	876
12,726	−19,514	921	2,183	−3,321	1,420	598	−220
160,707	**123,485**	**16,060**	**14,227**	**22,684**	**23,731**	**31,553**	**28,106**
134,964	105,028	13,026	11,341	20,161	21,680	28,035	25,083
6,969	7,531	2,248	2,207	1,556	1,341	2,357	2,025
14,809	7,492	0	0	0	0	0	0
288	107	5	6	8	9	10	9
196	195	7	8	14	15	32	32
22,261	15,324	2,261	2,221	1,578	1,364	2,398	2,068
747	629	432	368	340	220	477	392
798	733	114	62	158	114	186	144
158,769	**121,715**	**15,832**	**13,992**	**22,237**	**23,378**	**31,096**	**27,686**
969	885	114	117	224	176	229	210
969	885	114	117	224	176	229	210
0	0	0	0	0	0	0	0
160,707	**125,485**	**16,060**	**14,227**	**22,684**	**23,731**	**31,553**	**28,106**
157,408	119,266	14,472	13,058	23,474	23,683	34,012	29,944
22,444	14,238	1,446	1,717	3,313	2,003	5,978	4,861
134,964	**105,028**	**13,026**	**11,341**	**20,161**	**21,680**	**28,035**	**25,083**
...	...	...	...	...	...	...	...
		...	...	...	...	...	...
...	...	...	...	...	...	...	...
...	...	...	...	...	...	...	...

2. Statement of Condition of Each Federal Reserve Bank, December 31, 1993 and 1992—Continued

Millions of dollars[1]

Item	Atlanta		Chicago	
	1993	1992	1993	1992
ASSETS				
Gold certificate account	509	503	1,186	1,270
Special drawing rights certificate account	318	318	1,036	1,036
Coin	55	38	32	30
Loans				
To depository institutions	1	1	1	2
Other	0	0	0	0
Acceptances held under repurchase agreements	0	0	0	0
Federal agency obligations				
Bought outright	189	184	539	670
Held under repurchase agreements	0	0	0	0
U.S. Treasury securities				
Bought outright[2]	13,507	10,043	38,585	36,537
Held under repurchase agreements	0	0	0	0
Total loans and securities	13,697	10,229	39,124	37,210
Items in process of collection	775	1,305	674	923
Bank premises	61	57	113	112
Other assets				
Denominated in foreign currencies[3]	2,120	1,971	2,531	2,603
All other	380	326	960	777
Interdistrict Settlement Account	2,185	3,833	1,743	−3,444
Total assets	**20,101**	**18,579**	**47,400**	**40,517**
LIABILITIES				
Federal Reserve notes	14,960	13,232	41,541	35,485
Deposits				
Depository institutions	3,617	4,083	4,022	3,422
U.S. Treasury, general account	0	0	0	0
Foreign, official accounts	13	13	16	17
Other	2	5	81	49
Total deposits	3,632	4,101	4,118	3,489
Deferred credit items	736	600	679	621
Other liabilities and accrued dividends[4]	132	67	282	231
Total liabilities	**19,461**	**18,000**	**46,620**	**39,825**
CAPITAL ACCOUNTS				
Capital paid in	320	290	390	346
Surplus	320	290	390	346
Other capital accounts	0	0	0	0
Total liabilities and capital accounts	**20,101**	**18,579**	**47,400**	**40,517**
FEDERAL RESERVE NOTE STATEMENT				
Federal Reserve notes outstanding (issued to Bank)	19,797	17,318	45,621	38,700
Less: Held by Bank	4,837	4,086	4,081	3,215
Federal Reserve notes, net	**14,960**	**13,232**	**41,541**	**35,485**

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.

—Continued

St. Louis		Minneapolis		Kansas City		Dallas		San Francisco	
1993	1992	1993	1992	1993	1992	1993	1992	1993	1992
392	304	243	195	409	329	510	463	1,392	1,299
168	168	186	186	199	199	377	377	904	904
22	25	15	16	21	36	42	27	61	98
1	5	4	1	1	5	0	0	0	69
0	0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0	0
164	132	106	84	176	146	199	199	542	616
0	0	0	0	0	0	0	0	0	0
11,723	7,218	7,600	4,598	12,592	7,981	14,219	10,823	38,761	33,583
0	0	0	0	0	0	0	0	0	0
11,888	7,356	7,710	4,683	12,769	8,131	14,418	11,021	39,303	34,268
246	294	465	415	583	482	511	418	1,555	1,349
31	30	35	33	51	51	158	161	151	146
512	531	585	566	795	807	1,550	1,717	3,295	2,724
271	152	181	120	292	169	380	282	895	667
1,857	5,311	−1,004	2,555	1,442	5,062	−2,831	2,314	−12,122	2,134
15,387	**14,171**	**8,418**	**8,768**	**16,561**	**15,266**	**15,115**	**16,781**	**35,433**	**43,589**
14,006	12,824	7,048	7,458	14,511	13,544	12,097	14,082	26,323	35,878
907	952	677	721	1,233	1,079	2,021	1,808	6,791	5,466
0	0	0	0	0	0	0	0	0	0
3	3	4	4	5	5	10	11	21	18
9	3	5	5	11	6	4	27	21	6
919	958	686	730	1,249	1,090	2,034	1,846	6,833	5,490
215	204	435	390	427	362	381	356	1,016	1,108
99	44	67	29	118	53	112	73	272	212
15,238	**14,031**	**8,236**	**8,608**	**16,305**	**15,049**	**14,623**	**16,357**	**34,443**	**42,688**
74	70	91	80	128	109	246	212	495	450
74	70	91	80	128	109	246	212	495	450
0	0	0	0	0	0	0	0	0	0
15,387	**14,171**	**8,418**	**8,768**	**16,561**	**15,266**	**15,115**	**16,781**	**35,433**	**43,589**
16,735	14,440	8,219	8,191	16,022	15,086	16,082	16,914	37,716	45,448
2,729	1,617	1,171	733	1,511	1,542	3,986	2,831	11,393	9,570
14,006	**12,824**	**7,048**	**7,458**	**14,511**	**13,544**	**12,097**	**14,082**	**26,323**	**35,878**

3. Federal Reserve Open Market Transactions, 1993[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	0	0	121
Gross sales	0	0	0	0
Exchanges	24,542	19,832	23,796	30,124
Redemptions	0	0	0	0
Others within 1 year				
Gross purchases	0	0	279	244
Gross sales	0	0	0	0
Maturity shift	561	2,892	4,303	1,950
Exchanges	−1,202	−6,044	−2,602	−1,100
Redemptions	0	0	0	0
1 to 5 years				
Gross purchases	0	0	1,441	2,490
Gross sales	0	0	0	0
Maturity shift	−64	−2,617	−4,303	−1,630
Exchanges	882	4,564	2,602	800
5 to 10 years				
Gross purchases	0	0	716	1,147
Gross sales	0	0	0	0
Maturity shift	−497	−98	0	−320
Exchanges	0	1,000	0	300
More than 10 years				
Gross purchases	0	0	705	1,110
Gross sales	0	0	0	0
Maturity shift	0	−177	0	0
Exchanges	0	480	0	0
All maturities				
Gross purchases	0	0	3,141	5,111
Gross sales	0	0	0	0
Redemptions	0	0	0	0
Matched transactions				
Gross sales	114,543	111,491	146,563	127,115
Gross purchases	116,510	113,349	143,049	128,924
Repurchase agreements				
Gross purchases	34,768	28,544	37,815	30,197
Gross sales	42,231	25,889	33,714	36,953
Net change in U.S. Treasury securities	−5,497	4,513	3,728	163
FEDERAL AGENCY OBLIGATIONS				
Outright transactions				
Gross purchases	0	0	0	0
Gross sales	0	0	0	0
Redemptions	103	85	101	28
Repurchase agreements				
Gross purchases	2,237	1,107	1,811	197
Gross sales	2,868	832	1,519	764
Net change in agency obligations	−734	190	191	−595
Total net change in System Open Market Account	**−6,231**	**4,703**	**3,918**	**−431**

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.

3.—Continued

May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
349	7,280	0	902	366	1,396	5,931	1,394	17,737
0	0	0	0	0	0	0	0	0
26,610	24,821	35,943	27,775	31,128	25,783	27,641	30,836	328,829
0	0	0	0	0	468	0	0	468
0	0	0	100	411	0	0	189	1,223
0	0	0	0	0	0	0	0	0
4,108	4,002	0	1,497	3,074	913	5,158	2,910	0
–4,013	–2,152	0	–5,491	–1,861	–1,566	–7,641	–2,910	0
0	0	0	0	0	0	0	0	0
0	0	200	1,100	2,400	0	100	2,619	10,350
0	0	0	0	0	0	0	0	0
–3,652	–4,002	666	–834	–3,074	–31	–4,689	–2,910	–27,140
3,245	2,152	0	3,866	1,861	1,566	5,341	2,910	0
0	0	0	500	797	0	0	1,008	4,168
0	0	0	0	0	0	0	0	0
–333	0	–666	–432	0	–882	–272	0	0
468	0	0	1,100	0	0	2,300	0	0
0	0	0	100	717	0	0	826	3,457
0	0	0	0	0	0	0	0	0
–123	0	0	–231	0	0	–197	0	0
300	0	0	525	0	0	0	0	0
349	7,280	200	2,702	4,691	1,396	6,031	6,035	36,935
0	0	0	0	0	0	0	0	0
0	0	0	0	0	468	0	0	468
124,462	111,726	115,504	136,037	124,898	115,160	109,941	137,645	1,475,085
123,227	113,095	117,074	135,705	122,578	112,837	112,772	136,821	1,475,941
33,987	53,051	41,190	53,053	62,905	27,693	38,493	33,751	475,447
28,640	43,342	56,246	48,263	61,399	30,397	34,072	29,577	470,723
4,461	18,357	–13,286	7,160	3,878	–4,099	13,283	9,386	42,047
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
41	22	366	125	35	70	15	81	1,072
2,105	2,968	3,479	2,485	9,810	3,812	2,841	2,211	35,063
2,105	2,019	4,428	2,415	7,734	5,509	2,861	1,615	34,669
–41	927	–1,315	–55	2,041	–1,767	–35	515	–678
4,420	**19,284**	**–14,601**	**7,105**	**5,919**	**–5,866**	**13,248**	**9,901**	**41,368**

4. Federal Reserve Bank Holdings of U.S. Treasury and Federal Agency Securities, December 31, 1991–93[1]

Millions of dollars

Description	December 31			Change	
	1993	1992	1991	1992–93	1991–92
U.S. TREASURY SECURITIES					
Held outright[2]	**339,584**	**303,435**	**272,583**	**36,149**	**30,852**
By remaining maturity					
Bills					
1–91 days	90,186	79,988	74,888	10,198	5,100
92 days to 1 year	77,749	70,231	63,844	7,518	6,387
Notes and bonds					
1 year or less	35,423	37,758	30,542	−2,335	7,216
More than 1 year through 5 years	79,826	68,750	64,299	11,076	4,451
More than 5 years through 10 years	24,659	18,903	14,469	5,756	4,434
More than 10 years	31,739	27,805	24,540	3,934	3,265
By type					
Bills	167,936	150,219	138,732	17,717	11,487
Notes	132,076	118,179	101,520	13,897	16,659
Bonds	39,572	35,037	32,331	4,535	2,706
Repurchase agreements	**12,187**	**7,463**	**15,345**	**4,724**	**−7,882**
MSPs, foreign accounts	**7,568**	**8,424**	**6,097**	**−856**	**2,327**
MSPs, in the market	**0**	**0**	**0**	**0**	**0**
FEDERAL AGENCY SECURITIES					
Held outright[2]	**4,638**	**5,413**	**6,045**	**−775**	**−632**
By remaining maturity					
1 year or less	1,823	2,064	2,340	−241	−276
More than 1 year through 5 years	2,105	2,511	2,508	−406	3
More than 5 years through 10 years	569	696	1,008	−127	−312
More than 10 years	142	142	189	0	−47
By issuer					
Federal Farm Credit Banks	1,201	1,296	1,440	−95	−144
Federal Home Loan Banks	1,249	1,766	2,029	−517	−263
Federal Land Banks	66	66	66	0	0
Federal National Mortgage Association	2,005	2,167	2,342	−162	−175
U.S. Postal Service	0	0	37	0	−37
Washington Metropolitan Area Transit Authority	117	117	117	0	0
General Services Administration	0	0	12	0	−12
Repurchase agreements	**1,025**	**631**	**553**	**394**	**78**

1. Details may not sum to totals because of rounding. The categories have been revised since last year's REPORT.

2. Excludes the effects of temporary transactions—repurchase agreements and matched sale–purchase agreements (MSPs).

5. Number and Salaries of Officers and Employees of Federal Reserve Banks, December 31, 1993

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	177,600	62	6,004,850	1,190	214	46,884,828	1,467	53,067,278
New York	205,000	189	20,381,600	4,044	60	162,281,650	4,294	182,868,250
Philadelphia	184,500	60	5,439,000	1,304	58	40,315,639	1,423	45,939,139
Cleveland	165,500	50	4,861,030	1,279	69	39,172,150	1,399	44,198,680
Richmond	159,600	80	6,975,300	1,929	125	58,550,532	2,135	65,685,432
Atlanta	212,000	79	6,866,200	2,273	61	69,127,082	2,414	76,205,282
Chicago	221,700	103	9,228,200	2,392	55	82,937,284	2,551	92,387,184
St. Louis	190,900	51	4,099,300	1,055	105	32,122,551	1,212	36,412,751
Minneapolis	175,200	49	4,353,100	1,076	112	35,012,882	1,238	39,541,182
Kansas City	159,800	60	5,264,500	1,553	61	48,633,867	1,675	54,058,167
Dallas	161,500	58	5,062,804	1,480	52	46,868,099	1,591	52,092,403
San Francisco	229,600	96	9,865,313	2,364	74	86,783,392	2,535	96,878,305
Federal Reserve Automation Service		25	2,482,100	360	5	17,048,727	390	19,530,827
Total	**2,242,900**	**962**	**90,883,297**	**22,299**	**1,051**	**765,738,683**	**24,324**	**858,864,880**

6. Income and Expenses of Federal Reserve Banks, 1993

Dollars

Item[1]	Total	Boston	New York	Philadelphia	Cleveland
CURRENT INCOME					
Loans	5,564,193	75,142	784,389	269,540	181
U.S. Treasury and federal agency securities	16,890,720,955	1,014,558,922	6,128,066,220	598,122,497	1,105,592,400
Foreign currencies	1,249,248,686	44,484,936	362,139,604	48,088,241	72,384,137
Priced services	757,299,472	43,728,635	107,985,749	39,574,727	44,464,874
Other	11,417,269	331,696	7,835,815	213,306	229,592
Total	**18,914,250,574**	**1,103,179,331**	**6,606,811,777**	**686,268,311**	**1,222,671,184**
CURRENT EXPENSES					
Salaries and other personnel expenses	918,424,802	55,083,540	188,872,094	50,240,255	47,423,217
Retirement and other benefits[2]	123,643,287	15,560,945	52,377,963	14,879,105	13,098,353
Fees	30,598,366	3,065,541	3,622,890	885,679	1,663,506
Travel	44,266,367	2,353,408	5,890,137	2,258,335	2,462,776
Software expenses	42,818,464	1,917,492	8,006,978	2,049,311	1,955,385
Postage and other shipping costs	79,172,820	4,616,997	11,392,724	3,470,908	6,200,669
Communications	10,342,162	457,345	2,078,431	439,147	789,999
Materials and supplies	56,718,191	3,270,334	9,766,938	3,294,703	3,119,800
Building expenses					
Taxes on real estate	26,095,361	3,445,646	4,245,810	1,867,048	1,436,091
Property depreciation	44,102,286	3,311,943	7,445,546	2,004,877	1,745,684
Utilities	32,184,538	2,567,002	6,524,026	2,856,679	1,840,594
Rent	26,654,949	654,085	13,817,274	366,110	343,016
Other	23,995,451	752,127	4,518,651	1,205,779	838,200
Equipment					
Purchases	8,642,796	261,294	1,552,210	415,939	247,956
Rentals	29,006,750	913,164	5,262,208	801,363	888,906
Depreciation	118,576,407	4,827,820	20,272,801	4,404,454	5,556,610
Repairs and maintenance	61,670,630	3,629,508	11,313,329	2,674,606	3,655,485
Earnings-credit costs	182,588,684	11,330,964	41,389,736	23,892,111	10,756,841
Other	37,931,989	2,418,358	6,654,606	1,651,681	2,484,371
Shared costs, net[3]	0	1,178,016	(2,599,142)	4,903,908	4,294,432
Recoveries	(46,974,192)	(9,572,696)	(5,471,428)	(3,076,407)	(3,339,219)
Expenses capitalized[4]	(3,399,758)	(316,416)	(18,717)	(187,038)	(295,864)
Total	**1,847,060,349**	**111,726,417**	**396,915,065**	**121,298,553**	**107,166,808**
Reimbursements	(189,260,435)	(9,152,913)	(39,459,321)	(20,096,109)	(17,177,478)
Net expenses	1,657,799,914	102,573,504	357,455,744	101,202,444	89,989,330

For notes see end of table.

6.—Continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
230,416	144,962	351,679	692,396	1,749,488	334,916	97,125	833,959
1,309,605,453	648,986,059	1,988,279,841	537,603,849	347,124,853	581,368,658	687,482,280	1,943,929,922
85,509,215	118,231,697	142,291,217	28,783,433	32,740,073	44,658,649	87,712,656	182,224,829
65,142,479	93,871,686	101,646,876	30,570,393	41,659,094	48,114,654	54,170,503	86,369,801
251,348	466,250	790,056	209,876	128,893	101,457	236,070	622,909
1,460,738,911	**861,700,654**	**2,233,359,669**	**597,859,947**	**423,402,401**	**674,578,334**	**829,698,634**	**2,213,981,421**
91,935,994	85,184,076	97,304,524	40,174,380	43,306,573	58,186,606	56,339,181	104,374,362
23,657,995	24,418,047	26,957,750	11,825,720	10,512,847	17,831,515	15,540,235	28,333,072
13,941,639	1,197,813	1,231,198	663,097	1,525,252	496,466	994,598	1,310,687
5,522,976	4,602,075	5,451,591	2,064,642	2,727,575	3,003,613	2,876,279	5,052,960
12,395,381	1,972,904	4,566,038	1,761,629	2,142,749	1,163,537	1,150,954	3,736,106
7,432,219	10,530,374	9,497,409	3,975,228	5,814,473	6,012,414	4,383,275	5,846,130
936,681	1,318,703	931,954	598,118	499,649	818,655	861,461	612,019
6,884,473	5,985,768	6,084,905	3,408,515	2,431,160	3,267,861	3,413,271	5,790,463
2,184,823	1,668,282	3,876,771	481,137	865,808	843,395	2,572,993	2,607,557
4,707,131	3,265,448	4,808,628	2,022,685	1,149,274	3,145,825	4,719,212	5,776,033
3,045,710	2,420,586	2,533,702	1,634,318	1,046,076	1,602,171	2,508,107	3,605,567
5,429,269	2,053,958	1,977,958	422,803	752,589	327,913	163,835	346,139
2,730,934	2,489,320	5,228,823	805,944	687,548	854,559	1,784,191	2,099,375
848,098	866,100	1,065,739	260,369	1,114,640	351,573	742,502	916,376
1,866,166	2,305,213	9,964,700	672,247	970,110	2,074,696	1,098,794	2,189,183
40,635,291	7,747,233	11,869,680	3,320,756	4,015,268	2,472,037	4,203,869	9,250,588
7,655,027	6,695,941	10,234,537	2,019,383	3,028,852	1,969,669	2,664,934	6,129,359
10,500,338	8,436,001	32,414,846	3,602,738	3,944,819	8,588,564	7,932,378	19,799,348
4,258,019	4,424,451	4,688,365	1,727,848	1,690,120	2,298,782	2,559,203	3,076,185
(27,826,938)	2,847,825	(6,956,708)	4,570,892	(870,118)	6,734,630	10,267,831	3,455,372
(9,324,124)	(2,569,051)	(3,091,860)	(1,518,036)	(833,480)	(704,234)	(3,468,669)	(4,004,988)
(895,734)	(323,383)	(149,290)	(59,088)	(333,731)	(657,274)	(135,188)	(28,035)
208,521,368	**177,537,684**	**230,491,260**	**84,435,325**	**86,188,053**	**120,682,973**	**123,173,246**	**210,273,858**
(12,548,330)	(14,054,507)	(19,478,772)	(10,541,249)	(8,783,775)	(13,066,460)	(9,317,353)	(15,584,168)
195,973,038	163,483,177	211,012,488	73,894,076	77,404,278	107,616,513	113,855,892	194,689,690

6. Income and Expenses of Federal Reserve Banks, 1993—Continued

Dollars

Item[1]	Total	Boston	New York	Philadelphia	Cleveland
PROFIT AND LOSS					
Current net income	17,256,450,656	1,000,605,827	6,380,706,293	585,065,867	1,132,681,854
Additions to and deductions from current net income[5]					
Profit on sales of U.S. Treasury and federal agency securities	38,910,354	2,362,418	14,033,132	1,372,820	2,556,007
Net profit on foreign exchange transactions	265,499,308	9,425,225	76,941,700	10,195,173	15,319,310
Other additions	179,019	1,803	74,740	14,126	13,958
Total additions	304,588,682	11,789,446	91,049,572	11,582,120	17,889,275
Total deductions[6]	(505,508,552)	(32,979,239)	(96,561,073)	(33,108,635)	(30,269,967)
Net additions to or deductions (–) from current net income	(200,919,870)	(21,189,793)	(5,511,501)	(21,526,515)	(12,380,692)
Cost of unreimbursed Treasury services	29,348,049	1,157,577	3,139,404	1,634,962	1,685,404
Assessments by Board					
Board expenditures[7]	140,465,600	5,006,300	40,674,400	5,218,700	8,215,500
Cost of currency	355,947,291	20,988,078	116,794,492	12,787,760	23,192,101
Net income before payment to U.S. Treasury	16,529,769,846	952,264,079	6,214,586,496	543,897,930	1,087,208,158
Dividends paid	195,422,234	7,076,855	55,967,417	6,873,347	12,010,618
Payments to U.S. Treasury (interest on Federal Reserve notes)	15,986,764,712	930,501,974	6,074,995,179	540,619,683	1,027,887,290
Transferred to surplus	347,582,900	14,685,250	83,623,900	(3,595,100)	47,310,250
Surplus, January 1	3,053,622,100	108,310,750	885,020,600	117,317,900	176,218,550
Surplus, December 31	3,401,205,000	122,996,000	968,644,500	113,722,800	223,528,800

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 $131,350,260.
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. See the extract on pp. 290–91 for correction to last year's data.
6. Includes initial accrual of postretirement employee benefits required by the adoption of the Statement of Financial Accounting Standards (SFAS) No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." The effect of SFAS 106 on the Reserve Banks was ($503,725,767).
7. For additional details, see the last four pages of the preceding section: Board of Governors, Financial Statements.

6 — Continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
1,264,765,873	698,217,478	2,022,347,181	523,965,870	345,998,122	566,961,821	715,842,741	2,019,291,730
3,037,703	1,492,373	4,626,090	1,225,942	790,987	1,327,376	1,582,614	4,502,890
18,266,352	25,195,884	30,081,072	6,079,934	6,956,082	9,451,775	18,425,652	39,161,148
4,334	9,217	13,264	67	29,654	46	10,417	7,393
21,308,390	26,697,474	34,720,426	7,305,944	7,776,723	10,779,197	20,018,683	43,671,431
(36,520,950)	(45,491,325)	(55,108,616)	(31,391,290)	(20,924,316)	(40,079,091)	(29,448,056)	(53,625,994)
(15,212,560)	(18,793,851)	(20,388,189)	(24,085,346)	(13,147,593)	(29,299,894)	(9,429,373)	(9,954,563)
2,875,705	3,084,435	3,073,702	1,774,207	1,890,219	2,402,305	2,370,626	4,259,504
9,619,500	13,209,600	15,939,100	3,186,600	3,739,300	5,031,000	9,932,200	20,693,400
29,323,293	16,958,398	37,898,065	14,141,071	8,021,270	14,773,237	16,563,299	44,506,227
1,207,734,815	646,171,194	1,945,048,124	480,778,646	319,199,740	515,455,385	677,547,243	1,939,878,036
13,061,399	18,375,321	22,248,839	4,292,762	5,321,308	7,103,256	14,333,677	28,757,435
1,176,241,766	597,512,673	1,879,027,386	472,141,134	303,003,282	489,172,679	629,121,366	1,866,540,300
18,431,650	30,283,200	43,771,900	4,344,750	10,875,150	19,179,450	34,092,200	44,580,300
210,062,000	289,640,200	346,093,200	69,932,250	79,968,800	108,819,900	211,943,300	450,294,650
228,493,650	319,923,400	389,865,100	74,277,000	90,843,950	127,999,350	246,035,500	494,874,950

Errata *79th Annual Report, 1992*

The portion of table 6 on pp. 272–73 of the 1992 REPORT covering "Additions to and deductions from current net income" contains incorrect data. The corrected data appear in bold type in the excerpt below.

6. Income and Expenses of Federal Reserve Banks, 1992—Continued

Dollars

Item	Total	Boston	New York	Philadelphia	Cleveland
Additions to and deductions from current net income					
Profit on sales of U.S. Treasury and federal agency securities	**121,119,028**	**7,919,191**	**47,361,641**	**3,494,576**	**7,605,686**
Other additions	**518,036**	**336,269**	**39,331**	**9,953**	**4,203**
Total additions	**121,637,064**	8,255,461	47,400,973	3,504,528	7,609,888
Net loss on foreign exchange transactions	**(1,078,709,567)**	**(39,804,383)**	**(313,796,613)**	**(42,716,899)**	**(65,585,542)**
Other deductions	**(2,003,418)**	**(74,297)**	**(729,155)**	**(54,974)**	**(10,279)**
Total deductions	**(1,080,712,986)**	(39,878,680)	(314,525,769)	(42,771,873)	(65,595,821)
Net additions to or deductions (–) from current net income	(959,075,922)	(31,623,219)	(267,124,796)	(39,267,344)	(57,985,932)

6.—Errata, continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
9,514,182	**4,094,691**	**15,087,036**	**3,059,936**	**1,760,568**	**3,308,309**	**4,565,278**	**13,347,935**
11,215	**3,353**	**1,612**	**4,818**	**91,948**	**6,055**	**4,244**	**5,036**
9,525,397	4,098,044	15,088,647	**3,064,754**	1,852,516	3,314,363	4,569,522	13,352,971
(69,361,025)	**(98,809,796)**	**130,523,858)**	**(26,644,126)**	**(28,370,062)**	**(40,451,609)**	**(86,081,023)**	**(136,564,631)**
(120,020)	**(92,463)**	**(34,020)**	**(10,180)**	**(117,722)**	**(440,742)**	**(36,341)**	**(283,224)**
(69,481,045)	(98,902,259)	(130,557,878)	**(26,654,306)**	(28,487,784)	(40,892,351)	(86,117,364)	(136,847,856)
(59,955,648)	(94,804,215)	(115,469,230)	(23,589,553)	(26,635,268)	(37,577,988)	(81,547,843)	(123,494,885)

7. Income and Expenses of Federal Reserve Banks, 1914–93[1]

Dollars

Federal Reserve Bank and period	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.

Dividends paid	Payments to U.S. Treasury			Transferred to surplus (section 13b)	Transferred to surplus (section 7)
	Franchise tax	Under section 13b	Interest on Federal Reserve notes		
217,463	. . .	. . .	. . .	. . .	. . .
1,742,775	. . .	. . .	. . .	. . .	. . .
6,804,186	1,134,234	. . .	. . .	. . .	1,134,234
5,540,684	. . .	. . .	. . .	. . .	48,334,341
5,011,832	2,703,894	. . .	. . .	. . .	70,651,778
5.654,018	60,724,742	. . .	. . .	. . .	82,916,014
6,119,673	59,974,466	. . .	. . .	. . .	15,993,086
6,307,035	10,850,605	. . .	. . .	. . .	–659,904
6.552.717	3.613.056	. . .	. . .	. . .	2,545,513
6,682,496	113,646	. . .	. . .	. . .	–3,077,962
6,915,958	59,300	. . .	. . .	. . .	2,473,808
7,329,169	818,150	. . .	. . .	. . .	8,464,426
7,754,539	249,591	. . .	. . .	. . .	5,044,119
8,458,463	2,584,659	. . .	. . .	. . .	21,078,899
9,583,911	4,283,231	. . .	. . .	. . .	22,535,597
10,268,598	17,308	. . .	. . .	. . .	–2,297,724
10,029,760	. . .	. . .	. . .	. . .	–7,057,694
9,282,244	2,011,418	. . .	. . .	. . .	11,020,582
8,874,262	. . .	. . .	. . .	. . .	–916,855
8,781,661	. . .	. . .	. . .	–60,323	6,510,071
8,504,974	. . .	297,667	. . .	27,695	607,422
7,829,581	. . .	227,448	. . .	102,880	352,524
7,940,966	. . .	176,625	. . .	67,304	2,616,352
8,019,137	. . .	119,524	. . .	–419,140	1,862,433
8,110,462	. . .	24,579	. . .	–425,653	4,533,977
8,214,971	. . .	82,152	. . .	–54,456	17,617,358
8,429,936	. . .	141,465	. . .	–4,333	570,513
8,669,076	. . .	197,672	. . .	49,602	3,554,101
8,911,342	. . .	244,726	. . .	135,003	40,327,237
9,500,126	. . .	326,717	. . .	201,150	48,409,795
10,182,851	. . .	247,659	. . .	262,133	81,969,625
10,962,160	. . .	67,054	. . .	27,708	81,467,013
11,523,047	. . .	35,605	75,283,818	86,772	8,366,350
11,919,809	. . .	. . .	166,690,356	. . .	18,522,518
12,329,373	. . .	. . .	193,145,837	. . .	21,461,770
13,082,992	. . .	. . .	196,628,858	. . .	21,849,490
13,864,750	. . .	. . .	254,873,588	. . .	28,320,759
14,681,788	. . .	. . .	291,934,634	. . .	46,333,735
15,558,377	. . .	. . .	342,567,985	. . .	40,336,862
16,442,236	. . .	. . .	276,289,457	. . .	35,887,775
17,711,937	. . .	. . .	251,740,721	. . .	32,709,794
18,904,897	. . .	. . .	401,555,581	. . .	53,982,682
20,080,527	. . .	. . .	542,708,405	. . .	61,603,682
21,197,452	. . .	. . .	524,058,650	. . .	59,214,569
22,721,687	. . .	. . .	910,649,768	. . .	–93,600,791
23,948,225	. . .	. . .	896,816,359	. . .	42,613,100
25.569,541	. . .	. . .	687,393,382	. . .	70,892,300
27,412,241	. . .	. . .	799,365,981	. . .	45,538,200
28,912,019	. . .	. . .	879,685,219	. . .	55,864,300
30,781,548	. . .	. . .	1,582,118,614	. . .	–465,822,800
32,351,602	. . .	. . .	1,296,810,053	. . .	27,053,800
33,696,336	. . .	. . .	1,649,455,164	. . .	18,943,500
35,027,312	. . .	. . .	1,907,498,270	. . .	29,851,200
36,959,336	. . .	. . .	2,463,628,983	. . .	30,027,250
39,236,599	. . .	. . .	3,019,160,638	. . .	39,432,450

7. Income and Expenses of Federal Reserve Banks, 1914–93—Continued

Dollars

Federal Reserve Bank and period	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
1992	20,235,027,938	1,474,530,523	(959,075,921)	128,955,300	295,400,692
1993	18,914,250,574	1,657,799,914	(200,919,870)	140,465,600	355,947,291
Total, 1914–93	**345,938,644,285**	**24,985,375,340**	**4,832,520,986**	**1,843,398,508**	**3,248,226,064**
Aggregate for each Bank, 1914–93					
Boston	18,613,420,920	1,639,334,224	155,627,514	67,082,986	197,265,169
New York	107,548,933,556	5,012,056,041	1,356,577,841	490,173,186	936,268,463
Philadelphia	13,225,644,800	1,359,916,750	205,290,910	86,203,818	132,025,678
Cleveland	22,731,714,462	1,614,879,766	217,242,707	130,716,190	205,468,574
Richmond	27,414,783,831	2,079,903,128	271,921,382	102,915,176	292,233,490
Atlanta	14,826,850,937	2,252,713,406	440,233,955	148,880,760	177,181,330
Chicago	47,871,002,837	3,254,187,995	593,806,937	249,781,772	429,784,923
St. Louis	11,292,498,289	1,279,601,235	107,009,268	54,212,872	115,753,225
Minneapolis	6,318,691,261	1,174,727,956	147,156,772	53,877,715	59,267,890
Kansas City	14,045,187,169	1,612,710,483	176,301,137	76,058,509	139,051,995
Dallas	18,714,096,795	1,515,667,037	408,499,610	125,663,173	176,558,810
San Francisco	43,335,819,429	2,701,371,440	752,852,952	257,832,351	387,366,517
Total	**345,938,644,285**	**24,985,375,340**[4]	**4,832,520,986**	**1,843,398,508**	**3,248,226,064**

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 $3,529,877,199 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 $3,401,204,998 on December 31, 1993.
4. See note 2, table 6.

7.—Continued

Dividends paid	Payments to U.S. Treasury			Transferred to surplus (section 13b)	Transferred to surplus (section 7)
	Franchise tax	Under section 13b	Interest on Federal Reserve notes		
41,136,551	...	...	3,493,570,636	...	32,579,700
43,488,074	...	...	3,356,559,873	...	40,403,250
46,183,719	...	...	3,231,267,663	...	50,661,000
49,139,682	...	...	4,340,680,482	...	51,178,300
52,579,643	...	...	5,549,999,411	...	51,483,200
54,609,555	...	...	5,382,064,098	...	33,827,600
57,351,487	...	...	5,870,463,382	...	53,940,050
60,182,278	...	...	5,937,148,425	...	45,727,650
63,280,312	...	...	7,005,779,497	...	47,268,200
67,193,615	...	...	9,278,576,140	...	69,141,200
70,354,516	...	...	11,706,369,955	...	56,820,950
74,573,806	...	...	14,023,722,907	...	76,896,650
79,352,304	...	...	15,204,590,947	...	78,320,350
85,151,835	...	...	14,228,816,297	...	106,663,100
92,620,451	...	...	16,054,094,674	...	161,995,900
103,028,905	...	...	17,796,464,292	...	155,252,950
109,587,968	...	...	17,803,894,710	...	91,954,150
117,499,115	...	...	17,738,879,542	...	173,771,400
125,616,018	...	...	17,364,318,571	...	64,971,100
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
171,762,924	...	...	16,774,476,500	...	402,114,350
195,422,234	...	...	15,986,764,712	...	347,582,900
2,950,412,027	**149,138,300**	**2,188,893**	**313,770,870,360**	**(3,657)**	**3,529,877,199**[3]
118,157,958	7,111,395	280,843	16,593,044,628	135,411	133,090,825
808,430,647	68,006,262	369,116	101,056,342,370	(433,412)	1,055,801,071
149,140,400	5,558,901	722,406	11,535,384,767	290,661	128,053,022
221,463,390	4,842,447	82,930	20,506,402,265	(9,906)	236,762,593
159,849,550	6,200,189	172,493	24,789,464,998	(71,517)	234,373,458
223,669,318	8,950,561	79,264	12,106,937,089	5,491	325,189,940
393,168,780	25,313,526	151,045	43,677,063,350	11,682	405,193,854
88,382,056	2,755,629	7,464	9,764,663,347	(26,515)	79,396,628
83,061,582	5,202,900	55,615	4,981,452,579	64,874	94,721,163
119,766,409	6,939,100	64,213	12,113,664,108	(8,674)	132,139,300
191,229,424	560,049	102,083	16,846,432,420	55,337	250,312,978
394,092,512	7,697,341	101,421	39,800,018,437	(17,089)	504,742,367
2,950,412,027	**149,138,300**	**2,188,893**	**313,770,870,360**	**(3,657)**	**3,529,877,199**

8. Acquisition Costs and Net Book Value of Premises of Federal Reserve Banks and Branches, December 31, 1993[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	86,118,643	5,919,179	114,111,322	90,943,976	...
NEW YORK	20,354,440	99,526,036	43,528,039	163,408,514	136,215,094	...
Buffalo	887,844	2,775,173	2,767,406	6,430,424	4,136,601	...
PHILADELPHIA	2,251,556	55,497,145	5,903,704	63,652,405	47,217,109	...
CLEVELAND	1,074,281	11,606,243	6,969,480	19,650,005	13,906,160	1,224,363
Cincinnati	2,246,599	13,752,555	8,235,221	24,234,375	11,562,935	...
Pittsburgh	1,658,376	9,535,710	4,347,570	15,541,656	11,904,502	...
RICHMOND	5,812,396	80,449,462	18,295,193	104,557,050	77,796,619	...
Baltimore	6,476,335	26,826,903	3,842,189	37,145,427	28,948,142	...
Charlotte	3,129,645	27,402,251	4,737,485	35,269,381	31,873,809	...
ATLANTA	1,209,360	14,312,239	4,319,451	19,841,050	14,928,470	13,086,575
Birmingham	3,197,830	1,905,770	1,303,037	6,406,637	4,449,752	...
Jacksonville	1,665,439	16,395,261	2,863,295	20,923,995	18,419,483	951,603
Miami	3,717,791	12,099,721	2,706,338	18,523,850	14,000,195	...
Nashville	592,342	1,474,678	2,219,668	4,286,688	2,107,059	...
New Orleans	3,087,693	4,549,849	2,598,505	10,236,047	7,207,467	283,753
CHICAGO	4,565,008	113,070,421	19,226,634	136,862,063	105,034,915	...
Detroit	797,734	4,431,451	5,120,023	10,349,208	8,344,944	...
ST. LOUIS	700,378	15,832,985	5,298,206	21,831,569	18,601,949	...
Little Rock	1,148,492	2,080,669	1,003,022	4,232,183	3,220,696	...
Louisville	700,075	2,907,002	1,131,238	4,738,315	3,815,201	...
Memphis	1,135,623	4,216,382	2,280,473	7,632,478	5,222,711	...
MINNEAPOLIS	1,394,384	33,252,859	7,851,532	42,498,775	24,445,460	...
Helena	1,954,514	9,042,980	501,857	11,499,351	10,867,325	...
KANSAS CITY	1,829,420	16,015,019	11,638,819	29,483,258	21,760,171	149,948
Denver	3,187,962	4,625,568	3,185,925	10,999,455	8,194,847	...
Oklahoma City	646,386	4,296,538	861,305	5,804,229	4,264,366	...
Omaha	6,534,583	10,987,009	1,401,083	18,922,675	16,723,865	1,412,500
DALLAS	29,102,860	108,688,568	11,969,538	149,760,966	145,766,078	10,533,831
El Paso	262,477	1,662,527	404,946	2,329,950	2,134,716	...
Houston	2,205,500	3,631,039	1,150,965	6,987,504	6,562,297	...
San Antonio	482,284	2,610,854	1,626,589	4,719,728	3,732,234	...
SAN FRANCISCO	15,599,928	67,895,364	17,887,493	101,382,785	79,582,418	...
Los Angeles	3,891,887	51,200,999	8,842,898	63,935,784	54,684,516	...
Portland	415,924	5,163,133	1,776,067	7,355,124	6,685,697	126,444
Salt Lake City	494,556	4,619,366	2,441,387	7,555,310	5,504,171	...
Seattle	324,772	2,918,056	2,573,283	5,816,111	4,418,652	...
Total	**156,810,174**	**933,376,429**	**228,729,045**	**1,318,915,647**	**1,055,184,604**	**27,769,016**

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.

9 Operations in Principal Departments of Federal Reserve Banks, 1990–93

Operation	1993	1992	1991	1990
Millions of pieces (except as noted)				
Loans (thousands)	6	8	11	15
Currency received and counted	20,768	20,166	19,711	19,462
Currency verified and destroyed	7,376	7,506	6,254	6,561
Coin received and counted	7,690	8,660	9,462	12,072
Checks handled				
U.S. government checks	480	493	503	547
Postal money orders	192	181	166	162
All other	19,009	19,053 r	18,743	18,595
Issues, redemptions, and exchanges of U.S. Treasury and federal agency securities	79	77 r	52	44
Transfer of funds	70	68	65	63
Automated clearinghouse transactions				
Commercial [1]	1,545	1,327	1,119	915
Government	555	531	521	520
Food stamps redeemed	4,198	4,183	3,439	2,875
Millions of dollars				
Loans	20,760	29,427	64,597	194,538
Currency received and counted	290,989	277,681	265,473	252,430
Currency verified and destroyed	79,599	96,744	77,496	65,863
Coin received and counted	1,143	1,275	1,354	1,734
Checks handled				
U.S. government checks	534,236	588,311	610,106	623,008
Postal money orders	22,207	20,188	17,716	16,485
All other	14,066,518	13,241,785	12,164,175	12,514,201
Issues, redemptions, and exchanges of U.S. Treasury and federal agency securities	151,042,782	142,761,160 r	119,114,811	102,332,172
Transfer of funds	207,629,814	199,175,034	192,254,895	199,067,200
Automated clearinghouse transactions				
Commercial [1]	7,862,307	7,597,811	6,188,185	4,173,667
Government	885,011	859,774	723,426	486,809
Food stamps redeemed	21,661	21,452	17,888	14,517

1. Data for years preceding 1991 do not include items sent to the Reserve Banks by the New York Automated Clearing House.

r Revised.

10. Federal Reserve Bank Interest Rates, December 31, 1993

Bank	Loans to depository institutions			
	Adjustment credit [1]	Seasonal credit [2]	Extended credit [3]	
			First 30 days of borrowing	After 30 days of borrowing [4]
All Federal Reserve Banks	3.0	3.1	3.0	3.6

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.

2. 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. The discount rate on seasonal credit takes into account rates on market sources of funds and ordinarily is reestablished on the first business day of each two-week reserve maintenance period; however, it is never lower than the discount rate applicable to adjustment credit. See section 201.3(b)(1) of Regulation A.

3. 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(c) of Regulation A.

4. Extended-credit loans outstanding more than thirty days ordinarily will be charged a flexible rate somewhat above rates on market sources of funds; however, the rate will always be at least fifty basis points above the discount rate applicable to adjustment credit. In no case will the rate be less than the basic discount rate plus fifty 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 flexible rate may be charged on extended-credit loans that are outstanding less than thirty days.

11. Reserve Requirements of Depository Institutions[1]

Type of deposit[2]	Requirements	
	Percent of deposits	Effective date
Net transaction accounts[3]		
$0 million–$51.9 million	3	12/21/93
More than $51.9 million[4]	10	12/21/93
Nonpersonal time deposits[5]	0	12/27/90
Eurocurrency liabilities[6]	0	12/27/90

1. Reserve requirements in effect on December 31, 1993. 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 Act 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 December 21, 1993, the exemption was raised from $3.8 million to $4.0 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 may 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 December 21, 1993 for institutions reporting quarterly and weekly, the amount was increased from $46.8 million to $51.9 million.

4. The reserve requirement was reduced from 12 percent to 10 percent on April 2, 1992, for institutions that report weekly, and on April 16, 1992, for institutions that report quarterly.

5. 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 December 13, 1990, and to zero for the maintenance period that began December 27, 1990. The reserve requirement on nonpersonal time deposits with an original maturity of 1½ years or more has been zero since October 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 January 17, 1991.

6. The reserve requirement on Euroccurency liabilities was reduced from 3 percent to zero in the same manner and on the same dates as was the reserve requirement on nonpersonal time deposits with an original maturity of less than 1½ years (see note 4).

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 value 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 October 15, 1934; Regulation U, effective May 1, 1936; Regulation G, effective March 11, 1968; and Regulation X, effective November 1, 1971.

On January 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 September 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 October 1, 1934, to October 31, 1937, the requirement was the margin "customarily required" by the brokers and dealers.

13. Principal Assets and Liabilities and Number of Insured Commercial Banks, by Class of Bank, June 30, 1993 and 1992[1]

Asset and liability items shown in millions of dollars

Item	Total	Member banks			Nonmember banks
		Total	National	State	
	June 30, 1993				
Loans and investments	2,589,765	1,887,748	1,469,708	418,041	702,016
Gross loans	1,829,457	1,348,320	1,066,867	281,453	481,137
Net loans	1,822,977	1,344,351	1,064,062	280,289	478,626
Investments	760,308	539,428	402,841	136,587	220,880
U.S. Treasury and federal agency securities	620,719	445,135	335,555	109,579	175,585
Other	139,589	94,294	67,286	27,008	45,295
Cash assets, total	184,607	143,027	111,514	31,513	41,580
Deposits, total	2,331,857	1,679,272	1,320,636	358,636	652,585
Interbank	45,538	37,536	27,669	9,867	8,002
Other transaction	742,464	549,842	432,025	117,817	192,623
Other nontransaction	1,832,239	1,294,118	1,025,163	268,955	538,122
Equity capital	276,357	202,248	155,024	47,224	74,109
Number of banks	11,126	4,404	3,435	969	6,722
	June 30, 1992				
Loans and investments	2,483,478	1,796,867	1,440,629	356,238	686,611
Gross loans	1,796,571	1,319,239	1,072,473	246,766	477,332
Net loans	1,788,168	1,314,068	1,068,465	245,603	474,101
Investments	686,907	477,628	368,156	109,473	209,279
U.S. Treasury and federal agency securities	549,316	386,440	300,159	86,281	162,876
Other	137,591	91,188	67,996	23,192	46,403
Cash assets, total	189,611	147,732	119,426	28,306	41,879
Deposits, total	2,316,586	1,661,042	1,344,573	316,468	655,544
Interbank	48,504	41,429	30,236	11,193	7,076
Other demand	669,361	493,488	396,539	96,948	175,874
Other time and savings	1,855,420	1,303,164	1,064,842	238,322	552,256
Equity capital	243,062	174,420	136,404	38,016	68,642
Number of banks	11,598	4,634	3,686	948	6,964

1. All insured commercial banks in the United States.
Details may not sum to totals because of rounding.

14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–93, and Month-End 1993[1]

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

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

14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–93 and Month-End 1993[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[11]	Held under repurchase agreement[12]								
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
1992	308,518	300,424	8,094	675	3,350	0	30,278	342,820	11,056	8,018	21,503
1993	349,865	336,653	13,212	94	909	0	33,394	384,262	11,053	8,018	22,053

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			
260,453	450	6,217	589	1,298	0	1,626	8,486	36,701	n.a.	n.a.	n.a.
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			
334,757	508	7,492	206	372	0	5,901	7,984	26,178			
365,229	377	14,809	386	397	0	6,336	9,292	28,285			

14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–93, and Month-End 1993[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[11]	Held under repurchase agreement[12]								
1993											
Jan.	302,287	302,287	0	35	226	0	30,578	333,126	11,055	8,018	21,490
Feb.	306,990	304,060	2,930	57	784	0	29,865	337,696	11,055	8,018	21,528
Mar.	310,907	303,584	7,323	753	337	0	31,450	343,447	11,054	8,018	21,578
Apr.	310,476	310,476	0	84	735	0	32,627	343,922	11,054	8,018	21,629
May	314,895	309,548	5,347	129	115	0	32,002	347,141	11,053	8,018	21,674
June	334,180	318,175	16,005	1,534	221	0	32,989	368,924	11,057	8,018	21,711
July	319,578	319,578	0	234	539	0	31,731	352,082	11,057	8,018	21,748
Aug.	326,684	321,824	4,860	236	850	0	31,428	359,198	11,057	8,018	21,808
Sept.	332,603	324,161	8,442	2,918	74	0	33,089	368,684	11,057	8,018	21,871
Oct.	326,736	322,695	4,041	145	502	0	32,857	360,240	11,056	8,018	21,927
Nov.	339,965	331,523	8,442	55	643	0	31,186	371,849	11,054	8,018	21,983
Dec.	349,865	336,653	13,212	94	909	0	33,394	384,262	11,053	8,018	22,053

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 in 1960, figures reflect a minor change in concept; see *Federal Reserve Bulletin*, vol. 47 (February 1961), p. 164.

3. Principally acceptances and, until August 21, 1959, industrial loans, authority for which expired on that date.

4. For the period before April 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 January 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 November 13, 1980, includes reserves of all depository institutions.

9. Between December 1, 1959, and November 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 date was December 29). Beginning on September 12, 1968, the amount is based on close-of-business figures for the reserve period two weeks before the report date.

14.—Continued

Factors absorbing reserve funds												
		Deposits, other than reserves, with Federal Reserve Banks						Member bank reserves [8]				
Currency in circulation	Treasury cash holdings [7]	Treasury	Foreign	Other	Other Federal Reserve accounts [4]	Required clearing balances	Other Federal Reserve liabilities and capital [4]	With Federal Reserve Banks	Currency and coin [9]	Required [10]	Excess [10,13]
326,573	508	9,572	244	282	0	5,881	9,141	21,652			
329,621	463	5,350	296	302	0	6,005	9,180	27,080			
332,822	515	6,752	318	314	0	5,904	8,844	28,629			
335,907	505	7,273	221	291	0	5,849	291	24,730			
340,856	489	5,787	194	300	0	6,111	9,263	24,888			
344,123	432	28,386	286	297	0	6,046	8,705	21,132			
346,113	386	5,818	284	232	0	6,145	9,349	24,580	n.a.	n.a.	n.a.
349,169	383	7,975	187	272	0	5,922	10,164	26,009			
351,530	384	17,289	501	306	0	6,017	9,687	23,917			
352,815	379	6,032	390	325	0	6,094	8,879	26,329			
359,697	370	6,334	596	297	0	6,157	9,561	29,893			
365,229	377	14,809	386	397	0	6,336	9,292	28,285			

11. 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.

12. Beginning December 1, 1966, includes federal agency obligations held under repurchase agreements and beginning September 29, 1971, includes federal agency issues bought outright.

13. Beginning with week ending November 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 November 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 December 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 November 19, 1975.

15. Changes in Number of Banking Offices in the United States, 1993[1]

Type of office and change	Total	Commercial banks[2]						State-chartered savings banks[3]	
		Total	Member[4]			Nonmember			
			Total	National	State	Insured	Non-insured[5]	Insured	Non-insured
Banks, Dec. 31, 1992	12,118	11,689	4,608	3,641	967	6,815	266	429	0
Changes during 1993									
New banks	71	71	21	16	5	33	17	0	0
Ceased banking operation[6]	−92	−86	−57	−52	−5	−22	−7	−6	0
Banks converted into branches[7]	−484	−470	−225	−191	−34	−245	0	−14	0
Other[8]	97	8	−9	−54	45	15	2	89	0
Net change	−408	−477	−270	−281	11	−219	12	69	0
Banks, Dec. 31, 1993	**11,710**	**11,212**	**4,338**	**3,360**	**978**	**6,596**	**278**	**498**	**0**
Branches and additional offices, Dec. 31, 1992	55,006	52,218	35,213	27,956	7,257	16,924	81	2,788	0
Changes during 1993									
De novo	1,732	1,499	1,017	805	212	478	4	233	0
Banks converted into branches	484	473	311	263	48	162	0	11	0
Discontinued	−1,287	−1,215	−1,004	−886	−118	−208	−3	−72	0
Other[8]	86	74	27	22	5	47	0	12	0
Net change[8]	1,015	831	351	204	147	479	1	184	0
Branches and additional offices, Dec. 31, 1993	**56,021**	**53,049**	**35,564**	**28,160**	**7,404**	**17,403**	**82**	**2,972**	**0**

1. Preliminary. Final data will be available in the *Annual Statistical Digest, 1993*, forthcoming.
2. Includes nondeposit trust companies, private banks, industrial banks, and nonbank banks. Member institutions are those that are members of the Federal Reserve System.
3. Formerly called mutual savings banks.
4. As of Dec. 31, 1988, includes noninsured trust companies that are members of the Federal Reserve System.
5. Includes three workout national banks.
6. Includes five banks that converted to thrift institutions.
7. Includes three banks that converted to thrift institution branches.
8. Includes interclass changes and sale of branches.

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1993

BancFirst, Oklahoma City, Oklahoma *to merge with* **United Bank and Trust Company of Norman, Norman, Oklahoma**[1]

SUMMARY REPORT BY THE ATTORNEY GENERAL (1/22/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1/5/93)
The applicant has assets of $700 million; the target has assets of $33.7 million. The parties 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* **six branch offices of The First National Bank, Dayton, Ohio**

SUMMARY REPORT BY THE ATTORNEY GENERAL (2/12/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1/7/93)
The applicant has assets of $5.6 billion; the targets have assets of $117 million. The parties 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.

First Community Bank, Inc., Princeton, West Virginia *to merge with* **Peoples Bank of Richwood, Inc., Richwood, West Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (12/4/92) The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1/19/93)
The applicant has assets of $393 million; the target has assets of $32 million. The parties 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.

1. The institution or group of institutions named before the italicized words is referred to subsequently as the applicant, and the institution or group of institutions named after the italicized words is referred to subsequently as the target institution or target institutions.

Sun Bank/Gulf Coast, Sarasota, Florida *to acquire assets and liabilities of the* **Coast Bank, FSB, Sarasota, Florida**

SUMMARY REPORT BY THE ATTORNEY GENERAL (2/12/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (1/20/93)
The applicant has assets of $304 million; the target has assets of $1.2 billion. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Alice Bank of Texas, Alice, Texas *to merge with* **New First City Bank, Alice, Texas**

SUMMARY REPORT BY THE ATTORNEY GENERAL
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard the depositors of New First City Bank.[2]

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2/8/93)
The applicant has assets of $138 million; the target has assets of $106 million. The OCC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

Humboldt Bank, Eureka, California *to acquire assets and liabilities of the* **Arcata and McKinleyville branches of HomeFed Bank, F.A., San Diego, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL
Request for report dispensed with as authorized by the Bank Merger Act.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2/19/93)
The applicant has assets of $66 million; the targets have assets of $57 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

2. Hereafter, the entry for the summary report by the Attorney General will read, "Request for report dispensed with as authorized by the Bank Merger Act," for cases in which the Attorney General's report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard depositors.

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1993—Continued

Tri-City Bank and Trust Company, Blountville, Tennessee *to acquire assets and liabilities of the* **Rhea Parkway Branch of Home Federal Bank, FSB, Johnson City, Tennessee**

SUMMARY REPORT BY THE ATTORNEY GENERAL (2/26/93)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2/23/93)

The applicant) has assets of $198 million; the target has assets of $25.6 million. The parties 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.

First Interstate Bank of California, Los Angeles, California *to merge with* **HomeFed Bank, F.A., San Diego, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL (2/19/93)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2/25/93)

The applicant has assets of $20 billion; the target has assets of $149 million. The parties 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.

Farmers State Bank (formerly Jewell County Bank), Mankato, Kansas *to merge with* **Traders State Bank, Glen Elder, Kansas, and Tipton State Bank, Tipton, Kansas**

SUMMARY REPORT BY THE ATTORNEY GENERAL (2/26/93)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2/26/93)

The applicant has assets of $29 million; the target has assets of $21 million. The parties 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.

Fleet Bank of New York, New York, New York *to merge with* **Jefferson National Bank, Watertown, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL

Request for report dispensed with as authorized by the Bank Merger Act.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2/26/93)

The applicant has assets of $9.9 billion; the target has assets of $216 million. The OCC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

Shelby County State Bank, Shelbyville, Illinois *to merge with* **Bank of Findlay, Findlay, Illinois**

SUMMARY REPORT BY THE ATTORNEY GENERAL (1/22/93)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (03/09/93)

The applicant has assets of $76.9 million; the target has assets of $9.3 million. The parties 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 West Florida, St. Petersburg, Florida *to merge with* **Gulf Bank of Dunedin, Dunedin, Florida**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3/12/93)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/10/93)

The applicant has assets of $452 million; the target has assets of $41 million. The parties 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.

Central Bank of the South, Birmingham, Alabama *to merge with* **Altus Federal Savings Bank, Mobile, Alabama**

SUMMARY REPORT BY THE ATTORNEY GENERAL

Request for report dispensed with as authorized by the Bank Merger Act.

16.—Continued

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/22/93)
The applicant has assets of $5.1 billion; the target has assets of $12.6 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

PremierBank & Trust, Elyria, Ohio *to acquire assets and liabilities of* **one branch office of Home Savings of America, FSB, Irwindale, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3/12/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/26/93)
The applicant has assets of $489 million; the target has assets of $28 million. The parties 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.

Crestar Bank, Richmond, Virginia *to merge with* **Continental Federal Savings Bank, Fairfax, Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (2/26/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3/26/93)
The applicant has assets of $10 billion; the target has assets of $926 million. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Salamanca Trust Company, Salamanca, New York *to acquire assets and liabilities of the* **West Main Street branch of Chemical Bank, Allegheny, New York.**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3/26/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/9/93)
The applicant has assets of $49 million; the target has assets of $29.1 million. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Commonwealth Bank, Williamsport, Pennsylvania *to merge with* **Valley Community Bank, Kingston, Pennsylvania**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3/12/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/20/93)
The applicant has assets of $2.0 billion; the target has assets of $45.8 million. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Banco Popular de Puerto Rico, Hato Rey, Puerto Rico *to acquire the assets and liabilities of the* **Third Avenue branch of North Side Savings Bank, Bronx, New York, and four branches of Bank of Leumi Trust Company, New York, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3/26/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/30/93)
The applicant has assets of $9.5 billion; the targets have assets of $16.0 million and $14.8 million, respectively. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

California Center Bank, Los Angeles, California *to merge with* **Wilshire Center Bank, N.A., Los Angeles, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL
Request for report dispensed with as authorized by the Bank Merger Act.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (5/7/93)
The applicant has assets of $211 million; the target has assets of $9 million. The OCC has recom-

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1993—Continued

mended immediate action by the Federal Reserve System to prevent the probable failure of the target.

Rio Blanco State Bank, Rangely, Colorado *to merge with* **Bank of Rangely, Rangely, Colorado**

SUMMARY REPORT BY THE ATTORNEY GENERAL (11/13/92) The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (5/26/93)
The applicant has assets of $9 million; the target has assets of $11 million. The parties 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 merge with* **Granite Savings Bank, SSB, Granite Falls, North Dakota**

SUMMARY REPORT BY THE ATTORNEY GENERAL (4/19/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (6/4/93)
The applicant has assets of $2.9 billion; the target has assets of $100 million. The parties 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.

F&M Bank-Winchester, Winchester, Virginia *to merge with* **The Farmers and Merchants National Bank of Hamilton, Hamilton, Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (6/11/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (6/30/93)
The applicant has assets of $516 million; the target has assets of $189 million. The parties 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.

Centura Bank, Rocky Mount, North Carolina *to merge with* **First Savings Bank of Forest City, SSB, Forest City, North Carolina**

SUMMARY REPORT BY THE ATTORNEY GENERAL (6/11/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (7/7/93)
The applicant has assets of $3.1 billion; the target has assets of $62 million. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Union Bank and Trust Company, Bowling Green, Virginia *to acquire the assets and liabilities of a* **branch office of Dominion Bank, N.A., Roanoke, Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (6/11/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (7/7/93)
The applicant has assets of $234 million; the target has assets of $12 million. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

First Security Bank of Windsor, Windsor, Colorado *to merge with* **Bank of Windsor, Windsor, Colorado**

SUMMARY REPORT BY THE ATTORNEY GENERAL (5/7/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (7/12/94) The applicant has assets of $23 million; the target has assets of $22 million. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Meridian Bank, Reading, Pennsylvania *to merge with* **Commonwealth Bank, Williamsport, Pennsylvania**

SUMMARY REPORT BY THE ATTORNEY GENERAL (6/4/93)
The proposed transaction would not be significantly adverse to competition.

16—Continued

Basis for Approval by the Federal Reserve (7/26/93)
The applicant has assets of $12 billion; the target has assets of $2.1 billion. The parties do not operate in the same market.

The banking factors and considerations relating tot he convenience and needs of the community are consistent with approval.

Sulphur Springs State Bank, Sulphur Springs, Texas *to merge with* **Wolfe City National Bank, Wolfe City, Texas**

Summary Report by the Attorney General (6/30/93)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (7/29/93)
The applicant has assets of $210 million; the target has assets of $32 million. The parties 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.

PremierBank & Trust, Elyria, Ohio *to merge with* **Crestline Savings and Loan, Crestline, Ohio**

Summary Report by the Attorney General
Request for report dispensed with as authorized by the Bank Merger Act.

Basis for Approval by the Federal Reserve (7/30/93)
The applicant has assets of $489 million; the target has assets of $19 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

United Bank of Philadelphia, Philadelphia, Pennsylvania *to merge with* **Chase Federal Savings and Loan Association, Philadelphia, Pennsylvania**

Summary Report by the Attorney General
Request for report dispensed with as authorized by the Bank Merger Act.

Basis for Approval by the Federal Reserve (7/30/93)
The applicant has assets of $27 million; the target has assets of $15 million. The RTC has recommended immediate action by the Federal Reserve to prevent the probable failure of the target.

Bank of Hampton Roads, Chesapeake, Virginia *to merge with* **New Atlantic Bank, NA, Norfolk, Virginia**

Summary Report by the Attorney General
Request for report dispensed with as authorized by the Bank Merger Act.

Basis for Approval by the Federal Reserve (8/12/93)
The applicant has assets of $76 million; the target has assets of $16 million. The OCC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

Banco Popular de Puerto Rico, Hato Rey, Puerto Rico *to acquire the assets and liabilities of* **five Virgin Islands branches of CoreStates Bank, NA, Philadelphia, Pennsylvania**

Summary Report by the Attorney General (7/13/93)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (8/12/93)
The applicant has assets of $9.7 billion; the targets have assets of $274.5 million. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

United Bank of Philadelphia, Philadelphia, Pennsylvania *to acquire assets and liabilities of* **three branches of Home Unity Federal Savings and Loan Association, Lafayette Hills, Pennsylvania**

Summary Report by the Attorney General
Request for report dispensed with as authorized by the Bank Merger Act.

Basis for Approval by the Federal Reserve (8/31/93)
The applicant has assets of $94 million; the targets have assets of $35 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the targets.

Ambassador Bank of the Commonwealth, Allentown, Pennsylvania *to acquire the assets and liabilities of* **one branch of Lehigh Valley Bank, Bethlehem, Pennsylvania**

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1993—Continued

SUMMARY REPORT BY THE ATTORNEY GENERAL (9/20/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/15/93)
The applicant has assets of $75 million; the target has assets of $1 million. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Meridian Bank, Reading, Pennsylvania *to merge with* **First National Bank of Bath, Bethlehem, Pennsylvania**

SUMMARY REPORT BY THE ATTORNEY GENERAL (8/8/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/21/93)
The applicant has assets of $12.5 billion; the target has assets of $126 million. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Triangle Bank and Trust Company, Raleigh, North Carolina *to acquire the assets and liabilities of* **New East Banks of Greenville, New Bern, Goldsboro, Fayetteville, and Elizabeth City, North Carolina**

SUMMARY REPORT BY THE ATTORNEY GENERAL (9/10/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/27/93)
The applicant has assets of $161 million; the targets have assets of $28 million, $16 million, $28 million, $43 million, and $16 million, respectively. The parties 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.

Centura Bank, Rocky Mount, North Carolina *to acquire the assets and liabilities of* **Canton Savings Bank, SSB, Canton, North Carolina**

SUMMARY REPORT BY THE ATTORNEY GENERAL (9/10/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9/29/93)
The applicant has assets of $3.2 billion; the target has assets of $65 million. The parties 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* **branches of First American Federal Savings Bank, Greensboro, North Carolina**

SUMMARY REPORT BY THE ATTORNEY GENERAL
Request for report dispensed with as authorized by the Bank Merger Act.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10/8/93)
The applicant has assets of $3.4 billion; the targets have assets of $303 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the targets.

Mid-South Bank and Trust Company, Sanford, North Carolina *to acquire the assets and liabilities of* **branches of First American Federal Savings Bank, Greensboro, North Carolina**

SUMMARY REPORT BY THE ATTORNEY GENERAL
Request for report dispensed with as authorized by the Bank Merger Act.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10/8/93)
The applicant has assets of $207 billion; the targets have assets of $11 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

Banco Popular de Puerto Rico, Hato Rey, Puerto Rico *to acquire the assets and liabilities of the* **Southern Boulevard branch of Emigrant Savings Bank, Bronx, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (9/28/93)
The proposed transaction would not be significantly adverse to competition.

16.—Continued

Basis for Approval by the Federal Reserve (10/15/93)
The applicant has assets of $10 billion; the target has assets of $50 million. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

FCNB Bank, Frederick, Maryland *to acquire the assets and liabilities of the* **Eldersburg, Maryland branch of The Columbia Bank, Columbia, Maryland**

Summary Report by the Attorney General (10/1/93)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (10/26/93)
The applicant has assets of $380 million; the target has assets of $11 million. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Heartland Bank, Croton, Ohio *to acquire the assets and liabilities of* **one branch office of Century Bank, Upper Arlington, Ohio**

Summary Report by the Attorney General (10/18/93)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (10/28/93)
The applicant has assets of $87 million; the target has assets of $23 million. The parties 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 merge with* **First Financial Savings Association, FA, Cincinnati, Ohio**

Summary Report by the Attorney General (10/18/93)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (11/1/93)
The applicant has assets of $6.6 billion; the target has assets of $378 million. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Fayette Bank and Trust Company, Uniontown, Pennsylvania *to merge with* **FirstSouth Savings Bank, Pittsburgh, Pennsylvania**

Summary Report by the Attorney General (10/1/93)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (11/1/93)
The applicant has assets of $280 million; the target has assets of $161 million. The parties 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 West Florida, St. Petersburg, Florida *to merge with* **Ameribank, Clearwater, Florida, and First National Bank of the South, Wesley Chapel, Florida**

Summary Report by the Attorney General
Request for report dispensed with as authorized by the Bank Merger Act.

Basis for Approval by the Federal Reserve (11/8/93)
The applicant has assets of $540 million; the targets have assets of $167 million. The FDIC has recommended immediate action by the Federal Reserve to prevent the probable failure of the targets.

First Interstate Bank of California, Los Angeles, California *to merge with* **California Republic Bank, Bakersfield, California**

Summary Report by the Attorney General (9/28/93)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (11/9/93)
The applicant has assets of $19 billion; the target has assets of $569 million. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1993—Continued

Centura Bank, Rocky Mount, North Carolina *to merge with* **the Robeson Interim Bank, Lumberton, North Carolina, the successor by merger and conversion from Robeson Savings Bank, Inc., SSB**

Summary Report by the Attorney General (11/5/93)

The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (11/10/93)

The applicant has assets of $3.2 billion; the target has assets of $99 million. The parties 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 merge with* **First Charlotte Bank and Trust Company, Charlotte, North Carolina**

Summary Report by the Attorney General (9/20/93)

The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (11/12/93)

The applicant has assets of $3 billion; the target has assets of $168 million. The parties 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.

Omnibank Arvada, Arvada, Colorado *to merge with* **Denver West Bank and Trust, Golden, Colorado**

Summary Report by the Attorney General (10/12/93)

The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (11/19/93)

The applicant has assets of $31 million; the target has assets of $16 million. The parties 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 merge with* **New River Bank, Oakland Park, Florida**

Summary Report by the Attorney General (10/12/93)

The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (11/30/93)

The applicant has assets of $124 million; the target has assets of $29 million. The parties 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.

First Interstate Bank of California, Los Angeles, California *to acquire assets and liabilities of four branches of* **HomeFed Bank, F.A., San Diego, California**

Summary Report by the Attorney General (10/28/93)

The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (12/2/93)

The applicant has assets of $20 billion; the targets have assets of $248 million. The parties 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.

First Interstate Bank of California, Los Angeles, California *to merge with* **First State Bank of the Oaks, Thousand Oaks, California**

Summary Report by the Attorney General (9/20/93)

The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (12/13/93)

The applicant has assets of $20 billion; the target has assets of $139 million. The parties 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.

West One Bank, Idaho, Boise, Idaho *to merge with* **Idaho State Bank, Glens Ferry, Idaho**

Summary Report by the Attorney General (8/8/93)

The proposed transaction would not be significantly adverse to competition.

16.—Continued

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12/20/93)
The applicant has assets of $4 billion; the target has assets of $46 million. The parties 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 merge with* **Virginia Federal Savings Association, Richmond, Virginia, and Providence Savings and Loan Association, Vienna, Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (11/5/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12/22/93)
The applicant has assets of $11 billion; the targets have assets of $1.2 billion. The parties 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 New York, Albany, New York *to acquire the assets and liabilities of* **twenty-nine branches of Chemical Bank, throughout New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10/12/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12/23/93)
The applicant has assets of $10 billion; the target has assets of $786 million. The parties operate in the same market.

The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

Meridian Bank, Reading, Pennsylvania *to merge with* **The Grange National Bank of Susquehanna County, New Milford, Pennsylvania**

SUMMARY REPORT BY THE ATTORNEY GENERAL (11/26/93)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12/24/93)
The applicant has assets of $13 billion; the target has assets of $28 million. The parties 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
1st Source Bank, South Bend, Indiana	1,310	1/4/93
Merger		
1st Source Bank of Starke County, Hamlet, Indiana	44	
First Florida Bank, Tampa, Florida	1,900	1/13/93
Merger		
Barnett Bank of Tampa, NA, Tampa, Florida	1,500	

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1993—Continued

Institution [1]	Assets (millions of dollars)	Date of approval
Sun Bank/Gulf Coast, Sarasota, Florida	304	1/20/93
Merger		
Sun Bank and Trust/Port Charlotte, Port Charlotte, Florida	351	
First National Bank of Venice, Venice, Florida	372	
The Jackson State Bank, Jackson, Wyoming	185	1/25/93
Merger		
The State Bank, West Jackson, Wyoming	6	
First of America Security, Southgate, Michigan (formerly Security Bank and Trust Company)	1,700	2/17/93
Merger		
Security Bank of Monroe, Monroe, Michigan	267	
Independent Banks of Arizona, Phoenix, Arizona	0	2/17/93
Merger		
Caliber Bank, Phoenix, Arizona	1,600	
The Bank of Woodward, Woodward, Oklahoma	119	4/9/93
Merger		
Cimmarron Bank, Waukomis, Oklahoma	17	
Union Colony Bank, Greeley, Colorado	142	4/30/93
Merger		
Union Colony Bank of Loveland, NA, Loveland, Colorado	11	
Chemical Bank, New York, New York	109,000	5/17/93
Merger		
Texas Commerce Banks, Newark, Delaware	63	
Meridian Bank, Reading, Pennsylvania	1,060	5/25/93
Merger		
The First National Bank of Pike County, Milford, Pennsylvania	155	
Texas Bank, Weatherford, Texas	231	6/11/93
Merger		
Texas Bank, Grapevine, Texas	35	
Bank of Montana Great Falls, Great Falls, Montana	439	6/18/93
Merger		
Montana Bank, Billings, Montana	319	
Sunbank of Tampa Bay, Tampa, Florida	1,701	6/30/93
Merger		
The Hillsboro Sun Bank, Plant City, Florida	190	
NBD Bank, Elkhart, Indiana	694	6/30/93
Merger		
NBD Bank, NA, Gary, Indiana	2,271	
Bank of Colorado–Western Slope, Grand Junction, Colorado	57	6/30/93
Merger		
Bank of Colorado, Glenwood Springs, Colorado	57	

16.—Continued

Institution [1]	Assets (millions of dollars)	Date of approval
Wesbanco Bank Wheeling, Wheeling, West Virginia	379	8/26/93
Merger		
Wesbanco Bank Sisterville, Sisterville, West Virginia	23	
Vectra Bank, Denver, Colorado	127	9/3/93
Merger		
Vectra Bank of Denver, Englewood, Colorado	54	
Barnett Bank of West Florida, Pensacola, Florida	389	10/25/93
Merger		
The Citizens and Peoples National Bank of Pensacola, Pensacola, Florida	415	
Jefferson Bank of Florida, Miami, Florida	234	10/28/93
Merger		
Jefferson National Bank at Sunny Isles, Miami Beach, Florida	111	
BancFirst, Oklahoma City, Oklahoma	738	11/5/93
Merger		
Security Bank, Coweta, Oklahoma	23	
United Community Bank, Weatherford, Oklahoma	35	
First American Bank, Stratford, Oklahoma	15	
Security Bank, Coweta, Oklahoma	23	
Compass Bank, Birmingham, Alabama	5,100	11/29/93
Merger		
Compass Bank of Calhoun County, Anniston, Alabama	126	
Nevada Community Bank, Las Vegas, Nevada	52	12/2/93
Merger		
Continental National Bank, Las Vegas, Nevada	211	
First Interstate Bank of California, Los Angeles, California	2,010	12/13/93
Merger		
First State Bank of the Oaks, Thousand Oaks, California	139	
Arkansas Bank and Trust Company, Hot Springs, Arkansas	394	12/14/93
Merger		
Hot Springs Village, Arkansas, branch of Benton State Bank, Benton, Arkansas	201	
Central Bank of Oklahoma City, Oklahoma City, Oklahoma	281	12/17/93
Merger		
Friendly Bank of Oklahoma City, Oklahoma City, Oklahoma	250	

1. Each proposed transaction was to be effected under the charter of the first named bank. The entries are in chronological order of approval. Some transactions include the acquisition of only certain assets and liabilities of the affiliated bank.

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1993—Continued

Mergers Approved Involving a Nonoperating Institution with an Existing Bank

The following transactions have no significant effect on competition; they merely facilitate the acquisition of the voting shares of a bank (or banks) by a holding company. In such cases, the summary report by the Attorney General indicates that the transaction will merely combine an existing bank with a nonoperating institution; in consequence, and without regard to the acquisition of the surviving bank by the holding company, the merger would have no effect on competition. The Board of Governors, the Federal Reserve Bank, or the Secretary of the Board, 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
Barnett Bank of Hillsborough County, Tampa, Florida	...	1/13/93
Merger		
First Florida Bank, Tampa, Florida	1,900	
UniSouth Interim Bank, Columbus, Mississippi	...	2/5/93
Merger		
UniSouth Banking Company, Columbus, Mississippi	168	
Exchange Interim Bank, Luckey, Ohio	...	3/26/93
Merger		
The Exchange Bank, Luckey, Ohio	67	
New Bank, Morristown, Tennessee	...	7/8/93
Merger		
United Southern Bank of Morristown, Morristown, Tennessee	42	
WTC Interim Bank, Wilmington, Pennsylvania	...	8/13/93
Merger		
Freedom Valley Bank, West Chester, Pennsylvania	111	
FB&T Bank, Fairfax, Virginia	...	8/31/93
Merger		
Fairfax Bank and Trust Company, Fairfax, Virginia	141	

1. Each proposed transaction was to be effected under the charter of the first-named bank. The entries are in chronological order of approval.

2. Where no assets are listed, the bank is newly organized and not in operation.

Federal Reserve
Directories and Meetings

Board of Governors of the Federal Reserve System

December 31, 1993

Members

	Term expires
ALAN GREENSPAN of New York, *Chairman*[1]	January 31, 2006
DAVID W. MULLINS, JR., of Arkansas, *Vice Chairman*[1]	January 31, 1996
WAYNE D. ANGELL of Kansas	January 31, 1994
SUSAN M. PHILLIPS of Iowa	January 31, 1998
LAWRENCE B. LINDSEY of Virginia	January 31, 2000
JOHN P. LAWARE of Massachusetts	January 31, 2002
EDWARD W. KELLEY, JR., of Texas	January 31, 2004

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Donald J. Winn, *Assistant to the Board*

Theodore E. Allison, *Assistant to the Board for Federal Reserve System Affairs*

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Lynn Fox, *Special Assistant to the Board*

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Diane E. Werneke, *Special Assistant to the Board*

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1. The designations as Chairman and Vice Chairman expire on March 2, 1996, and July 22, 1995, respectively, unless the service of these members of the Board shall have terminated sooner.

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Charles J. Siegman, *Senior Associate Director*
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David H. Howard, *Senior Adviser*
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Peter Hooper III, *Assistant Director*
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Normand R.V. Bernard, *Special Assistant to the Board*

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Donald L. Robinson, *Assistant Inspector General*
Barry R. Snyder, *Assistant Inspector General*

Federal Open Market Committee

December 31, 1993

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WAYNE D. ANGELL, Board of Governors
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LAWRENCE B. LINDSEY, Board of Governors
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RICHARD W. LANG, *Associate Economist*
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THOMAS D. SIMPSON, *Associate Economist*
LAWRENCE SLIFMAN, *Associate Economist*

JOAN E. LOVETT, *Manager for Domestic Operations, System Open Market Account*
PETER R. FISHER, *Manager for Foreign Operations, System Open Market Account*

During 1993 the Federal Open Market Committee held eight meetings (see Minutes of the Federal Open Market Committee Meetings in this REPORT.)

Federal Advisory Council

December 31, 1993

District 1—MARSHALL N. CARTER, *Chairman and Chief Executive Officer*, State Street Bank and Trust Company, Boston, Massachusetts

District 2—CHARLES S. SANFORD, JR., *Chairman*, Bankers Trust Company, New York, New York

District 3—ANTHONY P. TERRACCIANO, *Chairman, President, and Chief Executive Officer*, First Fidelity Bancorporation, Newark, New Jersey

District 4—JOHN B. MCCOY, JR., *Chairman, President, and Chief Executive Officer*, Banc One Corporation, Columbus, Ohio

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District 6—E. B. ROBINSON, JR., *Chairman and Chief Executive Officer*, Deposit Guaranty Bank, Jackson, Mississippi

District 7—EUGENE A. MILLER, *Chairman and Chief Executive Officer*, Comerica Incorporated, Detroit, Michigan

District 8—ANDREW B. CRAIG, III, *Chairman, President, and Chief Executive Officer*, Boatmen's Bancshares, Inc., St. Louis, Missouri

District 9—JOHN F. GRUNDHOFER, *Chairman, President, and Chief Executive Officer*, First Bank System, Inc., Minneapolis, Minnesota

District 10—DAVID A. RISMILLER, *Chairman, President, and Chief Executive Officer*, FirsTier Financial, Inc., Omaha, Nebraska

District 11—CHARLES R. HRDLICKA, *Chairman and Chief Executive Officer*, Victoria Bank and Trust, Victoria, Texas

District 12—RICHARD M. ROSENBERG, *Chairman and Chief Executive Officer*, Bank of America, San Francisco, California

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Directors

EUGENE A. MILLER

JOHN F. GRUNDHOFER

RICHARD M. ROSENBERG

The Federal Advisory Council met on February 4–5, May 6–7, September 9–10, and November 4–5, 1993. The Board of Governors met with the council on February 5, May 7, September 10, and November 5, 1993. The council, which is composed of one representative of the banking industry from each of the twelve Federal Reserve Districts, is required by law to meet in Washington at least four times each year and is authorized by the Federal Reserve Act to consult with, and advise, the Board on all matters within the jurisdiction of the Board.

Consumer Advisory Council

December 31, 1993

Members

BARRY A. ABBOTT, *Partner*, Morrison & Foerster, San Francisco, California

JOHN R. ADAMS, *Corporate Vice President and Compliance Officer*, CoreStates Financial Corporation, Philadelphia, Pennsylvania

JOHN A. BAKER, *Senior Vice President*, Equifax, Inc., Atlanta, Georgia

VERONICA E. BARELA, *Executive Director*, NEWSED Community Development Corporation, Denver, Colorado

MULUGETTA BIRRU, *Executive Director*, Urban Redevelopment Authority of Pittsburgh, Pittsburgh, Pennsylvania

D. DOUGLAS BLANKE, *Director of Consumer Policy*, Office of the Attorney General, St. Paul, Minnesota

GENEVIEVE BROOKS, *Deputy Borough President*, Office of the Bronx Borough President, Bronx, New York

TOYE L. BROWN, *Deputy Secretary of Transportation and Construction*, Intermodal Transportation Policy, Boston, Massachusetts

CATHY CLOUD, *Enforcement Program Director*, National Fair Housing Alliance, Washington, D.C.

MICHAEL D. EDWARDS, *President*, Prairie Security Bank, Yelm, Washington

MICHAEL FERRY, *Staff Attorney*, Consumer Unit, Legal Services of Eastern Missouri, Inc., St. Louis, Missouri

NORMA L. FREIBERG, *Executive Director*, New Orleans Neighborhood Development Foundation, New Orleans, Louisiana

LORI GAY, *Executive Director*, Los Angeles Neighborhood Housing Services, Los Angeles, California

DONALD A. GLAS, *President*, First State Federal Savings and Loan Association, Hutchinson, Minnesota

BONNIE GUITON, *Dean*, McIntire School of Commerce, University of Virginia, Charlottesville, Virginia

JOYCE HARRIS, *President and Chief Executive Officer*, Telco Community Credit Union, Madison, Wisconsin

GARY S. HATTEM, *Vice President*, Community Development Group, Bankers Trust Company, New York, New York

JULIA E. HILER, *Executive Vice President*, Sunshine Mortgage Corporation, Marietta, Georgia

RONALD A. HOMER, *Chairman and Chief Executive Officer*, Boston Bank of Commerce, Boston, Massachusetts

THOMAS L. HOUSTON, *Executive Director*, The Dallas Black Chamber of Commerce, Dallas, Texas

HENRY JARAMILLO, JR., *President*, Ranchers State Bank, Belen, New Mexico

EDMUND MIERZWINSKI, *Consumer Advocate*, U.S. Public Interest Research Group, Washington, D.C.

JOHN V. SKINNER, *President and Chief Executive Officer*, Jewelers Financial Services, Inc., Irving, Texas

LOWELL N. SWANSON, *President (Retired)*, United Finance Company, Portland, Oregon

MICHAEL W. TIERNEY, *Program Director*, Local Initiatives Support Corporation, Washington, D.C.

GRACE W. WEINSTEIN, *Financial Writer and Consultant*, Englewood, New Jersey

JAMES L. WEST, *President*, Jim West Financial Group, Inc., Tijeras, New Mexico

ROBERT O. ZDENEK, *Senior Program Officer*, Annie E. Casey Foundation, Greenwich, Connecticut

Consumer Advisory Council—Continued

Officers

DENNY D. DUMLER, *Chairman*
Senior Vice President, Colorado National Bank, Denver, Colorado

JEAN POGGE, *Vice Chairman*
Vice President, Development Deposits, South Shore Bank, Chicago, Illinois

The Consumer Advisory Council met with members of the Board of Governors on March 25, June 17, and October 28, 1993. The council is composed of academics, state and local 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, 1993

Members

DANIEL C. ARNOLD, *Director*, Farm & Home Financial Corporation, Houston, Texas

WILLIAM A. COOPER, *Chairman and Chief Executive Officer*, TCF Bank Savings F.S.B., Minneapolis, Minnesota

BEATRICE D'AGOSTINO, *Chairman, President, and Chief Executive Officer*, New Jersey Savings Bank, Somerville, New Jersey

PAUL L. ECKERT, *Chairman and President*, Citizens Federal Savings Bank, Davenport, Iowa

GEORGE R. GLIGOREA, *Chairman, President, and Chief Executive Officer*, First Federal Savings Bank, Sheridan, Wyoming

THOMAS J. HUGHES, *President*, Navy Federal Credit Union, Merrifield, Virginia

KERRY KILLINGER, *Chairman, President, and Chief Executive Officer*, Washington Mutual Savings Bank, Seattle, Washington

CHARLES JOHN KOCH, *President and Chief Executive Officer*, Charter One Bank, F.S.B., Cleveland, Ohio

ROBERT MCCARTER, *Chairman and Chief Executive Officer*, New Bedford Institution for Savings, New Bedford, Massachusetts

NICHOLAS W. MITCHELL, JR., *President and Chief Executive Officer*, Piedmont Federal Savings and Loan Association, Winston-Salem, North Carolina

STEPHEN W. PROUGH, *President and Chief Executive Officer*, Western Financial Savings Bank, Irvine, California

THOMAS R. RICKETTS, *Chairman, President, and Chief Executive Officer*, Standard Federal Bank, Troy, Michigan

DANIEL C. ARNOLD, *President*

BEATRICE D'AGOSTINO, *Vice President*

The members of the Thrift Institutions Advisory Council met with the Board of Governors on March 5, May 14, September 24, and December 10, 1993. The council, which is composed of representatives from credit unions, savings and loan associations, and savings banks, consults with, and advises, the Board on issues pertaining to the thrift industry and on various other matters within the Board's jurisdiction.

Officers of Federal Reserve Banks, Branches, and Offices

December 31, 1993[1]

BANK, Branch, or *facility*	Chairman[2] Deputy Chairman	President First Vice President	Vice President in charge of Branch
BOSTON[3]	Jerome H. Grossman Warren B. Rudman	Richard F. Syron Cathy E. Minehan	
NEW YORK[3]	Ellen V. Futter Maurice R. Greenberg	William J. McDonough James H. Oltman	
Buffalo	Joseph J. Castiglia		James O. Aston
PHILADELPHIA	Jane G. Pepper James M. Mead	Edward G. Boehne William H. Stone, Jr.	
CLEVELAND[3]	A. William Reynolds G. Watts Humphrey, Jr.	Jerry L. Jordan Sandra Pianalto	
Cincinnati	Marvin Rosenberg		Charles A. Cerino[4]
Pittsburgh	Robert P. Bozzone		Harold J. Swart[4]
RICHMOND[3]	Anne Marie Whittemore Henry J. Faison	J. Alfred Broaddus, Jr. Jimmie R. Monhollon	
Baltimore	Rebecca Hahn Windsor		Ronald B. Duncan[4]
Charlotte	Anne M. Allen		Walter A. Varvel[4]
Culpeper			John G. Stoides[4]
ATLANTA	Edwin A. Huston Leo Benatar	Robert P. Forrestal Jack Guynn	Donald E. Nelson[4]
Birmingham	Donald E. Boomershine		Fred R. Herr[4]
Jacksonville	Joan D. Ruffier		James D. Hawkins[4]
Miami	R. Kirk Landon		James T. Curry III
Nashville	James R. Tuerff		Melvyn K. Purcell
New Orleans	Lucimarian Roberts		Robert J. Musso
CHICAGO[3]	Richard G. Cline Robert M. Healey	Silas Keehn William C. Conrad	
Detroit	J. Michael Moore		Roby L. Sloan[4]
ST. LOUIS	Robert H. Quenon Janet McAfee Weakley	Thomas C. Melzer James R. Bowen	
Little Rock	Robert D. Nabholz, Jr.		Karl W. Ashman
Louisville	John A. Williams		Howard Wells
Memphis	Seymour B. Johnson		John P. Baumgartner
MINNEAPOLIS	Delbert W. Johnson Gerald A. Rauenhorst	Gary H. Stern Colleen K. Strand	
Helena	James E. Jenks		John D. Johnson

BANK, Branch, or *facility*	Chairman[2] Deputy Chairman	President First Vice President	Vice President in charge of Branch
KANSAS CITY	Burton A. Dole, Jr. Herman Cain	Thomas M. Hoenig Henry R. Czerwinski	
Denver	Barbara B. Grogan		Kent M. Scott
Oklahoma City	Ernest L. Holloway		David J. France
Omaha	Sheila Griffin		Harold L. Shewmaker
DALLAS	Leo E. Linbeck, Jr. Cece Smith	Robert D. McTeer, Jr. Tony J. Salvaggio	
El Paso	W. Thomas Beard III		Sammie C. Clay
Houston	Judy Ley Allen		Robert Smith III[4]
San Antonio	Erich Wendl		Thomas H. Robertson
SAN FRANCISCO	James A. Vohs Judith M. Runstad	Robert T. Parry Patrick K. Barron	
Los Angeles	Donald G. Phelps		John F. Moore[4]
Portland	William A. Hilliard		E. Ronald Liggett[4]
Salt Lake City	Gary G. Michael		Andrea P. Wolcott
Seattle	George F. Russell, Jr.		Gordon R. G. Werkema[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 June 2 and 3, and on December 1 and 2, 1993.

The members of the Executive Committee of the Conference of Chairmen during 1993 were Delbert W. Johnson, Chairman; Ellen V. Futter, Vice Chairman; and Burton A. Dole, Jr., member.

On December 2, 1993, the Conference elected its Executive Committee for 1994, naming Burton A. Dole, Jr. as Chairman, Jerome H. Grossman as Vice Chairman, and James A. Vohs, 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.

Robert T. Parry, President of the Federal Reserve Bank of San Francisco, served as Chairman of the Conference in 1993, and Richard F. Syron, President of the Federal Reserve Bank of Boston, served as its Vice Chairman. Robert L. Feinberg, of the Federal Reserve Bank of San Francisco, served as its Secretary, and Rena DeSisto, of the Federal Reserve Bank of Boston, served 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.

William H. Stone, First Vice President of the Federal Reserve Bank of Philadelphia, served as Chairman of the Conference for 1993, and James H. Oltman, First Vice President of the Federal Reserve Bank of New York, served as its Vice Chairman. Milissa M. Tadeo, of the Federal Reserve Bank of Philadelphia, served as its Secretary, and Ethan S. Harris of the Federal Reserve

Bank of New York, served as its Assistant Secretary.

On October 5, 1993, the Conference elected James H. Oltman, First Vice President of the Federal Reserve Bank of New York, as its Chairman for 1994, and Tony J. Salvaggio, First Vice President of the Federal Reserve Bank of Dallas, as its Vice Chairman.

Directors

The following list of directors of Federal Reserve Banks and Branches shows for each director the class of directorship, the director's principal business affiliation, and the date the director's 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.

Class A directors represent the stockholding member banks in each Federal Reserve District. Class B and Class C directors represent the public and are chosen with due, but not exclusive, consideration to the interests of agriculture, commerce, industry, services, labor, and consumers; they may not be officers, directors, or employees of any bank or bank holding company. In addition, Class C directors may not be stockholders of any bank or bank holding company.

For the election of Class A and Class B directors, the Board of Governors classifies the member banks of each Federal Reserve District into three groups. Each group, which comprises banks with similar capitalization, elects one Class A director and one Class B director. The Board of Governors designates one Class C director as chairman of the board of directors and Federal Reserve Agent of each District Bank and appoints another Class C director as deputy chairman.

Federal Reserve Branches have either five or seven directors, a majority of whom are appointed by the parent Federal Reserve Bank; the others are appointed by the Board of Governors. One of the directors appointed by the Board is designated annually as chairman of the board of that Branch in a manner prescribed by the parent Federal Reserve Bank.

For the name of the chairman and deputy chairman of the board of directors of each Reserve Bank and of the chairman of each Branch, see the preceding table, "Officers of Federal Reserve Banks, Branches, and Offices."

		Term expires Dec. 31
DISTRICT 1—BOSTON		
Class A		
David A. Page	President and Chief Executive Officer, Ocean National Bank of Kennebunk, Kennebunk, Maine	1993
Robert M. Silva	President, Chief Executive Officer, and Director, The Citizens National Bank, Putnam, Connecticut	1994
Ira Stepanian	Chairman and Chief Executive Officer, The Bank of Boston Corporation, Boston, Massachusetts	1995
Class B		
Stephen R. Levy	Chairman and Chief Executive Officer, Bolt Beranek and Newman, Inc., Cambridge, Massachusetts	1993
Edward H. Ladd	Chairman and Chief Executive Officer, Standish, Ayer and Wood, Inc., Boston, Massachusetts	1994
Joan T. Bok	Chairman, New England Electric System, Westborough, Massachusetts	1995
Class C		
John E. Flynn	Executive Director, The Quality Connection, East Dennis, Massachusetts	1993
Jerome H. Grossman	Chairman and Chief Executive Officer, New England Medical Center, Inc., Boston, Massachusetts	1994
Warren B. Rudman, Esq.	Sheehan, Phinney, Bass, and Green, Manchester, New Hampshire	1995
DISTRICT 2—NEW YORK		
Class A		
Barbara Harding	Chairman and Chief Executive Officer, Phillipsburg National Bank and Trust Company, Phillipsburg, New Jersey	1993
Thomas G. Labrecque	Chairman and Chief Executive Officer, The Chase Manhattan Bank, N.A., New York, New York	1994
Robert G. Wilmers	Chairman, President, and Chief Executive Officer, Manufacturers and Traders Trust Company, Buffalo, New York	1995
Class B		
Rand V. Araskog	Chairman, President, and Chief Executive Officer, ITT Corporation, New York, New York	1993

		Term expires Dec. 31
DISTRICT 2, *Class B*—Continued		
Robert E. Allen	Chairman and Chief Executive Officer, AT&T, Basking Ridge, New Jersey	1994
William C. Steere, Jr.	Chairman and Chief Executive Officer, Pfizer, Inc., New York, New York	1995
Class C		
Ellen V. Futter	President, American Museum of Natural History, New York, New York	1993
Maurice R. Greenberg	Chairman and Chief Executive Officer, American International Group, Inc., New York, New York	1994
Herbert L. Washington	Owner, HLW Fast Track, Inc., Rochester, New York	1995

BUFFALO BRANCH

Appointed by the Federal Reserve Bank

Susan A. McLaughlin	General Credit Manager, Eastman Kodak Company, Rochester, New York	1993
Charles M. Mitschow	Chairman, Western Region, Marine Midland Bank, N.A., Buffalo, New York	1994
Richard H. Popp	Operating Partner, Southview Farm, Castile, New York	1994
George W. Hamlin IV	President and Chief Executive Officer, The Canandaigua National Bank and Trust Company, Canandaigua, New York	1995

Appointed by the Board of Governors

Joseph J. Castiglia	President and Chief Executive Officer, Pratt & Lambert, Inc., Buffalo, New York	1993
Donald L. Rust	Plant Manager, General Motors Powertrain Division, Tonawanda Engine Plant, Buffalo, New York	1994
F. C. Richardson	President, Buffalo State College, Buffalo, New York	1995

DISTRICT 3—PHILADELPHIA

Class A

Gary F. Simmerman	President and Chief Executive Officer, United Jersey Bank/South, N.A., Cherry Hill, New Jersey	1993
H. Bernard Lynch	President and Chief Executive Officer, The First National Bank of Wyoming, Wyoming, Delaware	1994
Carl L. Campbell	President and Chief Executive Officer, Keystone Financial, Inc., Harrisburg, Pennsylvania	1995

Term expires Dec. 31

DISTRICT 3—Continued

Class B

J. Richard Jones	President and Chief Executive Officer, Jackson-Cross Company, Philadelphia, Pennsylvania	1993
James A. Hagen	Chairman, President, and Chief Executive Officer, Consolidated Rail Corporation (CONRAIL), Philadelphia, Pennsylvania	1994
David W. Huggins	President and Chief Executive Officer, R M S Technologies, Inc., Marlton, New Jersey	1995

Class C

Jane G. Pepper	President, The Pennsylvania Horticultural Society, Philadelphia, Pennsylvania	1993
Donald J. Kennedy	Business Manager, International Brotherhood of Electrical Workers, Local Union No. 269, Trenton, New Jersey	1994
James M. Mead	President and Chief Executive Officer, Capital Blue Cross, Harrisburg, Pennsylvania	1995

DISTRICT 4—CLEVELAND

Class A

Alfred C. Leist	Chairman, President, and Chief Executive Officer, Apple Creek Banking Company, Apple Creek, Ohio	1993
William T. McConnell	Chairman and Chief Executive Officer, The Park National Bank, Newark, Ohio	1994
Edward B. Brandon	Chairman and Chief Executive Officer, National City Corporation, Cleveland, Ohio	1995

Class B

Verna K. Gibson	President, Outlook Consulting International, Inc., Columbus, Ohio	1993
Douglas E. Olesen	President and Chief Executive Officer, Battelle Memorial Institute, Columbus, Ohio	1994
I. N. Rendall Harper, Jr.	President and Chief Executive Officer, American Micrographics Company, Inc., Monroeville, Pennsylvania	1995

Class C

John R. Hodges	Retired President, Ohio AFL-CIO, Columbus, Ohio	1993
G. Watts Humphrey, Jr.	President, GWH Holdings, Inc., Pittsburgh, Pennsylvania	1994
A. William Reynolds	Chairman and Chief Executive Officer, GenCorp, Fairlawn, Ohio	1995

Term expires Dec. 31

DISTRICT 4—Continued

CINCINNATI BRANCH

Appointed by the Federal Reserve Bank

Jack W. Buchanan	President, Sphar & Company, Inc., Winchester, Kentucky	1993
John N. Taylor, Jr.	Chairman and Chief Executive Officer, Kurz-Kasch, Inc., Dayton, Ohio	1993
Marvin J. Stammen	President and Chief Executive Officer, Second National Bank, Greenville, Ohio	1994
Jerry W. Carey	President and Chief Executive Officer, Union National Bank and Trust Company, Barbourville, Kentucky	1995

Appointed by the Board of Governors

Marvin Rosenberg	Partner, Towne Properties, Ltd., Cincinnati, Ohio	1993
Raymond A. Bradbury	Chairman, Martin County Coal Corporation, Prestonburg, Kentucky	1994
Eleanor Hicks	Hicks & Kinley, International Access Marketing, Cincinnati, Ohio	1995

PITTSBURGH BRANCH

Appointed by the Federal Reserve Bank

George A. Davidson, Jr.	Chairman and Chief Executive Officer, Consolidated Natural Gas Company, Pittsburgh, Pennsylvania	1993
Randall L. C. Russell	President and Chief Executive Officer, Ranbar Technology, Inc., Glenshaw, Pennsylvania	1993
David S. Dahlmann	President and Chief Executive Officer, Southwest National Corporation, Greensburg, Pennsylvania	1994
Frank V. Cahouet	Chairman, President, and Chief Executive Officer, Mellon Bank, N.A., Pittsburgh, Pennsylvania	1995

Appointed by the Board of Governors

Sandra L. Phillips	Executive Director, Pittsburgh Partnership for Neighborhood Development, Pittsburgh, Pennsylvania	1993
Jack B. Piatt	Chairman and President, Millcraft Industries, Inc., Washington, Pennsylvania	1994
Robert P. Bozzone	President and Chief Executive Officer, Allegheny Ludlum Corporation, Pittsburgh, Pennsylvania	1995

		Term expires Dec. 31
DISTRICT 5—RICHMOND		
Class A		
James G. Lindley	Chairman Emeritus, South Carolina National Corporation, Columbia, South Carolina	1993
Webb C. Hayes IV	Chairman, Palmer National Bancorp, Inc. and President, The Palmer National Bank, Washington, D.C.	1994
Charles E. Weller	President, Elkridge National Bank and ENB Financial Corporation, Elkridge, Maryland	1995
Class B		
Paul A. DelaCourt	Chairman, The North Carolina Enterprise Corporation, Raleigh, North Carolina	1993
L. Newton Thomas, Jr.	Retired Senior Vice President, ITT/Carbon Industries, Inc., Charleston, West Virginia	1994
R. E. Atkinson, Jr.	Chairman, Dilmar Oil Company, Inc., Florence, South Carolina	1995
Class C		
Stephen Brobeck	Executive Director, Consumer Federation of America, Washington, D.C.	1993
Anne Marie Whittemore	Partner, McGuire, Woods, Battle & Boothe, Richmond, Virginia	1994
Henry J. Faison	President, Faison Associates, Charlotte, North Carolina	1995
BALTIMORE BRANCH		
Appointed by the Federal Reserve Bank		
Claudine B. Malone	President, Financial & Management Consulting, Inc., McLean, Virginia	1993
Thomas J. Hughes	President and Chief Executive Officer, Navy Federal Credit Union, Vienna, Virginia	1994
F. Levi Ruark	Chairman and President, The National Bank of Cambridge, Cambridge, Maryland	1994
Richard M. Adams	Chairman and Chief Executive Officer, United Bankshares, Inc., Parkersburg, West Virginia	1995
Appointed by the Board of Governors		
Michael R. Watson	President, Association of Maryland Pilots, Baltimore, Maryland	1993
Rebecca Hahn Windsor	Chairman and Chief Executive Officer, Hahn Transportation, Inc., New Market, Maryland	1994
Daniel R. Baker	President and Chief Executive Officer, Tate Access Floors, Inc., Jessup, Maryland	1995

Term expires Dec. 31

DISTRICT 5—Continued

CHARLOTTE BRANCH

Appointed by the Federal Reserve Bank

Jim M. Cherry, Jr.	President and Chief Executive Officer, Williamsburg First National Bank, Kingstree, South Carolina	1993
Dorothy H. Aranda	President, Dohara Associates, Inc., Hilton Head Island, South Carolina	1994
L. Glenn Orr, Jr.	Chairman, President, and Chief Executive Officer, Southern National Corporation, Lumberton, North Carolina	1994
David B. Jordan	Vice Chairman, Chief Executive Officer, and Director, Security Capital Bancorp, Salisbury, North Carolina	1995

Appointed by the Board of Governors

William E. Masters	President, Perception, Inc., Easley, South Carolina	1993
Harold D. Kingsmore	President and Chief Operating Officer, Graniteville Company, Graniteville, South Carolina	1994
Anne M. Allen	President, Anne Allen & Associates, Inc., Greensboro, North Carolina	1995

DISTRICT 6—ATLANTA

Class A

James B. Williams	Chairman and Chief Executive Officer, SunTrust Banks, Inc., Atlanta, Georgia	1993
Simpson Russell	Chairman and Chief Executive Officer, The First National Bank of Florence, Florence, Alabama	1994
W. H. Swain	Chairman, First National Bank, Oneida, Tennessee	1995

Class B

Andre M. Rubenstein	Chairman and Chief Executive Officer, Rubenstein Brothers, Inc., New Orleans, Louisiana	1993
Victoria B. Jackson	President, DSS/ProDiesel, Nashville, Tennessee	1994
J. Thomas Holton	Chairman and President, Sherman International Corporation, Birmingham, Alabama	1995

Class C

Edwin A. Huston	Senior Executive Vice President-Finance, Ryder System, Inc., Miami, Florida	1993
Hugh M. Brown	President and Chief Executive Officer, BAMSI, Inc., Titusville, Florida	1994
Leo Benatar	Chairman and President, Engraph, Inc., Atlanta, Georgia	1995

		Term expires Dec. 31

DISTRICT 6—Continued

BIRMINGHAM BRANCH

Appointed by the Federal Reserve Bank

Julian W. Banton	Chairman, President, and Chief Executive Officer, SouthTrust Bank of Alabama, N.A., Birmingham, Alabama	1993
Marlin D. Moore, Jr.	Chairman, Pritchett-Moore, Inc., Tuscaloosa, Alabama	1994
Columbus Sanders	President, Consolidated Industries, Inc., Huntsville, Alabama	1994
J. Stephen Nelson	President and Chief Executive Officer, First National Bank, Brewton, Alabama	1995

Appointed by the Board of Governors

Donald E. Boomershine	President, Better Business Bureau of Central Alabama, Inc., Birmingham, Alabama	1993
Shelton E. Allred	Chairman, President, and Chief Executive Officer, Frit Incorporated, Ozark, Alabama	1994
Patricia B. Compton	President, Patco, Inc., Georgiana, Alabama	1995

JACKSONVILLE BRANCH

Appointed by the Federal Reserve Bank

Hugh H. Jones, Jr.	Chairman, Barnett Bank of Jacksonville, N.A., Jacksonville, Florida	1993
Perry M. Dawson	President and Chief Executive Officer, Suncoast Schools Federal Credit Union, Tampa, Florida	1994
Arnold A. Heggestad	William H. Dial Professor and Director, College of Business Administration, University of Florida, Gainesville, Florida	1994
Merle L. Graser	Chairman and Chief Executive Officer, First National Bank of Venice, Venice, Florida	1995

Appointed by the Board of Governors

Joan Dial Ruffier	General Partner, Sunshine Cafes, Orlando, Florida	1993
Samuel H. Vickers	President, Chairman, and Chief Executive Officer, Design Containers, Inc., Jacksonville, Florida	1994
Lana Jane Lewis-Brent	President, Paul Brent Designer, Inc., Panama City, Florida	1995

MIAMI BRANCH

Appointed by the Federal Reserve Bank

Steven C. Shimp	President, O-A-K/Florida, Inc., Fort Myers, Florida	1993

		Term expires Dec. 31

DISTRICT 6, MIAMI BRANCH
Appointed by the Federal Reserve Bank—Continued

Pat L. Tornillo, Jr.	Executive Vice President, United Teachers of Dade, Miami, Florida	1993
Roberto G. Blanco	Vice Chairman and Chief Financial Officer, Republic National Bank of Miami, Miami, Florida	1994
E. Anthony Newton	President, Island National Bank of Palm Beach, Palm Beach, Florida	1995

Appointed by the Board of Governors

Michael T. Wilson	President, Vinegar Bend Farms, Inc., Belle Glade, Florida	1993
Dorothy C. Weaver	Executive Vice President, Intercap Investments, Inc., Coral Gables, Florida	1994
R. Kirk Landon	Chairman and Chief Executive Officer, American Bankers Insurance Group, Miami, Florida	1995

NASHVILLE BRANCH

Appointed by the Federal Reserve Bank

Williams E. Arant, Jr.	President and Chief Executive Officer, First National Bank of Knoxville, Knoxville, Tennessee	1993
William Baxter Lee III	Chairman and President, Southeast Services Corporation, Knoxville, Tennessee	1994
Marguerite W. Sallee	President and Chief Executive Officer, Corporate Child Care Management Services, Nashville, Tennessee	1994
James D. Harris	President and Chief Executive Officer, Brentwood National Bank, Brentwood, Tennessee	1995

Appointed by the Board of Governors

Paula Lovell	President, Lovell Communications, Inc., Nashville, Tennessee	1993
James R. Tuerff	President and Chief Executive Officer, American General Life and Accident Insurance Company, Nashville, Tennessee	1994
Harold A. Black	James F. Smith Jr. Professor of Financial Institutions, College of Business Administration, University of Tennessee, Knoxville, Tennessee	1995

Term expires Dec. 31

DISTRICT 6—Continued

NEW ORLEANS BRANCH

Appointed by the Federal Reserve Bank

Howard C. Gaines	Chairman, President, and Chief Executive Officer, First National Bank of Commerce, New Orleans, Louisiana	1993
Angus R. Cooper	Chairman and Chief Executive Officer, Cooper/T. Smith Corporation, Mobile, Alabama	1994
Kay L. Nelson	Managing Director, Nelson Capital Corporation, New Orleans, Louisiana	1994
Thomas E. Walker	President and Chief Executive Officer, Bank of Forest, Forest, Mississippi	1995

Appointed by the Board of Governors

Victor Bussie	President, Louisiana AFL-CIO, Baton Rouge, Louisiana	1993
Jo Ann Slaydon	President, Slaydon Consultants and Insight Productions and Advertising, Baton Rouge, Louisiana	1994
Lucimarian Tolliver Roberts	President, Mississippi Coast Coliseum Commission, Pass Christian, Mississippi	1995

DISTRICT 7—CHICAGO

Class A

David W. Fox	Chairman and Chief Executive Officer, The Northern Trust Corporation and The Northern Trust Company, Chicago, Illinois	1993
Stefan S. Anderson	Chairman, President, and Chief Executive Officer, First Merchants Corporation, Muncie, Indiana	1994
Arnold C. Schultz	Chairman and President, Grundy National Bank, Grundy Center, Iowa	1995

Class B

A. Charlene Sullivan	Associate Professor of Management, Krannert Graduate School of Management, Purdue University, West Lafayette, Indiana	1993
Thomas C. Dorr	President and Chief Executive Officer, Dorr's Pine Grove Farm Co., Marcus, Iowa	1994
Donald J. Schneider	President, Schneider National, Inc., Green Bay, Wisconsin	1995

		Term expires Dec. 31

DISTRICT 7—Continued

Class C

Robert M. Healey	President, Chicago Federation of Labor and Industrial Union Council, AFL-CIO, Chicago, Illinois	1993
Duane L. Burnham	Chairman and Chief Executive Officer, Abbott Laboratories, Abbott Park, Illinois	1994
Richard G. Cline	Chairman, President, and Chief Executive Officer, NICOR Inc., Naperville, Illinois	1995

DETROIT BRANCH

Appointed by the Federal Reserve Bank

Charles E. Allen	President and Chief Executive Officer, Graimark Realty Advisors, Inc., Detroit, Michigan	1993
William E. Odom	Chairman, Ford Motor Credit Company, Dearborn, Michigan	1993
Vacancy		1994
Norman F. Rodgers	President and Chief Executive Officer, Hillsdale County National Bank, Hillsdale, Michigan	1995

Appointed by the Board of Governors

Beverly A. Beltaire	President, P R Associates, Inc., Detroit, Michigan	1993
John D. Forsyth	Executive Director, University of Michigan Hospitals, Ann Arbor, Michigan	1994
J. Michael Moore	Chairman and Chief Executive Officer, Invetech Company, Detroit, Michigan	1995

DISTRICT 8—ST. LOUIS

Class A

Ray U. Tanner	Chairman, Director, and Chief Executive Officer, Volunteer Bank, Jackson, Tennessee	1993
Henry G. River, Jr.	President and Chief Executive Officer, First National Bank in Pinckneyville, Pinckneyville, Illinois	1994
Douglas M. Lester	Chairman and President, Trans Financial Bancorp, Inc., Bowling Green, Kentucky	1995

Class B

Warren R. Lee	President, W. R. Lee & Associates, Inc., Louisville, Kentucky	1993
Sandra B. Sanderson-Chesnut	President and Chief Executive Officer, Sanderson Plumbing Products, Inc., Columbus, Mississippi	1994

		Term expires Dec. 31
DISTRICT 8, *Class B*—Continued		
Richard E. Bell	President and Chief Executive Officer, Riceland Foods, Inc., Stuttgart, Arkansas	1995
Class C		
Janet McAfee Weakley	President, Janet McAfee, Inc., St. Louis, Missouri	1993
Robert H. Quenon	Mining Consultant, St. Louis, Missouri	1994
John F. McDonnell	Chairman and Chief Executive Officer, McDonnell Douglas Corporation, St. Louis, Missouri	1995

LITTLE ROCK BRANCH

Appointed by the Federal Reserve Bank		
James V. Kelley	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
Barnett Grace	Chairman and Chief Executive Officer, First Commercial Bank, N.A., Little Rock, Arkansas	1994
Mark A. Shelton III	President, M. A. Shelton Farming Company, Altheimer, Arkansas	1995
Appointed by the Board of Governors		
L. Dickson Flake	President, Barnes, Quinn, Flake & Anderson, Inc., Little Rock, Arkansas	1993
Robert Daniel Nabholz, Jr.	Chief Executive Officer, Nabholz Construction Corporation, Conway, Arkansas	1994
Betta Carney	President and Chief Executive Officer, World Wide Travel Service, Inc., Little Rock, Arkansas	1995

LOUISVILLE BRANCH

Appointed by the Federal Reserve Bank		
Robert M. Hall	Owner, Mike Hall Farm, Seymour, Indiana	1993
Charles D. Storms	President and Chief Executive Officer, Red Spot Paint and Varnish Company, Inc., Evansville, Indiana	1993
Thomas E. Spragens, Jr.	President, The Farmers National Bank of Lebanon, Lebanon, Kentucky	1994
Malcolm B. Chancey, Jr.	Chairman and Chief Executive Officer, Liberty National Bank, Louisville, Kentucky	1995

		Term expires Dec. 31
DISTRICT 8, LOUISVILLE BRANCH—Continued		
Appointed by the Board of Governors		
John A. Williams	Chairman and Chief Executive Officer, Computer Services, Inc., Paducah, Kentucky	1993
Laura M. Douglas	Legal Director, Metropolitan Sewer District, Louisville, Kentucky	1994
Daniel L. Ash	Senior Consultant, Wenz-Neely Company, Louisville, Kentucky	1995
MEMPHIS BRANCH		
Appointed by the Federal Reserve Bank		
Thomas M. Garrott	Chairman and Chief Executive Officer, National Bank of Commerce and National Commerce Bancorporation, Memphis, Tennessee	1993
Larry A. Watson	Chairman and President, Liberty Federal Savings Bank, Paris, Tennessee	1993
Lewis F. Mallory, Jr.	Chairman and Chief Executive Officer, National Bank of Commerce of Mississippi, Starkville, Mississippi	1994
Anthony M. Rampley	President, Chief Executive Officer, and Director, Arkansas Glass Container Corporation, Jonesboro, Arkansas	1995
Appointed by the Board of Governors		
Seymour B. Johnson	Owner, Kay Planting Company, Indianola, Mississippi	1993
Sidney Wilson, Jr.	Owner, Wilson Automotive Group Inc., Jackson, Tennessee	1994
Vacancy		1995
DISTRICT 9—MINNEAPOLIS		
Class A		
Charles L. Seaman	President and Chief Executive Officer, First State Bank of Warner, Warner, South Dakota	1993
William W. Strausberg	Chairman and Chief Executive Officer, First Bank Montana, N.A., and General Manager, First Bank-Regional Banking Group, Billings, Montana	1994
Susanne V. Boxer	President and Chief Executive Officer, Houghton National Bank, Houghton, Michigan	1995
Class B		
Earl R. St. John, Jr.	President, St. John Forest Products, Inc., Spalding, Michigan	1993

		Term expires Dec. 31
DISTRICT 9, *Class B*—Continued		
Duane E. Dingmann	President, Trubilt Auto Body, Inc., Eau Claire, Wisconsin	1994
Dennis W. Johnson	President, TMI Systems Design Corporation, TMI Transport Corporation, Dickinson, North Dakota	1995
Class C		
Delbert W. Johnson	President and Chief Executive Officer, Pioneer Metal Finishing, Minneapolis, Minnesota	1993
Jean D. Kinsey	Professor, Consumption and Consumer Economics, Department of Agricultural and Applied Economics, University of Minnesota, St. Paul, Minnesota	1994
Gerald A. Rauenhorst	Chairman and Chief Executive Officer, Opus Corporation, Minneapolis, Minnesota	1995

HELENA BRANCH

Appointed by the Federal Reserve Bank		
Beverly D. Harris	President, Empire Federal Savings and Loan Association, Livingston, Montana	1993
Donald E. Olsson, Jr.	Executive Vice President, Ronan State Bank, Ronan, Montana	1994
Nancy M. Stephenson	Executive Director, Neighborhood Housing Services, Great Falls, Montana	1994
Appointed by the Board of Governors		
James E. Jenks	President, Jenks Farms, Hogeland, Montana	1993
Lane W. Basso	President, Deaconess Medical Center of Billings, Inc., Billings, Montana	1994

DISTRICT 10—KANSAS CITY

Class A		
Roger L. Reisher	Co-Chairman, FirstBank Holding Company of Colorado, Lakewood, Colorado	1993
Charles I. Moyer	Chairman and Chief Executive Officer, First National Bank, Phillipsburg, Kansas	1994
William L. McQuillan	President, Chief Executive Officer, and Director, City National Bank, Greeley, Nebraska	1995
Class B		
Don E. Adams	Buffalo, Oklahoma	1993
Frank J. Yaklich, Jr.	Pueblo, Colorado	1994
W. W. Allen	President and Chief Operating Officer, Phillips Petroleum Company, Bartlesville, Oklahoma	1995

		Term expires Dec. 31
DISTRICT 10—Continued		
Class C		
Thomas E. Rodriguez	President and Manager, Thomas E. Rodriguez & Associates, P.C., Aurora, Colorado	1993
Burton A. Dole, Jr.	Chairman and President, Puritan-Bennett Corporation, Overland Park, Kansas	1994
Herman Cain	President and Chief Executive Officer, Godfather's Pizza, Inc., Omaha, Nebraska	1995

DENVER BRANCH

Appointed by the Federal Reserve Bank		
Peter R. Decker	President, Decker & Associates, Denver, Colorado	1993
Clifford E. Kirk	President and Chief Executive Officer, First National Bank of Gillette, Gillette, Wyoming	1994
Richard I. Ledbetter	President and Chief Executive Officer, First National Bank of Farmington, Farmington, New Mexico	1994
Peter I. Wold	Partner, Wold Oil and Gas Company, Casper, Wyoming	1995
Appointed by the Board of Governors		
Gilbert Sanchez	President, New Mexico Highlands University, Las Vegas, New Mexico	1993
Barbara B. Grogan	President, Western Industrial Contractors, Inc., Denver, Colorado	1994
Sandra K. Woods	Vice President, Adolph Coors Company, Golden, Colorado	1995

OKLAHOMA CITY BRANCH

Appointed by the Federal Reserve Bank		
Gordona Duca	President and Owner, Gordona Duca, Inc., Realtors, Tulsa, Oklahoma	1993
C. Kendric Fergeson	Chairman and Chief Executive Officer, The National Bank of Commerce, Altus, Oklahoma	1993
John Wm. Laisle	President and Chief Executive Officer, MidFirst Bank, SSB, Oklahoma City, Oklahoma	1994
Dennis M. Mitchell	President, Citizens Bank of Ardmore, Ardmore, Oklahoma	1995
Appointed by the Board of Governors		
Ernest L. Holloway	President, Langston University, Langston, Oklahoma	1993
Victor R. Schock	President and Chief Executive Officer, Credit Counseling Centers, Tulsa, Oklahoma	1994

Term expires Dec. 31

DISTRICT 10, OKLAHOMA CITY BRANCH
Appointed by the Board of Governors—Continued

Barry L. Eller	Sr. Vice President and General Manager, MerCruiser, Mercury Marine Business Unit, Division of Brunswick Corp., Stillwater, Oklahoma	1995

OMAHA BRANCH

Appointed by the Federal Reserve Bank

Bruce R. Lauritzen	President, First National Bank of Omaha, Omaha, Nebraska	1993
Donald A. Leu	President and Chief Executive Officer, Consumer Credit Counseling Service, Omaha, Nebraska	1993
Thomas H. Olson	Chairman, First National Bank, Sidney, Nebraska	1993
Robert L. Peterson	Chairman, President, and Chief Executive Officer, IBP, Inc., Dakota City, Nebraska	1995

Appointed by the Board of Governors

LeRoy W. Thom	President, T-L Irrigation Company, Hastings, Nebraska	1993
Arthur L. Shoener	Executive Vice President - Operations, Union Pacific Railroad, Omaha, Nebraska	1994
Sheila Griffin	Special Advisor to the Governor of the State of Nebraska for International Trade, Lincoln, Nebraska	1995

DISTRICT 11—DALLAS

Class A

T. C. Frost	Chairman, Frost National Bank, San Antonio, Texas	1993
Eugene M. Phillips	Chairman and President, The First National Bank of Panhandle, Panhandle, Texas	1994
Jeff Austin, Jr.	Chairman, Texas National Bank, Longview, Texas	1995

Class B

J. B. Cooper, Jr.	Farmer, Roscoe, Texas	1993
Peyton Yates	President, Yates Drilling Company and Executive Vice President, Yates Petroleum Corporation, Artesia, New Mexico	1994
Milton Carroll	Chairman and Chief Executive Officer, Instrument Products, Inc., Houston, Texas	1995

Class C

James A. Martin	Third General Vice President, International Association of Bridge, Structural and Ornamental Iron Workers, Austin, Texas	1993

		Term expires Dec. 31
DISTRICT 11, *Class C*—Continued		
Cece Smith	General Partner, Phillips-Smith Specialty Retail Group, Dallas, Texas	1994
Leo E. Linbeck, Jr.	Chairman and Chief Executive Officer, Linbeck Construction Corporation, Houston, Texas	1995

EL PASO BRANCH

Appointed by the Federal Reserve Bank

Veronica K. Callaghan	Vice President and Principal, KASCO Ventures, Inc., El Paso, Texas	1993
Ben H. Haines, Jr.	President and Chief Operating Officer, First National Bank of Dona Ana County, Las Cruces, New Mexico	1993
Hugo Bustamante, Jr.	Owner and Chief Executive Officer, ProntoLube, Inc. and CarLube, Inc., El Paso, Texas	1994
Wayne Merritt	Chairman and President, Texas National Bank of Midland, Midland, Texas	1995

Appointed by the Board of Governors

Diana S. Natalicio	President, The University of Texas at El Paso, El Paso, Texas	1993
Alvin T. Johnson	President, Management Assistance Corporation of America, El Paso, Texas	1994
W. Thomas Beard III	President, Leoncita Cattle Company, Alpine, Texas	1995

HOUSTON BRANCH

Appointed by the Federal Reserve Bank

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
Tieman H. Dippel, Jr.	Chairman and President, Brenham Bancshares, Inc., Brenham, Texas	1994
J. Michael Solar	President, Solar & Ellis L.L.P., Houston, Texas	1995

Appointed by the Board of Governors

Robert C. McNair	Chairman and Chief Executive Officer, Cogen Technologies, Inc., Houston, Texas	1993
Isaac H. Kempner III	Chairman, Imperial Holly Corporation, Sugar Land, Texas	1994
Judy Ley Allen	Partner and Administrator, Allen Investments, Houston, Texas	1995

DISTRICT 11—Continued

San Antonio Branch

Appointed by the Federal Reserve Bank

		Term expires Dec. 31
Javier Garza	Executive Vice President, The Laredo National Bank, Laredo, Texas	1993
Sam R. Sparks	President, Sam R. Sparks, Inc., Progreso, Texas	1993
T. Jack Moore III	Owner and Manager, T.J. Moore Lumber Inc., Ingram, Texas	1994
Gregory W. Crane	President and Chief Executive Officer, Broadway National Bank, San Antonio, Texas	1995

Appointed by the Board of Governors

Erich Wendl	President and Chief Executive Officer, Maverick Markets, Inc., Corpus Christi, Texas	1993
Roger R. Hemminghaus	Chairman, President, and Chief Executive Officer, Diamond Shamrock, Inc., San Antonio, Texas	1994
Carol L. Thompson	Consultant and President, The Thompson Group, Austin, Texas	1995

DISTRICT 12—San Francisco

Class A

Richard L. Mount	Chairman, President, and Chief Executive Officer, Saratoga Bancorp, Saratoga, California	1993
William E. B. Siart	President, First Interstate Bancorp, Los Angeles, California	1994
Carl J. Schmitt	Chairman and Chief Executive Officer, University National Bank & Trust Company, Palo Alto, California	1995

Class B

John N. Nordstrom	Co-Chairman of the Board, Nordstrom, Inc., Seattle, Washington	1993
William L. Tooley	Chairman, Tooley & Company, Investment Builders, Los Angeles, California	1994
E. Kay Stepp	Former President and Chief Operating Officer, Portland General Electric Company, Portland, Oregon	1995

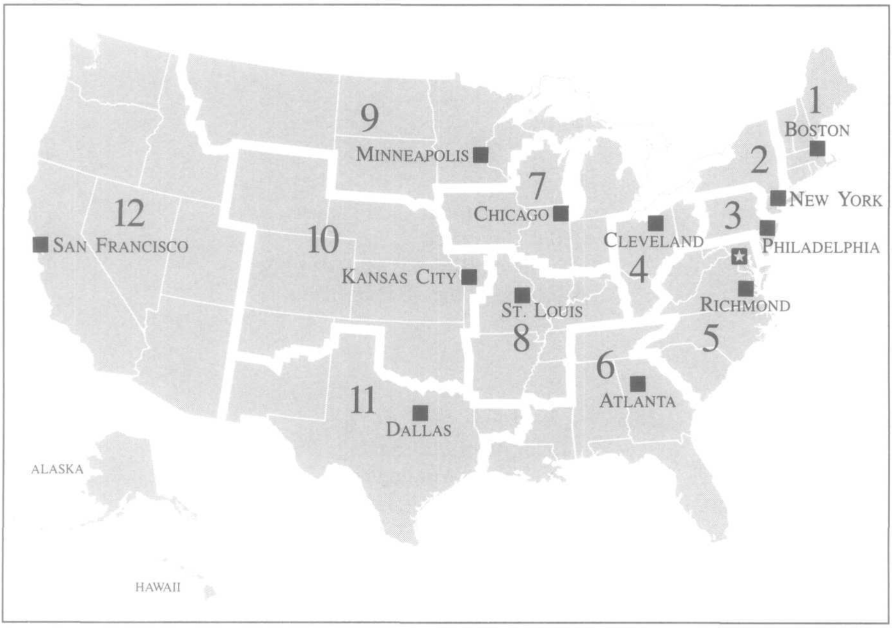
Class C

James A. Vohs	Chairman and Chief Executive Officer (Retired), Kaiser Foundation Health Plan, Inc., and Kaiser Foundation Hospitals, Oakland, California	1993
Judith M. Runstad	Partner and Managing Director, Foster, Pepper, and Shefelman, Seattle, Washington	1994
Cynthia A. Parker	Executive Director, Anchorage Neighborhood Housing Services, Inc., Anchorage, Alaska	1995

		Term expires Dec. 31
DISTRICT 12—Continued		
LOS ANGELES BRANCH		
Appointed by the Federal Reserve Bank		
Anita Landecker	Regional Vice President, Local Initiatives Support Corporation, Los Angeles, California	1993
Antonia Hernandez	President and General Counsel, Mexican American Legal Defense and Educational Fund, Los Angeles, California	1994
William S. Randall	Chief Executive Officer, Southwest Region, First Interstate Bank, Phoenix, Arizona	1994
Steven R. Sensenbach	President and Chief Executive Officer, Vineyard National Bank, Rancho Cucamonga, California	1995
Appointed by the Board of Governors		
Donald G. Phelps	Chancellor, Los Angeles Community College District, Los Angeles, California	1993
David L. Moore	President, Western Growers Association, Newport Beach, California	1994
Anne L. Evans	Chairman, Evans Hotels, San Diego, California	1995
PORTLAND BRANCH		
Appointed by the Federal Reserve Bank		
Cecil W. Drinkward	President, Hoffman Construction Company, Portland, Oregon	1993
Stephen G. Kimball	Chairman, President, and Chief Executive Officer, Baker Boyer Bancorp, Walla Walla, Washington	1993
Stuart H. Compton	Chairman, Pioneer Trust Bank, N.A., Salem, Oregon	1994
Elizabeth K. Johnson	President, TransWestern Helicopters, Inc., Scappoose, Oregon	1995
Appointed by the Board of Governors		
Ross R. Runkel	Professor of Law, Willamette University, Salem, Oregon	1993
William A. Hilliard	Editor, The Oregonian, Portland, Oregon	1994
Carol A. Whipple	Owner/Manager, Rocking C Ranch, Elkton, Oregon	1995
SALT LAKE CITY BRANCH		
Appointed by the Federal Reserve Bank		
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

		Term expires Dec. 31
DISTRICT 12, SALT LAKE CITY BRANCH		
Appointed by the Federal Reserve Bank—Continued		
Virginia P. Kelson	Partner, Ralston Consulting Group, Salt Lake City, Utah	1993
Vacancy		1994
Roy C. Nelson	President, Bank of Utah, Ogden, Utah	1995
Appointed by the Board of Governors		
Constance G. Hogland	Executive Director, Boise Neighborhood Housing Services, Inc., Boise, Idaho	1993
Gerald R. Sherratt	President, Southern Utah University, Cedar City, Utah	1994
Gary G. Michael	Chairman and Chief Executive Officer, Albertson's, Inc., Boise, Idaho	1995
SEATTLE BRANCH		
Appointed by the Federal Reserve Bank		
B. R. Beeksma	Chairman, InterWest Savings Bank, Oak Harbor, Washington	1993
Gerry B. Cameron	Vice Chairman, U.S. Bancorp, Seattle, Washington	1993
Thomas E. Cleveland	Chairman and Chief Executive Officer, Enterprise Bank of Bellevue, N.A., Bellevue, Washington	1994
Constance L. Proctor	Partner, Alston, Courtnage, MacAulay & Proctor, Seattle, Washington	1995
Appointed by the Board of Governors		
George F. Russell, Jr.	Chairman, Frank Russell Company, Tacoma, Washington	1993
William R. Wiley	Senior Vice President, Battelle Memorial Institute; Director, Battelle/Pacific Northwest Division; and Director, U.S. Department of Energy, Pacific Northwest Laboratory, Richland, Washington	1994
Emilie A. Adams	President and Chief Executive Officer, Better Business Bureau, Seattle, Washington	1995

Maps of the Federal Reserve System



LEGEND

Both pages

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- ◘ Board of Governors of the Federal Reserve System, Washington, D.C.

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 District 12, 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 maps show the boundaries within the System as of year-end 1993.


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NH
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CT
RI
BOSTON
2–B
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CT
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NJ
NY
NEW YORK
3–C
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NJ
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PHILADELPHIA
4–D
Pittsburgh
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Cincinnati
KY
CLEVELAND
5–E
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Helena
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