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*81st Annual  
Report  
1994*



*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., May 25, 1995**

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

This report covers operations of the Board during calendar year 1994.

Sincerely,

A handwritten signature in black ink, appearing to read "Alan Greenspan". The signature is fluid and cursive, with a long horizontal stroke at the end.

*Chairman*

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*Part 1*

*Monetary Policy and  
the U.S. Economy in 1994*



## Introduction

The U.S. economy turned in a strong performance in 1994. Real gross domestic product increased 4 percent over the four quarters of the year. The employment gains associated with this rise in production outpaced growth of the labor force by a sizable margin, and the unemployment rate thus declined substantially. Price increases picked up in some sectors of the economy in 1994 as labor and product markets tightened, but broader measures of price change showed inflation holding fairly steady: The consumer price index increased about 2¾ percent over the year, the same as in 1993.

Federal Reserve policy during 1994 was aimed at fostering a financial environment conducive to sustained economic growth. As the economy moved back toward high rates of resource utilization, pursuit of this aim necessitated acting to prevent a buildup of inflationary pressures. Federal Reserve policy had remained very accommodative in 1993 in order to offset factors that had been inhibiting economic growth. By early 1994, however, the expansion clearly had gathered momentum, and maintenance of the prevailing stance of policy would eventually have led to rising inflation that, in turn, would have jeopardized economic and financial stability. Taking account of anticipated lags in the effects of policy changes, the Fed-

eral Reserve began to firm money market conditions in February 1994. Additional tightening followed over the course of the year, as economic growth remained unexpectedly strong, eroding remaining margins of unused resources and intensifying price increases at early stages of production. During this period, the economic effects of the tightening of monetary policy may have been muted by developments in financial markets—for example, easier credit availability through banks and a decline in the foreign exchange value of the dollar.

Short-term interest rates increased about 2½ percentage points during 1994, with the federal funds rate rising from 3 percent to 5½ percent. Other market interest rates rose between 1½ percentage points and 3½ percentage points, on net, with the largest increases coming at intermediate maturities. Through much of the year, intermediate- and long-term rates were lifted by more rapid actual and expected economic growth, fears of a pickup in inflation, and market expectations of additional policy moves. However, a further substantial tightening in November and, near year-end, some tentative signs of moderation in economic activity appeared to reduce market concerns about increased inflation pressures and additional Federal Reserve policy actions. As a result, long-term rates declined, on net, from mid-November through the end of December.

The foreign exchange value of the dollar in terms of other Group of Ten currencies declined about 6½ percent during 1994, even as the economy picked up and interest rates rose. The positive effects on the dollar that would

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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 1995). Data cited here and in the next three chapters are those available as of mid-March 1995.

normally have been expected from higher U.S. interest rates were offset in large part by upward movements in long-term interest rates abroad. Indeed, foreign long-term rates increased as much, on average, as U.S. rates during 1994, because growth abroad, especially in Europe, was more rapid than expected. Concerns about U.S. inflation may have contributed to weakness in the dollar in the middle part of 1994; late in the year, the dollar rallied, as tighter monetary policy apparently reduced investors' inflation fears.

Despite the rise in U.S. interest rates in 1994, private-sector borrowing, abetted in part by more aggressive lending by intermediaries, picked up in support of increased spending. The debts of both households and businesses grew at their fastest rates in five years. The step-up in growth of private debt was accompanied by changes in its composition. As bond yields rose, businesses shifted toward short-term funding sources, increasing their bank borrowing and commercial paper issuance while cutting back on new bond issues. Similarly, households turned increasingly to adjustable rate mortgages as rates on fixed rate mortgages increased substantially. Banks encouraged the shift of households and businesses to bank borrowing by easing lending standards and not allowing all of the rise in market rates to show through to loan rates. In contrast to the trend in private-sector borrowing, federal borrowing was slowed in 1994 by policies adopted in previous years to narrow the federal deficit, as well as by the effects of the strong economy on tax receipts and spending. Taken together, the debt of all nonfinancial sectors expanded  $5\frac{1}{4}$  percent, a rise that was the same as the increase of a year earlier and that was in the middle portion of the 1994 monitoring range of 4 percent to 8 percent.

Growth in the broad monetary aggregates remained subdued in 1994. The expansion of M3, about  $1\frac{1}{2}$  percent, was well within the 0 percent to 4 percent range established by the Federal Open Market Committee and slightly more than its increase in 1993. M3 was buoyed by growth of 7 percent in large time deposits, as banks turned to wholesale markets to fund credit expansion. For the year, M2 rose about 1 percent, the lower bound of its 1 percent to 5 percent range. In contrast to 1992 and 1993, the slow growth in M2, and the resulting further substantial increase in its velocity (the ratio of nominal GDP to the money stock), was not a consequence of unusually large shifts from M2 deposits to bond and stock mutual funds. Rather, it seemed to reflect behavior similar to that in earlier periods of rising short-term market interest rates. During such periods, changes in the rates available on retail deposits usually lag changes in market rates, providing an incentive to redirect savings from these deposits to market instruments. These shifts tend to have an especially marked effect on M1 because yields on its components either cannot adjust or adjust quite slowly to shifts in market rates. Growth of M1 during the year was  $2\frac{1}{4}$  percent; it had been  $10\frac{1}{2}$  percent in 1993. Only continued strong growth in currency, much of which likely reflected increased use abroad, supported M1.

In 1995 the Federal Reserve will seek to promote continued economic expansion while avoiding the provision of so much liquidity that a sustained step-up in inflation might begin to develop. Much progress has been made over the past couple of business cycles in reducing the role that inflation plays in the economic decisions of households and businesses. Moving forward, the challenge will be to preserve and extend this progress, given that the Federal Reserve

can best contribute to long-run prosperity by establishing an environment of effective price stability.

Economic prospects for the long run will be further enhanced if the Congress and the Administration succeed in making further progress in reducing the federal budget deficit. An improved outlook for the federal deficit over the remainder of this decade and beyond could have significant favorable effects in financial markets, including a shift in long-term interest rates to a trajectory lower than that which would otherwise prevail. Such a shift in long-term rates would be an essential part of a process in which a larger share of the nation's limited supply of savings would be channeled to productivity-improving investment, thereby boosting growth in output and living standards. ■

## The Economy in 1994

The economy recorded a third year of strong expansion in 1994. Real GDP grew 4 percent over the four quarters of the year, industrial output rose 6 percent, and the number of nonfarm payroll jobs increased about 3½ million, the largest gain in ten years. Labor and product markets tightened appreciably. Price pressures intensified in the markets for materials, but broader measures of price change showed inflation holding steady.

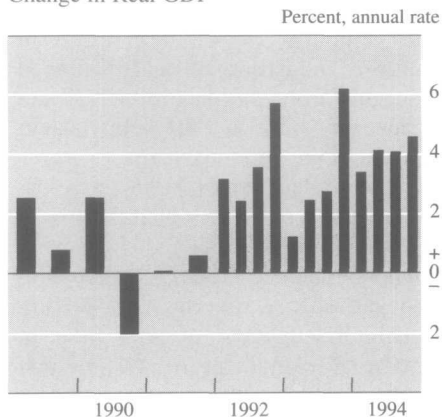
As in 1992 and 1993, the economic advance during 1994 was driven mainly by sharp increases in the real expenditures of households and businesses. Consumer purchases of motor vehicles rose further in 1994, and purchases of other consumer durables increased even faster than they had in the two previous years. Residential investment posted a small gain, on net, over the four quarters of the year, despite sharp increases in mortgage interest rates. Business investment in office and computing equipment slowed from the spectacular pace of 1993 but continued to rise rapidly nonetheless, and business investment in other types of equipment accelerated. Real outlays for non-residential construction, which had been a weak sector of the economy in previous years, picked up in 1994; outlays for office construction ended a long slide that had stretched well back into the 1980s. Business investment in inventories, which had been quite restrained in previous years of the expansion, increased appreciably in 1994. Much of the inventory buildup apparently was intentional and reflected the desires of firms to stock up in anticipation of continued strength in sales or to build

stronger buffers against potential delays in supply.

In contrast to the strength in private expenditures, government purchases of goods and services edged down on net over the four quarters of 1994. Federal purchases of goods and services, which had declined sharply in 1993, fell further in 1994 as a consequence of actions taken in recent years to reduce the size of the federal deficit. Meanwhile, the real purchases of state and local governments rose only modestly. Although the expanding economy provided states and localities with a stronger revenue base, many of these jurisdictions continued trying to hold spending in check; a number of states chose to cut taxes.

As in the two previous years, a significant portion of the rise in domestic spending in 1994 went for imports of goods and services, which increased about 14 percent in real terms during the

Change in Real GDP



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

year. Meanwhile, growth of real exports of goods and services picked up noticeably, with gains cumulating to about 11½ percent over the year.

Labor and product markets tightened in 1994. After ticking up in January in conjunction with the introduction of a new labor market survey, the civilian unemployment rate fell sharply over the remainder of the year, to 5.4 percent in December. In manufacturing, gains in production exceeded the growth of capacity by a sizable margin during 1994, and the rate of capacity utilization climbed 3 percentage points. Its level at year-end was in line with the highest level achieved during the economic expansion of the 1980s.

Inflation pressures picked up in some markets in 1994. Prices of raw industrial commodities rose even more rapidly than in 1993, and prices of intermediate materials accelerated sharply, especially after midyear. However, the inflation impulse in these markets did not carry through with any visible force to the consumer level, probably because unit labor costs, which make up by far the largest part of value added in production and marketing, continued to rise at a low rate. The employment cost index of hourly compensation in private nonfarm industries actually slowed noticeably from the pace of 1993, and productivity gains in 1994 held close to the pace of the previous year.

As for retail prices, 1994 was the fourth year in a row in which the rise in the total consumer price index has been around 3 percent. The CPI excluding food and energy rose just 2.8 percent over the four quarters of 1994, after an increase of 3.1 percent in 1993; the rate of rise in this index, which is widely used as an indicator of underlying inflation trends, was nearly halved from 1990 to 1994.

## The Household Sector

Real personal consumption expenditures advanced 3½ percent over the four quarters of 1994, a rate about in line with the average of the two previous years. Support for the rise in spending came from rapid income growth, and, according to surveys, from sharp increases in consumer confidence. Outlays for durable goods continued to rise especially rapidly, seemingly little affected by rising interest rates. Nor did spending appear to be much affected, in the aggregate, by poor performance of the stock and bond markets, which cut into the real value of household assets. Credit generally was readily available during 1994; growth of consumer installment debt picked up substantially, to a pace comparable with some of the larger increases that were observed during the expansions of the 1970s and 1980s.

Real consumer expenditures for durable goods increased about 8½ percent in 1994, bringing the cumulative rise in these outlays over the past three years to nearly 30 percent. The stock of durable goods that households wish to hold apparently continued to rise quite rapidly in 1994, and at least some households probably were still making up for purchases that had been put off earlier in the 1990s, when the economy was sluggish and concerns about job prospects were widespread. Real expenditures for motor vehicles moved up an additional 3½ percent over the four quarters of 1994, after gains of about 9 percent in each of the two preceding years; increases in sales of vehicles in 1994 might have been a bit stronger still but for capacity constraints and various supply disruptions that sometimes limited the availability of certain models. Real outlays for durable goods other than motor vehicles rose about 12 percent over the four quarters of 1994, a pickup

from the already rapid rates of expansion of the two previous years. Purchases of personal computers and other electronic equipment continued to surge in 1994, and spending on furniture and household appliances moved up further.

Consumer expenditures for nondurables and services exhibited mixed patterns of change in 1994. Real outlays for nondurables increased more than 3 percent over the year, a pickup from the subdued rate of growth recorded in the previous year and, for this category, a larger-than-average advance by historical standards. By contrast, real expenditures for services increased roughly 2¼ percent, a slightly smaller gain than that of 1993; growth of outlays for services was held down, to some degree, by a decline in real outlays for energy, as warm weather late in 1994 reduced the amount of fuel needed for heating.

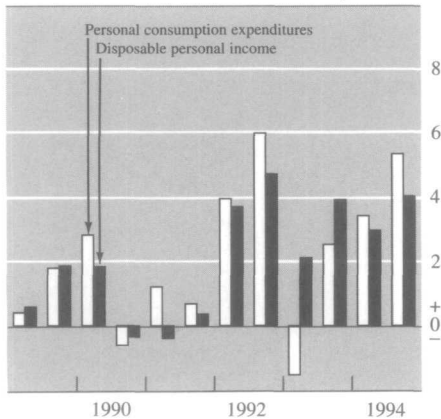
Real disposable personal income rose nearly 4½ percent during 1994. Except for a couple of occasions in previous years when income growth was boosted temporarily by special factors, the rise

in real disposable income in 1994 was the largest increase since the 1983–84 period. Growth of wages and salaries accelerated in 1994 in conjunction with the step-up of employment growth. Income from capital also rose: Dividends moved up along with corporate profits, and interest income turned back up after three years of decline. By contrast, transfer payments, the growth of which tends to slow as the economy strengthens, registered the smallest annual increase since 1987. The net income of nonfarm proprietors appears to have about kept pace with the average rate of growth in other types of income. Farm income rose moderately on an annual average basis, as an increase in the volume of output more than offset the effects of sharp declines in farm output prices that developed over the course of the year.

Consumers' perceptions of economic and financial conditions brightened considerably during 1994. By year-end, the composite measures of consumer confidence that are prepared by the Conference Board and the University of Michigan Survey Research Center had both moved to new highs for the current business expansion. Consumers became more optimistic over the year in regard both to current and to future economic conditions. Perceptions of employment prospects also improved, with a growing proportion of respondents saying that jobs were plentiful and a reduced proportion saying that jobs were hard to find.

In contrast to most other indicators for the household sector of the economy, household balance sheets—which had strengthened appreciably in previous years—showed little or no improvement in 1994. According to preliminary data, the aggregate net worth of households recorded a relatively small increase in nominal terms over the year, and, in real

Change in Real Income and Consumption  
Percent, annual rate



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

terms, net worth may have declined. Household assets rose only moderately in nominal terms, and the growth of nominal liabilities picked up a bit as a result of the sharp increase in use of consumer credit.

With personal income growing faster than net worth during 1994, the ratio of wealth to income fell over the course of the year. In the past, declines in this ratio sometimes have prompted households to boost the proportion of current income that is saved, in an attempt to restore wealth to more desirable levels, and this same tendency may have been at work, to some extent, in 1994. After dipping in the first quarter of the year to the lowest level of the current expansion, the personal saving rate rose a full percentage point over the remainder of the year, to a fourth-quarter level of 4.6 percent. Even then, however, the saving rate remained quite low by historical standards. Rising levels of income and employment and increased confidence in the outlook apparently convinced consumers to push ahead with increases in outlays, most notably on consumer durables.

Despite the apparent flagging in the improvement in household balance sheets, signs of outright stress in household financial conditions were not much in evidence in 1994. Delinquency rates on mortgages and most other types of household loans generally remained quite low relative to their historical ranges. Credit card delinquencies moved up toward the end of the year, however.

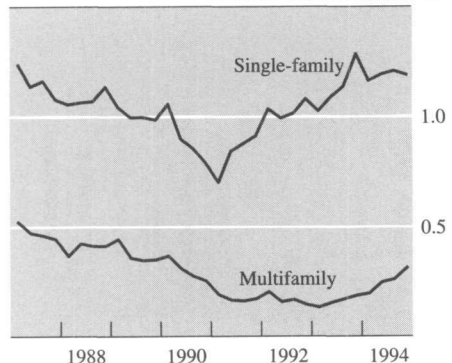
Residential investment held up remarkably well in 1994 in the face of sharp increases in mortgage interest rates. In real terms, these investment outlays were up about 3 percent, on net, over the four quarters of the year, after gains of 17 percent in 1992 and 8 percent in 1993. In the market for single-family houses, the number of sales and

the number of houses on which construction was started fell back from the exceptionally high peaks that were reached briefly in late 1993, but they remained at elevated levels. In total, construction began on 1.20 million single-family units in 1994, a figure that was slightly above the highest annual total of the 1980s. The number of sales of existing homes nearly matched the previous annual peak, reached in 1978; and although sales of new homes remained well short of previous highs, the 1994 total was in line with the number sold in the brisk market of 1993.

Declines in the starts and sales of single-family houses in early 1994 basically reversed the huge gains of late 1993. Whatever tendency there may have been for these indicators to exhibit at least a temporary setback after a period of unusual strength was probably reinforced by the initial reactions of builders and homebuyers to increases in mortgage interest rates that had begun in the final quarter of 1993. Exceptionally severe winter weather in the Northeast and Midwest early in 1994, coming on the heels of favorable conditions in late 1993, probably also helped to account for the sharpness of the downturn. In

Private Housing Starts

Millions of units, annual rate



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

any event, starts of single-family homes ticked back up a bit in the second quarter of the year, sales of existing homes essentially flattened out, and the rate of decline in sales of new homes slowed.

After midyear, sales of existing homes began to exhibit a clear downtrend. However, sales of new homes strengthened through the summer and into the autumn, and single-family starts held firm. Sizable gains in employment and income and rising optimism about the future of the economy apparently helped to blunt the effects of increases in interest rates during this period. In addition, the availability of a widening variety of alternative mortgage instruments and, perhaps, some easing of loan qualification standards may have permitted some buyers, who otherwise would not have been able to obtain financing, to go ahead with their purchases.

Toward year-end a softer tone seemed to be emerging in some key indicators of single-family housing activity. Sales of new homes tailed off sharply in November and December, and the ratio of the number of unsold homes to the number of sales, which had turned upward in early 1994, continued to rise. By December the ratio had moved up to a level that was a little above its historical average. Nonetheless, starts of new single-family houses remained strong through year-end, rising to a December level that was moderately above the average for the year as a whole.

Increases in the various measures of house prices were of small to moderate size in 1994. The median transaction prices of new and existing homes that were sold in the first half of the year were roughly 3½ percent above the level of a year earlier, and a similar rise was reported during that period in price indexes that adjust for changes in the quality and regional mix of homes that are sold. After midyear, the four-quarter

changes in median transaction prices slowed, but the rate of rise in the quality-adjusted indexes picked up somewhat. All told, prices have been firmer in the past couple of years than they were earlier in the 1990s.

After falling to exceptionally low levels in late 1992 and early 1993, construction of multifamily housing units increased throughout 1994. Although the level of activity in this part of the housing sector was not especially high, gains during the year were large in percentage terms: Starts of these units moved up about 65 percent from the fourth quarter of 1993 to the fourth quarter of 1994, at which point they were more than double the lows of a couple of years ago. The national average vacancy rate for multifamily rental units remained relatively high in 1994, but markets in some areas of the country had tightened enough to make construction of new multifamily units economically attractive. The August 1993 reauthorization of a tax credit on low-income housing units also provided some incentive for new construction. The financing of multifamily projects was facilitated through more ready availability of credit and increased equity investment.

## The Business Sector

Robust expansion was evident in most of the economic indicators for the business sector of the economy in 1994. Real output of nonfarm businesses increased about 4¼ percent over the four quarters of the year, according to preliminary estimates. For a second year, business investment in fixed capital advanced exceptionally rapidly. Inventory investment also picked up appreciably, spurred by large, sustained increases in sales. Business finances remained on a sound footing: Invest-



ment expenditures continued to be financed predominantly with internal funds, and signs of financial stress were largely absent.

Industry entered 1994 with considerable momentum and maintained a rapid pace of expansion throughout the year. Industrial production rose 6 percent over the four quarters of 1994, a growth rate exceeded in only one of the past ten years. The production of business equipment advanced especially rapidly, buoyed by rising investment in the domestic economy and further large increases in exports of capital goods. Production of intermediate products—which consist mainly of supplies used in business and construction—also moved up substantially during 1994, as did the output of materials, especially those used as inputs in the production of durable goods.

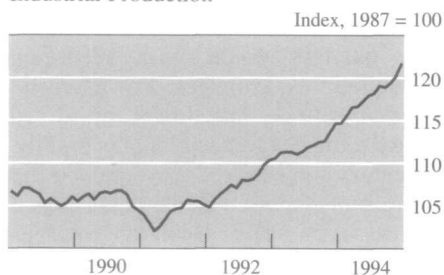
The rate of capacity utilization in industry increased about 2½ percentage points over the twelve months of 1994, to a level that was about ½ percentage point above the peak of the late 1980s. In manufacturing, the operating rate rose 3 percentage points during the year. By year-end, utilization rates in some industries had moved to exceptionally high levels. Most notably, the average operating rate among manufacturers engaged in primary processing (basically, the producers of materials) had climbed to the highest level since the end of 1973,

surpassing, by a percentage point or more, the peaks of the late 1970s and late 1980s.

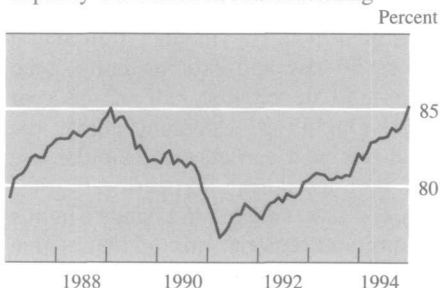
After rising 23½ percent during 1993, corporate profits increased another 4 percent over the first three quarters of 1994 (and as of mid-March 1995, indications are that profits also rose in the fourth quarter). The profits earned by nonfinancial corporations from their domestic operations increased about 7½ percent over the first three quarters of 1994, after a gain of 21½ percent in 1993. Although these 1994 gains were partly the result of increased volume, profits per unit of output also rose. In the second and third quarters, before-tax profits of nonfinancial corporations amounted to nearly 11 percent of the gross domestic output of those businesses—the highest level for this measure since the late 1970s. A reduced corporate reliance on debt, as well as the cyclical recovery of the economy, helped push up the profit share. In contrast to the experience of nonfinancial corporations, the profits of private financial institutions from their domestic operations fell about 7 percent over the first three quarters of the year, as net interest margins narrowed. The decline reversed some of the large rise in profits that these institutions had reported in 1993.

Business fixed investment increased nearly 13 percent in real terms over

Industrial Production



Capacity Utilization in Manufacturing



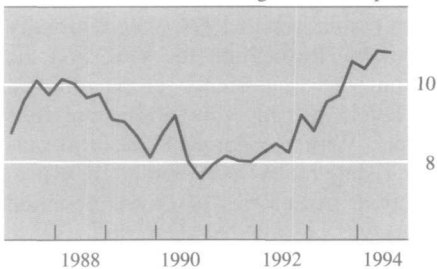
the four quarters of 1994, after a gain of 16 percent during 1993. Real expenditures for equipment, which had increased more than 20 percent in 1993, moved up an additional 15 percent over the four quarters of 1994, and investment in structures scored its biggest gain in several years.

In the equipment category, expenditures for office and computing equipment, which had registered an astonishing gain in 1993, slowed in 1994, but the rise in these outlays still amounted to nearly 20 percent in real terms. Meanwhile, the growth of real expenditures for most other types of business equipment picked up. Business investment in motor vehicles rose about 17 percent over the four quarters of 1994. With this gain coming on top of big increases in each of the two previous years, annual business outlays for vehicles reached a level nearly one-third higher than the peak year of the 1980s. Outlays for communications equipment also scored an especially big gain in 1994, more than 25 percent in real terms. Business purchases of industrial equipment advanced about 12 percent during 1994, one of the larger gains of the past two decades. By contrast, commercial aircraft once again was a notable area of

weakness; the investment cycle in that sector has been sharply out of phase with those of most other industries because of persistent excess capacity and poor profitability in the airline business.

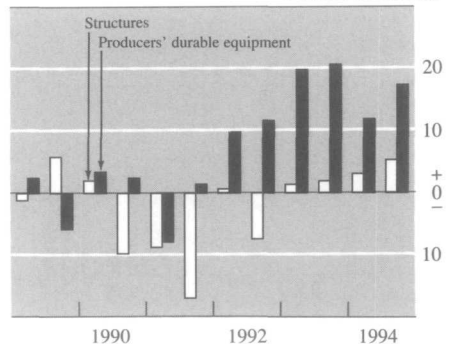
Business investment in nonresidential structures rose more than 4 percent during 1994, after an increase of 1½ percent in 1993 and declines in each of the three preceding years. Investment in industrial structures rose for the first time since 1990, more than likely in response to high—and rising—rates of capacity utilization. Investment in office buildings also picked up in 1994 after a long string of declines that, in total, had brought spending on these structures down about 60 percent from the peak of the mid-1980s; declining vacancy rates and a firming of property values provided additional evidence of improvement in this sector of the economy in 1994. The investment data for other types of structures showed a mix of pluses and minuses: Expenditures on commercial structures other than offices moved up further, after large gains in 1992 and 1993; however, outlays for drilling declined for a fourth year, to the lowest level since the early 1970s.

Corporate Profits before Taxes  
Percentage of nominal product



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

Change in Real Business Fixed Investment  
Percent, annual rate



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

Because a large share of the growth in business fixed investment in recent years has gone for items that depreciate relatively quickly—computers being a prime example—net additions to the stock of productive capital have not been as impressive as the data on gross investment expenditures might seem to indicate. Nonetheless, with the further increase in gross investment in 1994, net additions to the capital stock appear to have become more substantial. Still unclear is the degree to which these increases will ultimately translate into faster gains in output per worker and in living standards; as discussed in more detail below, the trend of growth in labor productivity, which is affected by the amount and quality of capital that workers have available, seems to have picked up in recent years but by a relatively small amount.

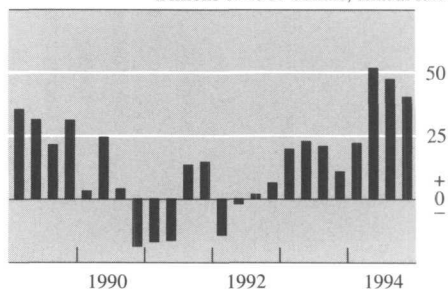
Business investment in inventories rose sharply in 1994. Earlier in the expansion, firms had refrained from building stocks, even as the economy strengthened. Increased reliance on “just in time” systems of inventory control reduced the level of stocks that firms needed to maintain their normal operations, and, with a degree of slack still present in the economy, businesses

usually were able to quickly obtain goods from their suppliers and thus were probably reluctant to hold stocks in house. At the end of 1993, the level of real inventories in the nonfarm business sector was only 2 percent higher than it had been at the start of the recovery in early 1991.

Circumstances changed in 1994, however. Markets tightened as demand continued to surge, and delays in the delivery of supplies became more common. Anticipation of further growth in demand and increased concern about possible bottlenecks apparently prompted businesses to begin investing more heavily in inventories. Some firms may also have been trying to stock up on materials in advance of anticipated price increases. For the year as a whole, accumulation of nonfarm inventories was more than twice what it had been in 1993. This additional accumulation brought to a halt the previous downtrend in the ratio of nonfarm inventories to business sales, but the ratio remained quite low by the standards of the past quarter-century.

Inventory accumulation in the farm sector of the economy also picked up in 1994. Stocks of farm products had been drawn down in 1993, when farm production fell sharply because of floods in the Midwest and droughts in some other regions of the country. However, crop conditions in 1994 were unusually favorable throughout the year, and the output of some major crops climbed to levels considerably above previous peaks. With the demand for farm output rising much less rapidly than production, inventories of crops increased sharply. Livestock production also rose appreciably in 1994; inventories of livestock, which consist mainly of the cattle and hogs on farms and ranches, continued to expand.

Change in Real Business Inventories  
Billions of 1987 dollars, annual rate



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

### The Government Sector

Federal purchases of goods and services, the part of federal spending that is included in GDP, fell almost 6 percent in real terms over the four quarters of 1994. Real outlays for defense remained on a sharp downtrend, and nondefense outlays, which had declined moderately in 1993, were little changed, on net, over the four quarters of 1994.

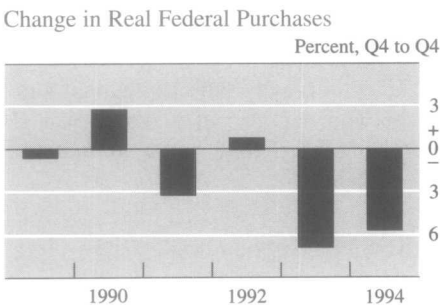
Total federal outlays, measured in nominal dollars in the unified budget, increased 3.7 percent in fiscal 1994 after a rise of 2.0 percent the previous fiscal year. These increases are among the smallest of recent decades. Nominal outlays for defense fell again in fiscal 1994. In addition, the growth of outlays for income security (a category that includes the expenditures on unemployment compensation and welfare benefits) slowed further as the economy continued to strengthen. Increases in social security outlays also slowed somewhat in fiscal 1994; the rise was about 1 percentage point less than that of nominal GDP. Outlays for Medicaid slowed as well, but the rate of rise in those expenditures once again exceeded the growth of nominal GDP.

Federal receipts were up 9 percent in fiscal 1994, the largest rise in several years. With rapid expansion of the economy giving a strong boost to almost all types of income, the major categories

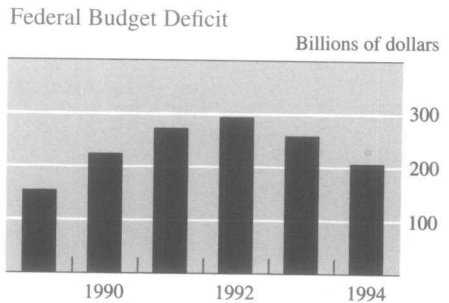
of federal receipts all showed sizable gains. Combined receipts from individual income taxes and social insurance taxes increased a bit more than 7 percent in fiscal 1994, after moving up 5.4 percent in the previous fiscal year. Receipts from taxes on corporate profits increased nearly 20 percent, slightly more than the gain of 1993.

The federal budget deficit declined to \$203 billion in fiscal 1994, an amount that was equal to 3.1 percent of nominal GDP. Earlier in the 1990s, when the economy was sluggish, the federal deficit had climbed to a cyclical peak of 4.9 percent of nominal GDP. The previous cyclical low in the ratio of the deficit to nominal GDP, 2.9 percent, was reached in fiscal 1989. Since fiscal 1989, defense spending as a share of GDP has dropped appreciably, but this source of deficit reduction has been essentially offset by increased outlays for health and social insurance. Thus, the ratio of total federal outlays to GDP has changed little, on net; it was about 22 percent in both fiscal 1989 and fiscal 1994. The ratio of federal receipts to nominal GDP was about 19 percent in both of those fiscal years.

The stronger economy of recent years has provided state and local governments with a growing revenue base and a broadening set of fiscal options. Some



NOTE. The data are from the Department of Commerce.



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

governments have responded to these developments by cutting taxes, in most cases by small amounts. Effective tax rates of state and local governments appear to have edged down a bit, on average, over the four quarters of 1994, and nominal receipts apparently rose somewhat less rapidly than nominal GDP over that period.

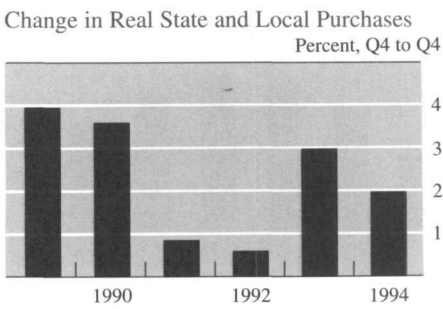
Many states and localities also have been trying to restrain the growth of expenditures, but success on that score has been difficult to achieve because of increased outlays for entitlements and rising demand for many of the public services that traditionally have been provided by state and local governments. Transfers of income from state and local governments to persons rose about 9 percent in nominal terms over the four quarters of 1994, roughly the same as the rise during 1993 but less than the increases of previous years; from 1988 to 1992, the average compound rate of growth in these transfers was about 15 percent a year. In categories other than transfers, increases in spending have been fairly restrained in recent years; nominal purchases of goods and services (which account for about 80 percent of the total expenditures of state and local governments) have been trending up less rapidly than nominal GDP since the early 1990s.

In real terms, the 1994 rise in purchases of goods and services by state and local governments amounted to just 2 percent. Compensation of employees, which accounts for about two-thirds of total state and local purchases, increased 1½ percent in real terms over the four quarters of 1994. Construction outlays declined slightly in real terms, as gains over the final three quarters of the year were not sufficient to offset a first-quarter plunge. Nonetheless, real outlays for structures remained at high levels; a strong uptrend in construction expenditures over the past ten or twelve years has more than reversed a long contraction that began in the latter half of the 1960s and bottomed out in the first half of the 1980s.

The deficit in the combined operating and capital accounts of all state and local governments (a measure that excludes the surpluses in state and local social insurance funds) amounted to about 0.6 percent of nominal GDP in calendar 1994, little changed from the corresponding figure for 1993 and down only slightly from a cyclical peak of 0.8 percent in 1991. The recent cyclical peak in this measure was larger than the peaks reached in recessions of the 1970s and 1980s, and declines in the deficit during this expansion have not been as large as the declines that occurred during other recent expansions. Historically, the combined operating and capital accounts of state and local governments have been in deficit more often than they have been in surplus; as a share of nominal GDP, the annual surpluses and deficits since World War II have averaged out to a deficit of 0.3 percent.

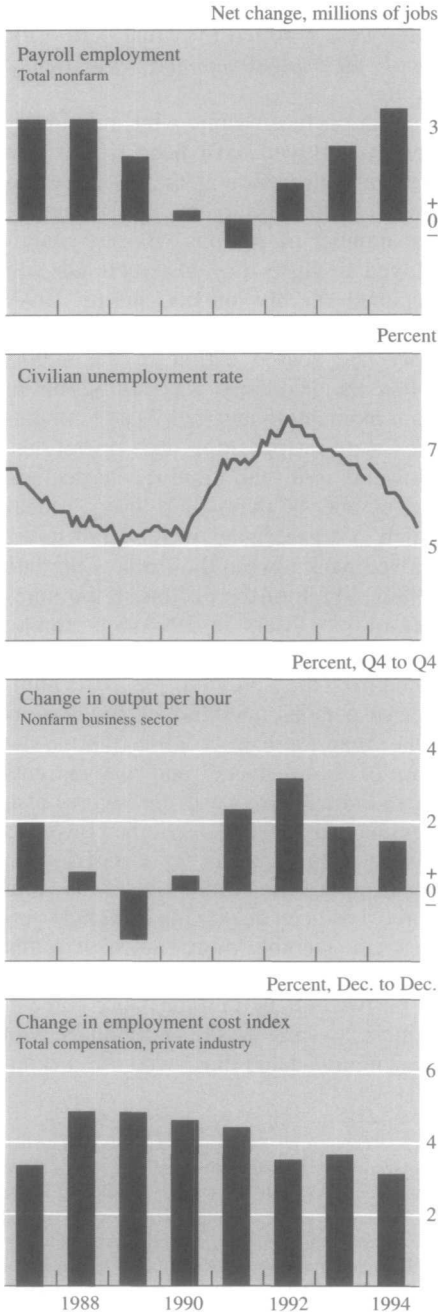
## Labor Markets

Employment rose substantially in 1994. The total number of jobs in the nonfarm



NOTE. The data are from the Department of Commerce.

Labor Market Conditions



NOTE. The data are from the Department of Labor. The department introduced a new survey of households in January 1994; unemployment data from that point on are not directly comparable with those of earlier periods.

sector of the economy increased 3.5 million over the twelve months ended in December, after a gain of 2.3 million during 1993.<sup>1</sup> About a quarter of a million of the rise in jobs during 1994 was in the government sector, mostly at the local level. Job growth in the private nonfarm sector amounted to 3.3 million, the largest gain since 1984. Increases in employment at nonfarm establishments were sizable in each quarter of 1994.

Producers of goods boosted employment more than half a million in 1994. The job count in construction increased about 310,000 over the year; employment at general building contractors rose briskly for a second year, as did the number of jobs at firms involved in special trades related to construction. The number of jobs in manufacturing increased about 285,000 during 1994, after five years of decline. Producers of durables accounted for most of the rise in manufacturing employment; among these producers, job gains were widespread. Employment at factories that produce nondurables rose slightly in total, as advances in some industries—such as printing and publishing and rubber and plastics—were partly offset by continued secular declines in the number of jobs in industries such as apparel, tobacco, and leather goods. The average workweek in manufacturing, which had stretched out in 1992 and 1993 when factory employment was declining, lengthened further in 1994, rising to new highs for the postwar period. The high fixed costs that are associated with adding new workers probably continued to be an important factor in firms’

1. The Bureau of Labor Statistics has announced that the level of nonfarm payroll employment in March 1994 will be raised 760,000 when revised estimates are released in the summer of 1995. The revision may lead to larger estimates of job growth in both 1993 and 1994.

decisions to rely still more heavily on a longer workweek as a way to boost labor input. Growth of factory output surpassed the rise in labor input by a sizable amount in 1994, a reflection of substantial gains in productivity that were realized in this sector of the economy in the most recent year.

Employment in the private service-producing sector rose nearly 2¾ million during 1994, after a gain of 2 million in 1993. The number of jobs in retail trade increased about 820,000 over the year. Auto dealers, stores that sell building materials, and those that sell general merchandise were among the retail outlets that reported impressive gains. Hiring at eating and drinking places also moved up briskly; after three years of slow growth around the start of the decade, hiring at these establishments has increased substantially in each of the past three years. Employment at firms that supply services to other businesses rose about 710,000 in 1994, even more than in 1993. Once again, job growth within this category was especially rapid at personnel supply firms—those that essentially lease the services of their workers to other employers, often on a temporary basis. Employment at businesses that supply health services increased a quarter of a million in 1994, about the same as the gain in 1993; hiring at hospitals has flattened out over the past couple of years, but elsewhere in the health sector job growth has continued at a rapid clip.

Strength also was evident in 1994 in data from the monthly survey of households. After ticking up in January 1994, when a redesigned household survey was implemented and new population estimates were introduced, the civilian unemployment rate turned back down in February and declined in most months thereafter. The rate in December, 5.4 percent, was 1.3 percentage

points below that of January.<sup>2</sup> Appreciable net declines in unemployment rates were reported over that period for nearly all occupational and demographic groups.

Data on the reasons why individuals are unemployed have been tracing out patterns fairly similar to those seen in previous business cycles. Most notably, the number of persons who are unemployed because they lost their last job declined sharply, on net, during 1994. The number of individuals in this category had soared earlier in the 1990s, when the economy was struggling to gain momentum and many large companies were restructuring their operations. However, with the more recent decline, the number of these “job losers,” measured as a percentage of the labor force, moved back toward the lows of the late 1980s. Much of the decline in the number of job losers in 1994 was among workers who were permanently separated from their previous jobs. The number of persons unemployed for reasons other than the loss of a job (that is, the sum of “job leavers” and new entrants or re-entrants unable to find work) also declined in 1994. As in other business cycles, the number of these individuals, measured relative to the size of the labor force, has been displaying a cyclical pattern considerably more muted than that of job losers.

Growth of the civilian labor force—which consists of the individuals who are employed and those who are seeking

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2. Research by the Bureau of Labor Statistics suggests that the unemployment rate would have run about two-tenths of a percentage point lower in 1994 but for the changes that were introduced in January of that year. Other series from the household survey were also affected by the introduction of the new survey and the revised population estimates; therefore, data for the period starting in January 1994 are not directly comparable with those for the period ended in December 1993.

employment but have not yet found it—picked up a bit in the second half of 1994. However, even with this increase, the cumulative rise in the labor force in the current business expansion has been relatively small compared with the gains recorded in other recent expansions; growth of the working-age population has been slower this decade than it was in the expansions of the 1970s and 1980s, and the share of the population participating in the labor force, which trended up in earlier expansions, has changed little, on net, during this one.

According to preliminary data, output per hour of labor input in the nonfarm business sector increased 1.4 percent over the four quarters of 1994, after a rise of 1.8 percent in 1993 and still larger gains in 1992 and 1991. Over the business cycle, productivity gains typically are largest in the early years of expansion, and, in that regard, the recent experience does not appear to be unusual. Abstracting from cyclical variation, the trend of productivity growth in recent years seems to have picked up somewhat from the unusually sluggish pace that prevailed through much of the 1970s and 1980s, but, at the same time, the pickup has not been nearly so large as some anecdotal reports might appear to suggest. For example, from late 1988 to late 1994, an interval of time that is long enough to capture all the phases that productivity goes through during the business cycle, the average rate of rise in output per hour in the nonfarm business sector amounted to slightly more than 1¼ percent, up only modestly from an average rate of rise of about ¾ percent during most of the 1970s and 1980s.<sup>3</sup>

3. Whether even this small degree of improvement in the productivity trend will withstand future revisions of the data is not clear. For example, among the many difficult issues that are

The rate of increase in hourly compensation moved down another notch in 1994. The employment cost index for private industry, a measure of hourly labor costs that comprises both wages and benefits, rose 3.1 percent during the twelve months ended in December 1994, after increases of 3.6 percent in 1993 and 3.5 percent in 1992. The rise in the wage component of compensation was slightly less than that of 1993, and the rate of increase in hourly benefits slowed appreciably. Increases in benefits were restrained, in large part, by another year of deceleration in health care costs and a further slowing in workers' compensation insurance costs. The rise in nominal compensation per hour in 1994 was the smallest yearly increase in the fifteen-year history of the series, the previous low of 3.2 percent having come midway through the expansion of the 1980s. Toward the end of that decade, as bidding for labor resources intensified, increases in compensation moved up for a time to around 5 percent a year.

Unit labor costs in the nonfarm business sector rose 1.9 percent over the four quarters of 1994, after an increase of just 0.6 percent over the four quarters of 1993. In manufacturing, a sector of the economy in which productivity has advanced quite rapidly in recent years, a rise in output per hour of 4.6 percent during 1994 more than offset a modest

involved in the measurement of productivity is the choice of an appropriate set of prices for valuing the output of goods and services. Currently, aggregate output is tallied by using the prices of 1987, but some major changes in relative prices have taken place since then, the most notable of which is the huge decline in the price of office and computing equipment. Using the prices of a more recent year to gauge real output would result in a reduced increment to growth from office and computing equipment. All else equal, the growth of productivity would also be negatively affected by a switch to the prices of a more recent year.



increase in hourly compensation, and unit labor costs declined noticeably for a second year.

## Price Developments

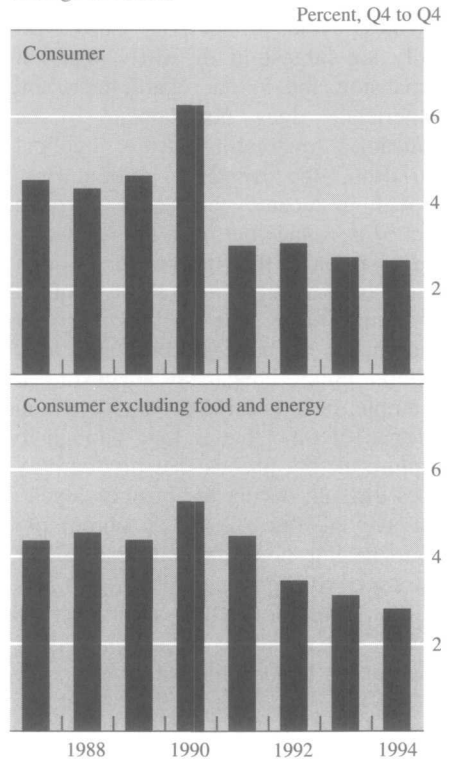
Although price increases picked up in some parts of the economy in 1994, the broader measures of price change continued to yield readings that were quite favorable. The rise in the total CPI was about 2¾ percent in 1994, the same as the increase during 1993. The CPI excluding food and energy also rose about 2¾ percent over the four quarters of 1994, after increasing slightly more than 3 percent in 1993. The producer price index for finished goods increased 1¼ percent during 1994, after edging up just ¼ percent during the previous year. As in 1992 and 1993, the past year's increases in all these price indexes were among the lowest readings of the past quarter-century. Measures of inflation expectations held steady in 1994, but continued to show readings that were somewhat higher, on average, than the actual rates of price increase.

The pickup of price increases in 1994 was confined largely to markets for materials. Prices of primary industrial inputs, which had moved up sharply during 1993, continued to surge in 1994, and price increases for intermediate materials accelerated as the year progressed. By year-end, the PPI for intermediate materials other than food and energy had moved to a level more than 5 percent above that of a year earlier, the largest such increase since the late 1980s. Prices of imports also picked up somewhat in 1994, influenced by the depreciation in the exchange value of the dollar; as was true in the domestic economy, the largest price increases for imported goods were those for materials. Gains in productivity apparently enabled manufacturers of finished goods

to absorb these increases in the costs of domestically produced and imported materials without raising their own prices very much.

In the CPI, the prices of commodities other than food and energy rose 1½ percent over the four quarters of 1994, about the same as the rise of 1993. Prices of new cars and new trucks, responding to strong demand and, at times, shortages in the supply of some models, moved up faster than prices in general; prices of used cars rose especially rapidly for a third year. The prices of tobacco products, which had fallen sharply in 1993 when producers made steep one-time price reductions, turned

Change in Prices



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

back up in 1994, rising moderately over the four quarters of the year. By contrast, prices of home furnishings changed little over the year, and the CPI for apparel fell noticeably.

The CPI for non-energy services, a category that accounts for about half of the total CPI, rose slightly less than 3½ percent over the four quarters of 1994, after an increase of about 3¾ percent in 1993. The increase in these prices in 1994 was just a bit more than half the rise that was recorded in 1990, when CPI inflation hit its most recent peak. Prices of medical services continued to slow in 1994, and airline fares, which have been an especially volatile category in the CPI in recent years, fell appreciably after having risen sharply the previous year. However, auto finance charges turned up, and the rate of rise in owners' equivalent rent, a category that has a weight of nearly 20 percent in the total CPI, rose slightly faster over the four quarters of 1994 than it had during the corresponding period of 1993.

In 1994, for a fourth year, neither food prices nor energy prices provided much impetus to the inflation process. The consumer price index for food rose a shade more than 2½ percent over the four quarters of 1994, about the same as the rise of 1993. Food prices in 1994 were restrained, in part, by sharp declines in the prices of domestically produced farm products, which, in turn, were pulled down by the huge increases in crop and livestock production noted previously. With beef and pork prices declining over the year, the CPI for meats, poultry, fish, and eggs changed little in total. Retail prices of dairy products rose only a small amount. Prices of foods that are more heavily influenced by the costs of nonfarm inputs also showed only small to moderate advances in 1994: The increase in the CPI for prepared foods amounted to

about 2½ percent, slightly less than the previous year's increase, and, for a third year, the rise in the price index for food away from home was less than 2 percent. Coffee was the only item in the CPI for food to show sustained price acceleration; freeze damage to the crop in Brazil caused world prices of raw coffee to surge and led to a price rise of more than 50 percent at retail over the four quarters of 1994. Prices for fresh vegetables jumped toward year-end after Hurricane Gordon had damaged crops in Florida; run-ups in these prices typically are reversed within a few months as new supplies become available.

The CPI for energy rose about 1½ percent during 1994, after edging down ½ percent in 1993. Gasoline prices increased 4½ percent over the four quarters of 1994, reversing the decline of the previous year. Much of the increase in gasoline prices came in the third quarter and followed, with a short lag, a second-quarter rise in crude oil prices, which were moving back up from the low levels of late 1993 and early 1994. Prices of other energy products exhibited brief periods of rapid increase, but sustained upward pressures in these prices did not materialize. Fuel oil prices shot up temporarily early in 1994, when stocks were pulled down for a time by cold weather in the Midwest and the Northeast; later in the year, however, stocks were replenished and the earlier price increases were more than reversed. Natural gas prices followed a pattern similar to the price of fuel oil, rising sharply in the first quarter of the year but falling back thereafter, to a fourth-quarter level that was about 2¼ percent lower than that of a year earlier. Electricity prices rose only slightly during the year.

With the favorable inflation performance of 1994, the average rate of rise in the total CPI from the business cycle

trough in early 1991 to December 1994 amounted to 2.9 percent at an annual rate. Excluding food and energy, the rate of rise was 3.2 percent at an annual rate. Inflation rates lower than these have not been sustained through the first few years of any business expansion since that of the 1960s, when both the CPI and the CPI excluding food and energy showed average rates of increase of less than 1.5 percent during the first four years after the business cycle trough of early 1961. Average rates of price increase during the current expansion have been much smaller than those reported during the expansion that began in the mid-1970s. They also have been somewhat smaller than those reported during the first few years of the expansion that began in late 1982, a period when price increases were braked in part by unusually steep declines in oil prices. In measuring the progress that has been made toward bringing the economy closer to the goal of long-run price stability, the ratcheting down of the rate of price advance from cycle to cycle since the 1970s is perhaps an even more meaningful indicator than the favorable trends in the annual price data of recent years. ■

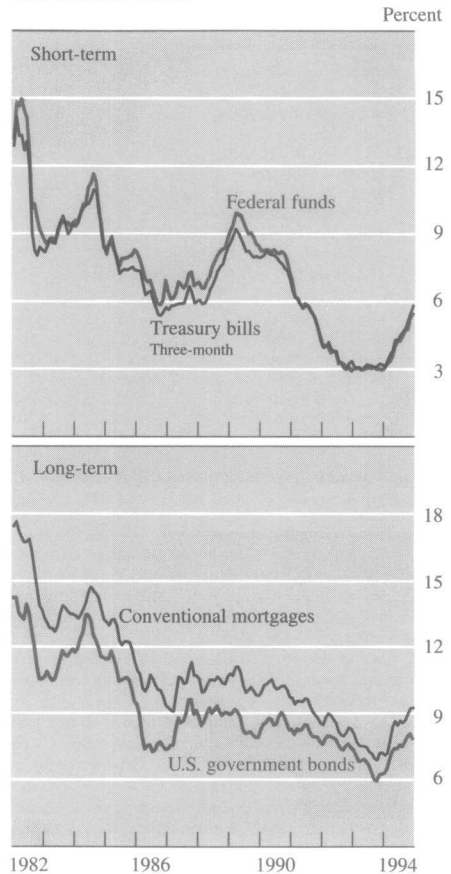
## Monetary Policy and Financial Markets in 1994

With the economy generally strong, financial markets in 1994 were characterized by somewhat more rapid growth in private debt and by higher interest rates. The increase in interest rates reflected, in part, the policy actions of the Federal Reserve. Concerned about inflationary pressures resulting from rapid economic growth and dwindling margins of available resources, the Federal Reserve firmed policy on six occasions during the year. These actions were taken to foster a financial environment more likely to be consistent with sustained economic growth and low inflation. In total, the policy tightenings raised the federal funds rate a cumulative  $2\frac{1}{2}$  percentage points between early February 1994 and the end of December. Other short-term rates rose similar amounts. Over this span, the Board of Governors increased the discount rate on three occasions, raising it a total of  $1\frac{3}{4}$  percentage points.

Longer-term rates increased  $1\frac{1}{2}$  percentage points to  $3\frac{1}{2}$  percentage points on balance from early February through the end of December, with the largest increases posted at intermediate maturities. In addition to the policy actions, these rates were boosted through much of 1994 by greater-than-expected underlying strength in the economy and the resulting higher demand for credit, as well as by upward revisions to expectations in financial markets about the policy tightenings that would be required to counter an incipient increase in inflation. Beginning in late autumn, however, the extent of Federal Reserve actions, along with incoming data suggesting some moderation in the pace of expansion, calmed inflation fears and

trimmed estimates of the eventual rise in short-term interest rates. As a conse-

U.S. Interest Rates



NOTE. 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.

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.

## Annual Rate of Change in Reserves, Money Stock, and Debt Aggregates

Percent

Item	1991	1992	1993	1994				
				Year	Q1	Q2	Q3	Q4
<b>Depository institution reserves<sup>1</sup></b>								
Total .....	8.7	20.1	12.2	-1.3	3.3	-3.2	-1.8	-3.3
Nonborrowed .....	9.1	20.3	12.2	-1.5	3.9	-4.2	-3.5	-2.1
Required .....	9.4	20.3	12.5	-1.1	2.7	-2.3	-1.9	-3.0
Monetary base <sup>2</sup> .....	8.2	10.4	10.4	8.4	9.8	8.4	7.5	6.9
<b>Concepts of money<sup>3</sup></b>								
<b>M1</b> .....	7.9	14.3	10.5	2.3	5.5	2.6	2.4	-1.2
Currency and travelers checks .....	7.9	9.1	9.9	10.1	11.0	10.3	9.3	8.5
Demand deposits .....	3.3	17.7	13.3	.4	7.1	-1.3	.3	-4.2
Other checkable deposits .....	12.3	15.6	8.6	-2.1	-.5	.2	-1.4	-6.7
<b>M2</b> .....	2.9	2.0	1.7	.9	1.8	1.7	.7	-.4
Non-M1 components .....	1.2	-2.3	-1.9	.3	.1	1.3	-.1	.0
MMDAs, savings, and small-denomination time deposits .....	.8	-2.4	-2.8	-1.9	-1.0	-2.4	-2.4	-1.9
General-purpose and broker-dealer money market mutual fund assets .....	4.9	-3.8	-.4	7.5	3.5	11.9	5.0	8.8
Overnight RPs and Eurodollars (n.s.a.) .....	-4.6	7.4	14.6	20.1	10.5	20.9	30.8	13.0
<b>M3</b> .....	1.2	.5	1.0	1.4	.6	1.3	1.9	1.7
Non-M2 components .....	-6.3	-6.3	-2.5	3.6	-5.8	-1.2	8.6	13.1
Large-denomination time deposits .....	-13.1	-15.5	-6.8	7.0	-2.2	.0	11.9	18.0
Institution-only money market mutual fund assets .....	33.9	18.4	-4.3	-8.2	-20.5	-15.6	-4.5	7.2
Term RPs (n.s.a.) .....	-20.4	8.3	18.5	7.0	-12.8	25.6	9.6	5.9
Term Eurodollars (n.s.a.) .....	-13.8	-22.8	-.4	16.1	.0	14.6	26.6	20.2
<b>Domestic nonfinancial sector debt</b> .....	4.6	4.8	5.2	5.2	5.6	4.8	4.7	5.5
Federal .....	11.3	10.7	8.5	5.7	7.3	5.4	3.9	5.9
Nonfederal .....	2.6	2.8	4.0	5.0	5.0	4.5	4.9	5.3

NOTE. Changes for quarters are calculated from the average amounts outstanding in each quarter. Changes for years are measured from Q4 to Q4. Based on seasonally adjusted data except as noted.

n.s.a. Not seasonally adjusted.

1. Data on reserves and the monetary base incorporate adjustments for discontinuities associated with regulatory changes in reserve requirements.

2. 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.

3. 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.

quence, longer-term rates reversed some of their earlier upward movements.

Increases in intermediate- and long-term rates over the course of the year caused significant capital losses for some investors. Well-publicized losses at a number of investment funds in the first half of the year, along with substantial portfolio reallocations in view of the changed economic and financial outlook, may have contributed to increased financial market volatility at that time. On the whole, however, risk premiums remained modest, and volatility ebbed over the course of the year. Late in the year, following the bankruptcy of Orange County, California, which resulted from losses in its investment fund, the tax-exempt securities market dipped; but the effects, beyond those on the investors in the Orange County fund, proved to be small and short-lived.

One consequence of the higher and more volatile long-term interest rates was a shift in business borrowing away from the capital markets and toward shorter-term sources, such as banks. This shift, which reversed the move toward long-term financing that occurred as bond yields fell in 1992 and 1993, was marked by the first annual increase in bank business loans in several years. Consumer lending also accelerated in 1994, as the improved economic outlook encouraged increased use of consumer credit. Higher interest rates limited the ability of households to "cash out" some of the equity in their homes when refinancing existing mortgages and thereby likely held down the growth of mortgage debt. Higher rates also encouraged households to shift to adjustable rate mortgages, which carried lower initial interest costs. The debt of all non-financial sectors increased 5¼ percent in 1994, the same as the increase in 1993, as the pickup in business and

household borrowing was offset by lower growth in government debt. The effects of the strong economy on government expenditures and receipts, policy moves to reduce the federal deficit, and retirements of tax-exempt securities that had been advance-refunded all contributed to the slowdown in government borrowing.

Banks funded much of the pickup in their loans with nondeposit funds and, in the second half of the year, with sales of securities. As a result, the faster rate of loan growth was not reflected in significantly stronger expansion of the monetary aggregates. M3, which was boosted by relatively heavy issuance of large certificates of deposit, rose 1½ percent, a somewhat larger increase than in 1993. With banks pricing savings and small time deposits unaggressively as market interest rates rose, M2 grew about 1 percent over the year, somewhat below its 1¾ percent pace in 1993. The increase in market interest rates relative to rates on transaction deposits slowed the growth of M1 to just 2¼ percent from the double-digit increases posted in 1992 and 1993.

### **The Course of Policy and Interest Rates**

In early 1994, short-term interest rates remained at the very low levels reached in late 1992, with the federal funds rate—fluctuating around 3 percent—roughly in line with the rate of inflation. The Federal Reserve had maintained an accommodative monetary policy throughout 1993, a stance that was believed to be necessary because of a number of extraordinary factors that seemed to be inhibiting growth during the early years of the expansion. These factors included efforts by households, firms, and financial intermediaries to repair strained balance sheets, business

restructuring activities, and the fiscal contraction associated, in part, with the downsizing of defense industries.

During the recovery and expansion, however, considerable progress had been made by households and businesses in decreasing their debt-service burdens, and lending institutions had succeeded in rebuilding their capital positions. By late 1993, the economy was expanding rapidly, and incoming data early in 1994 suggested that much of that momentum had likely carried over into the new year. In the circumstances, continued monetary accommodation risked pushing the demands on productive resources to levels that ultimately would be associated with increased inflation. Consequently, the Federal Open Market Committee, at its meeting in early February 1994, agreed that policy should be moved to a less stimulative stance.

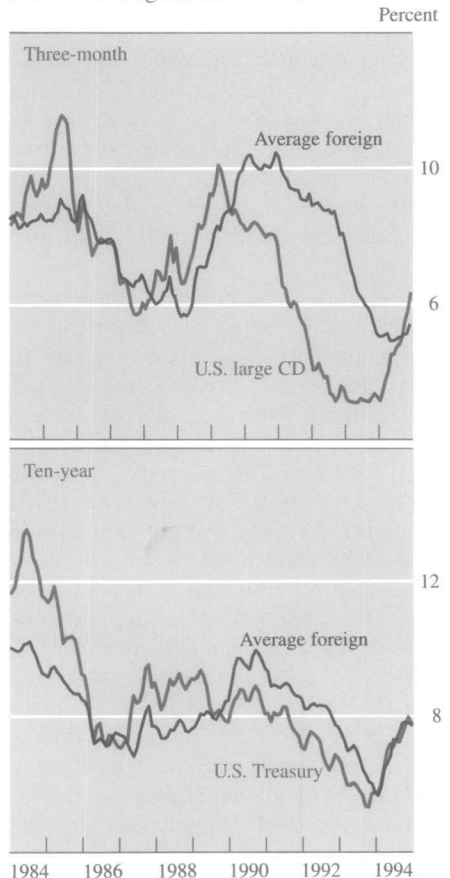
The pace at which the adjustment to policy should be made was less clear: A rapid shift would minimize the risk of allowing inflation pressures to build, while a more gradual move would allow financial markets time to adjust to the changed environment. Although many market participants seemed to anticipate a firming move fairly soon, it would be the first tightening in many years, and some investors would undoubtedly reconsider their portfolio strategies, possibly causing sharp movements in bond and stock prices. In addition, a slower initial shift would allow more time to assess the strength of the economy and the effects of the change in policy.

In the event, the Committee tightened policy gradually through the winter and early spring. Pressures on reserve positions were increased by relatively small amounts in February, March, and April; once market participants seemed to have made substantial adjustments to the new direction of policy, a larger tightening

move was implemented in May. Taken together, the four policy actions raised the federal funds rate about 1 1/4 percentage points. The May policy action was accompanied by a vote of the Board of Governors to increase the discount rate 1/2 percentage point.

Other interest rates moved up between 1 percentage point and 2 percentage points as a result of these policy

U.S. and Foreign Interest Rates



NOTE. The average foreign rates are the trade-weighted averages, for the non-U.S. G-10 countries, of bank rates (for the three-month comparison) and government bond yields (for the ten-year comparison) on instruments that are comparable to the U.S. instruments shown. The data are monthly.

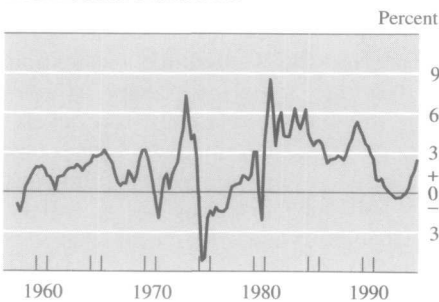
moves, with the largest increases coming at intermediate maturities. Besides the effect of the policy actions, longer-term rates were boosted by incoming data suggesting continued robust growth, which heightened market concerns about a pickup in inflation and expectations of further tightening by the Federal Reserve. In addition, uncertainty about the timing and magnitude of future policy actions, as well as the capital losses that followed the tightenings, encouraged investors to shorten the maturity of their investments and reduce their degree of leverage. The resulting portfolio adjustments likely contributed to increased market volatility and may have intensified the upward pressure on longer-term interest rates.

Incoming data in the late spring and early summer suggested that the economy still was expanding at an appreciable rate, led by increased sales of business equipment, a rebound in non-residential construction following bad weather earlier in the year, and a pickup in inventory investment. Inflation was of growing concern, as commodity prices increased rapidly, and measures of slack suggested that the economy was entering a range in which pressures on broad price indexes might begin to build. In

part reflecting this concern, long-term rates moved up, and the dollar weakened. Given the relatively large policy action in May, however, the Committee decided to take no action at the July meeting and to wait for more information on the performance of the economy. The Committee saw the possible need for tighter policy, however, and issued an asymmetric directive to the Federal Reserve Bank of New York suggesting that policy would respond promptly to evidence of increased inflation pressures.

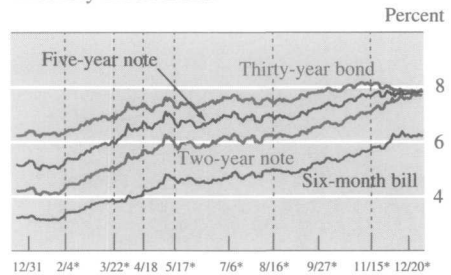
In the interval between the Committee meetings in early July and mid-August, the economy continued to expand robustly, and, coming into the August meeting, it appeared that the markets expected a small further increase in reserve pressures. At its meeting, the Committee agreed that a prompt further tightening move was needed to provide greater assurance that inflationary pressures in the economy would remain subdued, and the members chose a tightening action somewhat larger than had been expected by the markets. A rise of 1/2 percentage point in the discount rate, voted by the Board of Governors, was allowed to show through fully to the federal funds rate.

Real Federal Funds Rate



NOTE. The real federal funds rate is the nominal federal funds rate minus the change in the consumer price index less food and energy over the past four quarters. The data are quarterly.

Market Rates on Selected Treasury Instruments



NOTE. Asterisks indicate days in 1994 on which the Federal Open Market Committee held scheduled meetings. Dashed lines indicate days on which the Committee announced a monetary policy action. The data are daily.



Short-term market rates rose following the policy move, while long-term yields declined slightly, perhaps as a result of downward revisions to expectations of future tightening.

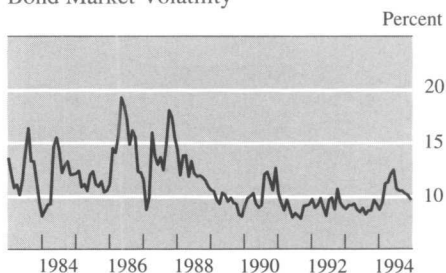
In advance of the late-September meeting, most market rates increased as incoming economic data were seen in the market as raising the likelihood of higher inflation and the resulting need for tighter reserve conditions. The data suggested that the economy had not yet been greatly affected by the tightening in monetary policy: Employment was growing strongly, and final sales, especially of consumer goods, appeared to have firmed. Manufacturing activity had continued to expand rapidly, boosted in part by an increase in motor vehicle production. Given the uncertain duration of lags between changes in monetary policy and the resulting effects on the economy, however, it was not clear whether the effects of the earlier interest rate increases were smaller than had been expected or were still in train. Another possibility was that the underlying momentum of the expansion was greater than had been evident earlier. Given these uncertainties, the Committee took no immediate tightening action at its September meeting. As in July, however, the Committee agreed to an asymmetric directive suggesting that the likely direction of any move over the

intermeeting period would be toward additional restraint.

Broad measures of inflation remained moderate through the fall in spite of continued substantial economic growth in an economy that was running close to its estimated potential. Nonetheless, strong economic data and continued upward pressure on prices at earlier stages of production apparently heightened investors' inflation concerns and expectations of future policy tightenings. Consequently, most market interest rates rose considerably between the September and November meetings, with intermediate maturities showing the largest increases. At the November meeting, the Committee members agreed that the stance of policy was not sufficiently restrained given the clear risks of higher inflation. As a result, they chose a sizable firming of monetary policy, tightening reserve conditions in line with the increase of  $\frac{3}{4}$  percentage point in the discount rate approved by the Board of Governors.

The yield curve flattened appreciably in response to the larger-than-expected policy action. The increase in the federal funds rate pushed up most short-term interest rates, and although long-term rates increased initially, they had, by early December, more than reversed their earlier increases. Evidently, market participants ultimately interpreted the substantial policy tightening as demonstrating the Committee's intention to take the actions necessary to contain inflation at relatively low levels. By contrast, intermediate-term rates increased over the weeks following the November meeting as a variety of incoming data indicated that the economy's growth had accelerated further in the fourth quarter and that additional tightenings might be required to slow growth to a more sustainable pace. By the time of the December

Bond Market Volatility



NOTE. Expected volatility, derived from prices of options on Treasury bond futures. Month-end data.

meeting, rates on two-year Treasury notes were only a little below those on thirty-year Treasury bonds, although the yields on both instruments remained well above short-term rates.

Financial markets were focused in early December on the failure of an investment fund run by Orange County, California, and the subsequent bankruptcy of the county itself. The municipal securities market bore the brunt of these developments, with rates rising for a time relative to those on comparable Treasury issues. The failure had a substantial effect on the finances of the municipalities that had invested in the fund. In addition, investors had to consider the likelihood of other state and local governments having similar investment difficulties. In the period that followed, however, only a few other problem situations emerged, and they were on a much smaller scale.

In the period leading up to the December meeting, incoming data continued to show robust growth and subdued inflation. The Committee felt that the effects on economic activity of the policy actions during the year, and especially the substantial tightening moves in the second half of the year, were not yet visible because of the lags in the economic effects of monetary policy. As a result, the Committee decided to take no new policy action at the meeting, waiting instead for additional information on the underlying strength in the economy and the effects of the earlier policy actions. This decision was reinforced by concerns that the financial markets might be somewhat unsettled not only as a result of the usual year-end adjustments but by the uncertain effects and incidence of the sizable market losses sustained by some investors over the year. In view of the substantial strength evident in the incoming data, however, the Committee again chose an

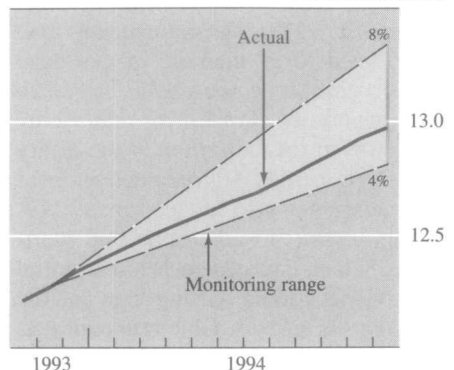
asymmetric directive pointing toward further restraint.

### Credit and Money Flows in 1994

The debt of all nonfinancial sectors grew 5¼ percent in 1994, somewhat below the middle of its monitoring range of 4 percent to 8 percent and the same as the increase of a year earlier. More rapid growth of private-sector debt was offset by slower growth of public-sector debt. As long-term rates rose well above their late 1993 lows, private-sector borrowing shifted toward shorter-term sources of funds. In part as a result of this shift, the proportion of new debt supplied by financial intermediaries was larger than it had been for several years. Much of the growth in depository credit was funded with nondeposit funds, however, and growth in the broad monetary aggregates, which consist primarily of deposits, remained subdued.

Debt growth both in the federal sector and in the state and local government sector slowed in 1994. Growth of federal government debt was smaller because of the narrowing of the federal budget deficit. The outstanding volume

Total Domestic Nonfinancial Debt  
Trillions of dollars



NOTE. The range was adopted by the FOMC for the period from 1993:Q4 to 1994:Q4.

of state and local government debt actually declined, as bonds that previously had been refunded in advance of their earliest call date were retired. Much of the bulge in tax-exempt issues in 1993 had been for the advance refunding of higher-cost debt issued in the 1980s. These offerings subsided early in 1994 as the amount of bonds eligible for advance refunding dwindled and borrowing costs rose.

The growth of household debt picked up slightly in 1994 as an acceleration in consumer credit was partly offset by slower growth in mortgage debt. The pickup in consumer debt reflected, in part, increased demand for consumer durables. In addition, responses to Federal Reserve surveys of banks indicated that many respondents were more willing to extend credit to households, which may have led them to ease terms and standards on consumer loans. Indeed, spreads between consumer loan rates and market rates narrowed significantly in 1994 as increases in loan rates lagged those in market interest rates. Consumer credit may also have been boosted somewhat by the increased use of credit cards offering rebates or other incentives.

Rising mortgage rates in 1994 greatly reduced the volume of mortgage refinancings from the very high levels reached in 1993. The refinancings had contributed to an increase in mortgage debt because some households had taken the opportunity afforded by refinancing to borrow against a portion of the equity in their properties. Higher rates on fixed rate mortgages also induced many borrowers to shift to adjustable rate mortgages, which carried much lower initial rates. Concessional starting rates and the growing use of adjustable rate contracts with initial fixed rate periods lasting several years also may have contributed to this shift. Over the last few months

of the year, about half of all new home mortgages carried adjustable rates. The shift to adjustable rates and the sluggish adjustment of consumer loan rates mitigated the effect of higher market interest rates on household debt-service burdens.

The debt of nonfinancial businesses expanded in 1994 after three years of stagnation. Earlier efforts to restructure balance sheets by increasing equity capital and refinancing higher-cost credit appeared to leave businesses in a better position to increase debt in 1994, as the sector's debt-service burden had fallen about one-third from the peak reached five years earlier. Increased spending on capital and inventories in 1994 raised the funding needs of business. Funding requirements also were boosted by a substantial increase in the total value of mergers and acquisitions; the share of such activity requiring cash payments to shareholders—rather than swaps of shares—rose sharply, although it remained below the levels reached in the late 1980s. Combined with a decline in equity issuance—perhaps resulting from the lackluster performance of the stock market—the increased funding needs of business translated into a step-up in borrowing.

Rising and more volatile long-term interest rates encouraged businesses to rely more heavily on short-term debt in 1994. This shift was reinforced by changes in supply conditions in various markets. Capital losses early in the year likely caused some of those supplying long-term funds to become more cautious; for example, some savers backed away from bond mutual funds. At the same time, banks were loosening terms on business loans as well as easing their underwriting standards. Banks attributed the easing of loan terms and standards to increased competition for business customers from other banks and also from nonbank lenders. The competitive pos-

ture of banks likely reflected, in part, the high level of profits earned by banks in recent years and the resultant strengthening of their balance sheets. As a result of these factors, bank business loans increased more than 9 percent, their first annual increase in several years. Other sources of short-term business finance, including commercial paper and finance company loans, also expanded over the year.

The effect of the pickup in business and consumer loans on bank credit growth was partially offset by slower growth in bank securities holdings. Early in the year, banks purchased a significant volume of government securities, and reported holdings of other securities were boosted by an accounting change.<sup>1</sup> Much of this growth was reversed later in the year, however, as banks used sales of securities to fund loan growth. Reported securities growth

was also damped by declining securities prices.<sup>2</sup>

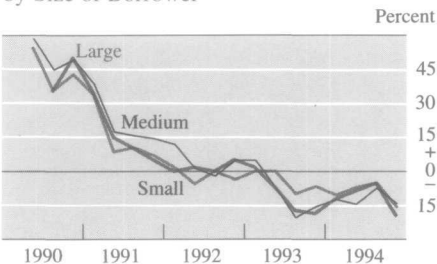
In 1994, credit extended by thrift institutions expanded for the first time in several years, as the Resolution Trust Corporation virtually completed its liquidation of insolvent thrift institutions. In part, the increase in credit from this sector also likely reflected the shift by households toward adjustable rate mortgages. Thrift institutions and banks find holding adjustable rate mortgages less risky than holding fixed rate mortgages, and so adjustable rate loans are less likely to be securitized or sold.

With the expansion of credit from banks and thrift institutions, the growth of depository credit in 1994 nearly matched that of total nonfinancial debt. Thus, the share of credit provided by these intermediaries stabilized after having declined substantially since 1988. Despite the growth in depository credit, the broad monetary aggregates continued to expand sluggishly. Domestic banks funded much of their credit expansion from nondeposit sources—such as borrowings from their foreign offices—that are not included in the monetary aggregates. Funds from these sources are not subject to deposit insurance premiums, which may help account for their recent rise.

The broadest monetary aggregate, M3, did pick up a bit as banks funded their asset growth in part from large time deposits. M3 expanded about 1½ percent, well above the lower bound of the 0 percent to 4 percent range established by the FOMC and a somewhat

1. New rules of the Financial Accounting Standards Board, effective at the start of 1994, limited the ability of banks to net off-balance-sheet items for reporting purposes. The new rules affected items such as swaps and options, the cash values of which are reported on balance sheets in the "other securities" category.

Changes in Business Lending Standards at Selected Large Commercial Banks, by Size of Borrower



NOTE. Data show percentage of domestic loan officers reporting tightening standards over the past three months less the percentage reporting easing.

SOURCE. Federal Reserve, Senior Loan Officer Opinion Survey on Bank Lending Practices.

2. A rule of the Financial Accounting Standards Board, implemented at the start of 1994, required each bank to divide its investment account securities into those that it intended to hold to maturity (which could be reported at book value) and those that were available for sale (which had to be marked to market).

larger increase than that in 1993. Growth in large time deposits was about 7 percent for the year, the first annual increase in this component since 1989. Much of the increase in large time deposits was in senior bank notes, on which banks are not required to pay deposit insurance premiums.

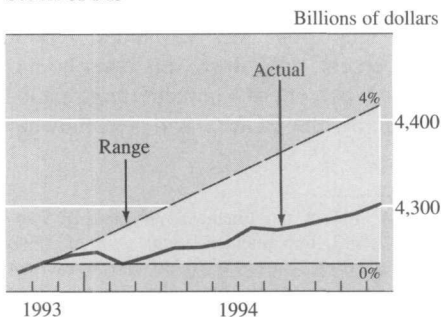
M2 grew about 1 percent in 1994. The slow growth of the aggregate reflected, in part, a relatively sluggish upward adjustment of retail deposit rates. Rates on savings accounts and other checkable deposits (OCDs), including NOW accounts, responded about as slowly as they have in the past to the increase in market rates, while the response of rates on small time deposits was sluggish relative to historical norms. Evidently, banks believed that generating increased retail deposits would be more expensive than raising wholesale funds, given that the offering of higher rates to attract new retail deposits would also mean paying those higher rates on existing liquid deposits and on time deposits as they were rolled over. Generating new and larger retail deposits would also require larger expenses for advertising, administration, and deposit insurance.

In 1994, for the first time in several years, M2 followed patterns that were

broadly consistent with the aggregate's longer-run historical relationship to nominal income and opportunity cost—traditionally defined as the difference between rates on short-term instruments (for example, Treasury bills) and rates on retail balances. Rising opportunity costs during the year helped to damp the growth of M2, offsetting a part of the impetus from increases in nominal income. By contrast, slow growth of M2 in the years leading up to 1994 had resulted from large portfolio shifts from M2 deposits to bond and equity mutual funds. With these portfolio shifts slowing in 1994, the growth in M2 plus long-term mutual funds ran slightly below the 1 percent growth rate of M2 itself.

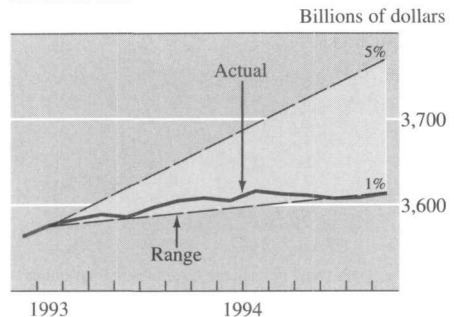
Net sales of shares in equity mutual funds continued at a high level in 1994, although the pace slowed somewhat late in the year. The sales of equity fund shares were partly offset, however, by outflows from bond mutual funds in the last three quarters of the year. Apparently, falling bond prices and greater market uncertainty, and, perhaps, reports of derivatives losses at some funds, led households to scale back their holdings of bond mutual funds in favor of investments that posed less risk of capital loss. With deposit rates lagging, however,

Stock of M3



NOTE. The range was adopted by the FOMC for the period from 1993:Q4 to 1994:Q4.

Stock of M2



NOTE. The range was adopted by the FOMC for the period from 1993:Q4 to 1994:Q4.

these outflows did not translate into faster M2 growth. Some of the withdrawals from bond funds may have been invested directly in Treasury securities. Reflecting such portfolio shifts, net noncompetitive tenders for Treasury bills, which had been negative in 1993, totaled more than \$16 billion in 1994, and net noncompetitive tenders for Treasury notes also increased substantially.<sup>3</sup>

Growth of M1 slowed considerably in 1994, much as it has in past periods when differentials between market interest rates and rates offered on transaction deposits were widening. The aggregate expanded only 2¼ percent over the year—down substantially from the double-digit increases of the previous two years. As is typical, the rates

3. The Treasury permits noncompetitive bids at its auctions to make it easier for smaller, less sophisticated bidders to participate. Those submitting noncompetitive tenders are assured of receiving the security, and the yield on the security they obtain is the average issue rate established at the auction. The level of net noncompetitive tenders during a period is the dollar volume of securities purchased under noncompetitive tenders less the volume of repayments of maturing securities that had been purchased under noncompetitive tenders.

Net Monthly Average Sales of Shares in Long-Term Mutual Funds

Millions of dollars

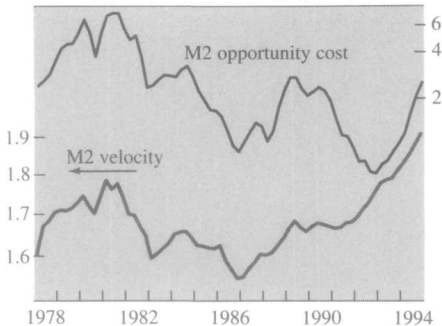
Period	Total	Equity funds	Bond funds
<i>Year</i>			
1991 .....	10,820	3,821	7,000
1992 .....	16,844	7,268	9,576
1993 .....	23,378	11,738	11,640
1994 .....	9,097	10,732	-1,636
<i>Quarter</i>			
1994:Q1 .....	17,286	13,697	3,589
Q2 .....	10,089	10,944	-856
Q3 .....	9,826	11,166	-1,340
Q4 .....	-814	7,122	-7,936

NOTE. Net sales are gross sales less redemptions.  
SOURCE. Investment Company Institute.

offered on OCD accounts adjusted slowly to higher market rates, encouraging households with OCDs to shift funds into higher-yielding assets. OCD balances also were depressed by the introduction of sweep accounts at some large banks. In these programs, the portion of customers' OCD balances in excess of a predetermined level are swept into money market deposit accounts at the end of each day.

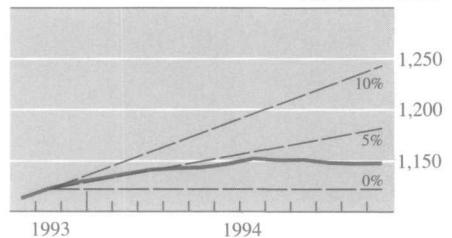
Higher market rates also encouraged holders of demand deposits—accounts that earn no interest—to economize on such assets. On balance, demand deposits edged up only about ½ percent in 1994, compared with 1¾ percent in 1993. The slide in the growth of demand deposits also reflected the decline in home mortgage refinancing activity in 1994: Demand deposits had been

M2 Velocity and M2 Opportunity Cost  
Ratio scale                      Percentage points, ratio scale



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

Stock of M1  
Billions of dollars



boosted in 1993 because prepayments of securitized mortgages were held primarily in such deposits for a time before they were distributed.

In contrast to transaction deposits, the currency component of M1 continued to register strong growth in 1994. Currency increased 10 percent, about the same as the rise in 1993 and close to the record increase in 1990. As has been the case since 1990, much of the currency growth appeared to reflect the rapid expansion in U.S. currency circulating abroad. Informal reports suggest that foreign demand in 1994 was particularly strong in Russia and the other former Soviet republics. ■

## International Developments

Economic activity in the major foreign industrial countries rebounded sharply during 1994, generally at a faster pace than most observers had expected at the start of the year. Although recoveries had begun during the previous year in the United Kingdom and Canada, activity in 1993 had been sluggish in Germany, France, and other continental European countries. Recovery was evident in Japan as well, if somewhat subdued in comparison with developments in the other industrial countries.

The expansionary climate notwithstanding, considerable slack persisted in most of the foreign industrial economies. As a result, consumer price inflation generally remained low or even subsided further. On average, consumer prices in the six major foreign industrial countries rose 2 percent over the year.<sup>1</sup>

Economic activity in developing countries remained robust in most parts of the world during 1994. Toward year-end, Mexico abandoned its exchange

rate regime in the face of an unsustainable current account position and severely depleted international reserves. A substantial decline in the exchange rate ensued, and policies aimed at restoring confidence in prospects for Mexico were subsequently adopted.

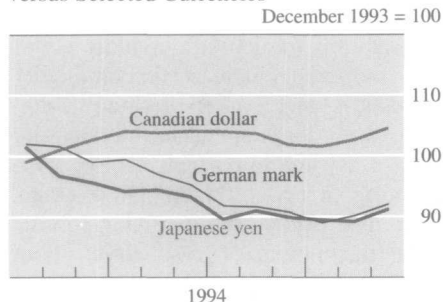
The U.S. international trade deficit in goods and services increased to \$106 billion in 1994, compared with \$76 billion in 1993. U.S. output expanded at about the same rate as that of the country's major trading partners, but U.S. imports are more responsive to increases in the growth of U.S. income than are U.S. exports to the growth in foreign income. Lagged effects of the dollar's appreciation during 1993 also continued to be felt. The current account deficit increased \$52 billion, to \$156 billion. Net investment income shifted from a small inflow to a moderate outflow in 1994. After several years of stagnation, foreign earnings on direct investment in the United States improved sharply with the expanding U.S. economy; U.S. earnings on direct investment abroad also rose, but at a more measured pace. In addition, net interest payments to foreigners increased with growing U.S. indebtedness and the rise in interest rates during the year.

A large increase in net capital inflows in 1994 was more than accounted for by flows through private channels. Net inflows reported by banks increased sharply, as did foreign direct investment in the United States; in addition, U.S. net purchases of foreign securities fell sharply. Official inflows fell this year, from a very high level in 1993.

The foreign exchange value of the dollar declined about 6½ percent on bal-

1. The six countries are Canada, France, Germany, Italy, Japan, and the United Kingdom.

Exchange Value of the Dollar  
versus Selected Currencies  
December 1993 = 100



NOTE. Foreign currency units per dollar. The data are monthly.



ance from December 1993 to December 1994 in terms of a trade-weighted average of the other G-10 currencies.<sup>2</sup> After showing some strength at the start of the year, the dollar's value fell about 10 percent from February through early November. As the year progressed, increasingly positive assessments of economic expansion in the other industrial countries led market participants to raise their estimates of prospective market interest rates abroad. This development, together with increased concerns over potential inflation pressures in the U.S. economy, put downward pressure on the dollar in terms of most foreign currencies. Toward the end of the year the dollar's value rebounded somewhat as the Federal Reserve tightened credit

conditions in November more than had been expected, reassuring market participants that U.S. inflation risks were being addressed.

## Foreign Economies

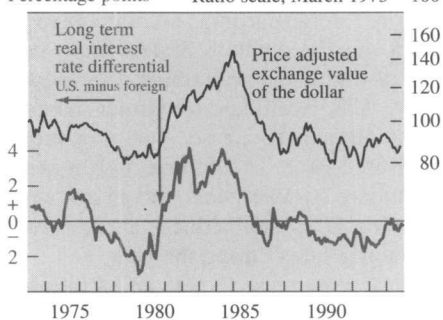
Economic activity in the major foreign industrial countries accelerated in 1994 as recoveries became more firmly established and widespread. Almost all countries experienced growth in gross domestic product at rates close to, or even somewhat above, the highest that are likely to prove sustainable for long periods. In many countries, exports continued to be a key factor, responding to strong demand from the United States and a number of developing countries where economic activity was robust. Much of the overall strength in demand, however, also came from domestic sources. Even in Japan, domestic demand and overall activity picked up somewhat in 1994, although the recovery remained tentative partly because external demand was held back by the yen's appreciation.

Even with strong growth in output, labor market conditions in most foreign industrial countries were slack, and levels of economic activity remained well below estimated potential levels. The exception was Germany, where the recent recession was not as deep as elsewhere. These conditions helped keep inflationary pressures low despite the acceleration of activity in most countries and sizable increases in commodity prices in global markets. In many countries, an improvement in productivity also was an important factor contributing to low inflation. On average, consumer prices in the major foreign industrial countries rose only about 2 percent, slightly below the increase of the previous year. In Japan, inflation was less than  $\frac{3}{4}$  percent, in part because the

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

### Exchange Value of the Dollar and Interest Rate Differential

Percentage points      Ratio scale, March 1973 = 100



NOTE. The exchange value of the U.S. dollar is its weighted average exchange value in terms of the currencies of the other 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 weighted-average rate on comparable foreign securities, both adjusted for expected inflation; expected inflation is estimated by a thirty-six-month moving average of actual consumer price inflation or staff forecasts of inflation where needed.

The data are monthly.

appreciation of the yen damped upward pressure on prices of tradable goods. Increased retail competition and discounting may also have helped limit inflation there.

Unemployment declined noticeably in the United Kingdom and Canada, where recoveries had been underway for several years, but continental Europe saw little change in labor market conditions. In some countries, the rate of unemployment actually rose. These developments heightened concerns about structural unemployment in Europe, which is thought to have increased significantly during the past decade, including during the

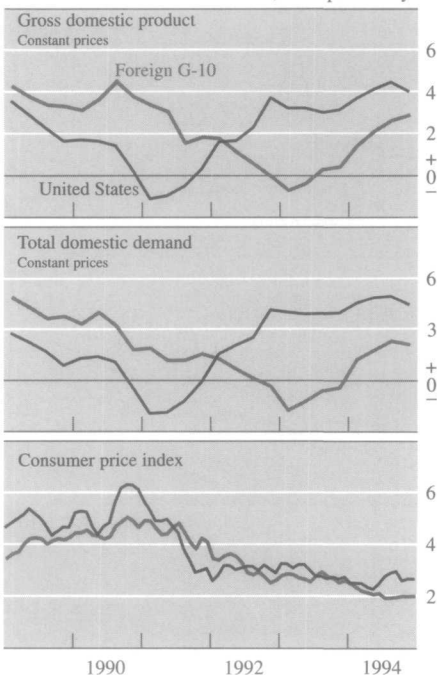
recent recession. In Japan, deterioration in labor market conditions appeared to level off in 1994, but the unemployment rate was still high by Japanese standards, and other indicators suggested that substantial slack persisted in Japan through the end of the year.

Government budget deficits narrowed as activity picked up in many countries, but progress in reducing structural budget deficits was more limited. Among the major industrial countries, only Germany narrowed its structural deficit substantially; this gain was achieved largely by imposing new taxes. In Japan, the structural budget deficit widened as further expansionary measures were introduced. Nonetheless, the Japanese budget deficit remained the smallest among the major industrial countries.

Long-term interest rates in major foreign industrial countries generally rose during the year. On average, foreign rates on instruments with a maturity of ten years increased 200 basis points in the twelve months to December, about the same as U.S. rates. In Japan, where evidence of a buoyant recovery remained somewhat mixed, long-term rates rose less. In contrast, foreign short-term rates were little changed on average and even declined slightly in several countries, including France and Germany. Major exceptions were Canada, where short-term market rates rose more than 250 basis points, and the United Kingdom, where they rose 100 basis points. In both of these countries, official lending rates were increased during the year to contain inflation risks attendant on the continuing vigorous growth of their economies.

The current account balance moved in the direction of surplus in several countries, notably Italy, Canada, Sweden, and the United Kingdom. Currency depreciations in recent years in

Changes in GDP, Demand, and Prices  
Percent, from previous year



NOTE. 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.

these countries together with recovering demand in key trading partners accounted for most of this movement. Japan's large surplus of about \$130 billion was similar to that for the previous year, while Germany's current account deficit expanded.

Economic growth in the major developing countries maintained the strength established in recent years. The newly industrializing economies in Asia benefited from recovery in industrial countries; in addition, their currencies' earlier depreciations versus the yen helped stimulate external demand in 1994. Although activity in China also continued to expand rapidly, the authorities succeeded in moderating the rate of growth somewhat by tightening credit conditions and imposing other measures to dampen demand. In Argentina, a rapid increase in investment, spurred by tariff reductions and other structural reforms, helped sustain growth. The growth of output was moderately strong in Brazil, where implementation of the Plan Real in July brought price increases down from near-hyperinflation rates to an average of about 3 percent per month during the second half of 1994. However, a substantial real appreciation of the currency contributed to a swing in the trade balance to deficit in November and December.

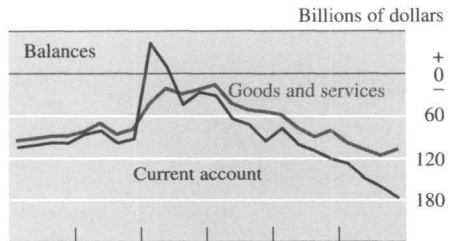
In Mexico, output expanded markedly during the second and third quarters after having been almost stagnant in 1993. The burst of activity was due partly to fiscal stimulus and generally lower interest rates in late 1993 and early 1994; it proved unsustainable when the peso came under severe pressure late in the year. Mexico was forced to devalue its currency after it had depleted much of its international reserves. Weakened investor confidence in the aftermath of the initial devaluation led to a further substantial decline

in the exchange rate, more reserve losses, and a large rise in interest rates. Subsequently, restrictive policies were adopted in an effort to restore balance to the Mexican economy under a program supported by the International Monetary Fund with additional financial support from the U.S. government.

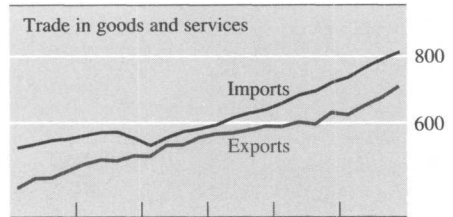
### U.S. International Transactions

With brisk economic activity this year both in the developing and industrial trading partners of the United States, the volume of U.S. exports of goods and services rose 11½ percent, and U.S. merchandise exports increased 14 per-

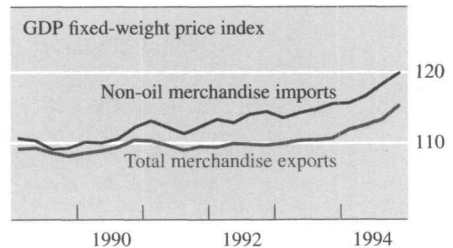
U.S. International Trade



Ratio scale, billions of 1987 dollars



Ratio scale, 1987 = 100



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

cent. An important contribution to this development came from exports of capital goods, including computers and a wide variety of other machinery. After declining in 1993, agricultural exports bounced back primarily because of a much better U.S. harvest.

Imports of goods and services rose nearly 14 percent in volume, and merchandise imports increased 16 percent, reflecting the vigorous growth of U.S. income during the year. Imports of computers continued to expand rapidly, and imports of other machinery, automotive products, industrial supplies, and con-

sumer goods were also buoyant. Import prices rose about 4 percent as world commodity prices increased sharply and oil prices moved back up after declining in 1993 and early 1994.

Recorded net capital inflows were substantially larger in 1994 than in 1993. Part of this development corresponded to the widening current account deficit, but the remainder was the counterpart of a large swing in net unrecorded transactions from inflows to outflows between 1993 and 1994. The source of this negative discrepancy is performe unknown and is all the more

### U.S. International Transactions

Billions of dollars, seasonally adjusted

Transaction	Year		Quarter				
			1993		1994		
	1993	1994 <sup>p</sup>	Q4	Q1	Q2	Q3	Q4 <sup>p</sup>
Goods and services, net	-76	-106	-20	-24	-27	-29	-27
Exports	642	698	166	165	170	177	186
Merchandise	457	503	120	118	123	128	135
Services	185	195	47	47	48	50	51
Imports	717	804	186	189	197	206	212
Merchandise	589	669	153	155	164	172	178
Services	128	135	33	34	33	34	35
Investment income, net	4	-15	-1	-1	-3	-4	-8
Direct investment, net	52	41	12	12	11	10	9
Portfolio investment, net	-49	-57	-13	-12	-14	-14	-16
Unilateral transfers, private and government, net	-32	-34	-10	-7	-8	-8	-11
<b>Current account balance</b>	<b>-104</b>	<b>-156</b>	<b>-31</b>	<b>-32</b>	<b>-38</b>	<b>-41</b>	<b>-45</b>
Private capital flows, net	13	145	4	35	30	35	46
Bank-related capital, net (outflows, -)	51	104	-2	34	41	20	10
U.S. net purchases (-) of foreign securities	-120	-61	-30	-25	-14	-8	-14
Foreign net purchases (+) of U.S. securities							
Treasury securities	25	33	8	9	-7	5	26
Corporate and other non-Treasury bonds	61	56	26	15	15	13	13
Corporate stocks	19	3	12	7	-2	1	-3
U.S. direct investment abroad	-58	-58	-23	-25	-8	-11	-14
Foreign direct investment in United States	21	60	8	12	5	15	28
Other corporate capital flows, net	14	8	4	8	-1	1	n.a.
Foreign official assets in United States (increase, +)	72	39	24	12	9	20	-1
U.S. official reserve assets, net (increase, -)	-1	5	-1	*	4	*	2
U.S. government foreign credits and other claims, net	*	*	*	*	*	*	-1
Total discrepancy	20	-33	4	-14	-4	-14	-1
Seasonal adjustment discrepancy	0	0	*	6	1	-7	*
Statistical discrepancy	20	-33	4	-20	-5	-7	-1

NOTE. Components may not sum to totals because of rounding.

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

n.a. Not available.

<sup>p</sup> Preliminary.

SOURCE. Department of Commerce, Bureau of Economic Analysis.

puzzling given the increase in net outflows of U.S. currency to foreigners in 1994: Net currency shipments—which are not recorded in the U.S. international accounts, whereas the corresponding payment for them is generally recorded—tend to make the discrepancy positive.

Much of the recorded capital inflow took the form of a substantial increase in net inflows reported by banks in the United States. Euromarket borrowing was apparently an attractive source of funding for banks expanding their domestic lending.

Direct investment in the United States also surged during 1994, while U.S. direct investment in other countries remained relatively static albeit at record levels. Direct investment from abroad took the form of takeovers of U.S. companies as well as the reinvestment of revived profits by affiliates of foreign companies in the United States.

The rest of the identifiable net private capital inflow was the result of a sharp retrenchment in U.S. net purchases of foreign securities, particularly bonds. By contrast, private foreign net purchases of U.S. securities fell only slightly. Rising interest rates on bonds denominated in many major currencies, including dollars, produced capital losses for U.S. holders of long-term bonds and led to outflows from U.S. global bond funds. Although U.S. investors proceeded more cautiously in their acquisition of foreign securities, the slowdown was concentrated in bonds rather than in stocks; U.S. investors expanded their net purchases of shares of firms in Japan and in a wide assortment of developing countries, many of which had received much smaller inflows in 1993.

Foreign official assets in the United States expanded substantially, although these accumulations were much smaller than in 1993. In particular, the large

reserve accumulations by certain developing countries in Latin America that experienced massive private capital inflows in 1993 were not repeated. A significant part of the 1994 inflows were funds acquired by foreign industrial countries as the consequence of intervention in foreign exchange markets.

## Foreign Exchange Developments

During 1994 the dollar depreciated 8 percent versus the mark and declined similar amounts in terms of the other currencies in the exchange rate mechanism (ERM) of the European Monetary System. The appreciation of the mark was associated with an unexpectedly strong recovery in real output in Germany and rather rapid growth of the Bundesbank's targeted monetary aggregate, M3, during much of the year. Market participants revised their expectations of further declines in official German lending rates, and German long-term interest rates rose. The dollar depreciated less in terms of the pound and the lira, both of which had been withdrawn from the ERM in 1992. The extended strong recovery in the United Kingdom began to raise concerns about inflation and, by extension, the pound; in Italy, political uncertainties weighed on the currency.

The dollar depreciated about 8 percent on balance in terms of the yen. As market perceptions developed that a recovery was under way in Japan, it began to look less likely that the Japanese authorities would continue to ease financial conditions as they had been doing for the past two years. In addition, fluctuations during the year in the status of trade negotiations between the United States and Japan were mirrored in movements in the exchange rate.

By contrast, the dollar appreciated nearly 4½ percent in terms of the Cana-

dian dollar during 1994. The relative weakness of the Canadian currency appeared to reflect pressures arising from increases in U.S. short-term rates, concerns over large fiscal deficits of the central government and the provinces, and, at times, the risk of secession by Quebec.

Adjusted for relative changes in consumer prices, the dollar depreciated in terms of the currencies of most of the major U.S. trading partners in Latin America and East Asia. The major exception was the Mexican peso; the dollar appreciated versus the peso, especially at the end of the year, when the Mexican authorities relaxed support for the peso and subsequently allowed the currency to float.

### Foreign Exchange Operations

During 1994 the U.S. monetary authorities conducted three major interventions to support the dollar, in each case selling marks and yen. The first two episodes, in early May and late June, involved coordinated intervention with several foreign central banks. The last episode was in early November. For the year as a whole, U.S. monetary authorities sold a total of \$3,500 million of marks and \$2,610 million of yen. In the three months from February through April, U.S. monetary authorities sold all their holdings of foreign currencies other than marks and yen, resulting in sales totaling \$768 million.

At year-end, the System held foreign currencies valued at \$22,031 million at current exchange rates. No Treasury balances were warehoused with the System during 1994. The System realized \$706 million in profits on sales of foreign currency during 1994 and recorded a translation gain of \$1,717 million on foreign currency balances.

Intervention in dollars by fifteen major foreign central banks amounted to net purchases of about \$35 billion in 1994. In March, a \$6 billion temporary bilateral swap facility was established for the Bank of Mexico in the aftermath of the assassination of a Mexican presidential candidate. This facility was replaced by an increase from \$700 million to \$3 billion in the conventional swap facility with the Bank of Mexico when a swap facility involving Canada, Mexico, and the United States was established in April. On December 30, Federal Reserve participation in the latter arrangement was activated and temporarily enlarged to \$4.5 billion.<sup>3</sup>

### Bank for International Settlements

On September 13 the Chairman of the Board of Governors assumed the ex officio seat reserved for the U.S. central bank on the Board of Directors of the Bank for International Settlements (BIS).<sup>4</sup> Ex officio members have the right to appoint another person of the same nationality to a three-year seat on the BIS board; the Chairman appointed the President of the Federal Reserve Bank of New York. The Federal Reserve has had the right of representation on the BIS board since the founding of the BIS in 1930 but had not exercised that right until this year for a variety of reasons. In taking its seat the Federal Reserve recognized the increasingly

3. Early in 1995, Federal Reserve participation in the trilateral facility was temporarily enlarged further, to \$6 billion, and the additional portion was activated.

4. See Charles J. Siegman, "The Bank for International Settlements and the Federal Reserve," *Federal Reserve Bulletin*, vol. 80 (October 1994), pp. 900-906.

important role of the BIS as the principal forum for consultation, cooperation, and exchange of information among central bankers and the likely broadening of that role. ■

## *Monetary Policy Reports to the Congress*

*Given below are reports submitted to the Congress on February 22 and July 20, 1994, pursuant to the Full Employment and Balanced Growth Act of 1978.*

### **Report on February 22, 1994**

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

Nineteen ninety-three turned out to be 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 the burden of servicing debt, 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 GDP picked up sharply in the second half, and the increases for all of 1993 cumulated to about 2¾ percent

according to initial 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 last year, as unfavorable reports in the first few months of 1993 gave way to more subdued readings thereafter. 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.

In conducting policy through 1993, the Federal Open Market Committee recognized that it was maintaining a very accommodative stance in reserve markets. Reserve conditions had been eased to this degree over the preceding four years to counter the effect of some unusual factors restraining aggregate demand. The Committee recognized that as these forces abated, short-term interest rates would likely have to rise to forestall inflationary pressures that would eventually undermine the expansion.

Toward the end of 1993 and into early 1994, incoming data on the economy and credit flows have increasingly conveyed a picture of considerable underlying strength. The marked speedup of growth in the economy has been reducing spare capacity, as is evident in the recent declines in unemployment and increases in capacity utilization rates in industry. Moreover, while movements in broadly based price indexes have remained relatively favorable, there also have been undercurrents suggesting that the process of disinflation might be stall-



ing out. In particular, after slowing considerably in 1992, nominal increases in hourly compensation—comprising wages and benefits—fell no further in 1993, and long-term inflation expectations remain stubbornly above recent inflation rates. Also, commodity prices generally have firmed in recent months.

Earlier this month, the Federal Reserve concluded that the weight of the evidence indicated that undiminished monetary stimulus posed the threat that capacity pressures would build in the foreseeable future to the point where imbalances would develop and inflation would begin to pick up. At its February 1994 meeting, the Federal Open Market Committee determined that it was time to move to a slightly less accommodative stance. While the discount rate remained at 3 percent, the federal funds rate edged up to trade around  $3\frac{1}{4}$  percent, a little above the prevailing rate of inflation.

Strength in spending last year 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. The total debt of all nonfinancial sectors is estimated to have grown about 5 percent last year, 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  $1\frac{1}{2}$  percent, placing it a little above the lower bound of its 1 percent to 5 percent annual growth cone. M3 expanded  $\frac{1}{2}$  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 a shade more than 5 percent, or  $3\frac{3}{4}$  percentage points above the rate of expansion of M2 and  $4\frac{1}{2}$  percentage points above that of M3.

Most of the increase in the broad aggregates was recorded in their M1 component, which grew  $10\frac{1}{2}$  percent in 1993, as low money market and deposit interest rates provided little reason to forgo the liquidity of transaction depos-

its. At times during the year, declines in longer-term market rates produced waves of mortgage refinancing, an activity that is associated with temporary flows through the transaction deposits that are counted in M1. In addition, the currency component expanded at about the same rate as the M1 total, spurred by considerable demands from abroad. The double-digit expansion of M1 deposits pushed reserves up at a 12½ percent rate in 1993, while the monetary base, which includes reserves and currency, increased 10½ percent, the same rate as was posted in the previous year.

*Money and Debt Ranges for 1994*

At its July 1993 meeting, the Committee provisionally chose the same ranges for 1994 as it had established for 1993—1 percent to 5 percent for M2 and 0 percent to 4 percent for M3 and a monitoring range of 4 percent to 8 percent for the domestic nonfinancial debt aggregate. At that time, the Committee noted that disturbances to the historical relationships between the aggregates and spending required that the actual determination of these ranges for 1994, in February of this year, be made in light of additional experience and analysis.

As noted above, the velocities of M2 and M3 increased further in 1993, but at

a slower rate than in the previous year. This deceleration might indicate that the forces that had distorted the aggregates over the past few years, while still potent, were beginning to wane. The yield curve, although quite steep, now offers investors less inducement to move outside M2 in search of better returns than at any time in the past three years. Additionally, firms, having strengthened their financial positions, may feel more comfortable taking on shorter-term obligations and, therefore, may direct more of their business to depositories. Banks, which are better capitalized and whose assets are more liquid, should be in a strong position to meet those needs. Still, capital markets will provide attractive alternatives to the depository sector, suggesting that the forces tending to divert funds from depositories—and to raise the velocities of the monetary aggregates—will continue to be important. However, the strength of these forces, and whether or how quickly they might be abating, remain difficult to judge.

Against this background, the Federal Open Market Committee at its most recent meeting reaffirmed the annual growth ranges for the money and credit aggregates that it had chosen provisionally last July (table 1). The annual ranges appear to be sufficiently wide to encompass growth of M2 and M3 consistent with Committee members' expectations for nominal income under a variety of alternatives for the behavior of the velocities of the aggregates. If the forces depressing the demand for money relative to income were to persist unabated in 1994, M2 and M3 might be in the lower portion of their cones; should M2 and M3 move closer to their former alignments with spending—buoying the demands for those aggregates and depressing their velocities—then outcomes in the upper portion of

Ranges for Growth of Monetary and Debt Aggregates

Percent

Aggregate	1992	1993	1994
M2 .....	2½–6½	1–5	1–5
M3 .....	1–5	0–4	0–4
Debt .....	4½–8½	4–8	4–8

NOTE. 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. Debt is of the domestic nonfinancial sector.

the ranges would be expected. The Committee will watch the monetary aggregates closely during the course of the year for evidence on unfolding economic and financial conditions. Given uncertainties about velocity behavior, however, that information will necessarily be assessed in combination with a variety of other financial and economic indicators as the Committee formulates policy. Through 1994, as was true last year, the Committee's primary concern will be to foster financial conditions that help contain price pressures and sustain economic expansion, and it will have to assess the rates of money growth consistent with these objectives as the year goes on.

Debt growth, which has moved in closer alignment with nominal income over the past few years than have the monetary aggregates, will again be monitored in light of a 4 percent to 8 percent annual range. With the federal sector's demands on the pool of saving diminishing, the Committee envisions that an unchanged range would be associated with some pickup in borrowing by the private sector. Healthier balance sheets, lighter debt service burdens, heavier capital spending, and more eager lenders should all act to boost the expansion of nonfederal debt. Overall, the debt of the nonfinancial sectors is expected to grow again at about the pace of nominal income.

### *Economic Projections for 1994*

In general, the governors and Reserve Bank presidents anticipate that 1994 will be another year of progress for the economy, with low inflation and financial market conditions continuing to provide a setting conducive to sustaining moderate economic growth and rising employment opportunities.

The Federal Reserve officials' forecasts of real GDP growth over the four quarters of 1994 span a range of 2½ percent to 3¼ percent, with the central tendency of the forecasts being 3 percent to 3¼ percent (table 2). The governors and Reserve Bank presidents anticipate that the rise in real GDP will be accompanied by a further increase in labor productivity. Nonetheless, employment gains are expected to be sufficient to bring about some further reduction in the degree of labor market slack over the four quarters of the year. Forecasts of the unemployment rate in the fourth quarter of 1994 span a range of 6½ percent to 6¾ percent. Because of changes in survey design, a comparable rate for the fourth quarter of last year is not available; however, the Bureau of Labor Statistics has estimated that the fourth-quarter rate would have exceeded 7 percent on the new basis.

The sectoral composition of growth in 1994 may well resemble that of 1993. The financial adjustments of recent years have left households better positioned and more willing to boost spending. Moreover, with employment rising, real income growth should be support-

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

Measure	Range	Central tendency
<i>Change, fourth quarter to fourth quarter<sup>1</sup></i>		
Nominal GDP .....	4¾-7½	5½-6
Real GDP .....	2½-3¼	3-3¼
Consumer price index <sup>2</sup> .....	2¼-4	About 3
<i>Average level, fourth quarter</i>		
Unemployment rate <sup>3</sup> .....	6½-6¾	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.

ive of increased consumer expenditures in the coming year, despite the higher taxes confronting some households. Business investment seems likely to be pushed ahead by ongoing efforts to modernize and by further declines in computer prices. By contrast, further cuts in federal outlays for defense likely will continue to be a factor restraining the growth of aggregate demand. With the passage of time, the more accommodative monetary policies now in place in a number of countries, together with the moderate fiscal stimulus in Japan, are likely to lead to a gradual pickup in the rates of growth of foreign industrial countries and U.S. exports. However, U.S. imports from abroad will likely continue to move up at a brisk pace. Net exports of goods and services thus may decline somewhat further, albeit at a slower rate than they have over the past year.

The majority of the governors and Bank presidents expect inflation in 1994 to run a shade higher than in 1993. Most of their forecasts for the rise in the consumer price index are close to 3 percent, although the full range of forecasts extends from a low of  $2\frac{1}{4}$  percent to a high of 4 percent. Several developments are likely to work against better inflation performance in 1994. In agriculture, a poor harvest in 1993 has left some crops in very tight supply, and the risk of unfavorable food price developments is greater than it has been in recent years. In addition, although the future course of energy prices is uncertain, a repeat of last year's declines, which helped to hold down the overall CPI, cannot be counted on. More fundamentally, the recent narrowing of the degree of slack in the labor and product markets suggests that competitive pressures damping wage and price increases will be less strong and less pervasive than they have been recently.

The central tendencies of the forecasts of GDP growth, unemployment, and inflation are quite similar to the projections put forth by the Administration in its recent reports. Moreover, insofar as the Administration's numbers were predicated, in part, on the assumption that short-term interest rates would rise modestly in 1994, the recent tightening action by the Federal Reserve does not appear to be inconsistent with the Administration's outlook.

Prospects for sustained growth over the longer run have been bolstered by policy actions on a number of fronts. Considerable work remains to be done, however. Although recent fiscal measures have been helpful in bringing about declines in the federal budget deficit, the Congress and the Administration still must deal with some difficult issues to ensure that the deficit is kept on a downward course through the latter part of the 1990s and into the next century. In the area of trade policy, the nation's long-standing support of an open world trading system was reaffirmed this past year in the form of 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. Nonetheless, serious obstacles to free trade remain. On a wide range of regulatory issues, the Congress and the Administration face decisions that have the potential to promote—or to damage—the flexibility in labor and product markets and the processes of innovation and investment that are so critical to long-run economic progress. In the area of monetary policy, the challenge is to build on the favorable price performance of late in a situation in which the economy will likely be operating closer to full capacity 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 Performance of 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 GDP over the year amounted to 2.8 percent, according to the Commerce Department's first estimate. 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 last year. Bolstered by the gains in these sectors, the four-quarter rise in the final purchases of households and businesses amounted to about 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 remained quite large both in absolute terms and relative to nominal GDP. 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 slow the rise of 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 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

amounted to about 3 percent, measured to the year's fourth quarter from the fourth quarter of the previous year. 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. Data for January of this year showed strong gains in the unit sales of both cars and trucks.

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 nearly 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 1¾ percent, after a jump of more than 3½ percent in 1992. Spending for services rose 2¾ percent during 1993, the same increase as reported for 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 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 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 aforemen-

tioned 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.

Consumer reliance on credit picked up in 1993. The volume of consumer credit outstanding rose 5¾ percent during the year, after three years in which credit growth had been quite subdued. Growth of consumer credit was especially rapid in the final quarter of the year—about 9 percent at an annual rate. The mortgage debt of households rose about 7 percent from the end of 1992 to the end of 1993, slightly more than in either of the two previous years.

Continued improvement was evident on the asset side of household balance sheets 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 the jump in growth of consumer credit and the slight pickup in the growth of home mortgage debt, household liabilities rose somewhat faster than in 1992. Nonetheless, net worth appears to have increased, proba-

bly in real terms as well as in 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 have improved of late, with some survey readings the most upbeat in more than three years.

Residential investment increased about 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, impetus for activity continued to come mainly from declines in mortgage interest rates, which by autumn had dropped to the lowest levels in more than two decades. Fairly sharp declines in mortgage interest rates took place early in the year, but the effect of those declines 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 almost without interruption from April on. By the fourth quarter they had climbed to the highest level on record (the series goes back to 1968). Sales of new homes proceeded in somewhat choppy fashion from month to month, but by the end of the year they had moved well toward the upper end of their historical range. Housing construction also strengthened. The number of single-family starts increased about 18 percent from the second quarter to the fourth quarter, rising to the highest quarterly level since 1979. Although housing starts fell sharply in January, the decline probably was in large measure a reflection of the unusually bad weather across the country that month. According to survey data, consumers' assessments of home-buying conditions continued to be very upbeat in January and early February. Builders' ratings of the market edged down a touch in early 1994 but remained at a very favorable level.

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

### *The Business Sector*

The year 1993 saw appreciable gains in most important barometers of business activity. Output of the nonfarm business sector increased 3¾ percent during the

year, the same as the rise during 1992. Profits rose further, and business balance sheets continued to strengthen. Capital spending surged.

In the industrial sector, production rose 4¼ percent during 1993, the largest advance in six years. Gains of at least moderate proportions were reported in each quarter of 1993. The gain in the year's final quarter was quite large—on the order of 6½ 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. 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 modestly, and production of defense and space equipment fell 9½ percent further, extending a downward trend that began in 1987. In January of this year, industrial production rose 0.5 percent. Severe winter weather and the California earthquake cut into the growth of production in the manufacturing sector in January, but the output of utilities was boosted by increased heating requirements. Underlying support for industrial production is coming from large gains in new orders that were reported toward the end of 1993.

The amount of spare capacity in the industrial sector continued to diminish in 1993 and early 1994. The utilization rate in January was 83.1 percent. The rate has increased more than two percentage points during the past year, to the highest level since the second half of 1989. In manufacturing, capacity use in primary processing industries has been



running above its long-run average for more than a year, and the rate of utilization in advanced processing industries recently has moved up into line with its long-run average.

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 non-financial 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 non-financial 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 decline.

Business fixed investment increased about 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 one-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. Technological advances embodied in the latest computers made them far more powerful than equipment that was at the forefront only a few years ago, and highly com-

petitive market conditions kept prices on a downward course. More real computing power thus continued to become ever more accessible, and 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 11 percent in real terms during 1993, the biggest rise in ten years. Business expenditures for motor vehicles advanced about 13 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. Ample cash flow from internal operations 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 suggest that spending will remain weak in 1994. The reductions in outlays had been foreshadowed by earlier declines in new orders for commercial aircraft, and producers of aircraft have been scaling back their operations for some time.

Business investment in structures rose nearly 5 percent in 1993, 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 suggest, 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; 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 1993. Prices of office buildings continued to trend lower, but survey data suggest that the rate of decline has eased in at least some markets.

Investment increased for most other types of structures in 1993. Outlays for industrial structures, which had declined sharply in 1991 and 1992, rose about 8 percent, on net, over the four quarters of 1993. Outlays for commercial structures other than office buildings increased fairly briskly for a second year; by the fourth quarter, they had retraced about 40 percent of the steep decline that took place during 1990 and 1991. Investment in drilling also rose in 1993, 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.

Swings in business inventory investment played only a small role in the economy in 1993. Inventory accumulation in the nonfarm business sector picked up in the early part of the year, but thereafter, the rate of stockbuilding slowed. 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 have scheduled a further hefty rise in production for the current quarter, with assemblies slated to move up to the highest quarterly rate in more than fifteen years.

In the farm sector, inventories declined in 1993. Stocks were pulled down by weather-related reductions in crop output, especially in parts of the Midwest, where the worst flood of the century caused millions of acres to be left idle and cut deeply into yields on the acres that were planted. Inventories of a number of major field crops are in tight supply, in some cases the tightest since the mid-1970s. 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 thus 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 in 1993. 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. Growth of debt was slow, both in absolute terms and relative to the high rates of debt

growth 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 in 1993. All this seemed to augur well for sustained expansion of the business sector and the economy.

### *The Government Sector*

Federal purchases of goods and services, the portion of federal outlays that are included in GDP, fell more than 6 percent in real terms over the four quarters of 1993. Real outlays for national defense, which have been trending down since 1987, declined nearly 9 percent over the year. Growth of nondefense outlays fell slightly, on net, after fairly sizable increases in each of the three previous years. The level of real federal purchases in the fourth quarter of 1993 was down about 10 percent from the level 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. Growth in federal expenditures for Medicare and other health programs also

slowed, but their rate of increase continued to exceed the growth of nominal GDP by a considerable margin.

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 6¾ percent over the four quarters of the year. State and local transfer payments to persons have 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 in excess of 10 percent in 1993. Nominal purchases of goods and services rose moderately, but at a pace

somewhat faster than that of 1992. The 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 3 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 more than 9 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 in 1993. Employee compensation, which makes up roughly two-thirds of state and local purchases, rose about 1¼ percent in real terms during the year, the same as in 1992. Employment growth in the state and local sector was slow by historical standards again in 1993, and increases in hourly compensation were relatively small. State and local purchases of goods rose only moderately.

### *The External Sector*

The trade-weighted foreign exchange value of the U.S. dollar, measured in

terms of the other Group of Ten (G-10) currencies, rose nearly 6 percent on balance from December 1992 to December 1993. The dollar's 1993 rise in real terms (that is, adjusted for movements in relative consumer prices) was slightly greater than its rise in nominal terms, as U.S. inflation exceeded weighted-average inflation in the other G-10 countries by about ½ percent. The dollar's rise continued into the early weeks of 1994, but by mid-February it had fallen back to a level a bit below its average in December 1993.

The main factor behind the strengthening of the dollar last year appears to have been the general downward revision in perceptions of the strength of economic activity in a number of foreign countries while activity in the United States seemed to be improving on balance, especially in the latter part of the year. The weakening of activity abroad contributed to large declines in interest rates in the foreign G-10 countries, both in absolute terms and relative to levels of interest rates in the United States. On average, foreign short-term rates fell nearly 3 percentage points relative to U.S. rates last year, and foreign long-term rates fell about 1 percentage point relative to U.S. rates. Foreign short-term rates have changed little on average during the first few weeks of 1994, while long-term rates have edged higher.

The dollar rose 8 percent against the mark and by similar amounts against other currencies in the exchange rate mechanism (ERM) of the European Monetary System during 1993. It appreciated a bit further, on balance, in early 1994. Potential existed for much greater divergence of dollar exchange rates against these currencies as the result of a widening of permitted fluctuation margins following the ERM crisis last summer. Strains developed in the ERM in

July and August on growing expectations that weakness in the French economy and an anticipated recovery of the German economy would cause French authorities to reduce interest rates ahead of German rates. Growing pressure on the French, Belgian, Danish, and Iberian currencies led to massive foreign exchange intervention, sharp increases in short-term interest rates in those countries, and in early August, a substantial widening of the ERM margins. Later, market pressures eased and interest rates returned to their pre-crisis levels as it became clear that these countries would not make use of the wider margins to ease policy, and as the German economy showed signs of weakening further.

The pound, which had depreciated sharply against the dollar in late 1992 after U.K. authorities pulled it from the ERM and substantially lowered interest rates, fell an additional 4 percent relative to the dollar during 1993. The Italian lira depreciated nearly 20 percent against the dollar last year, reflecting market concerns over political uncertainties and massive budget deficits in Italy. Similar concerns, although on a smaller scale, contributed to the Canadian dollar's depreciation against the U.S. dollar of about 4 percent during 1993.

The Japanese yen was the only currency of a foreign G-10 country to appreciate against the dollar in 1993, rising on balance about 11 percent. The dollar-yen exchange rate appeared to be subject to two conflicting sets of pressures last year. During the first eight months of the year, the dollar depreciated nearly 20 percent against the yen, as market attention appeared to be focused mainly on the rising Japanese external trade surplus and perceived political pressures from abroad, particularly from the United States, to reduce this surplus. The dollar reached a low of

almost 100 yen per dollar last August. At that point, statements by U.S. officials expressing concern over the implications of the yen's strength for Japanese growth, accompanied by U.S. intervention support for the dollar, appeared to shift the market's main focus from these external considerations back toward the Japanese domestic economy. Over the latter part of the year, as economic activity in Japan continued to weaken and Japanese interest rates moved lower, the dollar rose against the yen, partially offsetting its earlier decline. That uptrend was halted in February 1994, however, in the face of renewed trade tensions between the United States and Japan, and the dollar fell back close to the low reached in August.

The dollar depreciated slightly in real terms on average against the currencies of major U.S. trading partners among developing countries in Latin America and East Asia in 1993. The Mexican peso rose 6 percent, despite a period of downward pressure amid uncertainty about the outcome of the U.S. congressional vote on the North American Free Trade Agreement as that vote drew near. The rise in the peso's inflation-adjusted exchange value has cumulated to nearly 35 percent since 1989, reflecting in part a strong inflow of capital from abroad stimulated by domestic reforms, declining world interest rates, and the anticipated positive influence of NAFTA on Mexico's real growth. The Brazilian cruzeiro rose fairly strongly in real terms against the dollar, as substantial nominal depreciation of the cruzeiro did not keep pace with the even more rapid domestic inflation in that country. Meanwhile, the Hong Kong dollar rose in real terms and the Taiwan dollar fell.

Growth of real GDP in the major industrial countries picked up somewhat, on average, during 1993 from

depressed levels in 1992. Growth was lifted as economic recoveries in Canada and the United Kingdom gained some momentum. However, output in Japan and most of continental Europe remained sluggish at best, showing either small increases or small declines for most of the year. The weakness of real activity in the foreign Group of Six industrial countries put further downward pressure on CPI inflation, which receded to roughly 2 percent on average in those countries last year. Further declines in interest rates in most of these countries during the past year should enhance the prospects of recovery in the coming year. The economies of the major developing countries in Asia continued to grow rapidly, fueled in part by exceptionally strong growth in China. Real growth in Mexico fell to near zero, however, reflecting the depressing effects of policy restraint aimed at containing inflationary pressures and, for a time, growing uncertainty about whether NAFTA would be implemented.

The nominal U.S. merchandise trade deficit widened to more than \$130 billion in 1993, compared with \$96 billion in 1992. Imports grew much faster than exports, partly because the U.S. economic recovery gained momentum while economic growth in U.S. export markets was sluggish on average. The appreciation of the dollar also tended to depress real net exports. The current account worsened about in line with the trade deficit, moving from a deficit of \$66 billion in 1992 to nearly \$105 billion at an annual rate over the first three quarters of 1993. Net service receipts and net investment income receipts both remained little changed over this period.

U.S. merchandise exports grew 3¾ percent in real terms over the four quarters of 1993, based on the initial fourth-quarter estimate from the national income and product accounts. Exports

changed little, on net, over the first three quarters of the year but strengthened in the fourth quarter as shipments of machinery and automotive products increased. The growth of computer exports in real terms slowed from the very rapid pace of recent years but still posted an increase of more than 15 percent. Agricultural exports declined as a result of reduced U.S. output in the 1993 crop year. By region of the world, the rise in merchandise exports during 1993 was more than accounted for by increased shipments to Canada, the United Kingdom, and Mexico. Shipments to the sluggish economies in continental Europe and Japan declined somewhat, while the growth of exports to developing countries in Asia slowed from the rapid pace of 1992.

Merchandise imports grew about 14 percent in real terms during 1993. The growth in imports was broadly based across commodity categories. Computers accounted for one-third of the growth in real terms, but imports of consumer goods, machinery, automotive products, and industrial supplies all rose strongly as well. Import prices declined slightly during 1993, reflecting a sharp decline in the price of oil imports. The average price of non-oil imports rose only slightly, reflecting low inflation abroad and the rise of the dollar.

In the first three quarters of 1993, recorded net capital inflows balanced only part of the substantial U.S. current account deficit, as net statistical errors and omissions were positive and large. Sizable net shipments of U.S. currency to foreigners, which are not recorded in the U.S. international accounts, contributed to the positive net errors and omissions.

Net official capital inflows amounted to \$48 billion. G-10 countries accounted for part of the inflows. In addition, various developing countries, particularly in

Latin America, experienced large private capital flows into their countries and added substantially to their official holdings in the United States.

Net private capital inflows into the United States were negligible in the first three quarters of 1993. However, reflecting the continued internationalization of financial markets, both inflows and outflows grew. U.S. net purchases of foreign securities reached a record \$96 billion, about evenly divided between stocks and bonds. Most of these net purchases were accounted for by Western Europe, Canada, and Japan; developing countries in Asia and Latin America accounted for a small but growing share of total U.S. net purchases of foreign stocks and bonds. Foreign private net purchases of U.S. government securities and corporate bonds remained strong; foreign asset holders also resumed making net purchases of U.S. corporate stocks. In addition, capital inflows from foreign direct investors in the United States resumed in the first three quarters of 1993, while capital outflows by U.S. direct investors abroad remained strong.

### *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 almost 2 million over the twelve months of the year. Although this gain was only moderate compared with annual increases in many years of the 1970s and 1980s, it was about twice the increase of 1992. The increase in employment in January of this year apparently was held down by bad weather.

Hiring picked up in most major sectors in 1993. The number of jobs in

retail and wholesale trade increased about 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. Of these firms, the ones exhibiting by far the most rapid growth were 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 the gain took 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, and a

further rise in the number of factory jobs was reported in January of this year. Reliance by manufacturers on workers from personnel supply firms reportedly has increased; because these workers are carried on the payrolls of the personnel firms, actual labor input in manufacturing was greater than the data indicate.

Significant improvement in labor market conditions also was evident in data from the monthly survey of households. 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. Because of changes in the design of the monthly survey of households, the official rate reported for January of this year—6.7 percent—is not comparable with the official rates for 1993 or previous years. However, the Bureau of Labor Statistics has indicated that, abstracting from the changes in survey design, the unemployment rate probably fell in January, with estimates of the size of the decline ranging from 0.1 percentage point to 0.3 percentage point. The aim of the new survey is to achieve more precise classification of individuals whose labor market situations may not have been accurately captured by the questions included in the old survey.

Growth of the civilian labor force—the sum of persons who are employed and those who are looking for work—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 past four years, labor force growth has averaged less than 1 percent per year, and the labor

force participation rate has edged down slightly, on net. Based on data from the old survey, the number of persons 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 persons 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, according to data from the old survey. To the extent that these individuals have been honing 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 of 1992 to December of 1993, about the same as the rise of the previous year. Wages rose 3.1 percent over the year, one-half 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 1.5 percent during the year, after large increases in both 1991 and 1992. Although part of the gain in output per hour over this three-year period is no doubt a reflection of normal cyclical processes, the data 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, of the rising skill of workers in exploiting those technologies, and, perhaps, of 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 1.3 percent, a shade less than in 1992.

### *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 and early in 1994, these increases became more widespread. Producer prices picked up somewhat in January, but prices at the retail level were unchanged, on balance.

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 a percentage point less than in 1992. Within this category, the CPI for tobacco fell 5 percent in 1993 after many years of large increases, as the inroads being made by generic brands in that market forced major suppliers to alter their basic pricing strategies. Prices of apparel rose less than 1 percent during 1993, 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 small deceleration for some items and 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 a 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 output of some of the nation's 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 account for by far the larger share of total food in the CPI, showed almost no acceleration 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 it 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 in electricity prices over the year 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. Since the end of last year, oil prices have changed little, on net, as an upswing in prices during the first few weeks of 1994 has been reversed by more recent declines. The CPI for energy continued to fall in January.

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 1.6 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 and into early 1994. The producer price index for crude materials excluding food and energy thus moved up sharply over the year, by about 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. According to one such survey, conducted by the University of Michigan Survey Research Center, 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. A similar but much less pronounced swing in expectations was evident in some other surveys as well. The surveys have 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 have remained higher still, with the Survey Research Center's series on average inflation rates that are expected over a five- to ten-year horizon holding in a range of 4½ percent to 5 percent, according to surveys conducted in the second half of 1993 and early 1994.

### Monetary and Financial Developments 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 thrifts. In part spurred by the higher returns available in those markets, investors found bonds and stocks to be a more attractive alternative than deposits; flows into bond and stock mutual funds were at record levels last year. 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 (FOMC) 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 FOMC continued to use a wide variety of information about financial and economic conditions for this purpose.

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 FOMC viewed that a tightening in reserve conditions at some point would likely be needed to avoid pressures on capacity and a pickup in inflation.

Concerns about a buildup of inflationary momentum increased in the spring, and, over the three months from mid-May until mid-August, instructions from the FOMC to the Federal Reserve Bank of New York indicated that there was a greater likelihood that money market conditions should be tightened rather than eased before the next scheduled meeting of the FOMC. Those concerns

again came to the fore as 1994 opened. Considerable underlying strength in aggregate demand and dwindling levels of excess capacity to meet that demand raised the risk that inflation pressures would strengthen down the road, derailing the expansion. Consequently, in February, the FOMC tightened reserve conditions for the first time in five years, nudging short-term rates up  $\frac{1}{4}$  percentage point.

### *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 FOMC 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 GDP at a  $5\frac{3}{4}$  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  $7\frac{1}{4}$  percent (on the old basis)—price pressures were not perceived to be likely. The expansion of the monetary aggregates had faltered around the turn of the year, but the sense was that special factors—importantly including a decline of mortgage prepayments that constricted the level of transactions deposits—accounted for some of the weakness. Against this backdrop, it appeared to the members of the FOMC 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, owing in part to 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 FOMC 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, although many analysts thought that the major indexes were distorted by difficulties in seasonal adjustment, data releases showing a variety of price and labor compensation indexes on the high side of investor expectations still roiled financial markets. Slack in the economy remained appreciable, which weighed against any pickup in inflation, but inflation expectations were in danger of ratcheting higher, with possible adverse consequences for inflation itself. Meanwhile, 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 FOMC, 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 FOMC, the unemployment rate had moved back up to 7 percent (on the old basis), while 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 FOMC decided to retain the current degree of restraint in the reserve market and an asymmetric tilt toward tightening in the policy directive.

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, while 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. The resulting capital gains apparently added to the allure of stock and bond mutual funds, thereby weakening M2,

which only edged up 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 FOMC 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.

Leading up to the September FOMC meeting, the unemployment rate had edged lower, to 6.7 percent (old basis), 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 of 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. Although 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, 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 about  $\frac{3}{8}$  percentage point from their yearly lows set in mid-October. Over that same span, the dollar showed notable strength on foreign exchange markets.

Most market rates held at these higher levels as the FOMC met for the first time in 1994. Readings on activity suggested that 1993 had ended on a very strong note, with real GDP expanding about 6 percent at an annual rate in the fourth quarter and reports suggesting that some of this momentum had carried over into 1994. Slack in labor and product markets had been reduced considerably, and the prices of a number of commodities important in the production of durable goods and in construction had begun to move higher. With that backdrop, the Committee decided that it was time to trim back some of the stimulus provided by the current low level of short-term interest rates before it fed through to higher inflation. The Account Manager was directed to tighten reserve conditions, and the federal funds rate moved up to a range around  $3\frac{1}{4}$  percent, while the discount rate remained at 3 percent.

### *Money and Credit Flows*

The long expansion of the 1980s was associated with growth of total debt of domestic nonfinancial sectors that was about  $1\frac{1}{2}$  times the pace of nominal GDP growth. In the wake of this phenomenal leveraging, the recession and tepid economic recovery from 1990 to 1992 were importantly a balance-sheet phenomenon that was reflected in a slowing in debt growth. In retrospect, it

is apparent that this deceleration in debt was 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, about in line with nominal GDP. 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  $3\frac{3}{4}$  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, though net equity issuance remained sizable as well. However, the debt markets in 1993 saw far more activity than the net requirements for external funds implied. Low longer-term rates induced many firms to refinance existing obligations, pushing gross public debt issuance 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  $2\frac{1}{4}$  percentage points below the peak set at the end of the previous decade, and with 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 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 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  $4\frac{3}{4}$  times that of disposable income. Within those 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 post-World War II low. Much of the declining role for deposits probably owed to the pattern of financial returns, with investors, confronted by a steep yield curve, seeking out the higher yields provided by longer-maturity instruments that 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. By 1993, however, 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,  $2\frac{1}{2}$  times the proportion at the end of 1990 (table 3). 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. However, borrowers, 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 modestly in 1993, marking a substantial rebound from the declines posted in the previous three years. The increase in depository credit 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 in the neighborhood of 3½ percent, while thrift credit contracted only modestly. 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.

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 (table 4). 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 on a fourth-quarter-to-fourth-quarter basis, held down by a steep drop in institution-only money market mutual funds. Overall, M3 velocity rose at a 4½ percent annual rate in 1993, down almost 2 percentage points from the previous year.

The velocity of M2 rose at a 3¾ percent annual rate in 1993 after increasing nearly 5 percent in 1992. The rise in velocity last year 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 2 percent to 6 percent spread 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 a surge in mortgage refinancings that followed when mortgage rates fell to levels not seen in a generation. Refinancings are associated with the temporary parking of funds in transactions and other highly liquid deposit accounts.

Especially after taking account of such special factors, the growth of M2 was quite subdued in 1993, owing in large part to the attractiveness of capital

Distribution of Assets of Domestic Commercial Banks, by Adjusted Capital Category

Percent

Category	End of year			September 1993
	1990	1991	1992	
Well capitalized . . .	30.4	34.4	67.8	73.3
Adequately capitalized . . .	38.5	45.1	21.8	17.8
Undercapitalized . . .	31.1	20.5	10.3	8.9

NOTE. Adjustments to capital categories were made 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).



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 those 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, undoubtedly encouraging 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 the end of 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, roughly in line with nominal GDP over that period.

M1 grew at a 10½ percent pace last year, spurred on by double-digit 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 in mortgage refinancing. M1 velocity declined at a 4¾ percent annual rate, 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 high interest-rate sensitivity and the fairly loose relationship of M1 to 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 in the increase in currency results in a 10½ percent growth rate for the monetary base in 1993, the same performance as the previous year.

Confronted with this rapid expansion in transaction deposits, and therefore required reserves, and directed by the Federal Open Market Committee 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

Growth of Money and Debt  
Percent

Measurement period	M1	M2	M3	Domestic non-financial debt
<i>Year</i> <sup>1</sup>				
1980 .....	7.4	8.9	9.6	9.1
1981 .....	5.4	9.3	12.4	9.9
	2.5 <sup>2</sup>			
1982 .....	8.8	9.2	9.9	9.6
1983 .....	10.4	12.2	9.9	12.0
1984 .....	5.5	8.1	10.9	14.0
1985 .....	12.0	8.7	7.6	14.2
1986 .....	15.5	9.3	8.9	13.4
1987 .....	6.3	4.3	5.7	10.3
1988 .....	4.3	5.3	6.3	9.0
1989 .....	.6	4.8	3.8	7.8
1990 .....	4.2	4.0	1.7	6.6
1991 .....	7.9	2.9	1.2	4.6
1992 .....	14.3	1.9	.5	5.0
1993 .....	10.5	1.4	.6	4.9
<i>Quarter (annual rate)</i> <sup>3</sup>				
1993: 1 .....	8.3	-1.3	-3.2	4.0
2 .....	10.7	2.2	2.1	4.5
3 .....	12.0	2.6	1.1	5.7
4 .....	9.4	2.1	2.4	5.2

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.

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.

## Report on July 20, 1994

### Monetary Policy and the Economic Outlook for 1994 and 1995

The favorable performance of the U.S. economy continued in the first half of 1994. Economic activity advanced at a brisk pace, building on the substantial gains in late 1993, and broad measures of inflation moved still lower. Unemployment declined and industrial capacity utilization rose, substantially reducing the remaining slack in resource use.

In this context, monetary policy has been directed this year at heading off a buildup of inflationary pressures that could jeopardize the continuation of the economic expansion. To do so, the Federal Reserve has had to move away from its highly accommodative policy stance of recent years. That stance had been adopted to counteract unusual restraint on domestic spending associated in large part with the efforts of both borrowers and lenders to strengthen their financial condition. Data available in late 1993 and early 1994 suggested that the restraint on spending had dissipated and that the economic expansion had become strong and self-sustaining. Against this background, the Federal Reserve has firmed money market conditions in four steps this year.

Despite disruptions caused by severe winter storms, real gross domestic product (GDP) rose at an annual rate of 3½ percent in the first quarter, and available indicators point to another sizable

gain in the second quarter. Business fixed investment has continued to grow rapidly this year, as firms have sought to improve efficiency by installing state-of-the-art equipment; rising utilization rates have spurred interest in expansion of capacity as well. Consumer outlays have trended higher this year, buoyed by the considerable gains in income and an increased willingness to borrow or use savings; lately, though, spending growth appears to have moderated somewhat. The rise in long-term interest rates that began last fall has damped the growth of housing activity this year, but the effect has been relatively mild, in part because homes remain quite affordable by the standards of the past two decades. In the labor market, the employment gains during the first half of this year were substantially more rapid than those in 1993, and the unemployment rate has continued to move lower.

Inflation generally was moderate during the first half of 1994. Retail food and energy prices changed little, on balance, over the period, holding the rise in the consumer price index (CPI) to 2½ percent at an annual rate. At the same time, the prices of a wide range of materials used in manufacturing and construction have been boosted considerably by strong demand and the resulting higher rates of resource utilization. Looking ahead, retail energy prices likely will rise over the summer, pushed up by the rebound in crude oil prices in recent months; in addition, the decline in the dollar since the beginning of the year, if not reversed, probably will exert some upward pressure on prices.

The Federal Reserve's policy actions this year have raised the federal funds rate to around 4¼ percent, from 3 percent, and have boosted the discount rate to 3½ percent, also from 3 percent. Other market interest rates have risen 1¼ to 1¾ percentage points since the

beginning of the year. Increases in intermediate- and long-term rates have been unusually large relative to the adjustment of short-term rates, reflecting stronger-than-anticipated economic growth and market expectations of greater inflationary pressures as well as actual and expected tightening actions by the Federal Reserve to contain those pressures. On occasion, the declining value of the dollar also appeared to contribute to higher yields. Markets have been volatile at times this year as investors have adjusted to a changing economic and policy outlook. The uncertain conditions encouraged investors to try to reduce their risk exposure, and the associated attempts to make large shifts in portfolios over short periods seemed to add to the upward pressure on long-term rates at times.

Despite the rise in U.S. interest rates, the dollar has declined considerably this year, with its trade-weighted foreign exchange value against the Group of Ten (G-10) countries falling about 8 percent. Rising long-term interest rates abroad, associated with brighter prospects for economic growth, tended to offset the effect on the dollar of higher U.S. rates. Moreover, other factors, including diminished hopes for a prompt resolution of trade tensions with Japan and market concerns about future inflation in the United States, fostered downward pressure on the dollar. This pressure was especially intense in late April and early May and again in the second half of June and first half of July. The U.S. Treasury and the Federal Reserve made substantial dollar purchases on three occasions during these periods to deal with volatile trading conditions and movements in the dollar judged to be inconsistent with economic fundamentals. Other governments shared the concern of U.S. officials, and the more recent operations were coordinated with

the monetary authorities of a large number of other countries, including the other members of the Group of Seven (G-7).

The strength of spending and a renewed willingness to use and extend credit contributed to a pickup in borrowing by households and businesses in the second half of last year, and this trend extended into the first half of 1994. However, the composition of borrowing has been affected by financial market conditions. Rising and more volatile long-term interest rates have encouraged businesses to rely more heavily on sources of shorter-term financing, such as finance companies and banks, and have prompted households to shift to adjustable rate mortgages. Banks, which had been hampered by balance sheet problems of their own in recent years, sought business and household loans more aggressively by continuing to ease credit standards and the nonprice terms of lending. Total commercial bank credit has increased moderately this year, and thrift institution credit, which contracted sharply between 1989 and 1993, appears to have expanded a bit. In contrast to the strength of private borrowing, the growth of federal government debt has slowed this year, reflecting the subdued growth of expenditures and sharply higher tax receipts associated with fiscal policy actions and the robust economy. As a result, the total debt of the domestic nonfinancial sectors expanded at about a 5¼ percent annual rate from the fourth quarter of 1993 through May, close to its pace over the second half of last year and well within its monitoring range of 4 to 8 percent.

Growth of the broad money aggregates has not kept pace with that of nominal GDP again this year. M2 increased at about a 1¼ percent annual rate from the fourth quarter of last year through June, while M3 fell slightly,

placing these aggregates around the lower bounds of their respective annual growth ranges. In the usual pattern, increases in rates on retail deposits and on money market mutual funds have lagged the rise in market interest rates, inducing a redirection of savings from M2 into market instruments and boosting M2 velocity. With returns on interest-paying checking accounts virtually unchanged, compensating balance requirements for demand deposits reduced by rising rates, and transactions balances also depressed by several special influences, M1 growth this year has slowed to less than half its rate of advance in 1993; through June, this aggregate had expanded at about a 4 percent annual rate since the fourth quarter of last year. Owing to the anemic expansion of transactions deposits, total reserves fell slightly over the first half of the year. Only continued strong demand for currency, much of which reflected use abroad, has supported growth of M1 and the monetary base.

In contrast to 1992 and 1993, shifts into bond and stock mutual funds were not a major factor in the rise in M2 velocity this year. Falling securities prices created capital losses for bond and equity mutual funds, prompting some fund holders to reevaluate the risks and prospective returns of such investments. Bond mutual funds experienced outflows this spring, and a portion of the proceeds was directed to less-risky money market mutual funds, thus elevating M2 for a time. Even with more subdued moves in securities prices since the late spring, many small investors have retained a more cautious view of the possible risks and rewards of holding capital market instruments, and total inflows to bond and stock mutual funds have remained considerably weaker than in the past few years. The effect of these

slower flows on M2 has been offset by shifts into direct holdings of market instruments, such as Treasury bills. As a consequence, the sum of M2 and household holdings of bond and stock mutual funds has decelerated sharply this year.

*Money and Debt Ranges for 1994 and 1995*

At its July 1994 meeting, the Federal Open Market Committee reviewed the annual ranges for money growth for 1994 that it had established in February. In light of the experience of the first half of the year and the likelihood that funds would continue to be diverted from deposits to higher-yielding market instruments, the Committee expected a substantial increase in the level of M2 velocity over 1994. M3 velocity also was seen as likely to rise quite sharply, given the funding patterns of depository institutions, which had been favoring sources of funds not included in M3, such as capital and borrowing from overseas offices. As a consequence, the Committee continued to expect that money growth within, though perhaps toward the lower end of, the ranges of 1 percent to 5 percent for M2 and 0 percent to 4 percent for M3 would be consistent with its broader objective of

Ranges for Growth of Monetary and Credit Aggregates

Percent			
Aggregate	1993	1994	Provisional for 1995
M2 .....	1-5	1-5	1-5
M3 .....	0-4	0-4	0-4
Debt .....	4-8	4-8	3-7

NOTE. Change from average for fourth quarter of preceding year to average for fourth quarter of year indicated. Figures for debt of the domestic nonfinancial sector are monitoring ranges.

fostering financial conditions that would sustain economic expansion and contain price pressures. It therefore voted to retain these ranges for 1994 (table 1). With little information to suggest any new trends in velocity for 1995, the Committee chose simply to carry forward the 1994 ranges for M2 and M3 as provisional ranges for those aggregates for 1995. The Committee noted that these ranges, especially that for M2, provided an indication of the longer-run growth of this aggregate that might be expected with the attainment of reasonable price stability and a return to the past pattern of velocity fluctuating around a constant long-run level. Considerable uncertainty about the behavior of velocity is likely to persist, however, and the Committee will continue to monitor a broad range of financial and economic indicators in addition to the monetary aggregates when determining the appropriate stance of policy.

The Committee also decided to retain its current monitoring range of 4 percent to 8 percent for growth of the debt aggregate during 1994. With debt expanding at a rate close to that of nominal income, the Committee's expectation for the growth of nominal GDP for the year suggested that the debt aggregate would finish the year comfortably within this range. However, the Committee expected that in 1995, macroeconomic performance consistent with sustainable expansion would involve some slowing of the growth of nominal spending and moderate growth of debt; indeed, rapid credit growth might suggest the possibility of a borrow-and-spend psychology typical of strengthening inflation. Consequently, the Committee voted to set a provisional monitoring range for debt growth for 1995 of 3 percent to 7 percent, a reduction of 1 percentage point at each end of the range.

### *Economic Projections for 1994 and 1995*

The members of the Board of Governors and the Reserve Bank presidents, all of whom participate in the deliberations of the Federal Open Market Committee, generally anticipate that the growth of real GDP will moderate during the second half of this year and into 1995 from the unsustainable pace in recent quarters (table 2). Employment gains through the end of 1995 are expected to roughly balance the net flow of individuals into the labor force, leaving the unemployment rate about unchanged from its average level in the second quarter of this year. Inflation is expected to pick up a little over the next year and one-half.

The forecasts of the Board members and Reserve Bank presidents for economic growth in 1994 are quite close to those made in February. Most continue to expect that real GDP will rise 3 percent to 3¼ percent over the four quarters of this year. For 1995, the central tendency of the forecasts is a range of 2½ percent to 2¾ percent. The unemployment rate anticipated for the fourth quarter of 1994 has been revised down about ½ percentage point from that projected in February.<sup>1</sup> The forecasts of the unemployment rate in the fourth quarter of 1994 are now bunched between 6 percent and 6¼ percent; this range is also the central tendency of the projections for the fourth quarter of 1995.

These forecasts are based on the expectation that the next several quar-

1. The unemployment forecast in February was subject to an unusual degree of uncertainty, as it was made shortly after the introduction of major revisions to the survey that generates the unemployment data. In February, the revised survey was believed to have boosted the unemployment rate from January 1994 forward by roughly ½ percentage point. Subsequent analysis indicates that the upward shift caused by the new survey probably was smaller than originally thought.

ters will be a period of transition to a more moderate expansion accompanied by reasonably full use of available resources. This transition is already evident in the housing market and, perhaps, in consumer outlays as well. The resulting deceleration in private domestic spending is expected to be offset, in part, by a smaller decline in net exports than that registered over the past several quarters; this projection for the external sector largely reflects an expectation of stronger economic expansion abroad.

The Board members and Reserve Bank presidents generally expect the rise in the consumer price index over the four quarters of 1994 to end up in the range of 2¾ percent to 3 percent. So far this year, retail energy prices have been flat on balance and retail food prices have moved up only a little, restraining the rise in the total CPI. However, given the run-up in crude oil prices of late and the improbability of another large drop

in the prices of fruits and vegetables, the rate of inflation projected for the next year and one-half is slightly higher than that posted recently. The decline in the dollar to date, if not reversed, also could exert some mild upward pressure on inflation.

The Administration recently released its mid-year update of economic and budgetary projections. The projections for nominal and real GDP growth, inflation, and unemployment for 1994 and 1995 fall within the ranges anticipated by Federal Reserve officials and are essentially consistent with the central tendency of those ranges. Thus, it appears that the monetary ranges set by the Federal Open Market Committee are compatible with the goals of the Administration.

Both Federal Reserve policymakers and the Administration anticipate further economic expansion accompanied by relatively low inflation. The Federal

Economic Projections for 1994 and 1995

Percent

Measure	FOMC members and nonvoting Reserve Bank presidents		Administration
	Range	Central tendency	
1994			
<i>Change, fourth quarter to fourth quarter</i> <sup>1</sup>			
Nominal GDP .....	5¼-6½	5½-6	5.8
Real GDP .....	3-3½	3-3¼	3.0
Consumer price index <sup>2</sup> .....	2½-3½	2¾-3	2.9
<i>Average level, fourth quarter</i>			
Unemployment rate <sup>3</sup> .....	6-6¼	6-6¼	6.2
1995			
<i>Change, fourth quarter to fourth quarter</i> <sup>1</sup>			
Nominal GDP .....	4½-6¼	5-5½	5.6
Real GDP .....	2¼-2¾	2½-2¾	2.7
Consumer price index <sup>2</sup> .....	2-4½	2¾-3½	3.2
<i>Average level, fourth quarter</i>			
Unemployment rate <sup>3</sup> .....	5¾-6½	6-6¼	6.2

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.

Reserve can do its part to prolong and enhance this favorable performance of the economy by continuing to set monetary policy in accord with the long-run objective of price stability. An environment of stable prices is a necessary condition for attaining the maximum sustainable growth of productivity and living standards. However, the outcome for the economy will also depend on government policy in other areas. In this regard, the Congress and the Administration can help ensure that the nation's economy reaches its full potential by working to keep the federal budget deficit on a downward course, by promoting an open world trading system, and by adopting regulatory policies that preserve the flexibility of labor, product, and financial markets and minimize the costs imposed on the private sector.

### The Performance of the Economy in 1994

The economy entered 1994 with a considerable amount of forward momentum. Severe winter weather disrupted activity, but real GDP still posted a solid gain in the first quarter, amounting to 3½ percent at an annual rate. As had been the case during 1993, domestic private-sector spending was robust in the first quarter, with consumer purchases of motor vehicles and investment in business equipment both increasing at double-digit annual rates. At the same time, the ongoing cutbacks in defense spending depressed total purchases by the federal government, and the sluggish economic performance of some major foreign industrial countries held down the growth of U.S. exports.

The data in hand suggest that real GDP increased substantially further in the second quarter. In the labor market, gains in payroll employment and longer workweeks appreciably boosted total

hours worked, and the civilian unemployment rate fell further. The indicators of spending, although less robust on balance than those for the labor market, still point to a sizable increase in economic activity.

Inflation trends remained favorable over the first half of this year, with the consumer price index rising at an annual rate of only 2½ percent over the period. Inflation has been damped by the healthy uptrend in productivity—which has offset much of the increase in compensation rates—and by the minimal rise in non-oil import prices. In addition, the decline in crude oil prices through this spring held down retail energy prices. However, oil prices have since moved up considerably, and the rise likely will boost retail energy prices over the summer. Prices have also risen substantially for many industrial materials, but these increases have not had a noticeable effect on the prices of finished goods.

### *The Household Sector*

Household balance sheets strengthened over 1992 and 1993, and the setback in stock and bond markets this year has not made a major dent in the sector's financial position. In addition, real income has continued to trend up at a healthy pace. Averaging through the monthly ups and downs, consumer spending appears to have posted a sizable advance over the first half of 1994, with most of the gain coming in the first quarter. Higher mortgage rates have cooled the growth of housing demand, but the level of activity remains strong.

In the first quarter of 1994, real consumer spending rose at an annual rate of about 5¼ percent, building on the large increases registered during the second half of 1993. Real outlays for motor vehicles were particularly strong in the

first quarter. Spending on other durable goods, which had advanced robustly during most of 1993, rose only slightly in the first quarter, whereas outlays for nondurable goods and services remained on a solid uptrend. The severe weather that gripped much of the country this winter left its mark on the monthly pattern of outlays but appears to have had little effect on the level of consumer spending for the first quarter as a whole. Outlays for furniture and appliances, clothing, and food all tumbled in January but then rebounded smartly over the remainder of the first quarter. This pattern was reversed for energy consumption, which soared in January and then turned down.

The growth of real consumer spending appears to have slowed in the second quarter, with much of the deceleration reflecting declines in two areas. First, consumer outlays for motor vehicles softened in April and May, and the level of spending probably did not move up much, if at all, in June. However, underlying consumer demand has remained firmer than the recent spending data would suggest, as vehicle sales in the second quarter were held down by shortages of popular models. Second, household use of electricity and gas for the second quarter as a whole likely will turn out to have been below the weather-boosted level of the first quarter. Apart from these two categories, real consumer outlays evidently posted a moderate increase in the second quarter.

On a pre-tax basis, real income growth has been brisk over the past year, buoyed by a considerable gain in wages and salaries, a sharp increase in the net income of nonfarm proprietorships, and an upturn in interest income. However, the higher personal income taxes imposed on upper-bracket taxpayers by the 1993 Budget Act have cut into the growth of disposable income. All told,

the average level of real disposable income in April and May was about 3½ percent above the level during the same period in 1993. This rise in real income was slightly smaller than the advance in real consumer spending over the same time span.

According to preliminary estimates (which are subject to potentially large revisions), the personal saving rate averaged a bit less than 4 percent during the first five months of this year—quite a low rate by historical standards. The level was so low partly because of a one-time charge against income to account for the wealth lost in the Los Angeles earthquake. In addition, the higher taxes due on returns filed this spring probably pushed down the amount of personal saving. Still, a good part of the decline in the saving rate from the 5 percent level prevailing two years ago reflects a burst of spending on motor vehicles and other durable goods. Such a decline in the saving rate often accompanies cyclical surges in outlays for consumer durables, which are counted as consumption in the national accounts; in reality, much of the initial expenditure on durables is a form of saving, as these goods are assets that provide a flow of services for years to come.

Household balance sheets have remained relatively strong despite the lower prices in financial markets this year. The total value of household assets—which includes not only financial assets, but also housing and consumer durables—rose moderately on balance over the year ended in the first quarter of 1994. Moreover, survey data indicate that households, in the aggregate, continue to view their current and expected financial positions in a favorable light. This greater sense of financial security, and the attendant willingness to take on debt, help explain the rapid



growth of consumer credit since the middle of last year. Other measures of household financial conditions also remain positive. Debt-service burdens, measured as a percentage of disposable income, held about steady in the first quarter at a level well below the peak reached several years ago. Delinquency rates for consumer loans and home mortgages were little changed in the first quarter, with most measures of delinquencies holding near their lowest levels in a decade or more.

The market for single-family housing has softened in recent months. Starts of single-family homes, which strengthened over the course of 1993, plummeted in January and remained low in February. Much of this sharp decline can be attributed to adverse weather. With the return to more normal weather in the spring, starts did recover, but the rebound was relatively weak, leaving the May level below that in the fourth quarter of last year. Sales of both new and existing homes in May also were down from their respective fourth-quarter levels. In addition, consumer attitudes toward homebuying have deteriorated somewhat since late winter.

Nonetheless, the level of sales and building activity in the single-family market has remained fairly high. Even with the rise in mortgage rates, new homes continue to be quite affordable by the standards of recent decades. A simple measure of affordability is the monthly payment on a fixed-rate mortgage for a new home having a given set of attributes, divided by average household income. By this measure, the cost burden of homeownership in the second quarter of this year was lower than at any time from mid-1973 to early 1992. Moreover, in response to the rise in long-term rates, an increasing share of households have financed home purchases this year with adjustable-rate

mortgages (ARMs); the lower initial rates on ARMs allow some households to obtain financing when they would be unable to qualify for a fixed-rate mortgage. As another support for housing demand, the strong labor market in recent quarters has lessened the perceived likelihood of job loss, encouraging many households to assume the financial commitment of homeownership.

Starts of multifamily housing units this year have picked up from the extraordinarily low levels registered from 1991 through 1993. This rise likely reflects an improving balance between demand and supply in some local markets. Lenders have shown a greater willingness to fund multifamily projects, owing not only to the firming real estate market, but also to their own improved financial conditions; equity investors—including real estate investment trusts—also have been participating more actively in this market. However, for the nation as a whole, vacancy rates for multifamily rental units remain high and rent increases continue to be relatively small, suggesting that a major recovery in this sector is unlikely in the near term.

### *The Business Sector*

Developments in the business sector remained favorable during the first half of 1994. Apart from losses from the Los Angeles earthquake, earnings have continued to be strong, and the repair of balance sheets over the past few years has improved the access to credit for many businesses. Fixed investment has moved up further, supported by widespread efforts to boost productivity.

Business output, excluding that in the farm sector, continued to increase at a brisk pace in the first quarter. In real terms, the gross domestic product of this

sector rose in the first quarter at an annual rate of  $4\frac{1}{4}$  percent, about the same rate of advance recorded in 1993. Focusing on the industrial sector—for which output data are available on a more timely basis—production advanced at an annual rate of 5 percent over the first half of 1994, with the strongest gains registered early in the year. This pattern largely reflects developments in the motor vehicle industry, where production rose sharply from last August to February of this year in response to strengthening demand and dwindling inventories. Since February, assembly rates have moved lower on a seasonally adjusted basis, as capacity constraints have hindered automakers from achieving their normal seasonal gains. Excluding motor vehicles and parts, industrial production continued to advance strongly in the second quarter.

After having risen sharply over 1993, the profits of U.S. corporations from current operations fell back in the first quarter of 1994. However, this decline in economic profits appears to have been due entirely to the effects of the Los Angeles earthquake and the severe weather last winter; these events greatly increased the volume of claims against insurance companies and also resulted in uninsured damage to plant and equipment. Abstracting from these losses, pre-tax economic profits in the first quarter rose slightly from the already high fourth-quarter level. Profits of non-financial corporations have been boosted by the strong growth in sales and by continued tight control of costs. For financial corporations, domestic profits surged over 1993 and remained high in the first quarter (after adjustment for the jump in insurance payouts), buoyed by the relatively wide margin between their cost of funds and the interest rates earned on their assets.

Real outlays for business equipment continued to rise rapidly in the first quarter, increasing about 17 percent at an annual rate. This was the eighth consecutive quarter that showed a double-digit advance. Monthly data through May on orders and shipments of business capital goods point to further sizable gains in real equipment purchases.

The increase in equipment investment this year has been quite broad, as firms have attempted to cut costs and improve product quality through the use of more advanced technology. Real outlays for computers and related devices climbed at an annual rate of 20 percent in the first quarter, reaching a level more than double that of three years earlier. Businesses have invested heavily in computers to take advantage of the increasingly powerful equipment available at ever-lower prices. Outlays for industrial and other types of machinery, which turned up in the middle of 1992, continued to expand at a solid pace early this year. Business spending for motor vehicles also rose substantially in the first quarter, led by another large increase in purchases of trucks; these purchases have likely been bolstered by improvements in the safety and efficiency of new models and by the increased demand for shipping to support just-in-time inventory management. In contrast to this widespread strength in investment, domestic purchases of commercial aircraft dropped in the first quarter to a very low level, reflecting the excess capacity in the airline industry.

Business investment in nonresidential structures fell sharply in the first quarter after having posted a moderate gain over 1993. Severe weather was responsible for the skid in activity during January and February. Construction spending then recovered during the spring, leaving the level in May about the same as that registered in December of last year.

The absence of growth, on net, over this period might suggest that the sector has lost some momentum, quite apart from the effects of weather. However, the monthly construction data are prone to large revisions, which limits the usefulness of the initial estimates. Two leading indicators of private nonresidential construction—permit issuance and contract awards—remained on a choppy uptrend through May.

Looking at the major components of nonresidential construction, some progress has been made in reducing the huge stock of unoccupied office space, and the plunge in prices for office properties appears to have abated. Nonetheless, the national vacancy rate remains high by historical standards, and starts of new office buildings continue to be limited. In contrast, outlays for commercial structures other than offices moved up smartly last year. Financing for these projects has become more readily available, and the proliferation of large-scale discount stores in suburban locations has been a major source of construction activity. In the industrial sector, utilization rates have risen considerably over the past year, but little sign has yet emerged of a significant rise in construction of new plants. Public utilities, according to surveys taken this spring, anticipate only a small rise in investment this year, in part because of the perceived difficulty in gaining approval for rate hikes and because of new rules requiring utilities to purchase power generated by other sources. Meanwhile, real investment in petroleum drilling structures fell somewhat in the first quarter, to a level about unchanged from that of a year earlier.

Nonfarm inventory investment during the first five months of 1994 picked up substantially from the pace of late last year. Part of the pickup reflected efforts to replenish stocks at automotive deal-

ers, which had been depleted during the third quarter of 1993. In addition, the rate of inventory accumulation increased this year for producers of machinery, likely in response to the robust orders for these goods. At the wholesale level, stocks of machinery and other durable goods increased considerably during the spring; the pace of stockbuilding in the retail sector spurted at about the same time.

In the farm sector, output last year was depressed by floods in the Midwest and by drought conditions farther east. As a result, inventories of some major field crops—principally corn and soybeans—currently are unusually low. This year, changes in government subsidy programs encouraged farmers to increase their planted acreage, and favorable weather during the spring facilitated rapid planting. Although the harvest is still several months away, field conditions appear to be reasonably good at present.

Farmers hurt by bad weather last year suffered income losses, and the financial positions of some may have weakened. Nonetheless, the financial condition of the farm sector as a whole appears to be sound. Delinquency rates for farm loans at the end of 1993 were quite low compared with the experience of the past decade, and land values rose noticeably last year across most of the farm belt. Reflecting these favorable conditions, investment in farm machinery has been relatively strong this year.

### *The Government Sector*

Federal purchases of goods and services—the part of federal spending included in gross domestic product—fell at an annual rate of 5¼ percent in real terms in the first quarter. Real federal purchases have been trending down since the first half of 1991, and the level

of outlays in the first quarter of this year stood roughly 12 percent below the peak reached three years earlier. This decline has been driven by the ongoing reduction in military outlays. Real defense spending plunged at an annual rate of about 15 percent in the first quarter after having declined more than 9 percent over 1993. Real nondefense outlays jumped in the first quarter, more than reversing the drop in late 1993; however, given the appropriations for nondefense spending in the fiscal year 1994 budget, these outlays are not likely to increase much further in the near term.

As measured in nominal terms in the unified budget, total federal expenditures during the first eight months of fiscal 1994—the period from October through May—were only 2½ percent above the level during the comparable part of fiscal 1993. Although the drop in defense spending has figured importantly in the overall restraint on outlays, other factors have contributed as well. First, substantial gains in income and the expiration of the emergency unemployment compensation program have tempered the growth of income security payments. Second, net interest payments on the national debt have been about flat thus far in fiscal 1994, as a further decline in the average interest rate paid on federal debt has offset the effect of increases in the stock of debt. In addition, farm subsidy payments have fallen because of the rise in crop prices. The main stimulus to federal outlays still comes from spending on Medicare, Medicaid, and other health programs. Health-related outlays during the first eight months of fiscal 1994 were up 10 percent from the same period in fiscal 1993; this increase, although about the same as that during fiscal 1993, is considerably smaller than the increases registered during the preceding three fiscal years.

The growth of federal receipts was strong during the first eight months of fiscal year 1994, with all major categories posting solid gains. The 9¾ percent rise in receipts over the comparable part of fiscal 1993 exceeded the increase in nominal GDP by a wide margin. Receipts from corporate income taxes have been especially robust, reflecting the upswing in corporate profits and various provisions of the 1993 Budget Act. Receipts from individual income and social insurance taxes have also been boosted by the tax hikes in the 1993 act. In addition, revenues from excise taxes thus far in fiscal 1994 are up markedly from the year-earlier level, in part because of the higher tax on transportation fuels that became effective last October.

As a result of the slow growth in federal outlays and the robust rise in receipts, the federal budget deficit narrowed during the first eight months of fiscal 1994. The deficit, as measured in the unified budget, totaled \$165 billion during this period, down from the \$212 billion deficit recorded over the same part of fiscal 1993.

In contrast to the improved budget picture at the federal level, the fiscal pressures facing state and local governments have not abated much. It is true that for most states, receipts during the past year have matched or exceeded projected levels, as economic growth turned out to be somewhat more buoyant than anticipated. Even so, as measured in the national income accounts, the deficit (net of social insurance funds) in state and local operating and capital accounts has remained large. The \$57 billion deficit during the year ended in the first quarter of 1994 amounted to 6¼ percent of the sector's expenditures, about the same percentage as in the preceding three years.

State and local outlays have continued to rise at a fairly rapid pace despite efforts to curb spending. Over the year ended in the first quarter of 1994, these outlays increased 6¾ percent in nominal terms, about 1 percentage point faster than the rise in nominal GDP. Transfer payments to individuals have remained the fastest growing component of state and local spending, reflecting large increases for Medicaid. Although the growth in Medicaid spending has slowed markedly from the 30 percent jump during 1991, these outlays still rose 13 percent over the year ended in the first quarter. In addition, state and local governments remain under pressure to fight crime, to repair aging infrastructure, and to meet the needs of a growing school-age population. Boosted by higher spending on highways and schools, outlays for construction rose almost 7 percent in real terms over the year ended in the first quarter. This rise occurred even though adverse weather depressed construction activity early this year, dragging down total state and local purchases in the first quarter in real terms. Apart from transfer payments and construction spending, state and local outlays—mainly compensation for employees—have continued to grow at a relatively slow pace.

The receipts of state and local governments moved up about 6½ percent in nominal terms over the year ended in the first quarter, also outpacing the growth in nominal GDP. As noted earlier, this outcome was somewhat better than most states had anticipated. In response, tax cuts are now on the agenda in about one-third of the states. However, most of these proposals are fairly narrow in scope and, in the aggregate, would have only a small effect on expected revenues.

### *The External Sector*

Since December 1993, the trade-weighted foreign exchange value of the dollar has declined about 8 percent relative to the currencies of the other members of the G-10. In terms of the currencies of a wider group of major U.S. trading partners, the value of the dollar has dropped roughly 4 percent since last December, when adjusted for changes in consumer prices here and abroad. Taking a longer view, the exchange value of the dollar—adjusted for these price changes—has held within a rather narrow range since the end of 1992 despite the decline this year. (See the final section of this report for a discussion of developments in foreign exchange markets.)

Economic activity appears to be strengthening in the major foreign industrial countries. In Canada and the United Kingdom, where recovery has been under way for some time, real GDP continues to expand at a fairly steady pace. Continental European countries, most of which were in recession during 1993, are showing signs of a turnaround. In western Germany, real GDP rose moderately in the first quarter; although indicators suggest that growth may have slowed somewhat in the second quarter, economic activity continues to move back toward pre-recession levels. There is also some evidence of a turnaround in Japan: After no growth on net in 1993, real GDP moved up strongly in the first quarter; data for the second quarter point to continued, albeit slower, expansion.

The level of real GDP remains substantially below potential in all the major foreign industrial countries, and inflation generally has continued to slow. In western Germany, the twelve-month change in the consumer price index was 3 percent in June, down from more than 3½ percent at the end of 1993. In Japan, consumer prices rose

less than 1 percent over the twelve months ended in June, an even more modest increase than that recorded over the twelve months of 1993. Jobless rates remain very high in France and drifted somewhat higher in western Germany over the first half of this year. The unemployment rate in Japan is essentially unchanged from its level at the end of 1993; the number of job offers per applicant, a more sensitive indicator of labor market conditions in Japan, also has shown no improvement since the end of last year. In contrast, in both the United Kingdom and Canada, the unemployment rate has continued to edge down from the peaks reached in mid-1993.

So far this year, growth in the major developing countries appears to have slowed slightly, on balance, from its rapid pace in 1993. The growth of real output in China has moderated from its previously very strong—and unsustainable—pace in response to tighter macroeconomic policy, while real growth in the other Asian developing countries has remained robust on average. Real output in Mexico has rebounded somewhat this year after having declined during the second half of 1993. The rebound appears to have been due in part to the somewhat more expansionary fiscal policy in Mexico and to the ratification of the North American Free Trade Agreement, which resolved uncertainty that had held down investment activity during 1993.

After having surged in the fourth quarter of last year, real U.S. exports of goods and services fell back in the first quarter of this year; however, they remained about  $4\frac{3}{4}$  percent above the year-earlier level. Preliminary data indicate that real exports in April were somewhat above the first-quarter average. The uptrend largely reflects a boom in sales of capital goods; for other goods, and for services as well, exports

have risen only slightly over the past year. Looking across our major trading partners, exports to Canada and Latin America remained on an upward path through the first quarter. Although exports to Asia dropped back in the first quarter, they also remain on a strong upward trend. Exports to continental Europe continued to expand sluggishly through the first quarter.

Real imports of goods and services posted another sizable increase in the first quarter, reflecting the strength in U.S. economic activity. Over the year ended in the first quarter, real imports jumped more than 11 percent, and the level of imports in April stood somewhat above that in the first quarter. Imports of capital goods and industrial supplies have continued to be especially robust. Prices of non-oil imports rose relatively little over the twelve months ended in May, as inflation abroad generally remained subdued and the dollar's foreign exchange value against the currencies of the other G-10 countries was little changed on net over this twelve-month period.

The nominal trade deficit on goods and services widened to \$97 billion (at an annual rate) in the first quarter, significantly larger than in any recent quarter, and remained at about that level in April. Net investment income showed a small deficit in the first quarter, somewhat weaker than the average performance in 1993. The current account deficit widened to \$128 billion (at an annual rate) in the first quarter, compared with \$104 billion for all of 1993.

Recorded net capital inflows for the first quarter about balanced the current account deficit. Foreign official inflows slowed, particularly on the part of some developing countries that had substantial accumulations of reserves in 1993.

Net inflows of private capital into the United States picked up in the first

quarter of 1994. Private foreign net purchases of U.S. securities were strong, as foreign investors added to their holdings of U.S. government securities, corporate bonds, and stocks. U.S. net purchases of foreign securities also remained very high in the first quarter. Banking offices in the United States reported substantial inflows, as foreign-chartered banks in particular continued to substitute borrowing abroad for funding in the United States. Foreign branches of U.S. banks also became net providers of funds to their U.S. offices. Direct investment inflows and outflows were spurred by a revival of mergers and acquisitions. U.S. direct investment abroad continued at near-record levels; foreign direct investment in the United States was also significant, although far below the peaks reached in the late 1980s.

### *Labor Market Developments*

The labor market continued to strengthen in the first half of 1994. Non-farm payroll employment increased at an average rate of about 285,000 per month during the period, up from the average monthly gain of roughly 200,000 during 1993. These increases brought the total rise in payrolls to about 5 million since the beginning of the current expansion in early 1991.

The job gains this year have been spread across most major sectors of the economy. In manufacturing, employment turned up last October, and a choppy advance continued during the first half of 1994. Hiring has been concentrated in two industries that have experienced robust sales growth, machinery and motor vehicles; payrolls also have expanded in industries that supply materials and parts to these producers. In contrast, employment in defense-related industries has continued to drop this year. Meanwhile, construc-

tion employment, held down early in the year by the severe weather, moved up sharply in March and April and rose somewhat further in May and June.

Considerable employment growth has also taken place this year in the service-producing sector. Continuing the pattern of recent years, employment in business services rose at a rapid clip in the first half of 1994. Employment in health services has remained on a fairly brisk uptrend, and job gains have been widespread in other service industries. Another area of strength has been wholesale and retail trade, where the sizable employment gains recorded during 1993 and again this year contrast with the lack of job growth on net over the preceding four years.

In addition to boosting the pace of hiring, employers have continued to rely on a longer workweek to increase aggregate labor input. Indeed, in April, the workweek of production or nonsupervisory workers in manufacturing reached a record high for the post-World War II period; it has since edged off only slightly. Before this expansion, the typical pattern had been for the workweek to rise as the recovery got under way but to drift back down with the eventual pickup in hiring.

Firms have also shown an increased preference for using temporary workers. In the employment data, these workers appear on the payrolls of personnel supply agencies (a component of business services), where employment growth continued to be extremely fast in the first half of 1994. Although these agencies represent only about 2 percent of total payroll employment, they accounted for more than 15 percent of the total rise in employment in 1993 and for nearly that share so far this year. Manufacturing firms in particular have increased their use of temporary workers. Both the growing employment of

temporary workers and the lengthening of the workweek may be motivated, in part, by the desire to avoid the rising costs of health insurance and other fringe benefits, which typically are granted to new permanent workers. Moreover, given the greater costs now associated with hiring and firing employees, such behavior may be a response to uncertainty about future staffing needs.

In January, the introduction of the redesigned household survey, along with the incorporation of population estimates from the 1990 census, created a break in the household measure of employment, the civilian unemployment rate, and numerous other series. The decline in the unemployment rate from January to June of 6.7 percent to 6 percent provides additional evidence of strong labor demand this year. Unemployment rates by region have generally moved lower since January, and the dispersion across regions also has narrowed; the declines since January have been largest in California and other states in the Pacific region and in New England.

The strength in hiring has not drawn many workers into the civilian labor force. In fact, between January and June the labor force contracted a bit, pushing down the labor force participation rate—which measures the percentage of the working age population that is either employed or looking for work. The participation rate has changed little on net during the current expansion, in contrast to the upswing that typically occurs with a strengthening of labor demand. The reasons for this departure from the usual pattern are not entirely clear. It appears that more young women are opting for activities outside the labor market. Also, according to survey data, many individuals still perceive jobs as hard to find,

which may be limiting their desire to search for employment.

Output per hour in the nonfarm business sector rose at an annual rate of 1¼ percent in the first quarter after having advanced at a far more rapid pace over the second half of 1993. Averaging through these movements, labor productivity rose about 2½ percent over the year ended in the first quarter of 1994, roughly in line with the increases during the first two years of the current expansion. Most of the productivity gain over this three-year period likely reflects the normal cyclical upswing that accompanies the strengthening of output after a recession. Nonetheless, there does appear to have been some speedup in the trend rate of productivity growth from the relatively slow pace in the 1970s and 1980s.

The growth in labor compensation remained subdued early this year. The employment cost index (ECI) for private industry—a measure that includes both wages and benefits—rose 3¼ percent over the twelve months ended in March 1994, a shade below the increase registered over the preceding twelve months. The cost of employee benefits decelerated quite a bit over the past year, largely because of more moderate increases in employer costs for health insurance and workers' compensation. In contrast, wage increases have held fairly stable. The ECI for wages and salaries rose almost 3 percent over the twelve months ended in March, a figure at about the midpoint of the twelve-month changes recorded over the past two years. Separate data through June on average hourly earnings of production or nonsupervisory workers also show no significant change in the rate of wage inflation. With the rise in labor compensation largely offset by improvements in productivity, unit labor costs in nonfarm business rose only a little more



than ½ percent over the year ended in the first quarter of 1994.

### *Price Developments*

Inflation slowed slightly further during the first half of 1994. The CPI excluding food and energy—a measure of the underlying trend of inflation—rose 3 percent during the period, down a bit from the 3¼ percent increases recorded in 1992 and 1993. “Core” inflation has not been this low for an extended period since the early 1970s, when wage and price controls were in place; apart from that episode, the core inflation rate over a twelve-month span was last below 3 percent in 1966. Food prices have risen only slightly this year, and energy prices have been flat on net, holding the increase in the total CPI over the first half of the year to 2½ percent at an annual rate. Price pressures have been evident in the markets for raw materials, but these increases have not had an obvious effect on inflation at the retail level.

The news on food prices so far this year has been quite favorable. After having risen at close to a 4 percent annual rate during the second half of last year, the CPI for food edged up at an annual rate of less than 1 percent over the first half of 1994. This moderation largely reflects a decline in the prices of fruits and vegetables over the first few months of the year, which retraced much of the run-up that occurred over the second half of 1993. In addition, plentiful supplies of beef and pork pushed down retail meat prices a bit on balance over the first half of 1994. Prices of other foods—which represent about two-thirds of total food in the CPI—increased at an annual rate of 2¼ percent during the first half of the year. Looking ahead, the path for retail food prices will depend heavily on the out-

come of this year’s harvest. As discussed earlier, planting proceeded fairly smoothly this spring, and crops generally were in good condition as of mid-July.

The CPI for energy was about unchanged on balance over the first half of 1994, but this measure has yet to reflect the rise in crude oil prices since March. As the year began, consumer energy prices were still on a downward path, owing to the persistent oversupply of crude oil in world markets. Energy demand then soared when the frigid weather hit in January and February, depleting inventories of fuel oil, gasoline, and natural gas. In response, the CPI for energy jumped in February and rose slightly further in March, but most of this increase was reversed in April and May. Quite apart from any effects of abnormal weather, world oil markets have tightened since March, boosting the price of crude oil by as much as \$6 per barrel. This increase appears to have resulted from the expectation of improved economic conditions—and hence stronger demand—in Western Europe and Japan, combined with flat OPEC production and supply disruptions in the North Sea and other areas. Retail energy prices were little changed in June, but the higher costs of crude oil are likely to be passed through to the retail level over the summer.

The CPI for commodities excluding food and energy increased at an annual rate of 2½ percent over the first half of 1994, a somewhat faster rise than during 1993. However, the increase last year was held down by a huge drop in the price of tobacco products. Excluding tobacco as well as food and energy, goods prices rose at an annual rate of 2¼ percent during the first half of this year, about the same rate of advance as in 1993. Price increases for most consumer commodities have been modest

this year, owing in part to the very limited increases in the prices of imported goods. The only major area in which prices have clearly accelerated is motor vehicles. Reflecting strong demand and the weakness of the dollar vis à vis the yen, the CPI for new motor vehicles rose  $4\frac{3}{4}$  percent over the first half of 1994, up from the  $3\frac{1}{4}$  percent increase during 1993.

Inflation for consumer services other than energy has continued to trend lower. During the first half of the year, the CPI for this aggregate rose at an annual rate of  $3\frac{1}{4}$  percent, after increases of nearly 4 percent in 1992 and 1993 and  $4\frac{1}{2}$  percent in 1991. Shelter costs—which represent about half of non-energy services—have continued to rise at a relatively subdued rate, while price increases in a variety of other areas have slowed. Indeed, the CPI for medical care services rose only 5 percent over the year ended in June, the smallest twelve-month change in this series in twenty years. Tuition costs, which posted increases of 8 percent to 9 percent annually for several years, have decelerated as well, rising  $6\frac{3}{4}$  percent over the twelve months ended in June.

The producer price index (PPI) for finished goods excluding food and energy, which covers domestically produced consumer goods and capital equipment, rose only  $\frac{1}{2}$  percent over the twelve months ended in June 1994. As with the CPI, this measure of inflation has been held down by the plunge in tobacco prices; excluding tobacco, the  $1\frac{1}{4}$  percent rise over the twelve-month period was about the same as that over the preceding twelve months. At earlier stages of processing, price increases have remained fairly small on balance. The PPI for intermediate materials excluding food and energy rose 2 percent over the twelve months ended in

June, after an increase of  $1\frac{1}{2}$  percent over the preceding twelve months.

In contrast, inflation pressures continue to be evident in the markets for raw commodities. With the exception of steel scrap, prices of industrial metals have moved up from their lows last fall, in some cases quite substantially. Lumber prices, which have swung widely over the past few years, have been at relatively high levels for most of this year. Prices of other raw materials have been firm as well. As a summary measure of these movements, the PPI for crude materials excluding food and energy rose about 7 percent over the twelve months ended in June. However, crude materials constitute a relatively small part of the value of finished goods, and price increases for these inputs usually have a limited effect on the prices of finished goods in the absence of more general cost pressures.

Expectations of inflation appear to have changed little on net since the end of 1993. According to the survey of households conducted by the Survey Research Center of the University of Michigan, the mean expected increase in the CPI over the coming year rose from  $3\frac{3}{4}$  percent in the fourth quarter of 1993 to  $4\frac{1}{2}$  percent in March and April; however, the readings for May through early July dropped back to an average of about 4 percent. In the Conference Board survey of households, the expected rate of inflation over the coming year has held fairly steady at  $4\frac{1}{4}$  percent since last November. Expectations of inflation over longer periods also have not changed much on balance this year. In the University of Michigan survey, the expected rate of CPI inflation over the next five to ten years jumped in March but has since retraced the increase. Finally, the June 1994 survey of professional forecasters conducted by the Federal Reserve Bank of

Philadelphia produced the same expectation of inflation over the coming ten years—3.5 percent—as did the survey taken last December.

### Monetary and Financial Developments in 1994

Interest rates have increased substantially in 1994. Short-term rates started the year at the unusually low levels that prevailed throughout 1993, but they have subsequently risen in response to the Federal Reserve's monetary policy actions and market expectations about future actions. The Federal Reserve has moved away from its previously very accommodative policy posture in four steps, which lifted the federal funds rate a total of  $1\frac{1}{4}$  percentage points. Other short-term rates increased commensurately, and banks raised their prime lending rate, also by  $1\frac{1}{4}$  percentage points.

Longer-term interest rates have risen about  $1\frac{1}{4}$  to  $1\frac{3}{4}$  percentage points. These rates have been boosted by stronger-than-expected economic growth, market concerns about higher inflation, and actual and anticipated tightening moves. In addition, a shift in the financial setting, from one marked by yields that were stable or declining to one characterized by rising rates, was accompanied by greater market volatility and a reevaluation of the risks of and returns on long-term securities. Investors seemed to become more uncertain about the future path of interest rates, and the resulting portfolio shifts and volatility have contributed to the upward pressure on long-term yields at times.

Despite the rise in interest rates, overall borrowing has remained fairly strong. The composition of private borrowing, however, has been affected by financial market conditions. Businesses, in particular, have reduced their issuance of long-term debt and stepped up

their use of bank loans. Nonetheless, overall bank lending has increased only slightly, as growth in real estate loans has slowed. The expansion of bank securities holdings, after adjustment for certain accounting rule changes, has eased slightly, and bank credit growth has remained close to the pace recorded last year. Higher short-term market interest rates have also restrained the monetary aggregates. Growth of the broader aggregates has slowed somewhat from last year, and growth of M1 has decelerated substantially.

Since December 1993, the dollar has declined about 10 percent against the German mark and about 11 percent against the Japanese yen, although it has appreciated against the Canadian dollar. Over the same period, stronger growth prospects abroad as well as portfolio adjustments by globally diversified investors have lifted long-term interest rates in the G-10 countries about  $1\frac{1}{2}$  percentage points, similar to the rise in U.S. longer-term yields. By contrast, foreign short-term rates, which largely reflect the thrust of monetary policy in individual countries, are about unchanged on a trade-weighted basis; rates have declined substantially in Germany and a number of continental European countries, have changed little in Japan, and have risen more in Canada than in the United States. Dollar weakness against the yen and mark was intense from time to time and seemed to reflect, in part, difficulty in resolving trade tensions, changing expectations about macroeconomic developments in Japan and Germany, and investor concerns that U.S. inflation prospects were no longer improving while inflation abroad seemed likely to continue to move lower. On three occasions when conditions warranted, the U.S. Treasury and the Federal Reserve intervened to buy dollars.

### *The Course of Policy and Interest Rates*

At the beginning of 1994, financial markets had been characterized for several years by falling and then persistently low short-term interest rates, declining long-term rates, and unusually wide spreads between long- and short-term yields. Moreover, the volatility of bond prices had been quite low by recent historical standards. In this environment, investors had taken on riskier assets in pursuit of higher returns. For example, small investors had switched out of low-yielding, but low-risk, assets such as deposits and money market mutual funds and into such investments as bond and equity mutual fund shares.

In February, when the Federal Open Market Committee gathered for its first meeting of the year, the available data suggested that the economic expansion was solid and self-sustaining. Spending had picked up considerably, partly reflecting declines in long-term interest rates and the improved financial condition of businesses and households. Short-term interest rates had been at historically low levels for some time, measured both absolutely and relative to inflation, and banks and other lenders had been loosening their terms and standards for extending credit. In this environment, the Committee was concerned that keeping policy so accommodative risked elevating demands on productive capacity to the point where inflation pressures might emerge. Even though current inflation readings were favorable, delaying a policy move until these indicators signaled an actual acceleration of prices would permit an inflationary process to become embedded in the economy. In that event, larger and possibly disruptive actions eventually would be needed to bring inflation back under control. Against this backdrop, the Committee decided to take steps toward eliminating

the considerable degree of monetary accommodation that had prevailed for some time.

When discussing how to implement this decision, the Committee considered the possible reaction of financial markets. Market participants, while anticipating that interest rates would rise at some point, generally did not expect a tightening of policy at this meeting. The Committee was concerned that the capital losses engendered by the firming action might unsettle many investors, who had not faced a policy firming in nearly five years and whose portfolio choices in some cases seemed not to anticipate the consequences of rising rates. In these circumstances, the response to the policy action might be outsized, especially if a large adjustment were made. Consequently, the Committee decided to initiate its move toward a less accommodative stance with a small step, although it thought that additional firming steps likely would be necessary in the months ahead. The Committee instructed the Domestic Trading Desk to increase slightly the degree of pressure on reserve positions and authorized the Chairman to announce the action so as to avoid any misinterpretation of its action or purpose. The tightening of reserve conditions pushed up the federal funds rate about  $\frac{1}{4}$  percentage point, to a range around  $3\frac{1}{4}$  percent.

Although a policy firming in the months ahead was built into the structure of market interest rates, the timing of the move caught many market participants by surprise and, by itself, seemed to precipitate a substantial shift in expectations. When the move was followed by information indicating a much stronger path for U.S. economic activity than had been anticipated and by an associated heightening of concerns about inflationary pressures, short- and

long-term interest rates moved sharply higher throughout the remainder of the winter. International developments—such as trade tensions, improving economic prospects, rising long-term interest rates, and a declining value of the dollar—also may have played a role in elevating yields by raising investor concerns about price pressures in the United States and about foreign investor appetite for dollar-denominated assets. Rates were volatile on occasion, owing to shifting perceptions about the future course of economic and financial developments. Market participants generally believed that the System's firming action was the first of a series, but they were unsure of the timing and cumulative magnitude of future policy steps. This heightened uncertainty, as well as the capital losses in the wake of the firming action, prompted market participants to reduce their risk exposure by attempting to shorten the maturities of their investments and by trimming the degree to which positions were leveraged. They sold long-term assets denominated not only in dollars but in other currencies as well. This rebalancing of portfolios contributed to sharp rate swings and may have exacerbated the upward pressure on long-term interest rates, both in the United States and abroad.

When the Federal Open Market Committee convened in mid-March, the evidence suggested that the expansion of economic activity remained robust. There was a small risk that the weakness and volatility in financial markets might have significantly affected household and business confidence and spending. However, the Committee believed that, on balance, its policy stance still was overly accommodative and likely to promote inflationary pressures. It therefore decided to continue the process begun in February to remove the excess degree of

monetary accommodation and, in light of recent financial market conditions, chose to take another small step. The resultant increase in reserve pressures lifted the federal funds rate  $\frac{1}{4}$  percentage point, to about  $3\frac{1}{2}$  percent.

Data released over the next several weeks indicated considerable strength in economic activity. Yields increased across the maturity spectrum, with long-term rates rising especially sharply into early April before settling back somewhat. On April 18, the Committee reviewed the incoming data, as well as the apparently more stable conditions in financial markets, during a telephone consultation. Following that review, Committee members supported the Chairman's decision to continue the process of reducing the degree of monetary accommodation. Reserve pressures were tightened slightly further, and the federal funds rate again rose  $\frac{1}{4}$  percentage point.

Yields continued to increase, on balance, through mid-May. Short-term rates were affected by expectations of additional firming actions, while long-term rates were subject to countervailing forces. Incoming data that showed signs of a possible cooling in the pace of the economic expansion, favorable price reports, and more stable trading conditions helped push bond yields down for a time. Later, however, a falling dollar, especially in late April and early May, and the release of a stronger-than-expected employment report caused long-term yields to retrace some of the earlier decline.

Despite the earlier firming actions, real short-term rates were still fairly low at the time of the May Committee meeting. The economy continued to exhibit forward momentum, and a considerable portion of the remaining margin of slack in resource utilization had eroded. In financial markets, many of the more risk

averse investors had made the initial portfolio adjustments to a rising rate environment. Under these circumstances, the Federal Reserve thought that conditions warranted eliminating much of the remaining degree of monetary stimulus. The Board of Governors, therefore, approved an increase in the discount rate to 3½ percent, from 3 percent, and the Committee directed the Domestic Trading Desk to permit the entire ½ percentage point rise to show through to the federal funds rate, which moved up to 4¼ percent. These moves, along with the three earlier steps, were judged to have substantially removed the degree of monetary accommodation that had prevailed throughout 1993. Still, the Committee would have to monitor incoming financial and economic data carefully to determine whether additional policy adjustments were needed to accomplish its objective of maintaining favorable trends in inflation and thereby sustaining the economic expansion.

Long-term interest rates dropped immediately following the May 17 policy moves, but since that time they have retraced the decline. Market participants initially interpreted the Federal Reserve's policy announcement as signaling that it had completed its firming actions, at least for a while. In addition, investors apparently viewed the actions as reducing the degree and frequency of tightening that might be needed in the future. Long-term yields began to move up in June, however, reflecting the further depreciation of the dollar, intermittent jumps in commodities prices, less sanguine inflation reports, and rising foreign long-term interest rates.

At the time of the July Committee meeting, data on employment and hours worked suggested that the economy was still growing at a brisk rate, and there remained a risk that an inflationary pro-

cess could begin to build. However, data on spending showed some signs of moderation, and growth of money and credit had not picked up. In these circumstances, the Committee decided to maintain the existing degree of reserve pressure and await additional information to judge the trajectory of the economy and prices and the appropriateness of its policy stance.

### *Credit and Money Flows*

Since mid-1993, credit expansion has picked up as the economy has strengthened and the restraint exerted by financial restructuring has ebbed. Lower debt-service burdens and improved balance sheets have encouraged businesses and households to take on new debt, while stronger capital positions and more robust economic conditions apparently have made banks and other lenders more willing to extend credit. Growth of the debt of nonfederal nonfinancial sectors (nonfinancial businesses, households, and state and local governments) picked up in the second half of 1993 and has increased a bit more this year—to a 5 percent annual rate. Total domestic nonfinancial sector debt, which includes the debt of the federal government, rose at a 5¼ percent annual rate between the fourth quarter of last year and May, close to its pace over the second half of 1993 and a little below the midpoint of its monitoring range of 4 percent to 8 percent. (Historical data on the growth of the money and debt aggregates appear in table 3.)

Rising market interest rates and less-hospitable capital market conditions have affected the growth and composition of borrowing by nonfinancial businesses. The debt of such firms has expanded at a somewhat faster pace in 1994 after three years of very little growth, in part reflecting a shift away

from equity issuance as stock prices fell. Moreover, rising and more-volatile interest rates have played a role in discouraging businesses from issuing long-term debt securities. Such issuance had been strong in 1993 as businesses took advantage of relatively low interest rates to refinance high-rate longer-term debt and replace shorter-term debt, such as bank loans. In 1994, however, businesses have turned more to banks and finance companies to meet their financing needs.

Interest rate developments have also affected borrowing by households. The growth of household mortgage debt has slowed a bit from the pace recorded in

the second half of 1993, reflecting the rise in mortgage rates that began late in that year. Higher rates have curbed refinancing, a practice that tended to boost mortgage debt growth as some borrowers took the opportunity to liquefy some of the capital in their homes. In contrast to the behavior of mortgage debt, consumer credit growth has remained brisk, reflecting strong demand for consumer durable goods and relatively attractive rates on many consumer loans. Generally, rates on such loans have risen much less than market rates. Consumer credit at both finance companies and banks has picked up in 1994.

Total loans at commercial banks have risen at about a 4¼ percent annual rate, a bit above last year's pace. The faster growth of business and consumer loans has been offset by slower expansion of other types of loans, such as those for real estate. In addition, security loans have dropped off as the more subdued pace of debt issuance and the paring of dealer long positions in a rising rate environment have reduced dealer financing needs.

The expansion of bank lending in 1993 and 1994, following two years of virtually no growth, has reflected not only stronger loan demand but also an increased willingness on the part of banks to make loans. This heightened desire to extend credit stems from the improved financial condition of banks as well as their borrowers. In the early 1990s, banks had been pressed by balance sheet problems and the need to meet more stringent requirements for capital-asset ratios. By early 1993, however, the capitalization ratios of many banks were considerably stronger, and they have continued to improve since then as banks issued sizable volumes of equity and retained a high proportion of their record earnings. In mid-1993, some banks began to report an easing of their

### Growth of Money and Debt

Percent

Measurement period	M1	M2	M3	Domestic non-financial debt
<i>Year</i> <sup>1</sup>				
1980 .....	7.4	8.9	9.6	9.1
1981 .....	5.4	9.3	12.4	9.9
	2.5 <sup>2</sup>			
1982 .....	8.8	9.2	9.9	9.6
1983 .....	10.4	12.2	9.9	12.0
1984 .....	5.5	8.1	10.9	14.0
1985 .....	12.0	8.7	7.6	14.2
1986 .....	15.5	9.3	8.9	13.4
1987 .....	6.3	4.3	5.7	10.3
1988 .....	4.3	5.3	6.3	9.0
1989 .....	.6	4.8	3.8	7.8
1990 .....	4.2	4.0	1.7	6.6
1991 .....	7.9	2.9	1.2	4.6
1992 .....	14.3	1.9	.5	5.0
1993 .....	10.5	1.4	.6	5.0
<i>Half year (annual rate)</i> <sup>3</sup>				
1994:H1 .....	4.0	1.6	-.1	5.4
<i>Quarter (annual rate)</i> <sup>4</sup>				
1994:Q1 .....	6.0	1.8	.2	5.9
Q2 .....	2.0	1.5	-.3	4.7

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

2. Adjusted for shift to NOW accounts in 1981.

3. From average for fourth quarter of 1993 to average for second quarter of 1994. For debt aggregate, data for second quarter are through May.

4. From average for preceding quarter to average for quarter indicated. For debt aggregate, data for second quarter are through May.

standards and terms for business loans and residential mortgages, and this easing has continued, albeit at a reduced rate, into the first two quarters of 1994.

Measured growth of holdings of bank securities this year has been affected by two accounting changes. One change affects how banks report, on their balance sheets, the fair market value of off-balance-sheet items. Banks are no longer permitted to net positions in these items across customers; this change has appreciably boosted the "other securities" component, where these positions are booked. The other change in accounting rules requires banks to value at market prices those securities that they do not plan to hold to maturity. With the decline in securities prices this year, the requirement of "marking to market" likely has restrained the measured growth of bank securities portfolios, although to an uncertain extent. Abstracting from these special factors, growth of bank securities holdings likely has slowed slightly further in 1994. This slowing has been about offset by the pickup in loan growth, leaving underlying bank credit growth close to the pace recorded last year. Meanwhile, thrift institution credit has resumed expanding this year, albeit modestly, after declining over the past five years. Expansion at credit unions has been robust, while the contraction of the remainder of the thrift sector has slowed somewhat further.

Despite the expansion of depository credit, the broadest monetary aggregate, M3, has edged a bit lower since the fourth quarter of last year, as depository institutions have chosen to fund growth in assets with nondeposit sources. In June, M3 was around the bottom of the 0 percent to 4 percent growth range established by the Federal Open Market Committee, and its velocity seems to be increasing faster this year than in 1993.

The weakness in M3 partly reflects an exodus of investors from institution-only money market mutual funds, whose returns have lagged the rise in market rates. M3 has also been held back by declines in large time deposits. The run-off in this component has been concentrated at U.S. branches and agencies of foreign banks, which have stepped up their borrowings from affiliated foreign offices. Domestic banks have also boosted such borrowings. In December 1993, domestic banks for the first time borrowed more from their foreign affiliates than they lent to them. This net borrowed position has expanded considerably since that time. Apparently, weaker credit demands abroad have held down the costs of borrowing overseas relative to the costs of obtaining funds in the United States.

M2 growth has slowed a bit in 1994, and its velocity appears to have registered another sizable increase. The major factor behind the rise in velocity this year has been higher short-term market interest rates. In the usual pattern, the increases in rates paid on M2 deposits and money market mutual funds have lagged behind the rise in market rates, boosting the earnings forgone (opportunity costs) by holding the components of M2 and thus inducing shifts out of the aggregate. For example, noncompetitive bids at Treasury auctions have increased sharply this year, and some of the funds likely were drawn from the instruments included in M2. Moreover, the composition of M2 has been affected by the varying speed with which rates on different components have adjusted to higher market yields. Rates on money market mutual funds and retail certificates of deposit (CDs) have moved up considerably since February, while rates on liquid deposits, such as savings and NOW accounts, have been virtually unchanged. Partly as



a consequence, holdings of money market mutual funds have increased, small CDs have turned around, and liquid deposit growth has languished. From the fourth quarter of 1993 through June, M2 expanded at a 1¼ percent annual rate, placing this aggregate around the lower bound of the 1 percent to 5 percent growth range set by the Committee.

The depressing effect of higher interest rates on M2 was offset for a time by flows from bond and equity (or long-term) mutual funds into money market mutual funds. Declining securities prices and higher volatility prompted households to reconsider their investments in long-term mutual funds and encouraged many to liquidate some of their bond and equity mutual fund holdings. Over the March-to-May period, households pulled more money out of bond funds than they invested. A portion of the proceeds from the redemptions likely was placed in money market mutual funds, which grew quite rapidly. As changes in securities prices became more subdued in late May, flows into long-term mutual funds began to pick up, but they have remained weak by the standards of recent years. Shifts from M2 into direct holdings of securities, such as Treasury bills, as well as the capital losses on long-term mutual funds, have damped the growth of a measure that adds to M2 the net assets of mutual funds not held by institutional investors or in retirement accounts. This series has grown at an estimated 1 percent annual rate this year, well below its 5½ percent advance in 1993. Its velocity therefore also has increased, after several years of rough stability.

M1 growth has been restrained by wider opportunity costs as well as some special factors. From the fourth quarter of last year through June, M1 expanded at about a 4 percent annual rate, less than half of its 10½ percent rise in 1993.

M1 velocity, which fell at a 5 percent rate last year, appears to have increased this year. The growth of M1 has stemmed primarily from the continued rapid rise in currency, as overseas demand has remained robust and domestic demand has expanded with sales. In contrast, increases in transactions deposits have been quite weak. Growth of demand deposits, which pay no interest, has been reined in by higher market rates, the associated rise in earnings credits on compensating balances, and a drop-off in mortgage refinancings. Refinancings boost liquid deposits—especially demand deposits—because they are accompanied by a temporary parking of funds in such accounts; however, as the volume of refinancings declines, deposits return to more normal levels. Rate spreads have also depressed the growth of other checkable deposits, whose offering rates have changed little since the beginning of the year. In addition, growth has been restrained by a large bank's introduction of a program that sweeps excess balances out of NOW accounts and into money market deposit accounts. (The program, therefore, has no impact on M2.) The anemic expansion of transactions deposits has contributed to a decline in total reserves. This reserve measure has contracted at a 1¼ percent annual rate so far this year, a stark contrast with its 12 percent expansion in 1993. The continued strong demand for currency has propped up growth of the monetary base, whose growth has slowed only slightly this year, to a 9¼ percent annual rate.

#### *Foreign Exchange Developments*

After starting the year with a firm tone, the dollar declined on balance from February through late April. The dollar was supported initially by market expectations that it would rise over the near

term as the U.S. economy strengthened and U.S. interest rates rose, in contrast to expected developments abroad. Following the Committee's firming action on February 4, the dollar rose only modestly and briefly, in part because foreign long-term rates increased with U.S. rates. In the weeks that followed, the dollar weakened with respect to the yen, especially in mid-February, when market participants became more concerned about the sizable external surpluses in Japan in the wake of the lack of progress in the framework talks between the United States and Japan. The dollar also came under downward pressure against the German mark, particularly in February and March. Continued strong growth in German M3, amid signs of economic revival, suggested that further sizable cuts in German and other European rates were not as likely as had been previously thought, and long-term rates in these countries increased further. In early April, the dollar came under renewed downward pressure in terms of the yen. The resignation of Prime Minister Hosokawa rejuvenated concerns that progress on negotiations to open Japanese markets would stall and that plans to stimulate the Japanese economy would not be implemented.

Market sentiment against the dollar became particularly strong in late April and early May, in sometimes disorderly markets. On April 28, with U.S. bond prices falling, the dollar approached its postwar low against the yen in thin trading, and on the following day it started to drop sharply against the mark as trading became more volatile. In response, the Foreign Trading Desk at the Federal Reserve Bank of New York entered the market and purchased dollars against both marks (\$500 million) and yen (\$200 million). Treasury Secretary Bentsen confirmed the intervention and explained that it was prompted by dis-

orderly market conditions. The dollar recovered briefly but resumed falling over the next several days. On May 4, the U.S. Treasury and the Federal Reserve joined other monetary authorities in substantial, coordinated intervention in support of the dollar. Secretary Bentsen again confirmed the intervention and said it was in response to exchange market developments that were inconsistent with economic fundamentals. These actions stemmed the slide of the dollar and contributed to a partial recovery over the subsequent two weeks.

The dollar fluctuated in a narrow range following the May 17 policy actions by the Federal Reserve, but it later lost ground. These policy actions were consistent with the view expressed in the statement accompanying the May 4 intervention that the U.S. Administration did not believe that the prospects for the U.S. economy warranted a weak dollar. However, in mid-June, the dollar declined against the yen as market perceptions resurfaced that the United States was not concerned about a weak dollar, despite official statements to the contrary, and as an easing of trade frictions with Japan appeared less likely following the resignation of Prime Minister Hata on June 24. Downward pressure on the dollar in terms of the German mark intensified at this time as additional data confirmed that an economic recovery was under way in Germany. These data contributed to higher long-term rates and reinforced views that Bundesbank official rates were not likely to be reduced further following the substantial adjustment on May 11. The selling pressure on the dollar may also have been exacerbated by a rise in dollar-denominated commodity prices, which market participants viewed as indicative of a risk of higher U.S. inflation. With the dollar hovering

around a postwar low against the yen on June 24, the United States led substantial coordinated intervention with the monetary authorities of the G-7 countries and a number of other countries. Secretary Bentsen confirmed the intervention, citing shared concerns over recent developments in foreign exchange markets. Since that time, sentiment against the dollar has continued, with the dollar recording a new postwar low against the yen on July 12 before rebounding moderately in subsequent days.

#### *Federal Reserve Foreign Currency Transactions*

The Federal Reserve has undertaken other foreign currency transactions in 1994 in addition to the intervention actions of April 29, May 4, and June 24. The Federal Open Market Committee has authorized a restructuring of the System's portfolio of foreign currencies and has approved three reciprocal currency arrangements, also known as swap arrangements.

At its December 1993 meeting, the Committee authorized the Manager for Foreign Operations to sell all non-mark and non-yen foreign exchange reserves held by the Federal Reserve. The Manager sold these reserves, which were equivalent to \$750 million, during the first few months of 1994. These holdings along with those of the Exchange Stabilization Fund of the U.S. Treasury were eliminated in light of the practice of U.S. monetary authorities in recent years to conduct intervention operations exclusively in marks and yen.

On March 24, the Committee approved a temporary increase to \$3 billion, from \$700 million, in the System's swap arrangement with the Bank of Mexico. The value of the Mexican peso against the dollar had been nearly stable

during the initial weeks of the year, following ratification of the North American Free Trade Agreement by the United States in November. The peso began to weaken in late February, however, in response to disappointing economic news and political unrest in Mexico. The assassination of presidential candidate Luis Donaldo Colosio on March 23 further undermined the peso, which fell to the lower intervention limit against the dollar set by the Bank of Mexico. Mexican authorities then intervened heavily to support the peso. At the request of the Mexican government and the Bank of Mexico, U.S. monetary authorities established a \$6 billion temporary bilateral swap facility for the Bank of Mexico, which was split between the U.S. Treasury and the Federal Reserve. The swap was intended to help prevent any turmoil in Mexican markets, which could have spilled into U.S. financial markets. In the event, no drawings were made on this facility. In late April, the peso moved away from its lower intervention limit as the substantial increase in Mexican interest rates persuaded market participants of the commitment of the Mexican government to maintain the value of the peso.

On April 26, the monetary authorities of the United States, Canada, and Mexico announced the creation of the North American Financial Group to provide an opportunity for more regular consultation on economic and financial developments. Plans for this group had been under way for several months in recognition of the increasing interdependence of the three economies. In connection with the formation of the group, the authorities of the three countries established a trilateral foreign exchange swap facility. The United States and Mexico put in place swap arrangements for up to \$6 billion, with the Treasury and the Federal Reserve each partici-

pating up to \$3 billion. The Federal Reserve and the Bank of Canada reaffirmed their existing swap agreement of \$2 billion and extended its maturity to December 1995. The Bank of Canada increased its swap line with the Bank of Mexico to 1 billion Canadian dollars. These arrangements expand the pool of potential resources available to the monetary authorities of each country to maintain orderly exchange markets. The Federal Open Market Committee approved the Federal Reserve's participation in these arrangements effective April 26. ■

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*Part 2*

*Records, Operations,  
and Organization*

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

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

November 23, 1994—Amendments

The Board approved amendments to Regulation C, effective January 1, 1995, to facilitate the availability, and improve the quality, of information disclosed to the public under the Home Mortgage Disclosure Act.

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

The amendments require that most financial institutions report data required under the Home Mortgage Disclosure Act in machine-readable form and update quarterly their reports to regulatory agencies. Institutions may comply with the amendments at their option beginning January 1, 1995. Compliance is mandatory for the collection of data that begins January 1, 1996.

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

November 17, 1994—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, Blinder, Kelley, and LaWare and Ms. Phillips and Yellen. Absent and not voting: Mr. Lindsey.

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 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 1994, that amount was \$51.9 million. Recent increases in transaction balances warranted an increase to \$54 million, and the Board amended Regulation D accordingly.

The Garn–St Germain Depository Institutions Act of 1982 established a zero percent reserve requirement on the first \$2 million of an institution's reservable liabilities. The act also provides for annual adjustments to that exemption based on nationwide deposit growth. By the beginning of 1994, that amount had been increased to \$4 million. Recent growth in deposits warranted an increase to \$4.2 million, and the Board amended Regulation D accordingly.

The amendments are effective with the reserve computation period beginning December 20, 1994, for institutions reporting either weekly or quarterly.

To reduce the reporting burden for small institutions, the Board requires that depository institutions with total deposits below specified levels report

their deposits and reservable liabilities quarterly, or less frequently, although larger institutions must report weekly. To reflect increases in the growth rate of total deposits at all depository institutions from June 30, 1993, to June 30, 1994, the Board increased the deposit cutoff levels used in conjunction with the exemption level to determine the frequency and detail of deposit reporting required for each institution from \$55 million to \$55.4 million for non-exempt depository institutions and from \$44.8 million to \$45.1 million for exempt depository institutions beginning September 1995.

### **Regulation E (Electronic Fund Transfers)**

#### **February 16, 1994—Amendments**

The Board approved amendments to Regulation E, effective February 28, 1994, to make the regulation applicable to electronic benefit transfer programs established by federal, state, or local agencies.

Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Ms. Phillips. Absent and not voting: Mr. LaWare.<sup>1</sup>

The Electronic Fund Transfer Act governs any transfer of funds that is electronically initiated and that debits or credits a consumer's account. The statute, which is implemented by the Board's Regulation E, creates a legal framework of rights and responsibilities for consumers and for providers of electronic fund transfer services. Among other things, Regulation E requires

documentation of electronic fund transfer services through terminal receipts and periodic account statements, establishes limitations on consumer liability for unauthorized transfers, and provides procedures for error resolution.

The amendments to Regulation E make the regulation applicable to electronic benefit transfer programs established by federal, state, or local agencies. The amendments apply the unauthorized transfer liability and error resolution provisions of Regulation E to electronic benefit transfer programs, provide an exception for the periodic statement requirements under certain conditions, and apply most other provisions of Regulation E to electronic benefit transfer programs.

In response to a request by a federal task force working to establish a nationwide system for electronic delivery of government benefits, the Board delayed mandatory compliance with the amendments until March 1, 1997.

#### **November 23, 1994—Interim Rule**

The Board approved an interim amendment to Regulation E to revise the requirements for receipts at automated teller machines, effective December 1, 1994.

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

The interim rule gives financial institutions flexibility in identifying account numbers on receipts for transactions at automated teller machines. It eliminates the requirement that a receipt from an electronic terminal disclose a number or code that uniquely identifies the consumer, the consumer's account, or the

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

access device. In connection with this action, the Board also sought public comment on the interim rule.

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

#### May 23, 1994—Amendment

The Board approved an amendment to Regulation H to raise the threshold at which certain state member banks must apply to the Board for approval to invest in bank premises, effective July 5, 1994.

Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Ms. Phillips. Absent and not voting: Mr. LaWare.<sup>1</sup>

The amendments allow a state member bank that meets certain conditions to invest in bank premises in an amount up to 50 percent of its tier 1 capital without applying for the Board's approval.

#### November 2, 1994—Amendment

The Board approved an amendment to Regulation H to remove the requirement that a state member bank publish its reports of condition, effective November 10, 1994.

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

The Riegle Community Development and Regulatory Improvement Act of 1994 includes measures to reduce the regulatory burden of federal regulation on depository institutions. The amendment to Regulation H implements section 308 of the act, which amended the Federal Reserve Act to repeal the requirement that state member banks publish their reports of condition. The

reports will continue to be available to the public through the National Technical Information Service of the U.S. Department of Commerce under the Board's Rules Regarding Availability of Information.

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

#### August 3, 1994—Amendments

The Board approved amendments to Regulations H and Y to revise its risk-based capital guidelines for state member banks to take into account concentration of credit risk and the risks of nontraditional activities, effective January 17, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and Ms. Phillips.<sup>2</sup>

The Board revised its risk-based capital guidelines to explicitly identify concentrations of credit risk and an institution's ability to manage them as important factors in assessing its overall capital adequacy. The revision also identifies an institution's ability to manage the risks posed by nontraditional activities as an important factor in assessing its overall capital adequacy.

#### November 23, 1994—Amendments

The Board approved amendments to Regulations H and Y to revise its risk-based capital guidelines to recognize

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



the risk-reducing benefits of netting arrangements, effective December 31, 1994.

Votes for this action: Messrs. Greenspan, Blinder, and Kelley and Mses. Phillips and Yellen. Absent and not voting: Messrs. LaWare and Lindsey.

The revised guidelines allow state member banks and bank holding companies to net positive and negative market-to-market values of interest rate and exchange rate contracts in determining the current exposure portion of the credit-equivalent amount of such contracts to be included in risk-weighted assets.

#### November 30, 1994—Amendments

The Board approved amendments to Regulations H and Y to revise its risk-based capital guidelines to direct state member banks and bank holding companies not to include in regulatory capital the net unrealized holding gains or losses on debt securities available for sale, effective December 31, 1994.

Votes for this action: Messrs. Blinder, Kelley, LaWare, and Lindsey and Mses. Phillips and Yellen. Absent and not voting: Mr. Greenspan.

The Statement of Financial Accounting Standards Number 11 (FAS 11) from the Financial Accounting Standards Board created a new common stockholders' equity account for net unrealized holding gains or losses on debt securities available for sale. The amendments to Regulations H and Y instruct institutions not to include in tier 1 capital the component of common stockholders' equity. Net unrealized losses on marketable equity securities will continue to be deducted from tier 1 capital.

#### November 30, 1994—Amendments and Revised Interpretation

The Board approved amendments to Regulation H to allow state member banks to make certain investments designed primarily to promote the public welfare, effective January 9, 1995. The Board also approved a related revision of an interpretation of Regulation Y.

Votes for this action: Messrs. Blinder, Kelley, LaWare, and Lindsey and Mses. Phillips and Yellen. Absent and not voting: Mr. Greenspan.

The Depository Institutions Disaster Relief Act of 1992 amended the Federal Reserve Act to relax the restriction on the ability of state member banks to purchase, sell, underwrite, and hold investment securities; it also allows state member banks to make certain investments designed primarily to promote the public welfare. The Board amended Regulation H to permit state member banks to make certain public welfare investments without prior Board approval and to make other public welfare investments with specific Board approval. The amendment also addresses the procedural aspects of those investments.

The revised interpretation of Regulation Y provides that bank holding companies that have received approval to engage in activities that promote community welfare may make similar investments permissible for state member banks.

#### December 14, 1994—Amendments

The Board approved amendments to Regulations H and Y revising its capital adequacy guidelines to establish a limit on the amount of certain deferred-tax assets that may be included in tier 1

capital for risk-based and leverage capital purposes, effective April 1, 1995.

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

The Board revised its risk-based and leverage capital guidelines for state member banks and bank holding companies. Under the new rule, deferred-tax assets that can be realized only if an institution earns taxable income in the future are limited for regulatory capital purposes to the amount the institution expects to realize within one year of the quarter-end report date or 10 percent of tier 1 capital, whichever is less.

### **Regulation J** (Collection of Checks and Other Items by Federal Reserve Banks)

April 28, 1994—Amendments

The Board approved amendments to subpart A of Regulation J to conform the warranties and various other provisions of the regulation to Regulation CC (Availability of Funds and Collection of Checks) or to the Uniform Commercial Code, effective June 6, 1994.

Votes for this action: Messrs. Greenspan, Kelley, LaWare, and Lindsey and Ms. Phillips.<sup>1</sup>

Regulation CC warranties require private-sector collecting, returning, and presenting banks to warrant the accuracy of cash letter totals and check encoding. The amendments to Regulation J clarify that Federal Reserve Banks and institutions that send items to Reserve Banks must also make the Regulation CC warranties, to conform certain Regulation J provisions to the 1990 version of the Uniform Commer-

cial Code, and to make other minor changes in the regulation.

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

October 19, 1994—Amendments

The Board approved amendments to Regulation K concerning the permissible activities of state-licensed branches or agencies of foreign banks, effective January 1, 1995.

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

A provision in the Foreign Bank Supervision Enhancement Act of 1991 prohibits a state-licensed branch or a state-licensed agency of a foreign bank from engaging in any type of activity not permissible for a federal branch of a foreign bank unless the Board has determined that the activity is consistent with sound banking practice and, in the case of a state-licensed insured branch, unless the Federal Deposit Insurance Corporation has determined that the activity would pose no significant risk to the deposit insurance fund.

The amendment to Regulation K sets forth procedures that state-licensed branches and agencies of foreign banks are required to follow in requesting the Board's permission to engage, or continue to engage, in an activity not permissible for a federal branch of a foreign bank and to set forth the requirements for divestiture and cessation plans. The Board also amended Regulation K to clarify that the conversion of a U.S. branch or agency of a foreign bank from a federal license to a state license would not require an application to the Board.

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

January 26, 1994—Amendments

The Board approved amendments to Regulation O to increase the aggregate lending limit for small adequately capitalized banks and made certain other amendments designed to reduce the burden and complexity of the regulation, effective February 18, 1994.

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

The Board's amendment to Regulation O makes permanent an interim rule increasing the aggregate lending limit for small, adequately capitalized banks from 100 percent of the bank's unimpaired capital and surplus to 200 percent; clarifies the rule on tangible economic benefits; provides certain exceptions to the lending limit for insiders; permits banks to follow certain alternative procedures for recordkeeping; narrows the definition of extension of credit; and makes certain technical amendments in the regulation to make it more understandable and somewhat shorter.

**Regulation S** (Reimbursement to Financial Institutions for Assembling or Providing Financial Records)

December 21, 1994—Amendments

The Board approved amendments to Regulation S to incorporate enhanced recordkeeping requirements for certain wire transfers by financial institutions, effective January 1, 1996.

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

The Annunzio-Wylie Anti-Money Laundering Act of 1992 requires the Board and the Department of the Treasury to adopt joint regulations for recordkeeping in international funds transfers and authorizes the two agencies to adopt additional recordkeeping rules that promote law enforcement in connection with domestic funds transfers.

The Board and the Department of the Treasury jointly approved a rule that requires that domestic financial institutions involved in a wire transfer collect and retain certain information on transfers of \$3,000 or more. The amount and type of information that are required depend on the type of financial institution, its role in the transfer, and the relationship of the parties to the transaction with the financial institution. The rule also clarifies the requirements for verification and retrieval of information and clarifies and expands the types of transfers that are exempt.

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

October 17, 1994—Amendments

The Board approved amendments to Regulation T concerning the payment for securities purchases and the status of government securities transactions, effective November 25, 1994.

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

The amendment requires that, within two business days of the standard settlement period, customers meet initial margin calls or make cash payment in full

for securities purchased from a broker-dealer.

The Board approved related amendments to Regulation T to raise the amount below which liquidation of an unpaid transaction is not required, to require that brokers seeking extensions of the payment periods obtain them from their designated examining authority, and to clarify that the time periods provided for certain securities with extended settlement periods are the time periods used to determine procedures and penalties when payment is not made.

The Board also approved amendments to Regulation T to exempt broker-dealers whose business is limited to transactions in government securities and to provide a mechanism for other broker-dealers to effect customer transactions in government securities without regard to other provisions in the regulation.

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

#### **March 9, 1994—Amendments**

The Board approved amendments to provisions of Regulation Y pertaining to real estate appraisals, effective June 7, 1994.

Votes for this action: Messrs. Greenspan, Kelley, LaWare, and Lindsey and Ms. Phillips.<sup>1</sup>

The amended real estate appraisal provisions increase to \$250,000 the transaction-value threshold above which real estate appraisals are required; expand and clarify existing exemptions to the appraisal requirements; specify when exempt transactions require evaluations; and revise the requirements governing appraisal content and the use of

appraisals prepared by other financial services institutions. The amendments were issued jointly with amendments to the rules of other bank and thrift regulators.

#### **July 27, 1994—Amendments**

The Board approved amendments to Regulation Y to permit banks to offer discounts on traditional bank products and brokerage services for customers obtaining traditional bank products from affiliates, effective September 2, 1994.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey. Absent and not voting: Ms. Phillips.<sup>2</sup>

With certain exceptions, the Bank Holding Company Act prohibits a bank from tying a product or service to another product or service offered by the bank or any of its affiliates. A statutory exception allows a bank to discount any product or service on condition that a customer obtain a traditional bank product from that bank.

The Board's amendments extend the statutory exception to allow bank holding company affiliates to offer package discounts on traditional bank products, provided that all products in the package are separately available. The Board also amended the regulation to permit bank holding company affiliates to offer a discount on securities brokerage services on condition that a customer obtain a traditional bank product from the holding company or from an affiliate.

#### **October 24, 1994—Interim Amendments**

The Board approved interim amendments to Regulation Y to implement provisions of the Riegle Community Development and Regulatory Improve-

ment Act of 1994 that revised certain of the Board's application procedures, effective October 26, 1994.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and Meses. Phillips and Yellen.

The Riegle Community Development and Regulatory Improvement Act of 1994 establishes a prior notice procedure to replace the current application process for all proposals by bank holding companies to engage in nonbanking activities; establishes a streamlined notice procedure for the formation of a new bank holding company as part of a reorganization by the existing shareholders of a bank; permits the Board, with the consent of the Department of Justice, to shorten the time after approval of an application in which the department can file a court challenge to a bank acquisition on competitive grounds; and eliminates the need for prior Board approval of certain transactions under which a bank acquires a thrift institution or assets of a thrift institution. Because the amendments became effective upon passage of the act, the Board adopted interim rules implementing those changes and requested public comment on the rules.

#### December 14, 1994—Amendments

The Board approved an amendment to Regulation Y, effective January 23, 1995, to remove restrictions on tying between nonbank subsidiaries when the products are separately available.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, and LaWare and Meses. Phillips and Yellen. Absent and not voting: Mr. Lindsey.

The amendment to the anti-tying provisions of Regulation Y permits a bank

holding company or its nonbank subsidiary to offer a discount on a product or service on condition that a customer obtain any other product or service from that company or from any of its nonbank affiliates. The amendment generally lifts the regulation's anti-tying provisions when no bank is involved in the arrangement and products are separately available for purchase by the customer.

#### **Regulation Y** (Bank Holding Companies and Change in Bank Control) and Rules Regarding Delegation of Authority

##### April 25, 1994—Amendments

The Board approved amendments to Regulation Y and to its Rules Regarding Delegation of Authority to make final previously approved initiatives to reduce the regulatory burden associated with certain application and notice procedures, effective May 4, 1994.

Votes for this action: Messrs. Greenspan, Kelley, LaWare, and Lindsey and Ms. Phillips.<sup>1</sup>

The Board amended Regulation Y to reflect changes that had been in effect since 1992, when the Board eliminated the requirement in Regulation Y for stock redemptions by well capitalized bank holding companies. The Board also modified certain provisions in its Rules Regarding Delegation of Authority pertaining to competition and market concentration.

#### **Regulation DD** (Truth in Savings)

##### October 12, 1994—Amendments

The Board approved amendments to Regulation DD to decrease the number

of accounts subject to the Truth in Savings Act, effective September 23, 1994.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and Mses. Phillips and Yellen.

The Truth in Savings Act and the Board's implementing Regulation DD, which require that depository institutions provide consumers with information about deposit accounts, initially applied to accounts held by individuals and accounts held by unincorporated associations of individuals that are not businesses. A provision of the Riegle Community Development and Regulatory Improvement Act of 1994 limits the act's coverage to accounts held by individuals for personal, family, or household purposes. To implement that provision, the Board amended Regulation DD to exclude from the requirements of the regulation unincorporated associations of individuals that are not businesses.

### **Regulation EE (Netting Eligibility for Financial Institutions)**

January 26, 1994—New Rule

The Board adopted Regulation EE to expand application of the netting provisions in the Federal Deposit Insurance Corporation Improvement Act of 1991 to a broader range of financial market participants, effective March 7, 1994.

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

The Federal Deposit Insurance Corporation Improvement Act of 1991 validates netting contracts among members of clearing organizations and between financial institutions to increase efficiency and reduce systemic risk in the banking system and financial markets.

The act defines financial institution to include depository institutions, securities brokers or dealers, futures commission merchants, and any other institutions so determined by the Board.

The new regulation expands application of the netting provisions by including in the definition of financial institution those financial market participants meeting certain tests based on market activity.

### **Rules of Practice for Hearings**

December 14, 1994—Amendment

The Board approved an amendment to its Rules of Practice for Hearings to make its rules on *ex parte* communications conform to the Administrative Procedure Act, effective January 18, 1995.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, and LaWare and Mses. Phillips and Yellen. Absent and not voting: Mr. Lindsey.

The amendments clarify that the Board's rules governing *ex parte* communications do not apply to intra-agency communications, which are governed by a separate provision of that act.

### **Rules Regarding Equal Opportunity**

March 28, 1994—Amendments

The Board approved as a final rule its Rules Regarding Equal Opportunity, effective March 29, 1994, after having received comments on its interim rules. The final rule conforms the Board's rules to those of the Equal Employment Opportunity Commission.

Votes for this action: Messrs. Greenspan, Kelley, LaWare, and Lindsey and Ms. Phillips.<sup>1</sup>

The Board's final rule closely follows the rules of the Equal Employment Opportunity Commission. It differs only when necessary to take account of the Board's independent status under section 10(4) of the Federal Reserve Act, to clarify the processing of complaints in light of the Board's organizational structure, and to exclude matters that do not apply to the Board. The final rule also covers issues addressed by laws such as the Rehabilitation Act and the Equal Pay Act.

## **Policy Statements and Other Actions**

### **January 3, 1994—Policy Statement on Payments System Risk**

The Board approved certain revisions of its policy on payments system risk, effective April 14, 1994.

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

As part of its payments system risk reduction program, the Board revised its policy statement to streamline the procedures that depository institutions are required to use if they choose to complete a self-assessment to establish a daylight overdraft net debit cap. The Board also eliminated the requirement that branches and agencies of foreign banks provide certain information that had been used in determining their daylight overdraft net debit caps.

### **February 9, 1994—Expansion of Fedwire Operating Hours**

The Board approved the expansion, beginning in early 1997, of the operating hours of the Fedwire on-line funds transfer service.

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

The Board expanded the operating hours of Fedwire to eighteen hours per day, 12:30 a.m. to 6:30 p.m. eastern time, five days per week. Intraday credit from the Federal Reserve will be available during the expanded hours on the same terms on which it is currently provided. On December 21, 1994, the Board delayed implementation of the expanded operating hours (see below).

### **February 16, 1994—Policy Statement on Payments System Risk**

The Board approved penalty fees for daylight overdrafts by institutions that do not have regular access to the discount window, effective April 14, 1994.

Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Ms. Phillips. Absent and not voting: Mr. LaWare.<sup>1</sup>

The revised penalty rate for daylight overdrafts, which is equal to the regular daylight overdraft rate plus 100 basis points, applies to bankers' banks that do not maintain reserves, Edge Act and agreement corporations, and limited-purpose trust companies.

### **February 16, 1994—Policy on Overnight Overdrafts**

The Board adopted a new penalty rate structure for overnight overdrafts to make the structure more consistent with current market rates, effective April 1, 1994.

Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Ms. Phillips. Absent and not voting: Mr. LaWare.<sup>1</sup>

The Board eliminated the penalty-fee floor for overnight overdrafts, adopted a penalty fee for overnight overdrafts equal to the federal funds rate plus 4 percentage points, established a minimum penalty of \$100 for all overnight overdrafts, and increased the penalty fee 1 percentage point for each overnight overdraft after the third in a twelve-month period.

### March 4, 1994—Interagency Policy Statement on Discrimination in Lending

The Board approved issuance of an interagency policy statement on discrimination in lending, effective April 15, 1994.

Votes for this action: Messrs. Greenspan, Kelley, LaWare, and Lindsey and Ms. Phillips.<sup>1</sup>

The policy statement describes the general principles the agencies will use in identifying lending discrimination that violates the Equal Credit Opportunity Act or the Fair Housing Act. The Board also sought public comment on the application of the principles to specific policies and practices.

### September 29, 1994—Policy Statement on Payments System Risk

The Board approved a revision of the portion of its policy statement on payment system risk concerning net debit caps, effective October 13, 1994.

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

The revised policy statement increases the multiple associated with the de minimis net debit cap from

20 percent to 40 percent of risk-based capital. The Board also approved a program of administrative counseling flexibility for institutions that continue to exceed their net debit caps because of the posting of non-Fedwire transactions.

### December 21, 1994—Policy Statement on Privately Operated Large-Dollar Multilateral Netting Systems

The Board approved the adoption of a policy statement on privately operated large-dollar multilateral netting systems, effective December 21, 1994, to update and integrate certain existing policies and to incorporate certain minimum standards for multilateral netting systems.

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

The policy statement updates and integrates existing policies on privately operated large-dollar multilateral payment netting systems and on offshore large-dollar multilateral payment netting systems. The policy statement now also addresses multilateral foreign exchange clearinghouses involving settlements in U.S. dollars and multicurrency payment netting systems involving settlement in U.S. dollars. The policy applies to such arrangements the minimum standards for multilateral netting systems identified in the report of the Committee on Interbank Netting Schemes of the central banks of the Group of Ten countries. The policy statement is designed to cover more completely the range of multilateral netting systems involving settlements in U.S. dollars that might increase systemic risk in the financial markets.



## December 21, 1994—Fedwire Funds Transfer Format

The Board approved an expanded format for Fedwire funds transfers, to be fully implemented by the end of 1997.

Votes for this action: Messrs. Greenspan, Kelley, LaWare, and Lindsey and Mses. Phillips and Yellen. Absent and not voting: Mr. Blinder.

The expanded format contains a more comprehensive set of data elements intended to reduce the need for manual intervention when transfers are processed and posted.

## December 21, 1994—Delay in Expansion of Fedwire Operating Hours

The Board delayed, until the fourth quarter of 1997, implementation of the expansion of Fedwire operating hours that it had approved on February 9, 1994. The specific implementation date is to be announced a year before the effective date.

Votes for this action: Messrs. Greenspan, Kelley, LaWare, and Lindsey and Mses. Phillips and Yellen. Absent and not voting: Mr. Blinder.

## 1994 Discount Rates

The Board approved three increases in the basic discount rate during 1994; these actions raised the rate from 3 percent at the start of the year to 4¾ percent by year-end. Rates charged by the Federal Reserve Banks for seasonal and for extended credit also rose in 1994; rates for both types of credit are set on the basis of market-related formulas that are approved by the Board.

The reasons for the Board's decisions on the basic rate are summarized below. The decisions were made in conjunction

with policy actions of the Federal Open Market Committee (FOMC) and in the context of economic and financial developments that are covered in more detail elsewhere in this REPORT. A listing of the Board's actions on the basic rate during 1994, including the votes on those actions, concludes this review.

## Actions on the Basic Discount Rate

### *January through April:*

#### *No Change in the Basic Rate*

During the first four months of 1994 the Board considered but took no action on requests from an increasing number of Federal Reserve Banks—a total of ten by late April—to raise the basic rate. The economy appeared to be expanding at a brisk pace after posting substantial gains in late 1993, and broad measures of wages and prices indicated a generally moderate rate of inflation. During this period, however, the low level of short-term interest rates together with diminishing margins of unemployed labor and other producer resources and sizable increases in the prices of a wide range of materials used in manufacturing and construction led to increasing concerns about the potential for higher inflation. Against this background, the FOMC acted on three occasions beginning in early February to head off the threat of a more general buildup of inflationary pressures and to maintain conditions conducive to sustained economic expansion by reducing the degree of accommodation in the stance of monetary policy. The Board considered approval of the pending increases in the discount rate, but the members generally concluded that it was preferable to permit the gap that had emerged in early February between the discount rate and the federal funds rate to widen a little further; a wider gap was normal and

helped to provide flexibility in setting monetary policy. The basic discount rate and the average federal funds rate had been identical from September 1992 to early February 1994.

*May to Mid-November:*

*Basic Rate Increased*

By the middle of May, eleven Reserve Banks had proposed increases of  $\frac{1}{2}$  percentage point in the basic rate and one Reserve Bank an increase of 1 percentage point. On May 17 the Board approved the pending increases of  $\frac{1}{2}$  percentage point. This action was taken in conjunction with the FOMC decision on the same day to remove most of the remaining degree of accommodation in the stance of monetary policy. These decisions reflected increasing concerns that continued policy accommodation could lead before long to growing pressures on production resources and to a renewed outbreak of inflation.

On August 16 the Board approved a further increase of  $\frac{1}{2}$  percentage point in the basic rate for seven Reserve Banks that already had acted on such an increase. Growth in aggregate demand appeared to have moderated somewhat in previous months, and broad measures of wages and prices suggested little change in inflation trends. Nonetheless, the evidence of continuing strength in the economic expansion and high levels of resource utilization were seen as pointing to a considerable risk of further inflation in the absence of additional policy restraining measures. As in May, the increase in the discount rate was associated with some further tightening of reserve conditions by the FOMC.

The final increase in the basic rate during 1994, a rise of  $\frac{3}{4}$  percentage point on November 15, was approved in the light of indications that the expansion retained strong momentum at a time

when the utilization of labor and other producer resources had reached levels that in the past had often been associated with some increase in inflation. As in the case of the two previous actions in 1994, this larger-than-usual increase in the basic rate accompanied the implementation of a corresponding tightening of reserve conditions by the FOMC. On the date of this approval, all the Reserve Banks had pending rate increases ranging from  $\frac{1}{2}$  to 1 percentage point; by November 17, all had submitted, and the Board had approved, conforming increases of  $\frac{3}{4}$  percentage point.

*Mid-November to Year-End:*

*No Change*

Beginning in the first part of December, a number of Reserve Banks submitted requests for further increases of  $\frac{1}{4}$  or  $\frac{1}{2}$  percentage point in the basic rate. Pending an evaluation of the lagged effects of the considerable tightening measures already implemented, the Board took no action on these proposals. Four proposed increases were outstanding at year-end.

## Structure of Discount Rates

The basic rate is the rate charged on loans to depository institutions for short-term adjustment credit, while flexible, market-related rates generally are charged on seasonal and extended credit. These flexible rates are calculated periodically in accordance with formulas that are subject to Board approval.

Under the seasonal program, whose purpose is to assist smaller institutions in meeting regular needs arising from a clear pattern of intra-yearly movements in their deposits and loans, funds may be provided for periods longer than those permitted under adjustment credit. 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 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 1994 the structure of discount rates was as follows: a basic rate of 4.75 percent for short-term adjustment credit, a rate of 5.90 percent for seasonal credit, and a rate of 6.40 percent for extended credit. During 1994 the flexible rate on seasonal credit ranged from a low of 3.10 percent to a high of 5.90 percent, and the flexible rate on extended credit ranged from a low of 3.60 percent to a high of 6.40 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. Reserve Bank proposals on the discount rate include requests to renew the formulas for calculating the flexible rates on seasonal and extended credit. Votes on the reestablishment of existing rates or the updating of market-related rates under the seasonal and extended credit programs are not shown. All votes on discount rates taken by the Board of Governors during 1994 were unanimous.

### *Votes on the Basic Discount Rate*

*May 17.* Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco to increase the basic discount rate by  $\frac{1}{2}$  percentage point, to  $3\frac{1}{2}$  percent.

Votes for this action: Messrs. Greenspan, Kelley, LaWare, and Lindsey and Ms. Phillips. Votes against this action: None.<sup>1</sup>

The Board subsequently approved a similar action taken by the directors of the Federal Reserve Bank of Cleveland, effective May 18.

*August 16.* Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Richmond, Chicago, St. Louis, Kansas City, and Dallas to increase the basic discount rate  $\frac{1}{2}$  percentage point, to 4 percent.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and Meses. Phillips and Yellen. Votes against this action: None.

The Board subsequently approved similar actions taken by the directors of the Federal Reserve Banks of Cleveland

and San Francisco, effective August 17, and Philadelphia, Atlanta, and Minneapolis, effective August 18.

*November 15.* Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of New York, St. Louis, Kansas City, and San Francisco to increase the basic discount rate by  $\frac{3}{4}$  percentage point, to  $4\frac{3}{4}$  percent.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, LaWare, and Lindsey and Mses. Phillips and Yellen. Votes against this action: None.

The Board subsequently approved similar actions taken by the directors of the Federal Reserve Banks of Boston, Cleveland, Richmond, Atlanta, Minneapolis, and Dallas, effective November 16, and Philadelphia and Chicago, effective November 17. ■

## *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.

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 instructions 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 1994. 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, 1994

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

## Domestic Policy Directive

### In Effect January 1, 1994<sup>1</sup>

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.

## Authorization for Foreign Currency Operations

### In Effect January 1, 1994

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:

1. Adopted by the Committee at its meeting on December 21, 1993.

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 kroner
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 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(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, 1994

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, 1994**

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.

## **Meeting Held on February 3-4, 1994**

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 Thursday, February 3, 1994, at 2:30 p.m. and was continued on Friday, February 4, 1994, at 9:00 a.m.

*Present:*

Mr. Greenspan, Chairman  
Mr. McDonough, Vice Chairman  
Mr. Broadus  
Mr. Forrestal

Mr. Jordan  
Mr. Kelley  
Mr. LaWare  
Mr. Lindsey  
Mr. Parry  
Ms. Phillips

Messrs. Hoenig, Keehn, Melzer,  
Oltman,<sup>2</sup> and Syron, Alternate  
Members of the Federal Open  
Market Committee

Messrs. Boehne, McTeer, and Stern,  
Presidents of the Federal Reserve  
Banks of Philadelphia, Dallas, and  
Minneapolis respectively

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

Messrs. Beebe, J. Davis, R. Davis,  
Goodfriend, Lindsey, Promisel,  
Siegman, Simpson, and Stockton  
and Ms. Tschinkel, Associate  
Economists

Ms. Lovett, Manager for Domestic  
Operations, System Open Market  
Account

Mr. Fisher, Manager for Foreign  
Operations, System Open Market  
Account

Mr. Etting, Deputy Director, Division of  
Research and Statistics, Board of  
Governors

Mr. Slifman, Associate Director,  
Division of Research and  
Statistics, Board of Governors

Mr. Madigan, Associate Director,  
Division of Monetary Affairs,  
Board of Governors

Mr. Hooper, Assistant Director,  
Division of International Finance,  
Board of Governors<sup>2</sup>

Mr. Reinhart, Section Chief, Division  
of Monetary Affairs, Board of  
Governors<sup>3</sup>

Mr. Rosine, Senior Economist,  
Division of Research and  
Statistics, Board of Governors<sup>3</sup>

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

Messrs. T. Davis, Dewald, Lang,  
Rolnick, Rosenblum, and Scheld,  
Senior Vice Presidents, Federal  
Reserve Banks of Kansas City,  
St. Louis, Philadelphia,  
Minneapolis, Dallas, and  
Chicago respectively

Mr. McNeese, Vice President, Federal  
Reserve Bank of Boston

Ms. Krieger, Assistant Vice President,  
Federal Reserve Bank of  
New York

In the agenda for this meeting, it was reported that advices of the election of the following members and alternate members of the Federal Open Market Committee for the period commencing January 1, 1994, and ending December 31, 1994, had been received and that the named individuals had executed their oaths of office.

The elected members and alternate members were as follows:

William J. McDonough, 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;

J. Alfred Broaddus, Jr., President of the Federal Reserve Bank of Richmond, with Richard F. Syron, President of the Federal Reserve Bank of Boston, as alternate;

Jerry L. Jordan, President of the Federal Reserve Bank of Cleveland, with Silas

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2. Attended the Thursday session only.

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

Keehn, President of the Federal Reserve Bank of Chicago, as alternate;

Robert P. Forrestal, President of the Federal Reserve Bank of Atlanta, with Thomas C. Melzer, President of the Federal Reserve Bank of St. Louis, as alternate;

Robert T. Parry, President of the Federal Reserve Bank of San Francisco, with Thomas M. Hoenig, President of the Federal Reserve Bank of Kansas City, as alternate.

By unanimous vote, the following officers of the Federal Open Market Committee were elected to serve until the election of their successors at the first meeting of the Committee after December 31, 1994, 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
William J. McDonough	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

Jack H. Beebe, John M. Davis, Richard G. Davis, Marvin S. Goodfriend, David E. Lindsey, Larry J. Promisel, Charles J. Siegman, Thomas D. Simpson, David J. Stockton, and Sheila L. Tschinkel, 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, 1994.

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 board of directors of the Federal Reserve Bank of New York.

On January 24, 1994, the continuing rules, regulations, authorizations, and other instruments of the Committee had been 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 3-4 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, and no requests for substantive consideration were received.

At this meeting, the members agreed to update the references to the Management of the System Open Market Account in the following FOMC documents to reflect the new titles of Manager for Domestic Operations, System Open Market Account, and Manager for Foreign Operations, System Open Market Account: (1) FOMC Rules of Organization, (2) Procedures for Allocation of Securities in the System Open Market Account, and (3) Program for Security

of FOMC Information. Except for this change, all of the instruments identified 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 to Provide for the Continued Operation of the Federal Open Market Committee During an Emergency.
4. Resolution Authorizing Certain Actions by Federal Reserve Banks During an Emergency.
5. Resolution Relating to Examinations of the System Open Market Account.
6. Guidelines for the Conduct of System Operations in Federal Agency Issues.
7. Regulation Relating to Open Market Operations of Federal Reserve Banks.
8. Program for Security of FOMC Information.
9. Federal Open Market Committee Rules of Organization, Rules of Procedure, and Rules Regarding Availability of Information.

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

### Authorization for Domestic Open Market Operations

*Reaffirmed February 3, 1994*

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 secu-

rities or agency issues covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account; and provided further that in the event bankers acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market.

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

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

By unanimous vote, the Authorization for Foreign Currency Operations was amended to reflect the new title of Manager for Foreign Operations, System Open Market Account.

## Authorization for Foreign Currency Operations

*Amended February 3, 1994*

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

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

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

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

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

D. To maintain an overall open position in all foreign currencies not exceeding \$25.0 billion. For this purpose, the overall open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies. The net position in a single foreign currency is

defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

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

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

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

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

4. It shall be the normal practice to arrange with foreign central banks for the coordination of foreign currency transactions. In 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, System Open Market Account ("Manager"), 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.

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

## Foreign Currency Directive

*Reaffirmed February 3, 1994*

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 shown below were amended to reflect the new title of Manager for Foreign Operations, System Open Market Account.

## Procedural Instructions with Respect to Foreign Currency Operations

*Amended February 3, 1994*

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 ("Manager"), shall be guided by the following procedural understandings with respect to consultations and clearances 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.

### Agreement to "Warehouse" Foreign Currencies

At its meeting on February 2-3, 1993, the Committee had reaffirmed the \$5 billion limit on the amount of eligible foreign currencies that the System was prepared to "warehouse" for the Treasury and the Exchange Stabilization Fund (ESF). The purpose of the warehousing

facility is to supplement, at the discretion of the Federal Reserve, the U.S. dollar resources of the Treasury and the ESF for financing their purchases of foreign currencies and related international operations. There had been no use of this facility since an ESF repayment of \$2 billion on April 2, 1992. The Committee decided at this meeting to reaffirm the \$5 billion ceiling, which it viewed as providing adequate operational flexibility to respond on short notice to unanticipated developments.

Votes for this action: Messrs. Greenspan, McDonough, Broadus, Forrestal, Kelley, LaWare, Lindsey, and Parry and Ms. Phillips. Vote against this action: Mr. Jordan. Absent and not voting: Messrs. Angell and Mullins.

Mr. Jordan dissented because he felt that providing funds to the Treasury using a warehousing arrangement was, in effect, a loan to the Treasury. In his opinion, direct financing of government operations by the central bank is inappropriate and could compromise the effective conduct of monetary policy. He did not rule out the possible efficacy of some warehousing transactions in very exceptional circumstances in the future, but he believed that the latter should be approved only after full Committee discussion. Accordingly, he did not want to retain the standing \$5 billion authorization.

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on December 21, 1993, were approved.

The Manager for Foreign Operations reported on developments in foreign exchange markets during the period since the December 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 December 21, 1993, through February 3, 1994. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook, the ranges for the growth of money and debt in 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 indicated that economic activity recorded a strong advance during the closing months of 1993, and the limited data available on production and employment suggested appreciable further gains in the early weeks of this year. Housing starts had strengthened substantially in the fourth quarter of last year, and business fixed investment had registered a sharp rise. Increases in broad indexes of consumer and producer prices, excluding their food and energy components, had been somewhat larger in recent months than earlier in 1993, and prices of a number of commodities had turned up.

Assessment of the January labor market data was complicated by statistical revisions and weather-related reporting problems, but a variety of indicators pointed convincingly to a further strengthening in the demand for labor. Total nonfarm payroll employment posted a small gain in January after a sizable December increase. Manufac-

turing employment rose for a fourth consecutive month, with gains again concentrated in motor vehicles. Construction payrolls edged down, evidently reflecting the adverse effects of severe winter weather. The total number of jobs in the services industries was unchanged in January, but the inclement weather apparently held down employment in some segments of this sector as well. The average workweek of production or nonsupervisory workers rose in January to its highest level in almost five years; for manufacturing, the average workweek remained at its post-World War II high for a third consecutive month. The civilian unemployment rate, calculated on a new basis, was 6.7 percent in January.

Industrial production increased appreciably further in December, and the available information suggested a considerable rise in January. In December, the advance in manufacturing was led by the motor vehicle and computing equipment industries. Sizable increases in materials and construction supplies also were recorded. On the other hand, the output of consumer goods other than motor vehicles was sluggish, and the production of aircraft and defense and space equipment continued to shrink. Total utilization of manufacturing capacity rose again in December and reached a relatively high level, judged against historical experience.

Consumer spending, as measured by real personal consumption expenditures, posted another solid increase in the fourth quarter, and strong sales of motor vehicles in January suggested continued buoyancy in consumer demand. In the fourth quarter, real outlays on motor vehicles surged, and spending on other durable goods—particularly furniture, appliances, and other household equipment—registered further large gains. By contrast, real outlays for nondurable goods

and services rose only moderately. Housing starts jumped in December, with both single-family and multifamily starts sharing in the advance. For 1993 as a whole, housing starts were at their highest annual total in four years. Sales of new homes were up sharply in November, and sales of existing homes ended the year at the highest monthly level in the twenty-five-year history of the series.

Real business fixed investment recorded a very large increase in the fourth quarter. Business spending for equipment, notably for information processing equipment, was up sharply for a seventh straight quarter. The strength evident in recent orders for nondefense capital goods pointed to further gains in shipments of these goods in early 1994. Outlays for nonresidential structures in the fourth quarter posted their largest quarterly rise in six years; the increases were spread across a broad array of categories other than office buildings. Construction permits continued to rise in the fourth quarter, suggesting further growth of investment in nonresidential structures in the near term.

Business inventories remained generally well aligned with sales through November, the most recent month for which complete data were available. In manufacturing, inventory stocks fell in December after edging lower in November; with brisk gains in shipments in both months, the ratio of stocks to shipments fell further from levels that already were low by historical standards. At the wholesale level, inventories rose moderately in November after little change in the preceding two months. The inventory-to-sales ratio for this sector had changed little since May. Retail inventories expanded substantially in November for a third straight month. The buildup of stocks might have been in anticipation of robust holi-

day sales, but for some retail businesses, particularly general merchandise stores, the increases coincided with weak sales. For the retail sector as a whole, the inventory-to-sales ratio was up slightly in November.

The average nominal U.S. merchandise trade deficit for the October–November period was about the same as its average rate in the third quarter. The value of exports was up for the two-month period, with the increase occurring largely in machinery, automotive products, and aircraft. The higher value of imports for the two-month period reflected, as had been the case earlier in 1993, greater imports of consumer goods, automotive products, and machinery. Trends in economic activity in the major foreign industrial countries appeared to have diverged further in the fourth quarter. Moderate growth appeared to be continuing in Canada and the United Kingdom, but economic activity seemed to be growing more slowly or to have turned down in Japan, western Germany, and France.

Producer prices of finished goods were down slightly in December after being unchanged in November. Excluding the food and energy components, producer prices edged higher in December and were up slightly for the year as a whole. At the retail level, consumer prices rose modestly in November and December, with energy price declines holding down the increase in the overall index. For items other than food and energy, prices advanced in the two months at a slightly faster pace than that seen over previous months of the year; for 1993 as a whole, the increase was about the same as in 1992. Hourly compensation of private industry workers increased in the fourth quarter at the same pace as in the third quarter. For 1993, the rise in hourly compensation was little changed from the previous

year. Average hourly earnings of production or nonsupervisory workers rose sharply in January, but for the twelve months ended in January, the increase was the same as that recorded for the previous twelve months.

At its meeting on December 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 following months.

Open market operations were directed toward maintaining the existing degree of pressure on reserve positions throughout the intermeeting period. Additional reserves were supplied to the banking system on a temporary basis around year-end to meet seasonal movements in currency and required reserves as well as an enlarged demand for excess reserves. For the intermeeting period as a whole, the federal funds rate remained close to 3 percent while adjustment plus seasonal borrowing averaged somewhat more than anticipated.

Most market interest rates declined slightly during the intermeeting period, and major indexes of stock prices posted new highs. Market participants saw the incoming news on inflation as encouraging; still, they viewed the economy as relatively robust, and on balance they deemed a firming of monetary policy to

counteract a potential buildup of inflation pressures as likely in the next few months, but probably not in the very near term.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies changed little on balance over the intermeeting period. The dollar fell against the yen in the context of somewhat higher Japanese interest rates and renewed expressions of U.S. concern about bilateral trade issues. The dollar appreciated slightly relative to the German mark and other European currencies against the background of relatively strong U.S. economic data and generally sluggish economic activity in continental Europe.

Growth of the broad monetary aggregates, though a little faster than in most of 1993, remained relatively slow over December and January. Investors evidently continued to find low-yielding deposits less appealing than stock and bond mutual funds, although recent inflows to bond funds appeared to have been at a slower rate than that seen over most of 1993. For the year 1993, growth of both M2 and M3 was estimated to have been slightly above the lower ends of the Committee's ranges. Private borrowing had picked up in recent months, and total domestic nonfinancial debt expanded at a somewhat faster, though still moderate, pace in the fourth quarter; for the year, nonfinancial debt was estimated to have been in the lower half of the Committee's monitoring range.

The staff forecast prepared for this meeting suggested that economic expansion would slow from the very strong pace of the fourth quarter, but that the economy still would advance in 1994 at a rate somewhat in excess of the growth of potential. The severe winter weather over much of the country and the California earthquake would tend to distort

economic indicators for the early part of the year; however, taken together, these developments were not expected to have a material or lasting effect on the overall level of activity or prices. Consumer spending, which for some time had tended to outpace the growth of disposable income, was projected to increase at a rate more in line with incomes. Business fixed investment was expected to decelerate gradually from the very rapid rate of 1993, reflecting the diminishing effect of the earlier pickup in output growth, the slower growth of corporate cash flow, and a less rapid decline in the cost of capital. Home-building activity, driven by the greatly improved affordability of housing and increased confidence in employment prospects, was anticipated to continue at a relatively brisk pace through much of the year. Exports were projected to strengthen somewhat, bolstered by some pickup in foreign economic growth, and fiscal restraint was expected to exert a reduced drag on spending. In light of the limited margins of slack in labor and product markets that were anticipated to prevail over the forecast horizon, the ongoing expansion was projected to be associated with only a slight further reduction in the core rate of inflation.

In the Committee's discussion of current and prospective economic developments, members commented that the economy had entered the new year with appreciable forward momentum and that the expansion was likely to be sustained over the year ahead at a pace somewhat above the economy's long-run potential. The very rapid rate of economic growth now indicated for the fourth quarter of 1993 clearly could not be maintained. Much of the recent impetus to the expansion stemmed from a surge in expenditures on housing, business equipment, and consumer durables. Such spending had reached a very high level in relation

to underlying demands so that the pace of additional increases undoubtedly would moderate during the course of 1994. Still, the economic expansion seemed to have considerable momentum, largely as a consequence of diminishing balance sheet constraints and generally favorable financial conditions spurred by a highly accommodative monetary policy. As a consequence, a number of members expressed the view that the risks were on the upside of a moderate growth forecast. In the context of low and decreasing slack in the economy, little further progress would be made toward price stability in 1994, and there was a distinct risk of higher inflation at some point if monetary policy were not adjusted. While broad measures of inflation did not on the whole suggest any changes in inflation trends, some members noted that a number of commodity prices had turned up in recent months, and they referred to still scattered but increasing anecdotal reports that some business firms were paying slightly higher prices for various materials purchased for use in the production process.

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 1994. The central tendency of the forecasts pointed to somewhat faster economic growth this year than currently was estimated for 1993. The anticipated rate of economic expansion was expected to foster a limited further drop in the rate of unemployment by the fourth quarter of this year. With the slack in productive resources expected to diminish further to a quite low level, price and cost pres-

tures were unlikely to abate significantly; indeed, price increases in 1994 could exceed those of 1993 when inflation had been held down by favorable developments in energy prices. Measured from the fourth quarter of 1993 to the fourth quarter of 1994, the forecasts for growth of real GDP had a central tendency of 3 to 3¼ percent and a full range of 2½ to 3¾ percent. Projections of the civilian rate of unemployment in the fourth quarter of 1994 were all in a range of 6½ to 6¾ percent calculated on the basis of the new survey recently introduced by the Bureau of Labor Statistics. For the CPI, the central tendency of the forecasts for the period from the fourth quarter of 1993 to the fourth quarter of 1994 was centered on increases of about 3 percent within a range of 2¼ to 4 percent, and for nominal GDP the forecasts were clustered in a range of 5½ to 6 percent for the year.

In the Committee's review of factors underlying recent developments, members observed that generally favorable financial conditions provided a backdrop conducive to further robust expansion in business activity. Much of the recent strengthening in economic growth was generated by increased spending in interest-sensitive sectors of the economy such as housing in response to relatively low interest rates. Generally buoyant equity markets, a readier availability of financing from lending institutions, and the strengthened financial condition of businesses and households also were cited as factors tending to boost economic activity. Balance sheet restructuring activities appeared to have slackened markedly, and while balance sheet adjustments probably were still being made, the latter seemed to be exerting much less restraint on the willingness of businesses and especially households to spend and

to incur new debt to finance growing expenditures.

In their reports on developments across the nation, members commented on widespread indications of improving economic activity, including some strengthening in regions that earlier were characterized by stagnant business conditions. Some areas continued to be affected adversely by special factors, especially by spending cutbacks in defense and aerospace industries. California was a notable example, but a range of indicators suggested that the California economy might be stabilizing, albeit at a depressed level, after an extended period of declining activity. Mirroring these developments, business sentiment was characterized as generally optimistic around the nation. While business executives remained cautious in their hiring practices, the expansion in business activity was fostering sizable overall gains in employment even in areas where some major business concerns were reducing their workforces. A few large firms that previously had frozen or reduced their payrolls were now reported to be hiring additional workers.

Turning to prospective developments in key sectors of the economy, the members anticipated that the expansion in consumer expenditures would be well maintained during 1994, though the growth in such spending probably would moderate to a pace more in line with gains in disposable income. The available data on retail sales since the holiday period were still limited, but anecdotal reports pointed to continuing momentum in several parts of the country. Winter storms had hindered sales in a number of areas, but according to some retail contacts the adverse effects were likely to be temporary. In any event, the very rapid rates of growth in sales of automobiles and other consumer

durables were not sustainable, and already high consumer debt ratios would be a further inhibiting factor. It was noted in this connection that consumer debt had become more concentrated over the course of recent years among consumer groups that were most likely to borrow to help finance their spending, with the result that the ability of such consumers to incur additional indebtedness could be diminished. Higher taxes confronting some households also were cited as a negative factor in the outlook for the consumer sector. On balance, however, while the prospects for consumer spending clearly were not free of uncertainty, the marked improvement in consumer confidence and favorable financial conditions would provide a setting conducive to sustained moderate growth in consumer expenditures.

The improvement in consumer sentiment together with the availability of relatively low cost financing had fostered very strong growth in housing construction over the closing months of 1993 and, adjusting for seasonal weather conditions, anecdotal reports from many areas suggested a continued robust performance in this sector of the economy in the early weeks of this year. The strength in housing activity had induced increases in the costs of lumber and other building materials, and shortages of skilled construction workers were reported in some areas. Despite these developments, prices of new homes did not appear at this point to be under significant upward pressure. Looking ahead, with housing construction already at high levels, further gains over the course of 1994 were expected to be substantially below those recorded in recent quarters.

Business fixed investment was likely to be sustained by continuing efforts to modernize production facilities in order to achieve more efficient operations in

highly competitive domestic and world markets. The gains in such investment had been concentrated in expenditures for equipment, and while new orders pointed to further brisk growth in the months ahead, increases in such expenditures were likely to moderate over time. At the same time, growing economic activity and associated declines in commercial and industrial vacancy rates, at least in some parts of the country, suggested that nonresidential building construction other than office structures would post sizable increases over the year. Rebuilding activity following the earthquake in California would stimulate engineering and construction in the Los Angeles area over the quarters ahead.

Fiscal policy and foreign trade had exerted retarding effects on the economy in 1993. While the response of the economy to fiscal restraint and the outlook for export markets remained subject to substantial uncertainty, both fiscal policy and the trade deficit were expected at this point to be less negative factors in the performance of the economy during 1994. With regard to the outlook for fiscal policy, the downtrend in defense spending was projected to moderate and to contribute to a smaller net decline in overall federal government expenditures on goods and services in 1994. It was noted that the widespread political support of efforts to curtail federal government deficits could be expected to continue to contain new federal spending initiatives. With regard to the outlook for U.S. exports, more accommodative fiscal or monetary policies abroad were expected to foster a gradual improvement in rates of economic growth in major foreign industrial countries with beneficial effects on the demand from those countries for U.S. goods and services. One member also commented that NAFTA already

seemed to be having a favorable effect on some exports to Mexico.

One sector of the economy that was viewed as a source of particular uncertainty was the outlook for inventories. Business firms continued to maintain tight control over their inventories, and in general the latter were at quite low levels in relation to sales. Indeed, there were some anecdotal reports that inventory shortfalls had resulted in the loss of sales in recent months. Lean inventory levels in the context of diminishing slack in labor and product markets raised concerns about the potential for increasing capacity pressures should strong demands persist that would tend to deplete existing inventories and lead to efforts not only to rebuild but to increase them. Thus far, there were few signs of developments such as significant increases in delivery lead times or in the costs of goods purchased by business firms that in the past had triggered substantial inventory buildups. However, there were ample precedents in the history of business-cycle expansions of efforts to accumulate large inventories in periods when strong final demands already were exerting inflationary pressures in the economy.

The members generally expressed concern about a buildup in inflationary pressures during the year ahead, especially if what they currently viewed as a very accommodative monetary policy were maintained. A number of members emphasized that even with the substantial slowing that they anticipated in the rate of economic expansion from the very rapid growth in the fourth quarter, overall margins of slack in labor and product markets, already reduced to fairly modest levels, would shrink further in the quarters ahead with the clear possibility that various imbalances and added inflation would emerge in the absence of monetary tightening actions.

Continuing upward impetus to food prices, resulting from the adverse weather conditions during 1993, and the likelihood that energy prices would not decline further and might in fact turn up in an environment of somewhat stronger worldwide demand for energy products could add to overall price pressures.

The members acknowledged that broad measures of prices and wages had displayed mixed patterns over recent months and that on the whole they did not yet point to any clear change in inflation trends. However, some other indicators were more disquieting. One example was the growing, though still limited, number of anecdotal reports of shortages of skilled workers in some parts of the country or occupations, notably construction. Moreover, there were more reports of rising prices for products being purchased by business firms for use in the production process and in turn of successful efforts by businesses to raise their own prices in order to pass on higher costs or to improve their profit margins. More generally, many commodity prices had increased over the past several weeks. On the positive side, competitive pressures remained intense in many markets, augmented in markets for numerous products by competition from foreign producers. Some members also commented that the tradeoff between economic growth and inflation would be improved over the year ahead to the extent that the credibility of the System's anti-inflationary policy was maintained.

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 1994 that it had established on a tentative basis at its meeting on July 6-7, 1993. The tentative ranges included



expansion of 1 to 5 percent for M2 and 0 to 4 percent for M3, measured from the fourth quarter of 1993 to the fourth quarter of 1994. The monitoring range for growth of total domestic nonfinancial debt had been set provisionally at 4 to 8 percent for 1994. All of these ranges were unchanged from those that the Committee had set for 1993; the latter had been adjusted down to take account of ongoing increases in velocity.

In the Committee's discussion of the ranges for 1994, which tended to focus on M2, all the members expressed a preference for affirming the M2 and M3 ranges that had been established on a provisional basis in July and all but one favored adopting the provisional monitoring range for nonfinancial debt; that member preferred a lower range. Many of the members commented on the uncertainties that surrounded the establishment of ranges that were consistent with the Committee's goals for the economy. They noted that a variety of developments had altered the historical relationships between the monetary aggregates and broad measures of economic performance over the past several years. The resulting uncertainty implied that the Committee needed to retain a flexible approach to the behavior of the monetary aggregates in relation to their ranges, including the need to assess a broad array of other indicators to gauge the implications of monetary growth developments. Nonetheless, the members concluded that as best they could evaluate evolving financial conditions at this point, monetary growth within the tentative ranges would be likely to promote the Committee's objectives of sustained economic expansion and subdued inflation.

In 1993, both M2 and M3 had grown at rates about  $\frac{1}{2}$  percentage point above the lower bounds of the ranges that the Committee now contemplated retaining

for 1994. According to a staff analysis prepared for this meeting, somewhat faster growth in both of these aggregates could be expected in 1994. But with nominal GDP also expected to be stronger, as indicated by the central tendency of the members' forecasts, the velocity of M2 would continue to rise at an appreciably faster rate than historical relationships would have suggested. This assessment assumed that households would continue to redirect savings from M2-type accounts to higher-yielding investments, especially bond and stock mutual funds. However, such redeployments of funds should moderate this year to the extent that some investors already had accomplished a considerable portion of their desired portfolio reallocations and in light of the possibility that changes in the prices of stocks and bonds, including the drop in bond prices in recent months, would underline the risks of holding such instruments. Moreover, depository institutions had strengthened their capital positions markedly and were likely to compete more aggressively for M2 and especially for M3-type deposits in an effort to maintain or increase their role in the financing of expanding economic activity. While these developments and their implications for monetary growth could not be forecast with confidence, the members believed that the ranges under consideration would probably be sufficiently wide to accommodate M2 and M3 growth rates under a variety of likely velocity scenarios. For example, if the factors that had tended to depress the growth of the broad aggregates in relation to income did not abate as expected this year, M2 and M3 growth would again be near the lower bounds of the Committee's ranges. Alternatively, if the behavior of these aggregates were to move closer to earlier patterns, growth in the upper portions of the

ranges would foster an economic performance in line with the members' forecasts.

From the perspective of a longer time horizon, many of the members noted that the provisional range for M2 was essentially at a level that could well prove to be consistent with sustained and noninflationary economic expansion. This conclusion assumed that historical relationships between money growth and the expansion of broad measures of economic performance would be restored at some point. In the absence of such a development or the emergence of new, reasonably stable relationships, the Committee would have to continue to place diminished reliance on the monetary aggregates in the formulation of monetary policy.

With regard to the range for nonfinancial debt, the members anticipated that its growth this year would remain within the contemplated range. A staff analysis suggested that its federal borrowing component would decrease as a result of the ongoing effects of deficit reduction measures that had been enacted and the rise in tax receipts stemming from economic growth. At the same time, borrowing by the nonfederal sectors should strengthen further against the backdrop of more comfortable financial positions and the expected pickup in GDP expansion. In one view, however, a somewhat lower range was desirable for nonfinancial debt. In light of the shift in business preferences away from debt and toward equity, debt velocity could increase and slower growth in debt would be consistent with the Committee's objectives. However, this member could accept the higher range favored by the other members for 1994.

At the conclusion of the Committee's discussion, all the members indicated that they favored or could accept the ranges for 1994 that the Committee had

established on a tentative basis at its meeting in July 1993. In keeping with the Committee's usual procedures under the Humphrey-Hawkins Act, the ranges would be reviewed at midyear, or sooner if deemed necessary, in light of the behavior of the aggregates and interim economic and financial developments. The Committee approved the following paragraph for inclusion in the domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability 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 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1993 to the fourth quarter of 1994. The Committee anticipated that developments contributing to unusual velocity increases could persist during the year and that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was set at 4 to 8 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.

Votes for this action: Messrs. Greenspan, McDonough, Broaddus, Forrestal, Jordan, Kelley, LaWare, Lindsey, and Parry and Ms. Phillips. Votes against this action: None. Absent and not voting: Messrs. Angell and Mullins.

In the Committee's discussion of policy for the intermeeting period ahead, the members favored an adjustment toward a less accommodative policy stance, though views differed to some extent with regard to the amount of the adjustment. The current policy posture, which had been in effect since the late summer of 1992, was highly stimulative as evidenced, for example, by very low

or even slightly negative real short-term interest rates and, in the view of at least some members, the relatively rapid growth over an extended period in narrow measures of money and reserves. Such a policy had been appropriate in a period when various developments had tended to inhibit the expansion, including widespread efforts to repair strained balance sheets and a variety of business restructuring activities that had tended to depress confidence and spending. More recently, the considerable progress made by households and businesses in decreasing their debt service burdens and the much strengthened capital positions of lending institutions had provided a financial basis, in the context of low interest rates, for growth in demands on productive capacity that could generate inflation pressures. In this situation, the members agreed that monetary policy should be adjusted toward a more neutral stance that would encourage sustained economic growth without a buildup of inflationary imbalances. The members recognized that timely action was needed to preclude the necessity for more vigorous and disruptive policy moves later if inflationary pressures were allowed to intensify. The history of past cyclical upswings had demonstrated the inflationary consequences and adverse effects on economic activity of delayed anti-inflation policy actions.

In the course of the Committee's discussion, a number of members endorsed a policy move that would involve only a slight adjustment toward a less accommodative degree of reserve pressure. These members recognized that evolving economic conditions might well justify a somewhat greater policy adjustment. They believed, however, that even a slight move at this time was likely to have a particularly strong impact on financial markets because it would be

the first policy change after a long hiatus and indeed the first tightening action in about five years. The market effect might be amplified by a contemplated decision to authorize the Chairman to announce the policy action (discussed below). In the circumstances, these members felt that a somewhat greater policy adjustment would incur an unacceptable risk of dislocative repercussions in financial markets. A relatively small move would readily accomplish the purposes of signaling the Committee's anti-inflation resolve and together with expected further action should help to temper or avert an increase in inflation expectations and speculative developments in financial markets.

Other members indicated a preference for a somewhat greater firming action that would move monetary policy closer to a desirable neutral stance. In this view, recent developments in the economy had demonstrated that monetary policy was much too accommodative and that slow, gradual tightening moves risked allowing inflation pressures to build. A more decisive policy move at this juncture would in fact reduce uncertainty, because fewer discrete actions would be required and they would have a more pronounced and desirable effect in curbing inflationary sentiment and thus in minimizing upward pressures on longer-term interest rates over time. The result would be a policy stance that was more consistent with sustained economic expansion and progress toward price stability.

In further discussion, all the members indicated that they could accept the proposed slight policy adjustment at this point, but many observed that additional firming probably would be desirable later. The members did not see any unusual likelihood that a further policy action would be needed during the intermeeting period, and the Commit-

tee therefore decided to retain an unbiased intermeeting instruction in the directive. In this connection, it was understood that the Committee would be prepared to review its policy stance and take further action, if warranted by intermeeting developments, at a telephone conference during the period ahead.

At this meeting, Committee members discussed and agreed on a proposal to have the Chairman announce the Committee's short-term policy decision promptly. The purpose of such an announcement, which would be a departure from past Committee practice, was to avoid any misinterpretation of the Committee's action and its purpose. Because this would be the first tightening policy action in a long time, it was likely to attract considerable attention. The Committee did not intend this announcement to set any precedents or to imply any commitments regarding the announcement of its decisions in the future. That matter would be reviewed along with other issues relating to the disclosure of Committee information at a later meeting.

At the conclusion of the Committee's discussion, all the members indicated that they could support a directive that called for a slight increase in the 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 Committee decided that in the context of its 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 contemplated at this meeting were expected to be consistent with moderate

growth in M2 and M3 over the first half of 1994.

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 indicates a strong advance in economic activity during the closing months of 1993, and the limited data available for the early weeks of this year suggest appreciable further gains. The January labor market data were complicated by statistical revisions and weather-related reporting problems; however, a variety of indicators pointed convincingly to a continuing expansion of employment. Industrial production increased sharply in the fourth quarter and appears to have risen considerably further in January. Consumer spending and housing activity posted solid gains in late 1993, and strong sales of motor vehicles in January suggested continued buoyancy in consumer demand. Trends in contracts and orders point to further sizable gains in business fixed investment. The average nominal U.S. merchandise trade deficit in October–November was about the same as its average rate in the third quarter. Over the latter part of 1993, increases in broad indexes of consumer and producer prices, excluding their food and energy components, were somewhat larger than earlier in the year and prices of a number of commodities also turned up recently.

Most market interest rates have declined slightly since the Committee meeting on December 21, 1993. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies is about unchanged over the intermeeting period.

Growth of M2 and M3 was relatively slow over December and January. From the fourth quarter of 1992 to the fourth quarter of 1993, M2 and M3 are estimated to have grown at rates slightly above the lower ends of the Committee's ranges for the year. Private borrowing has picked up in recent months and total domestic nonfinancial debt expanded at a moderate rate in the fourth quarter; for the

year, nonfinancial debt 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 this meeting established ranges for growth of M2 and M3 of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1993 to the fourth quarter of 1994. The Committee anticipated that developments contributing to unusual velocity increases could persist during the year and that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was set at 4 to 8 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 increase slightly 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 the first half of 1994.

Votes for this action: Messrs. Greenspan, McDonough, Broaddus, Forrestal, Jordan, Kelley, LaWare, Lindsey, and Parry and Ms. Phillips. Votes against this action: None. Absent and not voting: Messrs. Angell and Mullins.

It was agreed that the next meeting of the Committee would be held on Tuesday, March 22, 1994.

The meeting adjourned at 11:45 a.m.

Donald L. Kohn  
Secretary

## Meeting Held on March 22, 1994

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 22, 1994, at 9:00 a.m.

### *Present:*

Mr. Greenspan, Chairman  
Mr. McDonough, Vice Chairman  
Mr. Broaddus  
Mr. Forrestal  
Mr. Jordan  
Mr. Kelley  
Mr. LaWare  
Mr. Lindsey  
Mr. Parry  
Ms. Phillips

Messrs. Hoenig, Keehn, Melzer, and  
Oltman, Alternate Members of the  
Federal Open Market Committee

Messrs. Boehne, McTeer, and Stern,  
Presidents of the Federal Reserve  
Banks of Philadelphia, Dallas, and  
Minneapolis respectively

Ms. Minehan, First Vice President,  
Federal Reserve Bank of Boston

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

Messrs. Beebe, J. Davis, Goodfriend,  
Promisel, Siegman, Simpson, and  
Stockton and Ms. Tschinkel,  
Associate Economists

Ms. Lovett, Manager for Domestic  
Operations, System Open Market  
Account

Mr. Fisher, Manager for Foreign  
Operations, System Open Market  
Account

- Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
- Mr. Slifman, Associate Director, Division of Research and Statistics, Board of Governors
- Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors
- Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors
- Mr. Bennett, Ms. Browne, Messrs. T. Davis, Dewald, Lang, Rolnick, and Scheld, Senior Vice Presidents, Federal Reserve Banks of New York, Boston, Kansas City, St. Louis, Philadelphia, Minneapolis, and Chicago respectively
- Mr. Cox, Vice President, Federal Reserve Bank of Dallas
- Mr. Hilton, Manager, Open Market Operations, Federal Reserve Bank of New York

By unanimous vote, the minutes of actions taken at the meeting of the Federal Open Market Committee held on February 3–4, 1994, were approved.

The Manager for Foreign Operations reported on developments in foreign exchange markets and on System transactions in foreign currencies during the period February 4, 1994, through March 21, 1994. By unanimous vote, the Committee ratified these transactions.

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 February 4, 1994, through March 21, 1994. By unanimous vote, the Committee ratified these transactions.

By unanimous vote, paragraph 1(a) of the Authorization for Domestic Open Market Operations was amended to raise

from \$8 billion to \$11 billion the dollar limit on intermeeting changes in System Account holdings of U.S. government and federal agency securities for the intermeeting period ending with the close of business on May 17, 1994.

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 indicated that economic activity had expanded appreciably further in the early months of 1994, despite unusually severe winter weather. Consumer spending and construction activity had been held down to some extent by the adverse weather conditions, but motor vehicle production had continued at a very strong pace and business fixed investment appeared to be headed for a significant gain in the first quarter. Factory utilization rates had moved still higher, and labor demand seemed to have grown moderately further. Outside of a surge in energy prices, increases in broad indexes of consumer and producer prices remained moderate.

Nonfarm payroll employment was unchanged in January but posted a February advance comparable to the sizable monthly increases recorded in the final quarter of 1993. Employment in the service industries declined slightly in January, then rebounded substantially in February. Manufacturing payrolls rose in January and February, but the number of jobs in construction declined in both months, reflecting that industry's vulnerability to weather disruptions. The civil-

ian unemployment rate, calculated on the new basis, fell to 6.5 percent in February; however, the Bureau of Labor Statistics cautioned that a variety of technical factors might have exaggerated the decline in joblessness in early 1994.

After a sharp rise in the fourth quarter, industrial production increased considerably further in January and February. Manufacturing output continued to rise, despite the apparent damping effect of adverse weather on a number of industries. Assemblies of motor vehicles remained quite buoyant, accounting for more than half of the increase in manufacturing production in the first two months of the year and reaching in February their highest level since the late 1970s. Production of manufactured goods other than motor vehicles also was up in the two months, but the advances were smaller than those of late 1993. Output of utilities surged in January, reflecting the heating demand resulting from abnormally cold temperatures, but a portion of that gain was retraced in February. Total utilization of industrial capacity increased in both January and February and was at relatively elevated levels, judged by historical norms; operating rates in primary processing industries were especially high.

Retail sales were little changed on balance over the first two months of the year, with sales recovering in February from a large January decline. By contrast, sales of motor vehicles remained quite brisk on average over the two months, despite the California earthquake and the severe weather. Soaring outlays for home heating contributed to rapid growth of consumer spending on services in January. The unusual weather also affected housing activity; starts were down considerably in January and February from the very high

levels of late 1993, and new home sales plunged in January. Sales of existing homes in January were only slightly below their high December level.

The limited available evidence pointed to a noticeably smaller gain in business fixed investment in the first quarter of 1994 after a very large increase in the previous quarter. Shipments of nondefense capital goods slowed in January, retracing part of the sharp rise of the fourth quarter, but the buoyancy of orders in recent months pointed to a further increase in shipments in coming months. Sales of heavy trucks were strong in January, and the backlog of orders for such vehicles remained large. Nonresidential construction activity, perhaps owing in part to bad weather, was down in January after trending up over most of 1993. The largest decline was in office building, which had posted large increases in the preceding two months.

Business inventories fell slightly in January, and stocks were lean, especially at manufacturing firms. Inventories in manufacturing rose, retracing in January part of a large December decline; much of the January increase was at producers of machinery, where stocks had fallen to very low levels relative to shipments. At both the wholesale and retail levels, inventories posted sizeable decreases. In the wholesale sector, the inventory-to-sales ratio edged down and had changed little since May of last year. The inventory-to-sales ratio for the retail sector was up slightly, reflecting weak sales in January.

The nominal deficit on U.S. trade in goods and services, measured on the new balance-of-payments basis, was slightly smaller in January than the average for the fourth quarter. However, the January deficit was substantially larger than that of December, with exports down by more than imports. Much of

the reduction in exports was in agricultural goods, aircraft, and gold; the drop in imports mainly reflected both lower quantities and lower prices of imported oil. The limited available data suggested that economic activity in the major foreign industrial countries picked up in early 1994 after a mixed performance in the fourth quarter of 1993.

Producer prices of finished goods were boosted in February by a surge in energy prices, especially for gasoline and heating oil, that more than offset a further decline in food prices. Excluding the food and energy components, producer prices edged higher in February; for the twelve months ended in February, producer prices increased by a significantly smaller amount than in the twelve-month period ended in February 1993. At the consumer level, higher energy prices in February were offset by lower food prices. For items other than food and energy, consumer prices also rose less over the twelve months ended in February than in the previous twelve months. Average hourly earnings of production or nonsupervisory workers increased more slowly in February, but for the twelve months ended in February, the advance was about the same as that recorded for the previous twelve months.

At its meeting on February 3-4, 1994, the Committee adopted a directive that called for a slight increase in the 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. The directive stated 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 moderate growth of M2 and M3 over the first half of 1994.

Immediately following the February meeting, Chairman Greenspan announced the Committee's decision, and open market operations were directed toward implementing the slightly less accommodative degree of reserve pressures sought by the Committee. The federal funds rate increased by  $\frac{1}{4}$  percentage point and then remained close to  $\frac{3}{4}$  percent over the intermeeting period, while adjustment plus seasonal borrowing averaged a little less than anticipated.

Most other market interest rates rose considerably more than the federal funds rate in frequently volatile markets. Market participants generally had anticipated a tightening of monetary policy, but the Committee's action apparently came a little sooner than had been expected. Strong fourth-quarter economic data and evidence of solid growth in early 1994 were seen as suggesting greater credit demands and the need for higher interest rates in the future to contain inflation. Heightened trade tensions and unsettled market conditions abroad also contributed to market concerns. In these circumstances, intermediate- and longer-term interest rates increased by appreciably more than short-term money market rates. Major indexes of stock prices had fallen on balance since early February in sometimes volatile trading.

The trade-weighted value of the dollar in terms of the other G-10 currencies initially rose following the tightening of monetary policy on February 4. The dollar depreciated over the balance of the intermeeting period, however, despite higher U.S. interest rates and the release of data indicating generally strong U.S. economic activity. The dollar declined against both the Japanese yen and the



German mark; trade frictions between the United States and Japan and disappointment over the pace of monetary easing in Germany appeared to be contributing factors in the depreciation of the dollar. Bond yields in all the major foreign industrial countries rose on average by almost as much as yields on comparable U.S. bonds.

M2 declined somewhat and M3 was down sharply in February. A substantial drop in mortgage refinancings since late 1993 that depressed demand deposits, and to a lesser extent savings deposits, contributed to the weakness of M2 in February. M3 also was affected by a precipitous decline in institution-only money funds as investors reacted quickly following the monetary tightening to widening spreads between returns on these funds and higher-yielding short-term instruments. Data for early March pointed to some rebound in both monetary aggregates, perhaps owing to portfolio readjustments that involved sizable net redemptions of bond funds and apparently weaker inflows to stock funds. Total domestic nonfinancial debt expanded at a moderate rate in recent months.

The staff forecast prepared for this meeting suggested that economic expansion would slow from the very strong pace of the fourth quarter but that the economy would advance in 1994 at a rate slightly in excess of the growth of potential. Consumer spending, which had tended for some time to outpace income growth, was projected to increase at a rate more in line with disposable incomes; spending on durable goods, in particular, was projected to slow markedly as stock-adjustment motives diminished and higher interest rates exerted some restraint. Business fixed investment was expected to increase less rapidly in 1994, reflecting the diminishing effect of the earlier

pickup in output growth and the slower growth of corporate cash flow. Homebuilding activity was anticipated to continue at a relatively brisk pace, spurred by the greater cash-flow affordability of housing and the good prospects for continued growth in employment and incomes. The restraint on output growth from federal spending cutbacks and weak export demand was projected to diminish somewhat. In light of the limited margins of slack in labor and product markets that were expected to prevail over the forecast horizon, little further reduction in the core rate of inflation was expected.

In the Committee's discussion of current and prospective economic developments, members referred to widespread indications of appreciable momentum in the economic expansion and decreasing margins of unemployed labor and other producer resources. While the members continued to anticipate a marked slowing in economic growth from the very rapid pace of the fourth quarter, some commented that despite unusually severe winter weather in large parts of the country the deceleration in the current quarter appeared to be less than they had expected. The indications of continuing strength in aggregate demand along with a still-accommodative monetary policy suggested a much reduced risk that the economic expansion would stall. Indeed, members continued to expect moderate economic growth, though perhaps for a time at a rate somewhat above the economy's potential. The amount of resources that could be mobilized readily to meet this demand was subject to substantial uncertainty, but the degree of slack in the economy clearly had diminished considerably in recent quarters to relatively low levels and likely would shrink further. The immediate outlook for inflation remained favorable: Costs and prices were being

contained by moderate wage increases, continuing pressures for productivity-enhancing investment, and competitive prices from abroad where slack was still quite ample; and broad measures of money and credit, though strengthening over the last half of 1993, remained moderate by historical standards. Nevertheless, looking ahead, members were concerned that, unless monetary policy were adjusted further from its still-accommodative stance, pressures on resources would intensify and inflation would pick up.

Members assessed the outlook for economic activity and prices against the backdrop of sharp changes in bond and, to a lesser extent, equity prices over the intermeeting period. Clearly, the tightening of reserve conditions announced on February 4 had played a role in market movements, but other factors had been at work as well. Members variously stressed the possibility that the backup in interest rates had reflected much stronger aggregate demand, added uncertainty about the course of interest rates, influences from foreign exchange and foreign capital markets, changes in trading strategies by wary participants, and rising inflation expectations. On balance, financial conditions were still seen as supportive of solid economic expansion, and a number of members referred in particular to the more accommodative lending policies of many depository institutions; however, some commented on the risk, which they viewed as having a low probability, that weakness and volatility in financial markets could at some point have a significantly inhibiting effect on business and consumer confidence and spending. To date, business sentiment was described as quite positive in most parts of the country, and although there were some exceptions—notably in California—members commented on numerous

indications of improving regional economies.

A number of members observed that they expected consumer spending to be relatively well maintained, buttressed by considerable strength in expenditures for motor vehicles and other consumer durables. Reports on retail sales from various parts of the country tended to support such assessments, and many contacts among retailers were expressing optimism about the outlook for their sales. At the same time, some members observed that a number of factors were likely to limit the potential strength of consumer spending. They referred in particular to the already low saving rate, relatively high consumer indebtedness, and recent declines in the value of securities held by households. More importantly, however, consumer confidence and spending would continue to depend heavily on the outlook for further growth in employment and incomes.

Business investment expenditures remained on a solid uptrend as firms continued to focus on the need to control costs and improve operating efficiencies in the face of vigorous competitive pressures. Members also cited some examples of investment spending induced by rising demands pressing against limitations in production capacity. While business investment had tended to be concentrated in new, more productive equipment, nonresidential construction also had strengthened and anecdotal reports from numerous areas tended to confirm more positive nationwide statistics. The rising levels of nonresidential construction activity tended to be concentrated in commercial and industrial facilities and public works projects; the construction of office buildings continued to lag but this sector appeared to have stabilized or perhaps improved marginally after a long period of decline. More generally, currently

positive business attitudes augured well for further growth in overall business investment, but on the negative side it was noted that further turbulence in financial markets could erode confidence with adverse implications for investment spending. Residential construction was described as quite strong in numerous areas, although overall housing construction had been held down thus far this year by severe winter weather in numerous parts of the country. Shortages of skilled construction workers and building materials were reported in many areas.

Despite generally rising final demands, business firms were continuing to maintain lean inventory positions in their ongoing efforts to hold down costs. Nonetheless, with production levels in many industries approaching or reaching full capacity utilization, prices of some materials and other business purchases coming under increasing pressure, and delivery lead times tending to lengthen at least in some industries, efforts to build inventories could be expected to materialize and in one view the potential for such a development represented a key upside risk from current forecasts. In this connection, some members referred to scattered indications of efforts to increase inventories, notably of steel products. Manufacturers of motor vehicles also were in the process of rebuilding depleted inventories, though the currently stimulative impact of such rebuilding on overall production was likely to be reversed when motor vehicle stocks reached desired levels in the months ahead.

The foreign trade sector was expected to remain a negative factor in the economic outlook. However, the members anticipated some improvement in the economies of major foreign industrial nations which, together with some moderation in the growth of domestic final

demands, was likely to slow the decline in real net exports. A few members cited growing indications that last year's NAFTA legislation would have quite positive effects on U.S. foreign trade, though those effects were still largely in the future.

In the discussion of the outlook for prices and wages, many of the members expressed concern about the potential for a pickup in inflation if, as they anticipated, margins of unemployed resources narrowed further or disappeared. The members acknowledged that broad measures of prices relating to final purchases and of wages currently did not suggest any increase in inflation. Indeed, in the view of at least some members, those measures still suggested on balance that the inflation trend had retained a downward tilt thus far. In this connection, some commented that the overall performance of the broad measures had been somewhat better in recent months than they had anticipated, especially given the very rapid expansion of the economy over the closing months of 1993 and the less than expected moderation thus far this year. Developments that had been exerting a favorable effect on prices included above-trend growth in productivity, relatively low prices in world oil markets, and strong competition in many markets from both domestic and foreign firms. Moreover, the strong rise in credit usage that often had accompanied intensified inflation pressures in the past had yet to materialize. To date, the pickup in price increases had been uneven and had tended to be concentrated in some regions or industries and in the early stages of the production process, and a number of members reported that they saw little change in inflation trends in their areas. Nonetheless, warning signs had emerged of the prospect of greater inflation, though perhaps not over the nearer term. These

included increases in a wide range of commodity prices and anecdotal reports from various parts of the country suggesting a further rise in the number of business firms that were facing somewhat higher prices of materials and other purchases and in turn were able, often for the first time in recent years, to raise their selling prices. Price and wage pressures appeared to be especially pronounced in the construction industry, where capacity constraints had been encountered in many localities. Members also referred to the potential for higher prices in the food and energy sectors; low crop carryovers for some grains made food prices vulnerable to unfavorable growing conditions, should they materialize; oil prices currently were at relative lows but were likely to come under some upward pressures as world economic growth accelerated and if political developments led to disruptions in world supplies. More fundamentally, the relatively robust economic expansion over the second half of 1993 and the further advance in early 1994 appeared in the view of many members to have appreciably diminished the gap between actual and potential GDP and to have reduced the rate of unemployment to a level that could well be not far from the natural rate. If this assessment proved to be correct, further economic expansion at a pace above the economy's potential would bring more industries and the economy more generally to capacity production levels before very long and could well generate growing inflation thereafter.

In the Committee's discussion of policy for the intermeeting period ahead, all the members supported a further move toward a less accommodative policy stance. An initial move in that direction had been made in early February, but the members still viewed monetary policy as too stimulative. In this regard,

members cited the very low inflation-adjusted interest rates in short-term debt markets as an indicator of excessive policy accommodation, and one member also referred to the rapid growth in reserves and narrow measures of money over an extended period. While a quite accommodative policy stance had been entirely appropriate earlier in the economic recovery, when constraints such as the widespread rebuilding of balance sheets and business restructuring activities were strongly inhibiting the expansionary forces in the economy, those constraints had greatly diminished and the expansion clearly had gained considerable momentum. In the circumstances, maintaining an accommodative monetary policy could be expected before too long to foster growing pressures on labor and capital resources with a resulting pickup in inflation. While actual inflation remained subdued and credit growth was still damped, it was only a matter of time before the current monetary policy induced a surge in credit extensions that could fuel an outbreak of inflation.

In these circumstances, the members concluded that monetary policy needed to move fairly quickly toward what might be characterized as a more neutral position. Such a policy posture could not be defined with precision and it undoubtedly varied to some extent with changing circumstances. Nonetheless, it provided a useful conceptual approach to policy in current circumstances and could be identified as a policy stance that sought to foster sustained noninflationary expansion consistent with the economy's potential. The members generally concluded that such a policy stance was still some distance away, and the key issue facing the Committee was not whether but how promptly the necessary policy adjustment should be completed. Whether further tightening

beyond that point would be needed later could not be determined at this time but would depend on the potential emergence of conditions pointing to an acceleration of inflation.

As had been the case at the February meeting, views differed on how much further current monetary policy should be adjusted at this meeting. Many members noted that money market interest rates would have to rise by a relatively sizable amount from current levels, given underlying economic conditions, but a majority indicated a preference for another small move at this time. Many were concerned about a possible over-reaction in financial markets that had become quite sensitive and volatile since early February. A few also placed some emphasis on their expectations of a considerable slowdown in the rate of economic growth and the possibility that the moderation of the expansion might prove to be somewhat more pronounced than was currently projected. In this view, a degree of caution was advisable to permit an assessment of ongoing developments.

Members who preferred a more sizable policy adjustment, or perhaps a small move through open market operations that was associated with a rise in the discount rate, believed that the increasing risks of greater inflation pointed to the need to move more promptly and decisively away from a policy stance that had become overly accommodative. A stronger policy action at this point would serve to underscore the Committee's commitment to its price stability objective and would help to counteract what some members interpreted as a significant increase in inflationary expectations since earlier in the year. A reduction in such expectations would over time have beneficial implications for bond markets and the economy. In the view of some

members, continued market expectations of further actions to tighten reserve conditions were themselves contributing to market instability. Some members also commented that any policy choice incurred the risk of proving to be wrong, but they viewed the greatest risk at this juncture to be a policy that allowed inflationary pressures to gather momentum. A policy decision that in hindsight led to the implementation of too much restraint could be corrected more readily and with less damage to the economy in this view.

In the Committee's discussion of possible intermeeting adjustments to the degree of reserve pressure, a majority of the members indicated a preference for retaining a symmetric directive. While the probability of an easing action during this period was deemed to be very low, the members also did not see as very likely any firming over the intermeeting period beyond that to be implemented after today's meeting. The Committee had embarked on a course of moving away from an accommodative stance toward one that was more neutral. The timing of the actions to implement this policy was not independent of the behavior of the economy, of course, but it was not as dependent on the nuances of incoming data as policy might be at other times when the course of policy was less clear. Symmetry did not rule out an intermeeting adjustment of policy by the Chairman on behalf of the Committee, as had been done with some frequency in the past when that seemed warranted by intermeeting developments. Members who favored an asymmetric directive observed that such a directive seemed more consistent with the current thrust of monetary policy toward less accommodation and the related need to respond promptly to indications of accelerating inflation. These members indicated, however, that they

could support a symmetric directive that was associated with the prospect of intermeeting consultations.

At the conclusion of the Committee's policy discussion, all but two of the members indicated that they could accept a directive that called for a slight increase in the 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 first half of 1994.

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 expanded appreciably further in the early months of 1994. Severe weather and changes in statistical methodology distorted movements in official labor market data in January and February, but it appears that employment increased somewhat on balance over the two months and that unemployment fell. Industrial production also increased substantially over this period after a sharp rise in the fourth quarter. Consumer spending and housing activity apparently have been held down to some extent by adverse weather in January and February; retail sales were little changed on balance over the two months and housing starts fell considerably. Trends in

contracts and orders point to a sizable increase in business fixed investment but at a rate well below that for the fourth quarter of 1993. The nominal deficit on U.S. trade in goods and services in January was slightly smaller than the average in the fourth quarter. Increases in broad indexes of consumer and producer prices have remained moderate in recent months despite a surge in energy prices.

Most market interest rates have risen considerably since the Committee meeting on February 3-4, 1994. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies depreciated over the intermeeting period.

M2 declined somewhat and M3 was down sharply in February, but data for early March point to some rebound in both aggregates. Total domestic nonfinancial debt has expanded at a moderate rate in recent months.

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 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1993 to the fourth quarter of 1994. The Committee anticipated that developments contributing to unusual velocity increases could persist during the year and that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was set at 4 to 8 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 increase slightly 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 the first half of 1994.

Votes for this action: Messrs. Greenspan, McDonough, Forrestal, Kelley, LaWare, Lindsey, and Parry and Ms. Phillips. Votes against this action: Messrs. Broaddus and Jordan.

Messrs. Broaddus and Jordan dissented because they preferred a stronger move toward a more neutral policy stance. In their view, the recent sharp increases in longer-term interest rates indicated clearly that inflationary expectations were rising and that the principal policy risk had become one of remaining accommodative for too long a period. In this environment, they believed that a more aggressive move would underscore the Committee's commitment to fostering sustainable longer-term growth and reduce the risk that a highly restrictive policy might be required at a later date to contain inflation.

The Committee then turned to a discussion of the desirability of making an immediate announcement of today's policy decision. All the members favored prompt disclosure in principle, but some expressed reservations about announcing today's decision immediately after the meeting. These members preferred to consider a decision on announcements of policy actions in the context of a broad range of disclosure issues, some of which had yet to be fully explored. Some stressed that they remained concerned about the inhibiting effects of some types of disclosures on the Committee's deliberations, and one member emphasized that the Committee also needed to consider the implications of immediate announcements of changes in open market policy for the role of the discount rate. Several members commented that announcing a decision reached at this meeting, because it

would come after a similar announcement following the most recent meeting in early February, would in effect set a precedent that would tend to limit the Committee's future options. A majority of the members concluded, however, that while the Committee was not making a formal, binding decision on this issue at this meeting, the Chairman would be authorized to release a short press statement regarding today's policy decision. A useful purpose would be served in reducing or eliminating potential misinterpretation of the Committee's policy decision and the related risk of overreactions in financial markets at a time of considerable uncertainty and volatility in those markets. The news of the Committee's action would be conveyed unambiguously to the entire public at once and not filtered through the financial markets' interpretation of open market operations. Moreover, the Committee would retain the option of specifying the exact contents and timing of future policy announcements, including intermeeting policy actions. Most of the members concluded that the advantages to the public of prompt release today outweighed the potential disadvantages.

It was agreed that the next meeting of the Committee would be held on Tuesday, May 17, 1994. This meeting adjourned at 2:05 p.m.

At a telephone conference held on March 24, 1994, the Committee approved a temporary increase, from \$700 million to \$3.0 billion, in the Federal Reserve System's reciprocal currency ("swap") arrangement with the Bank of Mexico. Concurrently, the U.S. Treasury announced a \$3 billion swap arrangement between the U.S. Exchange Stabilization Fund and the Bank of Mexico and the Mexican Ministry of Finance. The System's action was effective immediately and, subject to certain conditions, it authorized the Bank of

Mexico to draw on the enlarged arrangement until April 29, 1994, with full repayment of any drawings to be made by July 29, 1994.

A permanent increase in the System's swap arrangement with the Bank of Mexico had been discussed at the Committee's recent meeting on March 22, and it had been contemplated at that meeting that the Committee would vote on such an increase during April in the context of the establishment of a consultative mechanism involving the finance ministries and central banks of Canada, Mexico, and the United States. However, the assassination of a major candidate for the presidency of Mexico on the evening of March 23 had prompted the closing of Mexican financial markets on March 24 and had given rise to concerns regarding possible financial market disorder in reaction to unfolding political developments when those markets reopened. Against this background, the Committee decided to join the U.S. Treasury in an action that would help confirm continued U.S. support for Mexico's economic policies at a potentially critical time for Mexican financial markets.

Votes for this action: Messrs. Greenspan, McDonough, Forrestal, Jordan, Kelley, LaWare, Lindsey, and Parry and Ms. Phillips. Vote against this action: Mr. Broaddus.

Effective April 26, 1994, the Committee by notation vote approved a recommendation by Chairman Greenspan to establish an enlarged swap arrangement of \$3 billion on a permanent basis. As is the case for all swap arrangements, this arrangement is subject to periodic annual review after an initial maturity date of December 15, 1995. Simultaneously, the maturity date of the System's swap facility with the Bank of

Canada was extended by one year to December 15, 1995.

Votes for this action: Messrs. Greenspan, McDonough, Forrestal, Jordan, Kelley, LaWare, Lindsey, and Parry and Ms. Phillips. Vote against this action: Mr. Broaddus.

The enlarged foreign exchange swap arrangement with the Bank of Mexico constituted part of a new trilateral foreign exchange swap facility established in connection with the newly formed consultative group called the North American Financial Group and comprised of the Finance Ministers and Central Bank Governors of Canada, Mexico, and the United States. The purpose of this standing facility is to expand the pool of potential resources available to the monetary authorities of each country to maintain orderly exchange markets. Its establishment at this time was deemed desirable in light of the outlook for expanding and increasingly interdependent economic relationships among the three economies after the successful conclusion of the North American Free Trade Agreement.

The components of the trilateral facility include (1) swap agreements between the United States and Mexico for up to \$6.0 billion, with the Treasury and the Federal Reserve each participating up to \$3.0 billion; (2) an expansion of the swap agreement between the Bank of Canada and the Bank of Mexico to Can\$1.0 billion; and (3) a reaffirmation of the existing swap agreement between the Bank of Canada and the Federal Reserve in the amount of \$2.0 billion, with the above-noted maturity extension.

Mr. Broaddus dissented because he was concerned about the appropriateness of the System's involvement in this type of foreign currency operation. In



his view, the System's swap network raised a number of broad issues that he felt the Committee needed to review at some point. Accordingly, he would not favor increasing any existing swap arrangement until such a review had taken place.

At a telephone conference on April 18, Committee members reviewed economic and financial developments since the March meeting and discussed the desirability of taking further action to move policy away from its still accommodative stance. Broad indicators of economic activity, supported by widespread anecdotal evidence, pointed to considerable momentum in economic activity and further reductions in already limited margins of unutilized labor and other production resources. In financial markets, sharp declines in bond and stock prices suggested that speculative excesses had been reduced, and ongoing portfolio realignments probably were shifting long-term financial assets to firmer hands. As a result, financial markets now appeared to be less likely to overreact to adverse developments or to policy actions. In the circumstances, the members supported the Chairman's decision to reduce the degree of accommodation in reserve markets slightly further at this time rather than to await the next regularly scheduled meeting in mid-May. Some members expressed the view that an increase in the discount rate would provide a desirable supplement to this policy action.

Donald L. Kohn  
Secretary

### Meeting Held on May 17, 1994

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 17, 1994, at 9:00 a.m.

*Present:*

Mr. Greenspan, Chairman  
Mr. McDonough, Vice Chairman  
Mr. Broaddus  
Mr. Forrestal  
Mr. Jordan  
Mr. Kelley  
Mr. LaWare  
Mr. Lindsey  
Mr. Parry  
Ms. Phillips

Messrs. Hoenig, Keehn, and Melzer,  
Alternate Members of the Federal  
Open Market Committee

Messrs. Boehne, McTeer, and Stern,  
Presidents of the Federal Reserve  
Banks of Philadelphia, Dallas,  
and Minneapolis respectively

Ms. Minehan, First Vice President,  
Federal Reserve Bank of Boston

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. Goodfriend, Lindsey,  
Promisel, Simpson, and Stockton  
and Ms. Tschinkel, Associate  
Economists

Ms. Lovett, Manager for Domestic  
Operations, System Open Market  
Account

Mr. Fisher, Manager for Foreign  
Operations, System Open Market  
Account

Mr. Ettin, Deputy Director, Division of  
Research and Statistics, Board of  
Governors

Mr. Slifman, Associate Director,  
Division of Research and  
Statistics, Board of Governors

- Mr. Madigan, Associate Director,  
Division of Monetary Affairs,  
Board of Governors
- Ms. Johnson, Assistant Director,  
Division of International Finance
- Ms. Low, Open Market Secretariat  
Assistant, Division of Monetary  
Affairs, Board of Governors
- Mr. Bennett, Ms. Browne, Messrs.  
Davis, Lang, Rolnick,  
Rosenblum, and Scheld, Senior  
Vice Presidents, Federal Reserve  
Banks of New York, Boston,  
Kansas City, Philadelphia,  
Minneapolis, Dallas, and Chicago  
respectively
- Mr. Judd and Ms. White, Vice  
Presidents, Federal Reserve Banks  
of San Francisco and New York  
respectively
- Messrs. Altig and Coughlin, Assistant  
Vice Presidents, Federal Reserve  
Banks of Cleveland and St. Louis  
respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on March 22, 1994, were approved.

The Manager for Foreign Operations reported on developments in foreign exchange markets and on System open market transactions in foreign currencies during the period March 22, 1994, through May 16, 1994. By unanimous vote, the Committee ratified these transactions.

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 March 22, 1994, through May 16, 1994. 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 expanded substantially on balance thus far in 1994. Favorable business expectations and buoyant consumer sentiment in the context of stronger gains in employment appeared to have sustained strong growth in domestic final demand. Broad measures of inflation had remained subdued and labor cost increases had been moderate, though prices of industrial materials had continued to rise.

Nonfarm payroll employment increased sharply in March and April, in part reflecting a rebound in industries affected by earlier severe winter weather; for the first four months of the year, the average monthly rise exceeded the improved pace of the fourth quarter. Further large advances in employment in the March–April period were recorded in the services sector, notably at personnel supply services firms; hiring in construction was strong after earlier weather-related losses; and the number of jobs in manufacturing continued to expand, although at a somewhat slower pace than in previous months. The civilian unemployment rate registered another slight decline in April, to 6.4 percent, and the average workweek of production or nonsupervisory workers remained at an unusually high level.

Industrial production was up appreciably further in April, with increases widespread across sectors. The pace of motor vehicle assemblies slowed, but much of the indicated slowdown

reflected the effects of seasonal adjustment, which called for increases at a time when manufacturing operations already were at levels close to capacity. Output of public utilities fell again, as electricity generation dropped with the return to less severe weather patterns. Rates of industrial capacity utilization had risen rapidly in recent months and were at very high levels in many industries—especially in motor vehicles, petroleum refining, lumber, and primary metals.

Retail sales were estimated to have fallen in April after two months of very large increases. Despite the April decline, which was widespread by type of retail outlet, outlays were considerably above the first-quarter average. Sales of new and existing homes posted significant gains in March although they remained below their fourth-quarter averages. Housing starts decreased slightly in April but were well above the depressed winter pace. The third consecutive monthly gain in multifamily starts was more than offset by a decline in single-family starts.

Real business fixed investment continued to increase rapidly in the first quarter, but at a less robust pace than in the fourth quarter of 1993. Outlays for producers durable equipment posted another sizable advance, spending for computing equipment surged again, and purchases of most other types of equipment also continued to trend up. Moreover, business demand for automobiles and trucks remained strong. Outlays for nonresidential structures declined sharply in the first quarter, although construction activity showed some recovery in March after the disruptions associated with severe weather during January and February.

Business inventories declined in March, reversing part of the large run-up in stocks that had occurred in the first

two months of the year. For the first quarter as a whole, inventories rose at a slightly slower pace than in the second half of last year. In manufacturing, the accumulation in the first quarter retraced much of the drawdown that had taken place in previous months; the inventory-to-shipments ratio, already at a low level, edged still lower. Wholesale inventories were down on balance over the first quarter, with a large March decline more than retracing increases earlier in the year; the ratio of inventories to sales was well below the range prevailing over the last several years. Retail inventories expanded modestly in the first quarter, and the inventory-to-sales ratio fell slightly.

The nominal deficit on U.S. trade in goods and services was larger on average in January and February than it had been in the fourth quarter. The value of exports in the January–February period was sharply below the unusually strong level in the fourth quarter but was slightly higher than the levels recorded in the first three quarters of 1993. Exports were down in virtually all major trade categories; one important exception was semiconductors, for which exports continued to trend higher. Imports in the two-month period fell by less than exports; nearly all of the decline reflected reduced oil imports. Available indicators for the first quarter pointed to recovery in economic activity at a moderate pace on average in the major foreign industrial countries. Signs of recovery ranged from quite tentative in Japan to relatively well established in the United Kingdom and Canada.

Indexes of consumer and producer prices had increased slightly thus far in 1994. In April, consumer prices posted their smallest rise since January; food prices were up a bit further, but energy prices retraced their March run-up. Excluding the food and energy compo-

nents of the index, consumer prices edged up in April, and over the twelve months ending in April these prices increased less than they had over the previous twelve months. Producer prices of finished goods declined a little in April as prices of finished foods and energy moved down; for items other than food and energy, prices were up slightly in April and for the twelve months ending in April. At earlier stages of processing, the index of producer prices of crude materials other than food and energy was substantially above its year-ago level, despite a small drop in April. At the intermediate stage, the prices of some important construction materials had increased sharply although, overall, prices of nonfood, non-energy goods had risen only modestly over the past twelve months.

Increases in labor costs continued to moderate in early 1994. The employment cost index for private industry workers rose more slowly in the first quarter of 1994 than in any quarter of 1993. The slowdown reflected more moderate growth in both wages and salaries and benefit costs. Hourly compensation increased at a slightly slower pace over the twelve months ending in March 1994 than over the previous year. In April, average hourly earnings of production or nonsupervisory workers on nonfarm payrolls increased moderately after having changed little over February and March.

At its meeting on March 22, 1994, the Committee adopted a directive that called for a slight increase in the 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. The directive stated 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 moderate growth of M2 and M3 over the first half of 1994.

Immediately after the meeting, open market operations were directed toward implementing the slightly less accommodative degree of reserve pressure sought by the Committee. Subsequently, on April 18, against the background of incoming data suggesting considerable momentum and diminishing slack in the economy and of indications that financial markets were less likely to be destabilized by a further policy action, the degree of accommodation in reserve pressures was reduced a little further. The federal funds rate rose  $\frac{1}{4}$  percentage point, to  $3\frac{1}{2}$  percent, after the initial policy action; following the second policy move, the funds rate went up another  $\frac{1}{4}$  percentage point and generally remained near  $3\frac{3}{4}$  percent. Over the intermeeting period, adjustment plus seasonal borrowing averaged slightly above anticipated levels.

Most market interest rates increased by more than the federal funds rate over the period since the March meeting, with the largest increases occurring at intermediate maturities. Weakness in the dollar as well as the release of data suggesting considerable vigor in economic activity appeared to have contributed to the upward pressure on market rates. The bank prime rate was raised  $\frac{3}{4}$  percentage point, to  $6\frac{3}{4}$  percent, while major indexes of stock prices fell substantially.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined somewhat further on balance over the intermeeting period. The dol-

lar's depreciation occurred despite the implementation of less accommodative policy actions in the United States and monetary easing moves in several key foreign countries. Market concerns about political developments in Japan as well as a worsened outlook for progress toward more open trading relationships and for a more stimulative fiscal policy in that country contributed to downward pressure on the dollar. Against the backdrop of a falling dollar, U.S. authorities conducted intervention operations on April 29 and again on May 4. The latter operations were coupled with a statement by Treasury Secretary Bentsen indicating that intervention was being undertaken in response to recent movements in exchange markets that had gone beyond what could be justified by economic fundamentals and was being conducted in concert with operations by other major countries. Subsequent to these actions, the dollar retraced part of its earlier decline.

Growth of M2 and M3 turned up, on balance, in March and April despite the rising short-term opportunity costs of holding deposits. The strengthening of these aggregates seemed to be related to a reassessment by households of the relative attractiveness of investing in capital market instruments; capital losses sparked substantial net redemptions at bond mutual funds over March and April that were accompanied by a surge in flows to retail money market funds and slower runoffs of small time deposits. For the year through April, M2 expanded at a rate somewhat below the middle of its range for 1994, and M3 at a pace somewhat above the lower end of its range. Total domestic nonfinancial debt continued to expand at a moderate rate over recent months.

The staff forecast prepared for this meeting suggested that economic activity, after rebounding from the disrupt-

tions caused by adverse weather conditions earlier in the year, would expand in the second half of 1994 at a rate close to the growth of the economy's potential. Consumer spending, which had outpaced gains in household income for some time, was projected to slow to a growth rate more in line with the expansion of income; with pent-up demands apparently reduced and somewhat higher interest rates exerting a damping effect, much of the slowing was expected to be centered on outlays for durable goods. Business fixed investment would be restrained by the slower growth of business output and the associated moderation of corporate cash flows but would continue to advance at a faster rate than overall economic activity. Homebuilding was projected to remain at a pace that was relatively robust compared with the rate of recent years, though a bit below that of the fourth quarter. The restraint on output growth from federal spending cutbacks and weak export demand was expected to diminish somewhat. In light of limited margins of slack in labor and product markets over the forecast horizon, little or no further reduction in the core rate of inflation was anticipated.

In the Committee's discussion of current and prospective developments, members commented on widespread indications, both statistical and anecdotal, of considerable momentum in the economic expansion. Business activity seemed to be rebounding smartly from the disruptive effects of unusually severe winter weather, and it appeared that the expansion over the first half of the year was likely to be a little stronger than had been expected at the time of the March meeting. A deceleration in activity still seemed to be in train for the second half, but the extent of such a slowing was an important source of uncertainty in the outlook. The members

continued to see moderate growth at a rate in line with or slightly above the economy's potential as the most likely prospect, but the overall momentum of the expansion and the still accommodative stance of monetary policy suggested that there was an appreciable risk of faster growth for a period, with consequent implications for greater pressures on resources. At the same time, the members saw relatively few signs of the kinds of imbalances that would pose a significant downside potential for the economy, although some cautioned that the rise in long-term interest rates, recently weaker data on production and sales, and continuing anxiety about job security in an environment of corporate restructuring contributed elements of fragility to what was otherwise a healthy outlook. The near-term prospects for inflation were favorable. Wage and price trends generally remained moderate; the persisting high rate of business investment bode well for further enhancements of productivity; and competitive pressures, including those from imported goods, were restraining efforts by firms to raise prices. The members were concerned, however, that in an environment in which slack in the economy already had been reduced to a fairly low level and could decline further in the quarters ahead, inflation could begin to rise unless monetary policy were adjusted further from its accommodative stance.

In their comments about developments across the nation, members took note of the considerable strength in economic conditions in many parts of the country. However, they also recognized that some parts of the nation were experiencing relatively subdued growth and that economic activity remained depressed in other areas such as Southern California and Hawaii. The strong forward momentum in the economy was

most clearly evident in interest-sensitive sectors, including motor vehicles, other durable goods, and housing. The rise in interest rates over the course of recent months was cited by business contacts as a potential source of restraint on interest-sensitive expenditures, but thus far relatively few contacts had reported actual examples of adverse interest rate effects on spending. While higher rates would constrain aggregate demand going forward, their effects probably would be offset in part by more aggressive lending practices at banks and other institutions. At the same time, reports of industries that were operating at or near capacity limits were becoming more numerous, and capacity constraints were said to be limiting some sales.

With regard to the outlook for key sectors of the economy, consumer expenditures were viewed by many members as likely to be well maintained, particularly for motor vehicles and other consumer durables. Reports from various parts of the country indicated that sales had tended in many areas to exceed retailers' expectations by a considerable margin in recent months. Some members noted, however, that sales had been less ebullient since late winter and cited factors that might work to restrain somewhat the growth of consumer spending. These included high and rising debt levels, declines in household wealth owing to the drop in stock and bond prices, and the effects on consumer confidence of ongoing workforce reductions associated with business restructuring. Higher interest rates also might limit the pace at which pent-up demands would continue to be satisfied. On balance, in the view of a number of members, growth in consumer spending seemed likely to moderate to a pace close to the growth in incomes.

Members expected business fixed investment to continue to expand at a

pace substantially above that of the economy as a whole. With production straining capacity limits in a number of industries and firms striving for cost savings and productivity improvements to maintain their competitiveness, real outlays for producers' durable equipment were likely to stay on a strong upward trend despite an anticipated deceleration in business output and the recently increased cost of external capital associated with higher interest rates and lower equity prices. It was noted in this connection that order books at producers of capital equipment had grown considerably. Nonresidential construction appeared to be rebounding from the disruptive effects of unusually severe winter weather conditions; however, the pattern of construction activity across the nation was mixed, with some areas of the country displaying considerable strength in activity and other areas still depressed. The construction of office buildings for the most part remained at very low levels, but anecdotal reports indicated that markets for office space, especially those that had been hard hit in recent years, seemed to be improving considerably in some locales. Business inventories remained quite lean by historical standards, and some reports suggested that efforts to augment stocks had been negated by strong sales. With survey reports indicating that order backlogs had grown and lead times on materials deliveries had lengthened, the possibility was increasing that desired inventory ratios might be adjusted upward and some pickup in inventory investment might get under way, especially in manufacturing where stocks-to-sales ratios recently had fallen to new lows.

Residential construction was indicated to be robust across much of the country, with activity picking up rapidly in the aftermath of the unusually severe

winter. The affordability of housing remained high by historical standards, and the appeal of home ownership had been enhanced somewhat by the apparent firming of house prices over the past year. In these circumstances, housing activity had been well sustained, although there were some indications that the higher mortgage rates now prevailing had begun to damp residential investment.

The foreign trade sector was expected to continue to exert some drag on economic growth, but the members saw this as likely to lessen as an anticipated gradual pickup in economic activity among key trading partners bolstered demand for U.S. exports while imports were restrained by a projected moderation in the growth of U.S. domestic demand. In the view of one member, the export sector would tend to sustain and perhaps become an important stimulus to growth in the United States as earlier declines in the dollar, taken in conjunction with technological improvements and higher product quality, enhanced the competitiveness of U.S. exports.

In their discussion of the outlook for prices and wages, the members noted that broad measures of inflation remained subdued and increases in labor costs had been moderate. Nevertheless, they continued to be concerned that inflation could begin to rise if growth in excess of potential were to persist and margins of unutilized production resources were to shrink further, or even disappear. Production already had reached capacity limits in a number of industries, including motor vehicles and steel, and prices of some raw materials and intermediate goods had risen substantially over the past year. Ongoing efforts to expand production capacity through productivity-enhancing investment and the hiring of additional workers were likely to be of some help in

meeting growing demands, but an increasing number of contacts were reporting that business firms were taking advantage of opportunities to adjust prices upward. There also were indications of shortages of qualified workers in some labor markets or industries, but to date there were only limited signs of upward wage pressures and these did not seem to signal a near-term emergence of general upward cost pressures on prices. Indeed, even with sales strong, many business contacts were reporting that intense competition, in part from imports, was curbing or negating efforts to raise prices. Firms were continuing to look primarily to improvements in productivity and quality to bolster their profit margins, although there also were reports that price discounting was lessening and that sales promotions were becoming less frequent. Price and wage pressures were most clearly evident and widespread in the construction industry, where resource constraints appeared to be most pronounced.

In the Committee's discussion of monetary policy for the period until the meeting in early July, the members favored prompt further action to remove much of the remaining accommodation in the stance of monetary policy, at least as measured by real short-term interest rates. Many members commented that the expansion was on a solid and self-sustaining basis and appeared to have more underlying strength than they had foreseen earlier. The stimulative effects of an expansionary monetary policy had become increasingly apparent—especially in business purchases of capital equipment and consumer spending on housing, motor vehicles, and other consumer durables. At the same time, the constraints on economic expansion that had been associated with business restructuring activities, widespread efforts to strengthen balance sheets, and

other retarding forces had diminished considerably. The financial health of the banking system was greatly improved, and banking institutions had evidenced a growing willingness to make new loans. Moreover, the demand for bank loans, which had been sluggish for several years, now appeared to be on the rise. While a series of small steps earlier this year had already reduced the degree of accommodation in monetary policy and inflation was subdued for the time being, the members were concerned that continued policy accommodation could be expected to lead before long to growing pressures on production resources and to a fresh outbreak of inflation.

In the circumstances, all the members agreed that a further tightening action was needed at this point; and, in order to better ensure that the remaining degree of policy accommodation had been largely removed, the adjustment should fully reflect the  $\frac{1}{2}$  percentage point increase in the discount rate that the Board of Governors was expected to approve later in the day. The actions taken earlier in the year had been modest in size because of concerns that more aggressive steps might generate substantial uncertainty and undue disruptions in financial markets, with adverse consequences for the economy. Even though financial markets remained volatile, speculative sentiment and holdings seemed to have been reduced to a marked extent, and financial markets appeared to be in a much better position to absorb needed policy adjustments. Accordingly, a stronger action probably would not produce an unduly adverse market response and could well have a settling effect on the markets. A number of members cautioned that the Committee could not be sure that today's policy actions, along with those implemented earlier this year, had produced a policy stance that would foster economic



growth at a sustainable, non-inflationary pace. Thus, the Committee would have to remain alert to economic and financial developments that might signal the need for further tightening.

In the Committee's discussion of possible intermeeting adjustments to the degree of reserve pressure, all but one of the members indicated a preference for retaining a symmetric directive. Symmetry would be consistent with a judgment that further policy adjustment likely would not be needed during the intermeeting period ahead and, in particular, that additional tightening would not be triggered unless inflation pressures greater than those currently anticipated were to emerge. The adoption of a symmetric directive would not preclude an intermeeting consultation and possible adjustment by the Chairman on behalf of the Committee if such were warranted by intermeeting developments. One member expressed a preference for an asymmetric directive. In his view, a symmetric directive might be mistakenly interpreted both in the United States and abroad as a signal that the Committee believed that policy neutrality definitely had been achieved and that there was no need to allow for the possibility of further tightening.

At the conclusion of the Committee's policy discussion, all the members indicated they could support a directive that called for increasing somewhat the degree of pressure on reserve positions, taking account of a possible increase in the discount rate, 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 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 that economic activity has expanded substantially on balance thus far in 1994. Nonfarm payroll employment increased sharply in March and April, in part reflecting a rebound in sectors affected by severe winter weather; the civilian unemployment rate fell slightly further in April, to 6.4 percent. Industrial production was up appreciably in April after a strong rise over the previous two quarters. Advance data on retail sales indicate a decline in April, after very large increases in February and March. Housing starts fell slightly in April but remained well above the depressed winter pace. Orders for nondefense capital goods point to a continued strong uptrend in spending on business equipment, while nonresidential building has shown some recovery after severe weather disrupted construction during January and February. The nominal deficit on U.S. trade in goods and services widened on average in January and February from the fourth-quarter rate. Increases in broad indexes of consumer and producer prices remained moderate through April, though prices of industrial materials continued to rise.

Market interest rates have posted large additional increases since the Committee meeting on March 22, 1994. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined somewhat further on balance over the intermeeting period.

Growth of M2 and M3 picked up on average in March and April; for the year through April, M2 expanded at a rate somewhat below the middle of its range for 1994 and

M3 at a pace somewhat above the bottom of its range. Total domestic nonfinancial debt has expanded at a moderate rate in recent months.

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 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1993 to the fourth quarter of 1994. The Committee anticipated that developments contributing to unusual velocity increases could persist during the year and that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was set at 4 to 8 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 increase somewhat the existing degree of pressure on reserve positions, taking account of a possible increase in the discount rate. 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, Broaddus, Forrestal, Jordan, Kelley, LaWare, Lindsey, and Parry and Ms. Phillips. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, July 5–6, 1994.

The meeting adjourned at 12:45 p.m.

Donald L. Kohn  
Secretary

## Meeting Held on July 5–6, 1994

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., beginning on Tuesday, July 5, 1994, at 2:30 p.m. and continuing on Wednesday, July 6, 1994, at 9:00 a.m.

### *Present:*

Mr. Greenspan, Chairman  
Mr. McDonough, Vice Chairman  
Mr. Blinder  
Mr. Broaddus  
Mr. Forrestal  
Mr. Jordan  
Mr. Kelley  
Mr. LaWare  
Mr. Lindsey  
Mr. Parry  
Ms. Phillips

Messrs. Hoenig, Keehn, and Melzer,  
Alternate Members of the Federal  
Open Market Committee

Messrs. Boehne, McTeer, and Stern,  
Presidents of the Federal Reserve  
Banks of Philadelphia, Dallas,  
and Minneapolis respectively

Mr. Conrad and Ms. Minehan, First  
Vice Presidents, Federal Reserve  
Banks of Chicago 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. Beebe, Goodfriend, Lindsey,  
Promisel, Siegman, and Simpson  
and Ms. Tschinkel, 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
- Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
- Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors
- Mr. Struckmeyer and Ms. Zickler, Assistant Directors, Division of Research and Statistics, Board of Governors
- Ms. Edwards<sup>4</sup> and Mr. Oliner,<sup>4</sup> Economists, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors
- Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors
- Mr. Bennett, Ms. Browne, Messrs. Davis, Dewald, Lang, Rolnick, Rosenblum, and Scheld, Senior Vice Presidents, Federal Reserve Banks of New York, Boston, Kansas City, St. Louis, Philadelphia, Minneapolis, Dallas, and Chicago respectively
- Messrs. Guentner and Sniderman, Vice Presidents, Federal Reserve Banks of New York and Cleveland respectively

Secretary's Note: Advice had been received that Alan S. Blinder had executed his oath of office as a member of the Federal Open Market Committee.

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 17, 1994, were approved.

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

The Manager for Foreign Operations reported on developments in foreign exchange markets and on System open market transactions in foreign currencies during the period May 17, 1994, to July 5, 1994. The Committee ratified these transactions.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Broaddus, Forrestal, Kelley, LaWare, and Parry and Ms. Phillips. Votes against this action: Messrs. Jordan and Lindsey.

Messrs. Jordan and Lindsey dissented from this action, although they agreed that the foreign exchange transactions conducted during the intermeeting period were authorized under the Committee's rules. Their dissents were based on their strong reservations about the efficacy of sterilized intervention in most circumstances, including those prevailing during the intermeeting period. In their view, to the extent that repeated intervention failed to achieve stated or perceived objectives, questions would tend to arise about the credibility of monetary policy more generally.

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 May 17, 1994, to July 5, 1994. 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 recorded another substantial gain in the second quarter. Although consumer spending and homebuying apparently had increased at a slower pace, business spending on durable equipment remained quite strong and investment in nonresidential structures rebounded from a weather-depressed level in the first quarter. In addition, the rate of non-farm inventory investment evidently had picked up in the second quarter. Levels of resource utilization had risen further: Factory operating rates were at relatively high levels, and the slack in labor markets had narrowed considerably over the first half of the year to what appeared to be very low levels. Increases in consumer and producer prices had remained moderate in recent months, but prices of many basic industrial materials had risen.

Nonfarm payroll employment advanced somewhat less rapidly in May after the brisk increases of recent months; however, the average workweek of production and nonsupervisory workers reached its highest level since 1987. The reduction in job gains was widespread by sector—including business services; finance, insurance, and real estate; manufacturing; and construction. Employment in transportation rebounded, reflecting the end of a Teamsters strike. The civilian unemployment rate, measured on the new basis introduced in January, declined sharply in May, to 6.0 percent; the decline might have been overstated as a result of seasonal adjustment problems, but even after correcting for these factors, the unemployment rate had fallen sharply since late 1993.

The rise in industrial production slackened in April and May after strong first-quarter gains. Much of the slowing was the result of capacity constraints

that prevented normal seasonal increases in the production of motor vehicles. Growth of output of manufactured goods other than motor vehicles and parts was at a slightly less robust pace than in the first quarter but close to the rapid rate seen in 1993; business equipment and construction supplies continued to be areas of strength. The overall rate of utilization in manufacturing stayed at a high level in May, with most major industry groups operating at or near capacity. In addition to motor vehicles, capacity constraints were evident in the petroleum products and non-electrical machinery industry groups and in some individual product lines in other industries.

Real personal consumption expenditures fell on balance in April and May after a strong advance earlier in the year, but the level of expenditures for the two months combined was a little above the first-quarter average. The recent slowdown in consumer spending in large part reflected reduced outlays for motor vehicles. Spending for durable goods other than motor vehicles increased over April and May at about the first-quarter pace. Outlays for nondurable goods were down on balance in April and May, while spending for services in May more than reversed a small April decline. Housing activity had rebounded from weather disruptions early in the year to a pace close to the elevated fourth-quarter rate. Single-family starts edged down in May after declining substantially in April but were still at a relatively high level. While the cash-flow affordability of home ownership had fallen since late last year, it remained at favorable levels in comparison with recent years. Multi-family starts in May were at their highest level in more than three years; most of the pickup occurred in the South, where vacancy rates had declined recently.

Shipments of nondefense capital goods other than aircraft and parts posted a further solid gain in May, although the upward trend appeared to have moderated in recent months. Sales of heavy trucks also were strong in April and May. Shipments of aircraft declined sharply in April (latest available data), retracing much of a March surge. Available data on orders for nondefense capital goods pointed to a continued strong uptrend in business spending on durable equipment. Nonresidential construction picked up in April and May from a weather-depressed slump in the first quarter.

Business inventories increased in April, more than reversing a March runoff; the overall pace of accumulation remained moderate, and buildups were largely concentrated in segments of the economy where market demand was robust. In manufacturing, inventories increased in April and May after a small drawdown in March. The rise in stocks was in line with shipments, and the ratio of stocks to shipments stayed at a very low level. In April (latest available data), wholesale inventories retraced most of the sizable March drawdown. The ratio of inventories to sales in this sector remained below the range that has prevailed in recent years. At the retail level, inventory stocks again edged higher; the inventory-to-sales ratio for this sector was well within the range observed over the past year.

The nominal deficit on U.S. trade in goods and services widened in April but was little changed from the average for the first quarter; over the first four months of 1994, the deficit was significantly larger than that recorded in the fourth quarter of last year. The value of exports of goods and services was down somewhat in April, retracing part of a sharp runup in March. The uptrend in exports since last fall has been led by

shipments of machinery, especially to expanding markets in Asia. The value of imports of goods and services was about the same in April as in March; increases in consumer goods, machinery, and oil were offset by declines in other categories. The economies of all the major foreign industrial countries expanded in the first quarter of 1994. Growth resumed in Japan, western Germany, and France, while economic expansion continued at a healthy pace in the United Kingdom and Canada.

Broad indexes of consumer and producer prices had risen moderately through the first five months of the year. In May, the rise in the overall index of consumer prices continued to be held down by declines in energy prices. Excluding the food and energy components, the increase in consumer prices in the twelve months ending in May was smaller than that for the previous twelve months. Producer prices of finished goods continued to edge lower in May, reflecting further declines in prices of finished foods and energy goods. Producer prices for items other than food and energy increased at a faster rate in May, but the change over the twelve-month period ending in May was very small. At an earlier stage of processing, producer prices of crude materials other than food and energy registered another small decline in May, although the index was substantially higher in May than a year ago. Furthermore, prices of many basic industrial materials remained under upward pressure. Average hourly earnings of production or nonsupervisory workers increased by a larger amount in May than in April, but the rise over the twelve months ended in May was about the same as in the previous twelve months.

At its meeting on May 17, 1994, the Committee adopted a directive that called for increasing somewhat the

degree of pressure on reserve positions, taking account of a possible increase in the discount rate. The directive did not include a presumption about the likely direction of any further adjustment to policy during the intermeeting period. The directive stated 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.

Immediately after the conclusion of the May meeting, the Board of Governors approved a  $\frac{1}{2}$  percentage point increase in the discount rate, to  $3\frac{1}{2}$  percent, and the Committee permitted the full amount of the increase to pass through to interest rates in reserve markets. Thereafter, open market operations were conducted with a view to maintaining the less accommodative degree of reserve pressure sought by the Committee. After the policy change, the federal funds rate rose  $\frac{1}{2}$  percentage point, to  $4\frac{1}{4}$  percent, and remained at about that level over the intermeeting period. Adjustment plus seasonal borrowing trended higher over the intermeeting period, reflecting the usual seasonal pickup in lending activity, and averaged close to anticipated levels.

Market interest rates on instruments with more than three-month maturities moved lower immediately following the announcement of the Committee's action, although some very short-term interest rates moved up. The commercial bank prime rate also was raised by  $\frac{1}{2}$  percentage point, to  $7\frac{1}{4}$  percent. Market participants apparently interpreted the policy actions and the accompany-

ing announcement as signaling that the System would not take further tightening actions as soon as they had anticipated earlier. Incoming data suggesting sluggish spending and subdued inflation tended to confirm these market assessments. Late in the intermeeting period, however, bond yields retraced their earlier declines, partly in association with a weakening dollar in foreign exchange markets and rising commodity prices. Most major indexes of equity prices rose early in the intermeeting period, but they then moved lower in sympathy with the declines in bond prices and the dollar and ended the period with small losses.

The trade-weighted value of the dollar in terms of the other G-10 currencies fell significantly further on balance over the intermeeting period. The renewed decline, which began toward the middle of June, occurred in response to indications of an improved economic outlook abroad, associated increases in foreign bond yields, and heightened concerns about possible increases in U.S. inflation. Developments suggesting less favorable prospects for progress in U.S.-Japanese trade negotiations also tended to strengthen the yen against the dollar.

The broad monetary aggregates were weaker than the Committee anticipated at the time of its previous meeting, with both M2 and M3 declining on average over May and June. The declines appeared to be related in part to the continuing appeal of capital market instruments. More generally, however, the rise in short- and long-term interest rates since the beginning of 1994, coupled with the reluctance of banks and other depository institutions to adjust their offering rates promptly, had produced a widening of the opportunity costs of holding deposits and had led households to move deposit monies into direct and indirect holdings of market

instruments. For the year through June, both M2 and M3 were at the bottom of the Committee's ranges for 1994, and total domestic nonfinancial debt had expanded at a moderate rate in the lower half of its monitoring range.

The staff forecast prepared for this meeting suggested that the economy was operating at a level close to capacity and that the expansion would slow over the next several quarters to a rate generally in line with the growth of the economy's potential. To the extent that aggregate demand tended to expand at a pace that could foster higher inflation, it would not be accommodated by monetary policy, and pressures would be generated in financial markets that would restrain domestic spending. Consumer spending, which had been increasing faster than household income for some time, was expected to moderate as smaller gains in employment and income, coupled with higher interest rates and reductions in the value of household financial assets, exerted a restraining influence on consumption patterns. Business fixed investment was projected to continue at a brisk pace, although growth would be damped somewhat by the expected deceleration in economic activity, a growing shortfall of corporate cash flow relative to capital outlays, and higher financing costs. The effects of higher mortgage interest rates were expected to cause some slowing in the relatively robust pace of single-family homebuilding. The restraint on output growth exerted by weak export demand was expected to diminish because of the lower value of the dollar and the somewhat faster recovery now projected in economic activity abroad. The staff analysis suggested that, with the economy already operating close to its long-run potential, no further reduction in the core rate of inflation was likely over the forecast horizon.

In the Committee's discussion of current and prospective economic developments, members commented that the expansion continued to display considerable momentum, with business activity apparently still increasing at a pace above the economy's long-run growth potential. At the same time, indications of some slowing in aggregate demand had tended to increase over the past few months. The extent of that slowing remained subject to considerable uncertainty, especially in light of somewhat disparate data on employment and spending. Nonetheless, it was generally agreed that, in the context of appropriate fiscal and monetary policies, some moderation in economic growth to a pace closer to that of the economy's long-run potential was a reasonable expectation. Such a slowing seemed necessary to forestall a buildup of inflation pressures in the view of many members. A number of members emphasized that remaining margins of unemployed labor and other production resources, while difficult to assess, now appeared to be quite limited. Although views differed to some degree, the members generally concluded that the various factors affecting the course of inflation were likely to result, on balance, in little change, or perhaps a small rise, in inflation over the 1994-95 forecast horizon. Some members regarded the risks of a significant divergence from their forecasts of economic growth and inflation as fairly evenly balanced in either direction, but most believed that those risks were tilted to the upside.

In keeping with the usual practice at meetings when the Committee considers its long-run objectives for growth of the money and debt aggregates, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members provided specific individual projections of growth in real

and nominal GDP, the rate of unemployment, and the rate of inflation for the years 1994 and 1995. The central tendency of the forecasts of the rate of expansion in real GDP for 1994 as a whole was 3 to 3¼ percent, a little below the rate of growth estimated for the first half of the year; for 1995, the projections had a central tendency of 2½ to 2¾ percent. With regard to the expansion of nominal GDP, the forecasts centered on growth rates of 5½ to 6 percent for 1994 and 5 to 5½ percent for 1995. The projections of more moderate growth in economic activity were associated with rates of unemployment in a range of 6 to 6¼ percent in the fourth quarters of both 1994 and 1995, about the same as the average unemployment rate in recent months. For the rate of inflation, as measured by the CPI, the projections had a central tendency of 2¾ to 3 percent for 1994 and 2¾ to 3½ percent for 1995; both ranges represented a slight increase from the average rate over the past year. Favorable developments in the food and energy sectors, which had held down overall inflation measures over the past several quarters, were not expected to continue and the drop in the dollar would be exerting upward pressures on prices in coming quarters.

Pursuant to a request from the Chairman of the Senate Banking Committee, the members considered extending their specific forecasts by an additional year. Many expressed reservations about the reliability and thus the usefulness of numerical forecasts extending relatively far into the future. Moreover, they were concerned about misunderstandings of specific long-range forecasts in relation to the Committee's goals and the ongoing formulation of monetary policy. The members concluded that, on balance, the Committee's policy intentions and expectations would be con-

veyed more effectively by the Chairman in his upcoming congressional testimony through a discussion of the important factors bearing on trends in economic growth, prices, and unemployment; the uncertainties involved in projecting such variables; and the role of monetary policy in achieving desired economic goals. Committee members noted that the Administration's medium-term outlook contained reasonable estimates of the trend growth in output.

In their review of developments in different parts of the country and sectors of the economy, members referred to indications of continuing growth in regional business activity ranging from relatively modest to quite robust across much of the nation; at the same time, some areas such as California continued to experience generally stagnant economic conditions. While solid growth seemed to characterize the overall economy, the members saw increasing signs of some slowing in many areas. Business and consumer sentiment generally remained quite positive, although a number of members commented on a new note of caution among some of their business contacts and some shaving of industry forecasts for the balance of the year.

Turning to the key consumer sector, members commented on various indications of some moderation in the growth of expenditures. Higher interest costs were cited by some business contacts as constraining purchases of consumer durables, but members also referred to the negative impact of persisting, highly visible cutbacks in workforces by some major business firms and of growing consumer debt. Some members also noted that supply constraints, such as limitations on the availability of some popular automobile models, had tended to curb the expansion in sales. Looking ahead, more moderate growth in con-



sumer spending seemed likely; apart from the direct effects of higher interest rates on such spending, the prospectively less ebullient housing sector was likely to retard demands for household furnishings.

Business fixed investment was thought likely to continue to provide appreciable stimulus to the expansion, though to a diminishing extent in the context of slower overall growth in economic activity and higher financing costs. While spending for equipment was likely to moderate considerably from the extraordinarily rapid increases recorded over an extended period, ongoing business efforts to improve operating efficiencies would probably sustain substantial further growth in equipment outlays. Nonresidential construction expenditures were expected to post moderate increases after stagnating earlier; in this connection, a number of members observed that commercial vacancy rates were declining in various metropolitan areas and improved demand for space was likely to generate increased construction activity. Although higher interest costs could have some restraining effect, financing for such projects was more readily available than earlier. The outlook for inventory investment remained uncertain. Some buildup in inventories was occurring, but business firms were continuing to resist sizable increases and inventory-to-sales ratios remained at unusually low levels. Developments that might be expected to foster a faster buildup, such as some lengthening of order lead times and rising pressures on capacity in some industries, had not led to the strengthening in inventory investment that had characterized comparable stages of previous business cycle expansions.

Members observed that the outlook for exports appeared to have improved

and that foreign trade, on net, probably would make a small contribution to economic growth over the next several quarters. Some noted that business contacts were reporting strong foreign demand for various U.S. products. As members had noted at previous meetings, the North American Free Trade Agreement appeared to have stimulated increased trade between Mexico and the United States, although it was still too early to gauge the extent of this development. More generally, the decline in the foreign exchange value of the dollar and a somewhat greater strengthening in the economies of major trading partners than was expected earlier had enhanced the prospects for appreciable growth in U.S. exports, and in the view of at least some members that growth might prove to be considerably greater than was currently projected.

Members remarked that uncertainties about remaining margins of slack in the economy, accentuated by the change in the household employment survey, and about potential levels of economic activity over the quarters ahead made it particularly difficult to assess the outlook for inflation. However, based on what seemed to be reasonable estimates of resource utilization levels and their own projections that the rate of economic growth would slow to a pace nearer the economy's growth potential, the members generally concluded that the rate of inflation, as measured by the CPI, might remain about unchanged or tilt slightly higher over the forecast horizon. This conclusion took into account the effects of the decline in the foreign exchange value of the dollar, the increase in oil prices on world markets, and the at-least-temporary rise in food prices. Some members observed that the overall behavior of prices had been somewhat more favorable than they would have predicted, given the strength of the

expansion and the level of resource utilization. One explanation could be that increases in overall capacity and productivity stemming from business restructuring activities and investments in new equipment and facilities had been greater than expected. Comments from numerous business contacts around the country continued to indicate that despite the rising costs of many materials used in the production process, highly competitive markets rendered it very difficult or impossible to pass these higher costs through to prices of finished goods. At the same time, labor compensation increases had remained subdued despite indications of shortages of some types of labor in many parts of the country. Exceptions involving sizable wage increases continued to be cited for some industries, such as construction and trucking, that were operating at full capacity. Nonetheless, in the absence of an uptrend thus far in consumer price inflation and given continuing uncertainties about job prospects despite large job gains, wage pressures had remained restrained.

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 1994 and it decided on tentative ranges for growth in those aggregates in 1995. The current ranges set in February for the period from the fourth quarter of 1993 to the fourth quarter of 1994 included expansion of 1 to 5 percent for M2 and 0 to 4 percent for M3. A monitoring range for growth of total domestic non-financial debt had been set at 4 to 8 percent for 1994.

In the Committee's discussion, which as in the past tended to focus on M2, all the members indicated that they were in

favor of retaining the current ranges for M2 and M3 for 1994 and extending those ranges on a provisional basis to 1995. In their evaluation of appropriate growth ranges for 1994, the members anticipated that the projected moderation in the expansion of nominal GDP and the likelihood that funds would continue to be diverted from deposits to higher yielding market instruments would be reflected in relatively sluggish growth in M2 and M3 and further increases in their velocity—the ratio of nominal GDP to these monetary measures. In the circumstances, expected growth in M2 and M3 at rates around the lower end of their ranges would be consistent with the Committee's overall objective of fostering financial conditions that would promote sustainable economic growth and contain pressures on prices. Indeed, that objective might even imply a shortfall from current ranges, but a shortfall could be tolerated and explained if it reflected a greater-than-expected rise in velocities associated with an acceptable economic performance. While growth of the broad monetary aggregates might pick up somewhat next year, it probably would remain damped relative to income. In light of this prospect, and of the uncertainties about appropriate monetary growth in 1995, the Committee decided to carry forward the 1994 ranges, subject to a review early next year. The Committee noted that the current ranges, which had been reduced greatly over the years, could be viewed as long-run benchmarks for monetary growth consistent with maximum sustainable economic expansion in a noninflationary environment, if there were a return to more normal velocity behavior. The Committee recognized that considerable uncertainty about the behavior of velocity was likely to persist and that a broad range of financial and economic indica-

tors, in addition to the monetary aggregates, would need to be monitored in determining the appropriate course for monetary policy.

In their review of the Committee's monitoring range for the growth of total domestic nonfinancial debt, the members agreed that the current range for 1994 should be retained. This view took into account staff projections indicating that the debt aggregate was likely to grow within its present range this year, albeit the lower half of that range. Considerable sentiment was expressed, however, for reducing the debt monitoring range for 1995. Debt growth was expected to remain relatively subdued in association with projections of a slower rate of expansion in nominal GDP. Lowering the range would underscore the Committee's view that rapid debt growth, should it materialize and be sustained, could have adverse implications for inflation and financial stability. Members emphasized, however, that action to adjust the debt range did not imply increased Committee emphasis on the debt aggregate, and most believed that the risks of any misinterpretation could be minimized by including an appropriate explanation in the report to the Congress.

At the conclusion of this discussion, the Committee voted to reaffirm the ranges for growth of M2 and M3 and the monitoring range for growth of total domestic nonfinancial debt that it had established in February for 1994. The following statement was approved for inclusion in the Committee's 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 reaffirmed at this meeting the ranges it had established in February for growth of M2 and M3 of 1 to

5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1993 to the fourth quarter of 1994. The Committee anticipated that developments contributing to unusual velocity increases could persist during the year and that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was maintained at 4 to 8 percent for the year.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Broaddus, Forrestal, Jordan, Kelley, LaWare, Lindsey, and Parry and Ms. Phillips. Votes against this action: None.

For the year 1995, the Committee approved provisional ranges for M2 and M3 that were unchanged from the 1994 ranges. The Committee reduced the monitoring range for growth in total domestic nonfinancial debt by 1 percentage point from 1994 to a range of 3 to 7 percent. Accordingly, the Committee voted to incorporate the following statement regarding the 1995 ranges in its domestic policy directive:

For 1995, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1994 to the fourth quarter of 1995, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the associated monitoring range for growth of domestic nonfinancial debt at 3 to 7 percent for 1995. 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, McDonough, Blinder, Broaddus, Forrestal, Jordan, Kelley, LaWare, Lindsey, and Parry and Ms. Phillips. Votes against this action: None.

In the Committee's discussion of policy for the intermeeting period ahead, most members endorsed a proposal to

maintain an unchanged degree of pressure in reserve markets. The economy seemed to be slowing, although to an uncertain extent. Earlier policy tightening actions were being reflected in the sluggish behavior of money and reserves, although the extent of their effects on spending were still in question. Inflation was a concern, but direct evidence of additional pressures on costs and prices was quite fragmentary. In these circumstances, all but one of the members concluded that it would be prudent for the Committee to assess further developments before taking any action. One member believed that prompt further tightening was needed to avert the development of greater inflation.

In the discussion of the near-term course of policy, the members took account of the substantial weakness of the dollar in foreign exchange markets over the course of recent weeks. By itself, the drop in the dollar could put some pressure on resources and prices. However, the members agreed that these effects needed to be considered in the context of overall prospects for the economy and financial markets, and policy should not be focused narrowly on the dollar alone. In any case, given the negative sentiment in the foreign exchange markets, the effects on the dollar that would flow from a small change in policy were uncertain. Ultimately, the most effective support that monetary policy could provide for the dollar was to foster the objectives of sustainable economic growth and progress toward price stability.

With regard to possible changes in policy during the intermeeting period, a majority favored a change in the intermeeting instruction in the directive from symmetry to asymmetry toward restraint. Some of the members indicated that near-term developments were

not likely to call for an adjustment to policy. Nonetheless, the risk of inflationary momentum in the expansion remained high, given an economy that appeared to be operating at or very close to full capacity, and they believed that the probable direction of the next policy move was likely to be in the direction of restraint. Some emphasized that such a move should be made promptly in response to information suggesting a greater potential for inflation. In the view of many though not all members, the costs of policy errors were asymmetrical at this point. The costs of reversing a policy stance that turned out to be slightly too tight would be limited to somewhat slower economic growth for a time; the expansion appeared to be so well established at this juncture that the risks of a greater economic adjustment were remote. On the other hand, a policy that turned out to be unduly stimulative would foster greater inflation and inflationary expectations that probably could be reversed only at the cost of considerable disruption in financial markets and the economy. It also was noted that an asymmetric directive would underscore the Committee's determination to resist greater inflation; the asymmetry could be viewed as a logical extension of the strategy adopted in February to move to a policy stance consistent with averting inflationary pressures in a firmly established expansion.

Some members indicated a preference for retaining a symmetric directive. These members did not rule out the possible need for further policy tightening, but they believed that the risks surrounding current forecasts were about evenly weighted in both directions. One member expressed strong reservations about the use of an asymmetric directive on the grounds that such language made intermeeting changes more likely and

in the view of that member markets reacted more favorably when actions were taken and announced at regular meetings. However, all those favoring a symmetric directive with an unchanged policy stance could accept an asymmetric intermeeting instruction.

At the conclusion of the Committee's discussion, all but one of the members indicated that they could support a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward the 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 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 that economic activity recorded another substantial gain in the second quarter, causing levels of resource utilization to rise further. Increases in nonfarm payroll employment have been relatively large on average in recent months; the civilian unemployment rate is reported to have declined to 6.0 percent in May. The rise in industrial production slackened in April and May, primarily because capacity constraints prevented normal seasonal increases in the

production of motor vehicles. Growth in consumer spending has slowed in recent months after very large increases in February and March. Housing starts have rebounded from winter disruptions to a pace close to the elevated fourth-quarter level. Orders for non-defense capital goods point to a continued strong uptrend in spending on business equipment, while nonresidential construction has recovered from a weather-depressed level in the first quarter. The nominal deficit on U.S. trade in goods and services was larger in April than in March but about unchanged from the average for the first quarter. Increases in broad indexes of consumer and producer prices have remained moderate in recent months, though prices of many basic industrial materials have risen.

On May 17, 1994, the Board of Governors approved an increase in the discount rate from 3 to 3½ percent. Most market interest rates were up slightly on balance since the May meeting; declines in bond yields early in the intermeeting period were offset later by market reactions to a weakening dollar in foreign exchange markets and rising commodity prices. The trade-weighted value of the dollar in terms of the other G-10 currencies was down significantly further on balance over the intermeeting period, reflecting a sizable drop since early June.

M2 and M3 declined on average over May and June; for the year through June, both M2 and M3 are at the bottom of their ranges for 1994. Total domestic nonfinancial debt has continued to expand at a moderate rate in recent months.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at this meeting the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1993 to the fourth quarter of 1994. The Committee anticipated that developments contributing to unusual velocity increases could persist during the year and that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was maintained at 4 to 8 percent for the year. For 1995, the Committee agreed on tentative ranges for monetary growth, mea-

sured from the fourth quarter of 1994 to the fourth quarter of 1995, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the associated monitoring range for growth of domestic nonfinancial debt at 3 to 7 percent for 1995. 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 M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Forrestal, Jordan, Kelley, LaWare, Lindsey, and Parry and Ms. Phillips. Votes against this action: Mr. Broaddus.

Mr. Broaddus dissented because he believed that additional near-term tightening was necessary to contain inflation. The tightening actions implemented thus far this year were moderate by historical standards, and he doubted that they would prove sufficient to prevent higher inflation given the strength of the economic expansion, the minimal remaining margins of unemployed labor and other producer resources, and inflationary expectations that he feared might already be rising.

Before the conclusion of this meeting, the members discussed the desirability of announcing the outcome of a meeting when no action to change policy was taken. Views differed on this issue, but most of the members supported a proposal to provide a brief

and informal indication that the meeting had ended and that there would be no further announcements. Since early February, a statement had been released after each meeting, all of which had involved policy changes; failure to take some step after this meeting to make clear that there was no change to announce would lead for a time to a heightened degree of uncertainty. With regard to future announcements, it was understood that this issue along with other public disclosure questions would be considered at a later meeting. The Committee's decision regarding announcements would then be made public.

It was agreed that the next meeting of the Committee would be held on Tuesday, August 16, 1994.

The meeting adjourned at 12:35 p.m.

Donald L. Kohn  
Secretary

### **Meeting Held on August 16, 1994**

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 16, 1994, at 9:00 a.m.

*Present:*

Mr. Greenspan, Chairman  
Mr. McDonough, Vice Chairman  
Mr. Blinder  
Mr. Broaddus  
Mr. Forrestal  
Mr. Jordan  
Mr. Kelley  
Mr. LaWare  
Mr. Lindsey  
Mr. Parry  
Ms. Phillips  
Ms. Yellen

Messrs. Conrad, Hoenig, Melzer, and Ms. Minehan, Alternate Members of the Federal Open Market Committee

Messrs. Boehne, McTeer, and Stern, Presidents of the Federal Reserve Banks of Philadelphia, Dallas, and Minneapolis 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. Beebe, Goodfriend, Lindsey, Promisel, Siegman, Simpson, Stockton, and Ms. Tschinkel, Associate Economists

Ms. Lovett, Manager for Domestic Operations, System Open Market Account

Mr. Fisher, Manager for Foreign Operations, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors

Mr. Slifman, Associate Director, Division of Research and Statistics, Board of Governors

Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors

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

Messrs. Bennett, Davis, Dewald, Rosenblum, and Vander Wilt, Senior Vice Presidents, Federal Reserve Banks of New York, Kansas City, St. Louis, Dallas, and Chicago respectively

Messrs. McNees, Meyer, and Sniderman, Vice Presidents, Federal Reserve Banks of Boston, Philadelphia, and Cleveland respectively

Ms. Meulendyke, Assistant Vice President, Federal Reserve Bank of New York

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

*Secretary's Note:*

Advice had been received that Janet L. Yellen had executed her oath of office as member of the Federal Open Market Committee.

Advice also had been received of the election of Cathy E. Minehan by the boards of directors of the Federal Reserve Banks of Boston, Philadelphia, and Richmond as alternate member of the Federal Open Market Committee for the period ending December 31, 1994, and that she had executed her oath of office; and of the election of William C. Conrad by the boards of directors of the Federal Reserve Banks of Cleveland and Chicago as alternate member of the Federal Open Market Committee for the period ending with the appointment of a president for the Federal Reserve Bank of Chicago or December 31, 1994, whichever comes first, and that he had executed his oath of office.

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on July 5-6, 1994, were approved.

The 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 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 6, 1994, through August 15, 1994. 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 the pace of economic expansion, though still substantial, might have slowed somewhat recently. Consumer spending continued to post moderate gains, supported by rising labor income and favorable sentiment. Business outlays for plant and equipment remained on a steep uptrend, but higher interest rates seemed to be having some restraining effect on homebuilding activity. Resource utilization was at elevated levels, with factories operating at relatively high rates and labor markets evidencing very low levels of slack. Increases in broad indexes of consumer and producer prices had remained moderate in recent months, apart from the effects of short-run swings in the volatile food and energy components.

Nonfarm payroll employment continued to advance at a robust pace in July. Hiring in the services industries remained strong, with personnel supply agencies posting another sizable increase. Jobs also were up substantially in retail trade and construction. By contrast, employment in manufacturing was held down by strike activity. The civilian unemployment rate edged up to 6.1 percent in July, little changed from the average for the second quarter.

Industrial production rose moderately in July after a sizable gain in June; a decline in electricity generation from its unusually high weather-related level in June damped the July advance. Manu-

facturing output was up considerably in July, despite a drop in the production of motor vehicles and parts; outside of motor vehicles, increases were widespread, with a very large rise recorded in the output of durable consumer goods. The overall rate of capacity utilization in manufacturing remained at a high level, with most major industry groups operating at or near capacity.

Growth in consumer spending had slowed in recent months, owing in part to constraints on the supply of motor vehicles. Nominal retail sales edged lower in July after expanding at a slightly reduced pace in the second quarter. Sales at general merchandise and furniture and appliance stores increased further in July, while purchases at apparel outlets were down after large June increases. Sales at automotive dealerships fell appreciably in July after edging lower in the second quarter; these sales declines apparently resulted in part from the inability of manufacturers to produce enough of the most popular models. Housing starts in July retraced part of a large June decline but remained below their elevated rate in the fourth quarter of 1993.

Business fixed investment expanded in the second quarter at about the same brisk pace as in the first quarter but well below the rate recorded in 1993. In the second quarter, a strong recovery in non-residential construction activity from the weather-related decline of the first quarter offset a marked slowing in business purchases of durable equipment. Much of the slowdown in the growth of outlays for equipment reflected a reduction in the pace of acquisition of office and computing equipment. Other categories of durable equipment, with the exception of aircraft and motor vehicles, continued to show solid increases. Most indicators of business investment activity suggested further large gains in com-



ing months: Orders for nondefense capital goods pointed to a continued strong expansion in spending on business equipment, and permits for nonresidential construction had been rising as well.

Business inventory investment slowed in June after a sharp acceleration in April and May; for the second quarter as a whole, inventories were up substantially, but they appeared to have remained broadly in line with sales. In manufacturing, recent inventory build-ups had been concentrated in a few industries in which orders had been particularly strong. For manufacturing as a whole, the ratio of stocks to shipments declined from an already low level. At the wholesale level, the accumulation of inventories in the second quarter was largely in durable goods, which were in strong demand; the inventory-to-sales ratio for this sector remained below the range that has prevailed in recent years. A large part of the buildup of retail inventories in the second quarter was in nondurable goods, especially in stocks of general merchandise. For the retail sector as a whole, the inventory-to-sales ratio at the end of June was near the high end of the range observed in recent years.

The nominal deficit on U.S. trade in goods and services widened slightly in May; for April and May combined, the deficit was significantly larger than in the first quarter. Exports of goods and services were about the same in May as in April, with increased shipments of machinery and industrial supplies offset by reduced exports of aircraft and gold. Imports of goods and services were slightly higher in May than in April. Most of the increase was in imports of oil, as a consequence of higher prices, and consumer goods. The economies of all the major foreign industrial countries continued to expand in the second quarter. Growth remained at a healthy pace

in the United Kingdom and Canada and appeared to have firmed in continental Europe. In Japan, growth apparently slowed somewhat in the second quarter.

Trends in broad measures of prices and labor costs had shown no change thus far in 1994. In July, the overall index of consumer prices rose at the same pace as in June, despite larger monthly increases in the food and energy components of the index. The jump in energy prices reflected the effects of the earlier run-up in crude oil prices. For the twelve months ended in July, both the overall index and the index excluding food and energy rose by about the same amounts as during the preceding twelve-month period. At the producer level, prices of finished goods were up significantly in July after no change in June; large price increases were recorded for coffee and finished energy goods. Prices of finished goods other than food and energy were unchanged on balance over June and July and registered only a small rise over the twelve months ended in July. At an earlier stage of processing, producer prices of intermediate materials posted another sizable gain in July. These prices had increased at a faster rate thus far this year than in 1993, mirroring a similar pattern in prices of nonfood, non-energy crude materials. The employment cost index for private industry workers rose more rapidly in the second quarter after a sharp slowing in the first quarter, with the acceleration in compensation largely reflecting a pickup in wage and salary growth. The increase in total compensation over the last four quarters was little changed from the advance over the previous four-quarter period.

At its meeting on July 5–6, 1994, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions

but that included a bias toward the possible firming of reserve conditions during the intermeeting period. The directive stated 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 in 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 rose over the period in accommodation of the usual summer pickup in demands for seasonal credit and averaged near anticipated levels. The federal funds rate remained close to 4¼ percent.

Other market interest rates were unchanged to up slightly on balance over the intermeeting period. Rates generally edged lower during the early part of the period as incoming data were viewed by market participants as being consistent with continued moderation in final demands and a reduced need for any further monetary tightening actions. In early August, however, interest rates began to erase their previous declines, partly in response to the strong employment report, which generated expectations that monetary policy might need to be tightened substantially in the near term. Most major indexes of equity prices were up on balance over the intermeeting period, with second-quarter corporate profits generally better than had been expected.

The trade-weighted value of the dollar in terms of the other G-10 currencies

declined early in the intermeeting period but later recouped its losses and ended the period unchanged on balance. The fluctuations in the dollar partly reflected evolving perceptions of the degree to which U.S. authorities were concerned about further weakness in the currency. Over the intermeeting period, the dollar depreciated slightly against the mark but edged higher against the yen.

Both M2 and M3 expanded in July after declining on average over May and June. The growth of M2 in July owed in part to a sizable increase in liquid deposits, but in light of a resumption of run-offs at bond mutual funds it also may have reflected a renewed preference by households for the protection of principal provided by money market mutual funds. The strength in M2 showed through to M3, which also was boosted by funds garnered from wholesale sources to finance a surge in bank credit. For the year through July, M2 and M3 grew at rates slightly above the bottom of their ranges for 1994. Total domestic nonfinancial debt continued to expand at a moderate pace.

The staff forecast prepared for this meeting suggested that the economy was operating close to its long-run capacity and that growth would trend lower over the next several quarters to a rate generally in line with the increase in its potential. Under these circumstances, trends in the core rate of inflation would not deviate significantly from recent experience, but there was a risk that such an outcome might require further monetary policy tightening. Growth in consumer spending was projected to slow in response to smaller gains in employment and income, some reductions in pent-up demands, and the adverse effects on household financial wealth of earlier increases in interest rates and declines in stock market prices. Business fixed investment, while remaining

relatively brisk, was expected to decelerate somewhat over the forecast horizon, primarily owing to smaller projected gains in sales, a growing shortfall of corporate cash flow relative to capital outlays, and higher financing costs. Single-family housing construction would continue to be damped by the higher mortgage rates; however, the pace of homebuilding was expected to remain relatively robust compared with the rate of recent years, reflecting still unsatisfied demand for home ownership and the relatively favorable cash-flow affordability of housing, as judged by the standards of the past two decades. The restraint on economic activity exerted by weak export demand was projected to diminish as economic conditions improved abroad, given the competitiveness of U.S. produced goods.

In the Committee's discussion of current and prospective economic developments, members commented that final aggregate demand appeared to have slowed somewhat in recent months but that the expansion still seemed to have considerable underlying momentum. Indeed, available data on the various components of spending taken together might in fact be understating the growth in economic activity; the strength of labor markets and measures of gross domestic income suggested a somewhat stronger economic performance. Sustained expansion, perhaps at a pace broadly in line with or a bit above the economy's long-run growth potential, remained a reasonable expectation, but many members observed that they saw the risks as being on the upside of such a projection in the absence of some further policy tightening. Views varied to some degree with regard to available margins of unemployed resources, but the members agreed that the economy probably was operating very close to, and in the view of some might have

reached, its long-run potential. In these circumstances, the members saw appreciable risks of intensifying pressures on resources and higher inflation. Broad measures of wages and prices suggested little change in inflation trends in recent quarters, but worrisome signs of greater inflation were evident in the prices of materials purchased by business firms and in anecdotal reports of successful efforts by an increasing number of businesses to pass on rising costs by raising prices.

In their comments on business conditions in different parts of the nation, members reported continuing expansion ranging from modest to solid growth in most regions, however, the rise in business activity appeared to have slowed in some areas and business conditions had remained essentially unchanged in a number of others, notably in California. In the course of their review, members pointed to the general strength in labor markets as evidenced, for example, by statistical indications of large and persisting gains in employment and relatively low initial claims for unemployment compensation. These data for the national economy were reinforced by reports of sizable employment increases in numerous industries and parts of the country and associated indications of growing labor shortages in a number of areas and some occupations.

The financial climate remained supportive of sustained economic growth. It was clear that the rise in interest rates since the start of the year had had some restraining effects on interest-sensitive expenditures, notably housing and perhaps to a lesser extent some consumer durables, but to date these effects had not been large. Moreover, surveys and anecdotal reports suggested that banking institutions were becoming increasingly aggressive in their efforts to foster loan growth by easing many terms and

standards for lending. In financial markets more generally, risk spreads had remained relatively narrow and both debt and equity markets appeared to be well positioned to provide ample financing for further economic expansion.

In their review of developments in key sectors of the economy, members saw widespread evidence of a well established expansion. Some signs of moderation from the rapid advance in recent quarters had emerged, including statistical and anecdotal indications of somewhat slower growth of consumer spending. Members noted, however, that an apparently significant portion of the recent weakness in sales of motor vehicles appeared to be related to supply shortages that were in the process of being corrected. Consumer confidence remained at a high level and likely reflected, among other factors, the strength in job markets in many parts of the country. Nonetheless, more moderate consumer spending was a reasonable expectation in the context of a low saving rate, increased consumer debt levels, and higher interest rates. One member commented that some pause in the expansion of overall consumer spending would not be unusual after several quarters of robust growth, and another remarked that the rise in household expenditures had been larger than the increase in household cash incomes by an appreciable margin over the past year.

Further marked expansion in business fixed investment was likely to make a sizable contribution to continuing economic growth. Ongoing strength in orders, including foreign demand, pointed to rapid further growth in expenditures for business equipment over coming months. Some moderation in the growth of such spending appeared likely later in the context of projected slower expansion in sales and the rise in financ-

ing costs. The outlook for nonresidential construction, while not ebullient, nonetheless seemed likely to become a more positive factor in fostering further economic growth. Demand for commercial real estate space, including office space, had begun to improve in many areas. Against this background and given the apparent availability of financing for soundly based projects, nonresidential construction activity, while displaying considerable local variation, appeared to be on a moderate uptrend for the nation as a whole.

Prospective developments in foreign trade also were expected to have a positive effect on the expansion of the domestic economy and indeed to offset some of the anticipated slowing in the overall growth of domestic demand. Economic conditions abroad were improving faster than had been anticipated, and this development along with the decline in the foreign exchange value of the dollar was projected to stimulate faster growth in exports while curbing that of imports over the next several quarters.

Members focused on recent inventory developments, which in the context of some moderation in the growth of final demand had accounted for a considerable portion of the overall expansion in GDP reported for the second quarter. While the rate of inventory accumulation could be expected to slow in the current quarter, the extent of that slowing and its retarding effects on near-term economic growth were uncertain. Partly on the basis of anecdotal reports, the members concluded that much of the inventory buildup in the second quarter was voluntary, thereby reducing the probability of a sharp reversal. Indeed, to the degree that delivery lead times might edge up in various industries as capacity constraints were encountered, stronger efforts to build inventories

could emerge, especially against the background of currently low inventory-to-sales ratios. Some business contacts reported that they were planning to add to their inventories over the months ahead. At the same time, ongoing business efforts to maintain relatively lean inventories undoubtedly would tend to limit any broad buildup in inventories.

With regard to the outlook for residential construction, members reported some slowing in single-family housing demand in many parts of the country as homebuyers reacted to the rise in mortgage interest rates. However, single-family homebuilding activity was being maintained at relatively robust levels in some areas and multifamily housing construction was improving in numerous local markets. On balance, the housing sector probably would contribute little, if any, impetus to the expansion but homebuilding was likely to remain well above its earlier depressed levels.

In their assessment of the outlook for inflation, many members focused on the prospects for further growth in output in the context of diminishing margins of unemployed production resources. It was difficult to assess the extent of remaining margins of available resources, in part because of uncertainty about the effects on capacity of ongoing efforts to improve productivity through business restructurings and sharp increases in business investment expenditures. Despite somewhat differing views, the members generally concluded that the economy probably was operating at a level that was quite close to, if not already at, its long-run potential. In the circumstances, many of the members commented that the risks of intensifying inflation clearly were on the upside if the economic expansion did not moderate from its pace in recent quarters. Indications of accelerating cost and price pressures were not yet visible in broad

measures of inflation and wages. Those measures, while subject to fluctuations largely associated with swings in food and energy prices, had not displayed any discernible trend over the past several quarters. At the same time, signs of increasing prices and costs at earlier stages of production appeared to be multiplying, including sizable price increases for a wide range of industrial commodities. More generally, members cited a growing number of reports by business firms of rising input costs and of more successful efforts by some firms to raise prices. It also was noted that the decline in the value of the dollar would contribute, directly and indirectly, to some upward pressures on prices. However, business contacts, notably at the retail level, indicated that competition remained intense and made it very difficult to pass on cost increases through higher prices, thereby placing a premium on continued efforts to contain costs through improvements in productivity. From a differing perspective, one member noted that decelerating growth in money measures such as M1, the monetary base, and reserves—which had been expanding rapidly for several years—implied that monetary policy had been moved substantially to curtail any increase in inflation pressures, though more action might still be required.

In the Committee's discussion of policy for the intermeeting period ahead, the members agreed that a prompt further tightening move was needed to provide greater assurance that inflationary pressures in the economy would remain subdued. The members recognized that the Committee's earlier policy actions were exerting some restraining effects and that further lagged effects from those actions could be expected. Even so, the underlying strength in demand and narrow margins of slack in the econ-

omy pointed to a considerable risk of further inflation pressures in the absence of additional policy tightening.

With regard to the size of the policy adjustment, the members were apprised of a disposition on the part of the Board of Governors to approve the ½-percent-age-point increase in the discount rate that was pending at several Federal Reserve Banks. The Committee members endorsed a proposal to allow the effects of such a rise in the discount rate, should it be approved, to be reflected fully in reserve markets. Consideration was given to a lesser adjustment in reserve conditions, but the members concluded that a smaller step was unlikely to be adequate, and on perceiving this, financial markets would quickly build in further monetary tightening, the unknown size and timing of which would add to market uncertainty and volatility. A more decisive policy move might reduce the need for further tightening later, or possibly even avert that need entirely, by moderating or arresting the inflationary momentum in the economy more promptly and by helping to curb inflationary expectations more effectively.

In considering possible adjustments to policy during the period before the next meeting, all the members favored moving to a symmetric intermeeting instruction. Such a directive would be consistent with the members' expectations that a further policy action was not likely to be needed for some time, given the substantial nature of today's policy move. However, a symmetrical directive would not rule out the possibility of a policy move in the event that intermeeting developments differed substantially from expectations.

At the conclusion of the Committee's policy discussion, all the members indicated they could support a directive that called for increasing somewhat the

degree of pressure on reserve positions, taking account of a possible increase in the discount rate, and that did not include a presumption about possible adjustments 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. According to a staff analysis, the reserve conditions contemplated at this meeting would 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 that the pace of economic expansion, though still substantial, may have moderated somewhat recently, while resource utilization has remained at high levels. Nonfarm payroll employment continued to advance at a robust pace in July, but the civilian unemployment rate edged up to 6.1 percent—about the same as the average for the second quarter. Industrial production rose appreciably over June and July. Growth in consumer spending has slowed in recent months, owing in part to constraints on the supply of motor vehicles. Housing starts rose in July. Orders for nondefense capital goods point to a continued strong expansion in spending on business equipment; permits for nonresidential construction have been rising as well. Business inventories registered a large increase in the second quarter, but inventories appeared to have remained broadly in line with sales. The average nominal deficit on U.S. trade in goods and services was larger in April and May than

the average for the first quarter. Increases in broad indexes of consumer and producer prices have remained moderate in recent months, apart from the effect of short-run swings in volatile food and energy components.

Most market interest rates are unchanged to up slightly on balance since the July meeting. The trade-weighted value of the dollar in terms of the other G-10 currencies was unchanged on balance over the inter-meeting period.

M2 and M3 turned up in July following declines on average in both aggregates over May and June; for the year through July, M2 and M3 grew at rates slightly above the bottom of their ranges for 1994. Total domestic nonfinancial debt has continued to expand at a moderate rate in recent months.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1993 to the fourth quarter of 1994. The Committee anticipated that developments contributing to unusual velocity increases could persist during the year and that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was maintained at 4 to 8 percent for the year. For 1995, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1994 to the fourth quarter of 1995, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the associated monitoring range for growth of domestic nonfinancial debt at 3 to 7 percent for 1995. 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 increase somewhat the existing degree of pressure on reserve positions, taking account of a possible increase in the discount rate. 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 modest growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Broaddus, Forrestal, Jordan, Kelley, LaWare, Lindsey, and Parry and Ms. Phillips and Yellen. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, September 27, 1994.

The meeting adjourned at 12:30 p.m.

Donald L. Kohn  
Secretary

### Meeting Held on September 27, 1994

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 27, 1994, at 9:00 a.m.

#### *Present:*

Mr. Greenspan, Chairman  
Mr. McDonough, Vice Chairman  
Mr. Blinder  
Mr. Broaddus  
Mr. Forrestal  
Mr. Jordan  
Mr. Kelley  
Mr. LaWare  
Mr. Lindsey  
Mr. Parry  
Ms. Phillips  
Ms. Yellen

Messrs. Hoenig, Melzer, and Moskow,  
and Ms. Minehan, Alternate  
Members of the Federal Open  
Market Committee

Messrs. Boehne, McTeer, and Stern,  
 Presidents of the Federal Reserve  
 Banks of Philadelphia, Dallas, and  
 Minneapolis 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. Beebe, Goodfriend, Lindsey,  
 Mishkin, Promisel, Simpson,  
 Stockton, and Ms. Tschinkel,  
 Associate Economists

Ms. Lovett, Manager for Domestic  
 Operations, System Open Market  
 Account

Mr. Fisher, Manager for Foreign  
 Operations, System Open Market  
 Account

Mr. Ettin, Deputy Director, Division  
 of Research and Statistics, Board  
 of Governors

Mr. Slifman, Associate Director, Division  
 of Research and Statistics, Board  
 of Governors

Mr. Madigan, Associate 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

Ms. Browne, Messrs. Davis, Dewald,  
 Lang, Rolnick, Rosenblum, and  
 Vander Wilt, Senior Vice Presidents,  
 Federal Reserve Banks of Boston,  
 Kansas City, St. Louis, Philadelphia,  
 Minneapolis, Dallas, and Chicago  
 respectively

Mr. Sniderman, Vice President, Federal  
 Reserve Bank of Cleveland

Ms. Krieger, Assistant Vice President,  
 Federal Reserve Bank of New York

*Secretary's Note:*

Advice had been received of the election of Michael H. Moskow by the boards of directors of the Federal Reserve Banks of Cleveland and Chicago as alternate member of the Federal Open Market Committee for the period September 1, 1994, through December 31, 1994, and that he had executed his oath of office.

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on August 16, 1994, were approved.

By unanimous vote, the Committee elected Frederic S. Mishkin as Associate Economist from the Federal Reserve Bank of New York, to serve until the next election at the first meeting of the Committee after December 31, 1994, with the understanding that in the event of the discontinuance of his official connection with the Federal Reserve Bank of New York he would cease to have any official connection with the Federal Open Market Committee.

The Manager for Foreign Operations reported on developments in foreign exchange markets during the period since the August 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 August 16, 1994, through September 26, 1994. 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 the pace of economic expansion remained substantial, though it appeared to have moderated slightly in recent months. Final sales, especially of consumer goods, had firmed during the summer months while inventory investment apparently had slowed after a second-quarter surge. Manufacturing activity, bolstered by a pickup in production of motor vehicles, had been rising briskly, and the trend of payroll hiring remained strong. Increases in broad indexes of consumer and producer prices had been somewhat larger in recent months, and prices of materials had remained under considerable upward pressure.

Nonfarm payroll employment advanced appreciably further in August, though at a somewhat less rapid rate than the average pace in earlier months of the year. The slowdown in hiring in August was concentrated in retail trade, where employment was little changed after large gains in the two preceding months, and in construction, where it fell slightly. In manufacturing, employment was up considerably after essentially no change in July; while much of the strength was related to a pickup in the production of motor vehicles, hiring was up in a number of other industries as well. The average workweek of production or nonsupervisory workers declined in August from July's relatively high level, but for the two months combined the average hours worked was well above the second-quarter level. Both household employment and the labor force surged in August, and the civilian

unemployment rate was unchanged at 6.1 percent.

Industrial production rose sharply in August after sizable gains in previous months. The August advance reflected a large increase in manufacturing output that was partly offset by declines in mining production and electricity generation; much of the strength in manufacturing resulted from a large rise in the output of motor vehicles stemming from unusually rapid retooling for the new model year. Elsewhere in manufacturing, production of office and computing equipment continued to expand briskly, and output of industrial equipment was up significantly. Total utilization of industrial capacity rose further in August from already high levels.

Consumer spending remained on a solid upward trend. Retail sales rose considerably in August after holding steady in July. Sales of goods other than motor vehicles registered sizable increases in both July and August. Sales of motor vehicles, which had been constrained in recent months by shortages of popular domestic models, rebounded in August. Housing starts in July and August averaged slightly less than their second-quarter rate. Single-family starts had leveled off in recent months after declining earlier in the year; multifamily starts, though erratic from month to month, had been drifting higher.

The limited data available for the third quarter suggested that growth of real business fixed investment, though still strong, continued to slow from the very rapid pace of 1993. Shipments of nondefense capital goods declined in July, offsetting much of a large June advance. However, orders for nondefense capital goods were up significantly on balance in June and July, pointing to continued brisk expansion in business spending on durable equipment. Nonresidential construction activity in-

creased further in July, and permits for such construction remained on a mild uptrend.

The growth in business inventories slowed markedly in July after surging in the second quarter. The July deceleration reflected a sizable reduction in retail inventories, principally automotive and general merchandise stocks. For the retail sector as a whole, the inventory-to-sales ratio declined sharply in July to about the middle of the range seen in recent years. At the wholesale level, inventories increased substantially, both in July and over the second quarter, and the overall inventory-to-sales ratio edged up in July toward the middle of the range for this ratio in recent years. Inventory investment also picked up in manufacturing, where much of the July accumulation represented stocks of materials, supplies, and work-in-progress. The run-up in stocks was accompanied by a drop in factory shipments, and as a result, the inventory-shipments ratio recorded an unusually steep rise.

The nominal deficit on U.S. trade in goods and services widened substantially further in July after a large increase in the second quarter. The value of exports of goods and services slipped in July from a relatively high level in June, while the value of imports in July changed little from June. Economic activity in all of the foreign G-7 industrial countries except Japan expanded rapidly in the second quarter, and available indicators suggested that strong growth continued on average in the third quarter. In Japan, activity contracted in the second quarter, reflecting weakness in consumption and business investment; the limited data available for the third quarter suggested that growth in that country might have resumed.

Consumer prices rose a little faster in July and August than their average pace

for the first half of the year. The recent pickup in consumer inflation reflected large increases in energy prices as well as somewhat higher food prices; excluding the food and energy components, consumer price advances had remained moderate. Prices rose briskly at the producer level in July and August as prices of finished energy goods surged and prices of finished foods turned up after declining over the first half of the year. For items other than finished foods and energy, the increase over the July-August period was a little faster than in the first half of the year. Recent data indicated little change in wage trends. Average hourly earnings of production or nonsupervisory workers rose in August at about the rate observed over the previous twelve months.

At its meeting on August 16, 1994, the Committee adopted a directive that called for increasing somewhat the degree of pressure on reserve positions, taking account of a possible rise in the discount rate. The Committee did not include in the directive any presumption about further adjustments to policy during the intermeeting period. Accordingly, the directive stated 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 modest growth in M2 and M3 over coming months.

Immediately after the conclusion of the August meeting, the Board of Governors approved a 1/2-percentage-point increase in the discount rate to a level of 4 percent. The Committee permitted the full amount of the increase to pass

through to interest rates in the market for reserves, and the federal funds rate rose about  $\frac{1}{2}$  percentage point to an average of around  $4\frac{3}{4}$  percent. As indicated in an announcement released on the day of the meeting, the Committee did not anticipate that further policy tightening was likely to be needed for a time, given the substantial nature of the policy move. Accordingly, open market operations over the intermeeting period were conducted with a view to maintaining the less accommodative degree of pressure on reserve positions implemented just after the August meeting, and the federal funds rate remained near  $4\frac{3}{4}$  percent. In accordance with the usual cresting of seasonal demands for discount credit at this time of the year, adjustment plus seasonal borrowing rose over much of the period but began to edge lower subsequently. Borrowing averaged near anticipated levels.

Most market interest rates were up somewhat on balance since the August meeting. Short-term rates, which had risen before the meeting in anticipation of a smaller policy move, increased modestly further after the Federal Reserve tightened and then changed little over the next several weeks. Subsequently, however, these rates began to move higher in response to incoming economic data that were seen as pointing to the potential for greater inflation in the future and hence to further firming in reserve conditions. Long-term yields fell after the policy tightening, but these declines were erased within a few days, and rates later rose noticeably further in response to the incoming data. Most major indexes of equity prices were up on balance over the intermeeting period despite price declines near the end of the period.

The trade-weighted value of the dollar in terms of the other G-10 currencies depreciated somewhat over the inter-

meeting period. Bearish sentiment toward the dollar in the foreign exchange markets appeared to be influenced importantly by continuing concerns about inflation trends in the United States compared with those in other major industrial countries.

M2 and M3 declined in August after expanding moderately in July, and data available for September pointed to little further change in either aggregate. The August decline in M2 reflected weakness in most of its liquid components that may have been induced to a considerable extent by the rise, which began early this year, in the opportunity costs of holding such accounts. The decline in M3 was associated with a sharp drop in institution-only money funds in response to the increase in market yields, but the weakness in this broader aggregate was limited by the brisk issuance of large-denomination time deposits as banks continued to rely on managed liabilities to fund credit growth. For the year through August, M2 and M3 grew at rates slightly above the lower ends of their respective ranges for 1994. Total domestic nonfinancial debt continued to expand at a moderate rate in recent months.

The staff forecast prepared for this meeting suggested that growth in economic activity would slow appreciably over the next several quarters, dropping briefly below the rate of increase in the economy's potential output. According to a staff analysis, the economy already was operating at its long-run capacity, and the forecast assumed that monetary policy would not accommodate any continuing tendency for aggregate demand to expand at a pace that could foster sustained higher inflation. Growth in consumer expenditures was projected to moderate next year as spending on consumer durables lost some momentum in the context of diminishing pent-up

demands, the rise in borrowing costs, and smaller gains in income. After an extended period of very rapid increases, growth in business fixed investment also was expected to slow appreciably, partly reflecting less favorable financial conditions and partly the slower pace of output growth. Homebuilding would be damped by higher financing costs, though activity in this sector was expected to remain well above the depressed levels reached in recent years. With the economy operating close to its long-run potential, no further reduction in the core rate of inflation was anticipated over the forecast horizon. Consumer price inflation was projected to be elevated over the near term—by some pass-through of the ongoing run-up in materials prices and by higher import prices—before settling down again.

In the Committee's discussion of current and prospective economic conditions, members commented on continuing indications of a robust expansion in business activity, with output near maximum sustainable levels. They still viewed significant slowing in the pace of the expansion as a reasonable expectation, though they acknowledged that signs of such slowing currently were limited and in particular that the most recent data indicated a greater probability of somewhat more strength in aggregate demand than had appeared to be developing during the late spring and early summer. The policy tightening actions implemented earlier in the year seemed to have elicited only a mild response thus far in interest-sensitive sectors of the economy. However, much of the retarding effects of those actions, including the recent sizable tightening in August, probably had not yet been felt in the economy. In light of the strength of aggregate demand and lags in the effects of policy, the risks of some rise in inflation rates probably had

increased. How large this rise might be or when it might be reversed was very difficult to predict at this point. However, indications of a persisting pickup in inflation would be a matter of considerable concern, and further developments would need to be monitored with special care in light of the Committee's longstanding commitment to containing inflation and moving over time toward price stability to foster the maximum, sustainable performance of the economy.

In their review of developments across the nation, members commented on high levels of business activity in many regions and many of them referred to increasing reports of scarcities of specific types of labor resources. After softening earlier in many areas, business conditions appeared to have strengthened in a number of regions during recent weeks while displaying little change or continued moderate growth elsewhere. Robust expansion in manufacturing activity, especially in the motor vehicle and related industries, was a notable feature of recent business developments. On the financial side, the overall expansion of credit had remained moderate, but many members stressed the ready availability of financing from increasingly aggressive bank lenders. Moreover, despite higher interest rates, capital markets were providing continued support to a wide variety of borrowers. The constraints on the availability of credit and the reluctance of many borrowers to incur new debt, factors that had tended to retard the recovery during its earlier stages, had given way to a financial climate that might even be providing an extra impetus to spending.

With regard to the outlook for activity in key sectors of the economy, consumer spending had been more buoyant than expected over recent months and members saw such spending as likely to be

reasonably well maintained. Some moderation in its growth over the quarters ahead seemed likely, however, as pent-up demands increasingly were satisfied and housing-related purchases of consumer durables tended to moderate. Members cited anecdotal evidence of fairly brisk retail sales in many areas recently and associated optimism among retail business contacts. Recent survey results indicated that consumer sentiment remained favorable. Sales of motor vehicles were expected to continue the improvement noted in August as supply shortages were met through increased production.

Business fixed investment was viewed as likely to rise substantially further over the next several quarters, but the rate of growth had been moderating this year and probably would diminish further in conjunction with the projected slowing in overall demand. The expansion in expenditures for business equipment had slowed considerably this year from an extremely rapid rate in 1993 and could be expected to moderate somewhat further. At the same time, nonresidential construction was slowly trending higher as firms facing capacity constraints sought to expand their production facilities.

The prospects for inventory investment remained a key uncertainty in the outlook in that developments in this sector could well have an important bearing on the extent of the anticipated slowing in the expansion of overall economic activity over the next few quarters. The surge in inventory investment in the second quarter clearly was unsustainable, but some members questioned whether the expected cutback in inventory accumulation would be sizable over the near term. Continuing strength in new orders and anecdotal reports did not point to a desire to reduce inventories and suggested that much of the second-quarter

buildup probably had been intended. Indeed, in the context of increasing backlogs and lagging deliveries that pointed to growing capacity constraints, many business firms might seek to build "safety stocks" to avoid supply disruptions that would interfere with production schedules. At the same time, the trend toward "just in time" inventory management—even if temporarily arrested as safety stocks were increased—would help to limit a potentially excessive buildup in inventories that would present a threat later to the sustainability of the expansion.

Members cited anecdotal evidence tending to support statistical indications of some weakening in housing markets, and they generally anticipated that the rise that had occurred in mortgage interest rates would exert a further damping effect on housing activity over the year ahead. However, against the background of the still relatively favorable affordability of housing and the likelihood of some further pent-up demand, only a moderate drop in overall homebuilding activity seemed likely.

A number of members expressed the view that the external sector was likely to contribute to the expansion of domestic economic activity in light of the depreciation in the value of the dollar and indications of stronger economic growth in foreign industrial nations. However, relatively rapid expansion in foreign economic activity would add to pressures on world commodity prices at least for a time. One member expressed concern about the potential, albeit uncertain, effects on the exchange value of the dollar of developments unrelated to the conduct of monetary policy, such as the ongoing trade negotiations with Japan and forthcoming elections in Germany.

In their discussion of various factors bearing on the outlook for inflation,

members noted that some measures of inflation had picked up recently and that many private forecasters anticipated higher inflation in 1995 than in 1994. The worsening of inflation could perhaps be viewed as reflecting increasing capacity constraints in the face of recent growth in overall demand at a pace above the economy's long-run potential. From this perspective, the future path of inflation would depend importantly on the extent to which the expansion in overall activity would in fact abate from an unsustainable pace. Some members expressed particular concern that if above-trend growth did not moderate soon, existing inflationary pressures and inflationary expectations would quickly become more pronounced and inflation would gather momentum. Thus far, however, price pressures remained concentrated in the early stages of production. As evidenced by broad measures of prices and anecdotal information obtained from numerous business contacts, the pass-through of the higher costs of materials to the prices of final goods had been muted in what business executives continued to describe as highly competitive markets. The ability of business firms to hold down price increases in turn reflected to a marked degree their successful efforts to control unit costs through ongoing gains in productivity. Moreover, with profit margins currently at high levels, business firms facing competitive market conditions had some leeway to absorb rising costs. Increasingly tight labor markets in many parts of the country had not resulted in higher overall wage inflation, but members reported some upward pressure on the wages of certain categories of workers in strong demand. One member expressed the view that continued moderation in price and wage increases also might reflect in some measure a shift in price and wage-setting behavior attribut-

able to the credibility of the Committee's anti-inflationary stance in recent years. A number of members commented that the sluggish-to-moderate growth of a wide variety of money and credit measures provided some assurance that, to date, monetary policy had not laid the basis for a sustained upturn in inflation. Nonetheless, the members concluded that the potential for additional inflation remained substantial and, from a monetary policy standpoint, rendered especially urgent the ongoing assessment of inflation trends.

In the Committee's discussion of policy for the period ahead, most of the members agreed on the desirability of maintaining a steady policy course, at least for the near term. In light of the appreciable tightening of policy approved in August, the members had anticipated that no further policy change was likely to be required for a period, and at this juncture they generally continued to feel that the recent evidence did not warrant an immediate further tightening. Even so, the ongoing inflow of information on the performance of the economy continued to indicate a significant potential for higher inflation down the road, and for many members this suggested that additional monetary restraint could well be needed at some time. A key uncertainty in this regard related to the restraining effects of the policy moves implemented earlier this year; these actions appeared to have exerted less restraint to date than had been anticipated, but appreciable lagged effects from those actions—indeed, perhaps a large part of those effects—could still be expected. At this time, it was extremely difficult to evaluate whether the earlier tightening moves were exerting a lesser effect than usual or it simply was more delayed, or whether the members might have misjudged the underlying strength of the expansion. In the

view of many members, the information that would become available during the intermeeting period should provide a firmer basis for judging the course of the economy and the risks of greater inflation. Should incoming information point to a greater likelihood that price pressures would intensify, the Committee would need to act promptly and forcefully to avert an upward ratcheting of inflationary expectations and actual inflation that would be difficult to reverse. Consequently, while views differed with regard to the likely need for some policy tightening over the weeks immediately ahead, the members generally supported a shift from the symmetry in the August directive to asymmetry toward restraint. Some members indicated that they could accept an asymmetric directive, but they expressed misgivings about the use of such an instruction in the directive because they felt it was subject to misunderstanding in financial markets and could add to uncertainty about Committee intentions. One member favored an immediate move to somewhat greater reserve restraint because the available evidence in his view already suggested an upturn in inflationary expectations and the prospect of a significant rise in inflation.

In the course of the Committee's discussion, a number of members commented that the behavior of the monetary and credit aggregates should be taken into account in the evaluation of the current stance of monetary policy. While various money and related measures had for many years proved unreliable to a greater or lesser extent in gauging economic prospects, the weak growth in a wide array of these measures could not be entirely disregarded as a possible indicator of the degree of monetary restraint and argued for caution in implementing any further policy tightening. One member noted, how-

ever, that the slow growth in the narrow measures of reserves and money followed an extended period of rapid expansion and their recent weakness might not be indicative of constrained liquidity at this point. Moreover, the ready availability of bank credit and the receptivity of financial markets more generally argued that many borrowers, including small and medium-sized businesses, currently had access to ample financing.

At the conclusion of the Committee's discussion, all but one of the members indicated that they could support a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward the 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 somewhat 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 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 the pace of economic expansion, though perhaps moderating slightly in recent months, remains substantial. Nonfarm payroll employment advanced appreciably

further in August, and the civilian unemployment rate was unchanged at 6.1 percent. Reflecting strength in motor vehicles, industrial production rose sharply in August after posting sizable gains in other recent months, and capacity utilization moved up further from already high levels. Retail sales were up considerably in August, boosted by a rebound in sales of durable goods, including motor vehicles. Housing starts rose in August but were unchanged from their second-quarter level. Orders for nondefense capital goods point to a continued strong expansion in spending on business equipment; permits for nonresidential construction remain on a mild uptrend. Inventory accumulation appears to have moderated recently after surging in the second quarter. The nominal deficit on U.S. trade in goods and services widened in July from its second-quarter average. Prices of materials have remained under upward pressure, and increases in broad indexes of consumer and producer prices have been somewhat larger in recent months.

On August 16, 1994, the Board of Governors approved an increase in the discount rate from 3½ to 4 percent, and the Committee agreed that this increase would be allowed to show through completely to interest rates in reserve markets. Most market interest rates are up somewhat on balance since the August meeting. The trade-weighted value of the dollar in terms of the other G-10 currencies depreciated somewhat over the intermeeting period.

M2 and M3 declined in August after expanding moderately in July; for the year through August, M2 and M3 grew at rates slightly above the bottom of their ranges for 1994. Total domestic nonfinancial debt has continued to expand at a moderate rate in recent months.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1993 to the fourth quarter of 1994. The Committee anticipated that developments contributing to unusual velocity increases could persist during the year and that money growth

within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was maintained at 4 to 8 percent for the year. For 1995, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1994 to the fourth quarter of 1995, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the associated monitoring range for growth of domestic nonfinancial debt at 3 to 7 percent for 1995. 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, somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with modest growth in M2 and M3 over the balance of the year.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Forrestal, Jordan, Kelley, LaWare, Lindsey, and Parry and Meses. Phillips and Yellen. Vote against this action: Mr. Broaddus.

Mr. Broaddus dissented because he believed that a prompt move to somewhat greater monetary restraint was needed at this point. In his view, the current stance of monetary policy was overly accommodative in light of the signs of increasing price pressures and rising inflationary expectations that were associated with the continuing strength of the economic expansion and high levels of capacity utilization. In this situation, a delay in implementing some monetary policy tightening would incur a substantial risk of a further increase in inflationary expectations and could



make it more costly to achieve the Committee's longer-term anti-inflationary goals.

It was agreed that the next meeting of the Committee would be held on Tuesday, November 15, 1994.

The meeting adjourned at 1:00 p.m.

Donald L. Kohn  
Secretary

### Meeting Held on November 15, 1994

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 15, 1994, at 9:00 a.m.

*Present:*

- Mr. Greenspan, Chairman
  - Mr. McDonough, Vice Chairman
  - Mr. Blinder
  - Mr. Broaddus
  - Mr. Forrestal
  - Mr. Jordan
  - Mr. Kelley
  - Mr. LaWare
  - Mr. Lindsey
  - Mr. Parry
  - Ms. Phillips
  - Ms. Yellen
- Messrs. Hoenig, Melzer, and Moskow  
and Ms. Minehan, Alternate  
Members of the Federal Open  
Market Committee
- Messrs. Boehne, McTeer, and Stern,  
Presidents of the Federal Reserve  
Banks of Philadelphia, Dallas,  
and Minneapolis 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. Goodfriend, Lindsey, Mishkin,  
Promisel, Siegman, and Simpson  
and Ms. Tschinkel, Associate  
Economists

Ms. Lovett, Manager for Domestic  
Operations, System Open Market  
Account

Mr. Fisher, Manager for Foreign  
Operations, System Open Market  
Account

Mr. Ettin, Deputy Director, Division  
of Research and Statistics, Board  
of Governors

Mr. Slifman, Associate Director,  
Division of Research and  
Statistics, Board of Governors

Mr. Madigan, Associate Director,  
Division of Monetary Affairs,  
Board of Governors

Mr. Brayton, Assistant 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

Ms. Browne and Messrs. Davis,  
Dewald, Lang, Rolnick,  
Rosenblum, and Vander Wilt,  
Senior Vice Presidents, Federal  
Reserve Banks of Boston,  
Kansas City, St. Louis,  
Philadelphia, Minneapolis, Dallas,  
and Chicago respectively

Mr. Judd, Vice President, Federal  
Reserve Bank of San Francisco

Mr. Guentner, Assistant Vice  
President, Federal Reserve  
Bank of New York

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on September 27, 1994, were approved.

The Report of Examination of the System Open Market Account, con-

ducted by the Board's Division of Reserve Bank Operations and Payment Systems as of the close of business on June 30, 1994, was accepted.

The Manager for Foreign Operations reported on developments in foreign exchange markets and on System open market transactions in foreign currencies during the period September 27, 1994, through November 14, 1994. By unanimous vote, the Committee ratified these transactions.

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 September 27, 1994, through November 14, 1994. 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 the growth of the economy remained substantial. Consumer spending was robust, business fixed investment continued on a strong upward trend, and housing activity had been well sustained despite the increase in mortgage interest rates over the past year. Business inventory investment had been brisk since the spring, apparently in response to the strong growth in final sales. Further sizable gains had been recorded in industrial production and employment. Increases in labor compensation were still moderate, although

there were some tentative signs of wage acceleration associated with the further tightening of labor markets. Prices of many materials continued to move up rapidly, but broad indexes did not indicate a pickup in consumer inflation.

Nonfarm payroll employment rose appreciably further in October, with job gains widespread by industry. In the service-producing sector, retail trade posted a particularly large advance while health and business services continued to record moderate increases. Manufacturing employment was up in October after having been unchanged in September; the rise was related partly to continued job growth in automobile- and construction-related industries, but payrolls also expanded in a number of other industries, including textiles, paper, rubber, and plastics. Construction hiring slowed after a large rise in September. Employment, as measured by the household survey, increased by more than the labor force in October, and the civilian unemployment rate edged down to 5.8 percent.

Industrial production increased substantially in October after having posted appreciable advances on balance in previous months. Manufacturing output accounted for all of the October rise as production declined again in the mining and utilities components. In manufacturing, the pace of motor vehicle assemblies was unchanged, but production in automotive-related industries was stepped up noticeably and output of business equipment continued to expand vigorously. Total utilization of industrial capacity climbed further in October from already elevated rates.

Consumer confidence remained at a high level, and retail sales continued to rise rapidly in October. Automotive dealers reported a large increase in sales, but strength also was evident elsewhere: Furniture and appliance

stores posted another appreciable gain; apparel outlets registered a brisk rise; and spending at food and general merchandise stores grew moderately. Housing starts rose appreciably in September, reaching their highest level of the year. Sales of new and existing homes were stronger in September, despite the higher interest rates on both fixed- and adjustable-rate mortgages that had prevailed since earlier in the year.

Business capital spending remained on a solid uptrend. Shipments of non-defense capital goods were brisk during the third quarter, and with orders continuing to exceed shipments, already large backlogs increased further for most types of business equipment. Spending for transportation equipment grew at a healthy rate in the third quarter; purchases of heavy trucks persisted at a very high level, and spending for motor vehicles picked up after a second-quarter lull. Nonresidential construction activity advanced at a reduced pace in the third quarter; however, permits for new construction continued to trend higher.

Business inventory investment apparently continued at a brisk pace in the third quarter, with much of the accumulation occurring in types of goods where sales were strong. Manufacturing stocks fell in September, but for the third quarter as a whole they increased at the same moderate rate as in the second quarter; the inventory-to-shipments ratio for manufacturing in September remained near the historical low reached the previous month. At the wholesale level, inventory accumulation slowed slightly in the third quarter, and the inventory-to-sales ratio was in the lower end of its range over recent years. Retail inventories surged in August (latest data available) after having declined slightly in July. Nonetheless, the

inventory-to-sales ratio for this sector remained near the middle of its range in recent years.

The nominal deficit on U.S. trade in goods and services narrowed in August, but for July and August combined the deficit was substantially larger than its second-quarter average. The value of exports of goods and services rebounded in August, with increases spread widely among automotive products, aircraft, agricultural products, machinery, and consumer goods. The value of imports also increased in August, but by a lesser amount than that of exports; much of the rise reflected greater imports of automotive vehicles from Canada. Economic activity continued to expand in the major foreign industrial countries in the third quarter, but growth apparently was at a more moderate pace than in the first half of the year.

Consumer price inflation remained moderate in September. For items other than the food and energy components, the increase in consumer prices over the twelve months ending in September was slightly smaller than the rise over the previous twelve months. At the producer level, prices of finished goods declined, largely reflecting a sharp fall in prices of finished energy goods. Excluding food and energy items, producer prices edged up in September and had risen slowly over the twelve months ending in September. At intermediate stages of processing, prices of many materials, notably industrial materials, had continued to move up rapidly. Total compensation of private industry workers rose significantly less over the four quarters ending in September than over the previous four quarters, primarily reflecting a sharply smaller increase in benefit costs. Average hourly earnings of production or nonsupervisory workers recorded a large gain

in September after having expanded moderately over previous months.

At its meeting on September 27, 1994, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions but included a bias toward possible firming during the intermeeting period. The directive stated 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, somewhat 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 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. As the need for seasonal credit waned over the period, adjustment plus seasonal borrowing declined substantially, with actual borrowing remaining close to anticipated levels. Apart from some tightness in reserves markets around the end of the third quarter, the federal funds rate averaged close to  $4\frac{3}{4}$  percent.

Most market interest rates rose appreciably over the period since the September 27 meeting in response to incoming economic data that generally indicated sustained momentum in final sales and inventory investment and high levels of aggregate output relative to the economy's potential. The strong economic data and persisting upward pressures on prices at earlier stages of production appeared to heighten concerns among market participants about inflationary pressures and prospects for even more monetary tightening than had previously been anticipated. Most major indexes of

equity prices were little changed on balance over the intermeeting period.

The trade-weighted value of the dollar in terms of the other G-10 currencies changed little on net over the intermeeting period. The dollar trended lower over much of the period, apparently reflecting market perceptions that inflation risks in the United States were on the rise. In early November, after reaching a new post-World War II low against the yen and a two-year low against the mark, the dollar began to recover. The rebound in the value of the dollar apparently was in part a response to U.S. intervention in support of the dollar and heightened expectations of further monetary tightening in the United States.

M2 continued to edge lower in October; the weakness was concentrated in its more-liquid deposit components, for which opportunity costs had risen very substantially this year. M3 expanded at a moderate pace, buoyed by continued rapid growth in large-denomination time deposits issued to finance rapid loan growth and to counter runoffs of non-deposit sources of funds. For the year through October, M2 grew at a rate at the bottom of the Committee's range for 1994 and M3 at a rate in the lower half of its range for the year. Total domestic nonfinancial debt continued to expand at a moderate rate in recent months.

The staff forecast prepared for this meeting suggested that growth in economic activity would slow markedly over the next several quarters and for a period would average less than the rate of increase in the economy's potential output. In the staff's judgment, the economy currently was operating at or beyond its long-run capacity, and the forecast assumed that monetary policy would not accommodate any continuing tendency for aggregate demand to expand at a pace that could foster sustained higher inflation. The expansion of

consumer spending was projected to slow considerably in response to diminishing pent-up demands, higher borrowing costs, and reduced income growth. Business fixed investment also was anticipated to decelerate appreciably in the context of smaller increases in sales and less favorable financial conditions. Homebuilding was expected to be damped by higher financing costs, although housing activity likely would remain well above the depressed levels of recent years when cash-flow affordability had been less favorable. The lower value of the dollar and the favorable prospects for faster economic recovery abroad were projected to bolster the demand for U.S. exports. With the economy having reached or exceeded its long-run potential in the staff's judgment, wage and price inflation was projected to pick up for a period before turning down as pressures on productive resources eased.

In the Committee's discussion of current and prospective economic developments, members commented on widespread statistical and anecdotal indications of considerably greater strength in the business expansion than they had anticipated earlier, with numerous industries now operating at or beyond historic, long-run capacity levels. They saw few signs that growth in aggregate demand might be moderating toward a more sustainable pace; nonetheless, they continued to view some slowing as a reasonable expectation as the monetary policy tightening actions implemented earlier exerted their lagged effects on interest-sensitive sectors of the economy. At this point, increases in prices of final goods and services and of wages generally did not appear to be trending higher, but the members were concerned that inflation would worsen as the effects of continuing strong demand, rising production costs, and

higher import prices increasingly were felt in an environment where the utilization of labor and other producer resources was already at, if not above, sustainable full employment levels.

The evidence of persisting growth in aggregate demand at a pace appreciably above that of the economy's long-run potential and of developing pressures on resources tended to be confirmed by anecdotal reports of robust business expansion in many parts of the country and growing difficulties in hiring and retaining some types of labor. Ongoing cutbacks in some industries, such as defense, were tending to hold down overall economic activity in a few regions, but all parts of the country appeared to be experiencing at least modest economic growth, including California where economic activity now seemed to have turned up after an extended period of weakness. Sentiment among retailers and other business contacts was widely reported to be quite favorable. In addition, some members commented that despite higher interest rates financial conditions generally remained conducive to further business expansion. The lending constraints that had tended to retard the expansion earlier seemed to have given way to increasingly accommodative loan policies by depository institutions and ready access to market sources of financing for many business firms.

In their assessment of the contribution of key sectors of the economy to the expansion, members commented on the current strength of consumer spending and also noted that business contacts were expressing considerable optimism about the prospects for retail sales over the holiday season. Consumer sentiment, as evidenced by survey results and retailer comments, appeared to be at a high level. Some moderation in the growth of consumer spending could be

expected to emerge next year for a variety of reasons, including reduced pent-up demands and some anticipated slowing in the growth of employment and consumer incomes. Members also noted that rising interest rates were likely to damp consumer spending, notably for durable goods, though there was little evidence of such a development thus far. A projected softening in housing markets would contribute to slower growth in demand for housing-related consumer durables.

Expanding sales and favorable profit margins were fostering strong growth in business fixed investment, and much of the momentum in this sector probably would carry over into 1995. Some business contacts reported that they were developing plans for major capital outlays over coming months. As the year progressed, however, the increases that had occurred in interest rates, and the possibility of less receptive financial conditions more generally, should begin to exert some inhibiting effects on business fixed investment, especially if profit margins also were to fall in the context of rising labor and other costs.

With regard to the outlook for housing, members reported that conditions were somewhat uneven across the country but that for the nation as a whole rising mortgage rates had had surprisingly little effect thus far on this typically interest-sensitive sector of the economy. One reason, it was suggested, was the apparent willingness of some homebuyers to accept higher mortgage rates at this point because they expected rates to rise further later. Even so, the members continued to anticipate some slowdown in housing construction over coming quarters. Overall construction activity was likely to be supported to some extent, however, by further gradual gains in nonresidential construction, notably commercial and industrial

structures, and perhaps some continuing strength in multifamily housing.

After a surge in the second quarter, inventory investment remained substantial in the third quarter and appeared to be continuing at a robust pace in the current quarter. For a variety of reasons, inventory accumulation might well be relatively brisk for some period of time, given the favorable sales experience of numerous business firms and the still quite low levels of inventories relative to sales. Moreover, with capacity pressures in many industries leading to some lengthening in delivery times, businesses would tend to build inventories to support sales and avoid disruptions to production schedules. Tending to confirm such an assessment were anecdotal reports suggesting that recent additions to inventories were largely intended and not the result of disappointing sales. An inventory buildup at the pace recorded on average in the second and third quarters would not be sustainable, but inventory investment was likely to be relatively well maintained over coming months if aggregate demand were to expand in line with current expectations.

The members generally anticipated that the external sector of the economy would provide some impetus to the expansion. The recent depreciation of the dollar and strength in foreign economic activity could be expected to boost real exports at a time when growth in real imports was likely to moderate. The resulting improvement in the nation's net trade position would, however, tend to exacerbate any tendency for domestic demand to outrun the economy's output potential.

In the Committee's discussion of the outlook for prices, the members saw a considerable risk of higher inflation if growth in demand and output continued at an unsustainable pace, placing added pressures on labor and other producer

resources. They noted indications of greater inflation pressures, especially in the rising prices of many materials used in the production process and the increasing number of reports of labor shortages. To date, prices of finished goods and services did not reflect those pressures and overall wage inflation did not appear to be trending higher. Even so, at least some modest worsening of inflation seemed quite likely over the quarters immediately ahead, despite the persistence of strong competition that continued to limit attempts to raise prices in most markets. This view seemed to be reinforced by increasing reports of successful efforts by some business firms to establish and sustain higher prices and by numerous indications of business plans to raise prices around year-end or the early part of next year. Other factors that appeared to have adverse implications for the inflation outlook included faster increases in import prices, and in the view of at least some members the prospect of diminishing gains in productivity. Moreover, as evidenced by the comments of some business contacts and the behavior of financial markets, inflationary expectations might be in the process of worsening, though such a development could not be seen in broad survey results. To what extent such expectations would become more pervasive and foster greater inflation momentum was very difficult to gauge at this point. One member suggested that some further rise in inflation might reflect a typical development in a maturing cyclical expansion but that such a rise would not necessarily augur a permanent uptick in inflation or even that progress toward price stability would not continue to be made over time, provided appropriate monetary policies were pursued.

In the Committee's discussion of policy for the intermeeting period ahead, all

the members agreed that the current stance of monetary policy presented unacceptable risks of embedding higher inflation in the economy. The expansion retained appreciably more forward momentum and greater inflationary potential than the members had anticipated, given the policy restraint implemented earlier this year. The reasons for that outcome remained unclear. Among the suggested explanations were that the earlier restraint appeared to have had a less-than-expected effect on current economic conditions and, in particular, on the more interest-sensitive sectors of the economy. Some members also suggested that the underlying expansion was stronger than they had anticipated, and a couple referred to the possibility that the lingering effects from the accommodative policy stance maintained through last year were larger than had been expected. Moreover, additional monetary restraint seemed to be needed to counteract the stimulative effects on domestic economic activity of a number of atypical financial developments in a period of rising interest rates; these included the easing of nonprice credit terms by depository institutions, the ample availability of funds in debt and equity markets, and the depreciation of the dollar in foreign exchange markets. The members recognized that monetary policy actions exerted much of their effects after relatively long lags and that a substantial portion of the restraint stemming from the earlier policy actions undoubtedly had not yet been felt in the economy. They agreed, nonetheless, that monetary policy was still insufficiently restrictive in light of emerging inflationary signals in the economy. Views differed to some extent, however, regarding the degree of additional restraint that might be needed to foster the Committee's objectives for sustainable, non-inflationary economic growth.

A majority of the members believed that an unusually sizable firming of monetary policy was desirable at this time, and they endorsed a proposal to tighten reserve conditions in line with a  $\frac{3}{4}$  percentage point increase in the discount rate that a number of Federal Reserve Banks had proposed for approval by the Board of Governors. In this view, the data becoming available in recent months had suggested considerable resilience and underlying strength in economic activity and rising risks of greater inflation pressures. A somewhat aggressive tightening action would improve the prospects for curbing intensifying inflationary pressures before they gathered further momentum and would help position the economy on a sustainable growth path consistent with the economy's long-run potential. The members acknowledged the difficulty of judging the precise degree of monetary restraint that would be needed to attain the Committee's objectives and in particular the risk that further efforts to control inflation at this juncture might foster greater-than-intended weakening of the expansion. The Committee could not pre-judge how much, if any, additional monetary restraint might be needed in the future. That would depend on further developments, but for most members a sizable move at this point represented the most appropriate balance among the competing risks. During this discussion, it was noted that recent developments were having an unsettling effect on financial markets, and a tightening move of this magnitude might contribute to market stability by reducing expectations of higher inflation and a further near-term policy action. Some members also commented that the action would tend to reinforce the recent intervention in the foreign exchange markets.

Other members indicated that they preferred a less forceful policy move at this point, one that would be consistent with the  $\frac{1}{2}$  percentage point increase in the discount rate that had been proposed by several Federal Reserve Banks. In their view, substantial further restraint could be expected from the combined effects of the policy tightening actions implemented earlier this year and the inevitable waning of the stimulative effects of policy actions taken in previous years. While the need for further monetary restraint could not be ruled out, a more limited policy move at this point could reasonably be expected in this view to accomplish the greater part or all of the Committee's anti-inflationary objectives over time and would minimize the risk of setting policy on an overly restrictive course with undesired consequences for the business expansion later. Moreover, a cautious approach could lessen the risk that the Committee's policy intentions would be misinterpreted, with some resulting damage to consumer and business confidence and dislocation in financial markets. Despite their reservations, these members indicated that they could accept the degree of restraint preferred by the majority because of the quite small difference in the effects of the alternative moves on the economy over time.

With regard to possible changes in policy during the period until the next meeting, a majority of the members favored associating the more substantial policy adjustment with a symmetric intermeeting instruction. This preference was based on expectations that a further policy action was not likely to be called for over the near term, although a symmetric directive would not prevent an intermeeting adjustment if near-term developments differed substantially from expectations. One mem-



ber expressed the view that the unusually large move made it especially important to follow a steady policy course for some period of time and to undertake any further firming only if new information of a surprisingly strong nature were to be received. Another member indicated a preference for an asymmetric directive toward restraint because such a directive would be more consistent with the likely need in his view for further monetary restraint to contain inflationary forces in the economy.

At the conclusion of the Committee's policy discussion, all the members indicated that they could support a directive that called for a significant increase in the degree of pressure on reserve positions, taking account of a possible increase of  $\frac{3}{4}$  percentage point in the discount rate, 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 somewhat greater or somewhat lesser reserve restraint would be acceptable during the intermeeting period. According to a staff analysis, the reserve conditions contemplated at this meeting would 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 that the growth of the economy

has remained substantial. Nonfarm payroll employment advanced appreciably further in October, and the civilian unemployment rate edged down to 5.8 percent. Industrial production registered a large increase in October after posting sizable gains on average over other recent months, and capacity utilization moved up further from already high levels. Retail sales have continued to rise rapidly. Housing starts rose appreciably in September. Orders for nondefense capital goods point to a continued strong expansion in spending on business equipment; permits for nonresidential construction have been trending higher. Inventory accumulation appears to have continued at a brisk pace in the third quarter. For July and August combined, the nominal deficit on U.S. trade in goods and services widened from its second-quarter average. Prices of many materials have continued to move up rapidly, but broad indexes of prices for consumer goods and services have increased moderately on average over recent months.

Most market interest rates have risen appreciably since the September meeting. The trade-weighted value of the dollar in terms of the other G-10 currencies was essentially unchanged on balance over the intermeeting period, though it was weaker through much of the period.

M2 contracted further in October while M3 expanded at a moderate pace, buoyed by continued rapid growth in large-denomination time deposits. For the year through October, M2 grew at a rate at the bottom of the Committee's range for 1994 and M3 at a rate in the lower half of its range for the year. Total domestic nonfinancial debt has continued to expand at a moderate rate in recent months.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1993 to the fourth quarter of 1994. The Committee anticipated that developments contributing to unusual velocity increases could persist during the year and that money growth within these ranges would be consistent with its broad policy objectives. The monitoring

range for growth of total domestic nonfinancial debt was maintained at 4 to 8 percent for the year. For 1995, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1994 to the fourth quarter of 1995, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the associated monitoring range for growth of domestic nonfinancial debt at 3 to 7 percent for 1995. 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 increase significantly the existing degree of pressure on reserve positions, taking account of a possible increase in the discount rate. 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, somewhat greater reserve restraint or somewhat lesser reserve restraint would 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, Blinder, Broaddus, Forrestal, Jordan, Kelley, LaWare, Lindsey, and Parry and Mes. Phillips and Yellen. Votes against this action: None.

*Secretary's note.* The meeting was recessed briefly at this point and the members of the Board of Governors convened to consider pending Reserve Bank proposals for increases in the discount rate. After the conclusion of that meeting, the Presidents of the Federal Reserve Banks were informed that the Board of Governors had approved an increase of  $\frac{3}{4}$  percentage point in the discount rate, effective immediately, and the meeting of the Federal Open Market Committee then resumed.

### System Foreign Currency Arrangements

The Committee considered the renewal of the System's currency ("swap")

arrangements with foreign central banks. These arrangements normally have one-year maturities and, except for those with the Bank of Canada and the Bank of Mexico, were due to mature on various dates in December 1994.

In the course of their review, the members discussed sterilized intervention by the Federal Reserve in the foreign exchange markets. They generally agreed that in certain circumstances such intervention serves a useful purpose, such as helping to counter disorderly market conditions, but it normally would not be expected to have lasting effects on the foreign exchange value of the dollar in the absence of other policy adjustments. In the overwhelming number of instances for more than a decade, the Federal Reserve has participated jointly with the U.S. Treasury in foreign exchange operations. In the view of most members it seemed advisable to continue that procedure, especially given the System's responsibilities for the overall financial health of the economy and ongoing cooperation with the Treasury regarding the nation's broad financial objectives. Nonetheless, the apparently limited and temporary effectiveness of sterilized intervention counseled a cautious reliance on such transactions. Against this background, nearly all the members believed that the System's reciprocal currency arrangements, which were a potential source of foreign currencies that might be used for intervention purposes as well as an ongoing symbol of cooperation with other participating central banks, should be renewed for another year.

At the conclusion of this discussion, the Committee authorized the renewal for further periods of one year of the System's reciprocal currency arrangements with twelve foreign central banks and the Bank for Interna-

tional Settlements. The amounts and existing maturity dates of the arrangements are indicated in the table that follows:

Foreign bank	Amount of arrangement (millions of dollars equivalent)	Term (months)	Maturity date
Austrian National Bank	250	12	12/04/94
Bank of England	3,000	"	12/04/94
Bank of Japan	5,000	"	12/04/94
Bank of Mexico	3,000	20	12/15/95
Bank of Norway	250	12	12/04/94
Bank of Sweden	300	"	12/04/94
Swiss National Bank	4,000	"	12/04/94
Bank for International Settlements			
Swiss francs	600		12/04/94
Other authorized European currencies	1,250		12/04/94
National Bank of Belgium	1,000	"	12/18/94
Bank of Canada	2,000	20	12/15/95
National Bank of Denmark	250	12	12/28/94
Bank of France	2,000	"	12/28/94
German Federal Bank	6,000	"	12/28/94
Bank of Italy	3,000	"	12/28/94
Netherlands Bank	500	"	12/28/94

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Forrestal, Jordan, Kelley, LaWare, Lindsey, and Parry and Ms. Phillips and Yellen. Vote against this action: Mr. Broaddus.

Mr. Broaddus dissented because he believed that the Federal Reserve's participation in foreign exchange market intervention compromises its ability to conduct monetary policy effectively. Because sterilized intervention cannot have sustained effects in the absence of conforming monetary policy actions, Federal Reserve participation in foreign exchange operations risks one of two undesirable outcomes. First, the independence of monetary policy is jeopardized if the System adjusts its

policy actions to support short-term foreign exchange objectives set by the Treasury. Alternatively, the credibility of monetary policy is damaged if the System does not follow interventions with compatible policy actions, the interventions consequently fail to achieve their objectives, and the System is associated in the mind of the public with the failed operations. In these circumstances, he did not view renewal of the existing swap lines as desirable because they are used primarily to facilitate market intervention.

It was agreed that the next meeting of the Committee would be held on Tuesday, December 20, 1994.

The meeting adjourned at 2:05 p.m.

Donald L. Kohn  
Secretary

### Meeting Held on December 20, 1994

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 20, 1994, at 9:00 a.m.

#### Present:

- Mr. Greenspan, Chairman
- Mr. McDonough, Vice Chairman
- Mr. Blinder
- Mr. Broaddus
- Mr. Forrestal
- Mr. Jordan
- Mr. Kelley
- Mr. LaWare
- Mr. Lindsey
- Mr. Parry
- Ms. Phillips
- Ms. Yellen

Messrs. Hoenig, Melzer, and Moskow and Ms. Minehan, Alternate Members of the Federal Open Market Committee

Messrs. Boehne,<sup>5</sup> McTeer, and Stern,  
 Presidents of the Federal Reserve  
 Banks of Philadelphia, Dallas,  
 and Minneapolis 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. Beebe, Goodfriend, Lindsey,  
 Mishkin, Promisel, Siegman,  
 Simpson, Sniderman, and  
 Stockton and Ms. Tschinkel,  
 Associate Economists

Ms. Lovett, Manager for Domestic  
 Operations, System Open Market  
 Account 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. Slifman, Associate Director,  
 Division of Research and  
 Statistics, Board of Governors

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

Messrs. Davis, Lang, Rolnick, and  
 Rosenblum, Senior Vice  
 Presidents, Federal Reserve  
 Banks of Kansas City,  
 Philadelphia, Minneapolis,  
 and Dallas respectively

Messrs. Gavin and McNees, Vice  
 Presidents, Federal Reserve  
 Banks of St. Louis and Boston  
 respectively

Mr. Kuttner, Assistant Vice President,  
 Federal Reserve Bank of Chicago

Mr. Hilton, Manager, Open Market  
 Operations, Federal Reserve Bank  
 of New York

By unanimous vote, the minutes of  
 the meeting of the Federal Open Market  
 Committee held on November 15, 1994,  
 were approved.

By unanimous vote, the Committee  
 elected Mark S. Sniderman as Associate  
 Economist from the Federal Reserve  
 Bank of Cleveland to serve until the  
 next election at the first meeting of the  
 Committee after December 31, 1994,  
 with the understanding that in the event  
 he discontinued his official connection  
 with the Federal Reserve Bank of Cleve-  
 land, he would cease to have any official  
 connection with the Federal Open Mar-  
 ket Committee.

The Manager for Foreign Operations  
 reported on developments in foreign  
 exchange markets since the November  
 meeting. There were no System open  
 market transactions in foreign curren-  
 cies during this period, and thus no vote  
 was required of the Committee.

The Manager for Domestic Opera-  
 tions reported on developments in  
 domestic financial markets and on Sys-  
 tem open market transactions in govern-  
 ment securities and federal agency obli-  
 gations during the period November 15,  
 1994, through December 19, 1994. By  
 unanimous vote, the Committee ratified  
 these transactions.

The Committee then turned to a dis-  
 cussion of the economic and financial  
 outlook and the implementation of  
 monetary policy over the intermeeting  
 period ahead. A summary of the eco-  
 nomic and financial information avail-  
 able 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 Com-  
 mittee and issued to the Federal Reserve  
 Bank of New York.

5. Left before discussion of the economic  
 situation.

The information reviewed at this meeting suggested a further pickup in economic growth in recent months. Consumer spending, supported by strong expansion of employment and income and by buoyant consumer sentiment, remained robust. Business capital spending and exports were rising briskly. Payroll employment remained on a strong upward trend, and industrial output posted further substantial gains. Broad indexes of prices of consumer goods and services increased moderately on average over recent months, although prices of many industrial materials and intermediate supplies continued to move up rapidly.

Nonfarm payroll employment rose sharply in November after an appreciable expansion in October. Job gains in the service-producing sector were stronger in November than in October, as a pickup in hiring in business services more than offset slower growth in health services and retail trade. Employment in manufacturing recorded another sizable advance in November, with increases widespread by industry. Hiring in construction was up considerably in November after a small gain in October. Job growth outpaced the expansion of the labor force in November, and the civilian unemployment rate declined to 5.6 percent.

Industrial production, led by further increases in manufacturing output, registered another large gain in November. Among major market groups, production of business equipment surged and sizable increases were recorded for the output of materials and construction supplies. With the growth of production outpacing the expansion of capacity in November, the rate of utilization of total industrial capacity moved up further from an already high level.

Retail sales continued to rise rapidly in November. Sales were up solidly at

most types of stores, but gains were particularly large at durable goods outlets. Consumer spending on services also had grown significantly in October (latest data), with advances widespread among categories of services. Housing starts increased appreciably in November, when construction activity apparently was boosted by favorable weather in some parts of the country. Multi-family starts rose in November to their highest level in four years, while single-family starts retraced a large part of their October decline.

Business capital spending remained on a pronounced upward trend. Shipments of nondefense capital goods other than aircraft were up slightly further in October after having advanced sharply in the two previous months; shipments of computing equipment were brisk in October, while shipments of other capital goods were little changed. With regard to transportation equipment, outlays for aircraft continued to trend lower in October, while sales of heavy trucks rose appreciably. Recent data on orders for nondefense capital goods pointed to continued vigorous expansion of spending on business equipment. Nonresidential construction activity advanced further in October, led by higher spending for institutional and public utility structures. The uptrend in permits suggested further advances in nonresidential construction.

Business inventory investment was relatively robust in October. Manufacturing inventories rebounded after a small decline in September; a sizable amount of the October increase occurred at firms producing computers, office machinery, and telecommunications equipment for which demand had been strong. For manufacturing as a whole, the stocks-to-shipments ratio remained near a historically low level. Wholesale inventories continued to climb at a pace

in line with sales, and the inventory-to-sales ratio for this sector stayed near the middle of its range over recent years. Retail inventory accumulation slowed substantially in October; much of the slowdown reflected a sharp drop in stocks at automotive dealerships. With sales up sharply, the inventory-to-sales ratio for the retail sector fell in October and remained near the middle of its range over recent years.

The nominal deficit on U.S. trade in goods and services widened somewhat in October from its September level and from its average rate for the third quarter. The increase in the deficit from September's level reflected a small decline in the value of exports of goods and services, which resulted primarily from reduced aircraft shipments, and a small rise in the value of imports. Economic activity in the major foreign industrial countries continued to expand rapidly in the third quarter, and available indicators generally suggested further substantial gains in the fourth quarter.

Despite further sizable increases in the prices of many goods at the early stages of processing, inflation at the consumer level remained moderate in October and November. Energy prices were unchanged on balance over the two months, while food prices edged higher. Excluding food and energy items, consumer prices advanced at a slightly slower rate over October and November than in earlier months of the year and also increased a little less over the twelve months ended in November than over the comparable year-earlier period. At the producer level, prices of finished goods other than food and energy were down over the October–November period, but they rose by a little larger amount for the twelve months ended in November than they had in the year-earlier period. The increase in average hourly earnings of production or non-

supervisory workers over the October–November period remained in the moderate range that had prevailed for some time, although a pickup in earnings growth was evident in a few sectors, notably construction and services. Over the past twelve months, hourly earnings increased at a slightly faster pace than they had over the year-earlier period.

At its meeting on November 15, 1994, the Committee adopted a directive that called for a significant increase in the degree of pressure on reserve positions, taking account of a possible rise of  $\frac{3}{4}$  percentage point in the discount rate. The Committee did not include in the directive a presumption about likely further adjustments to policy during the intermeeting period. Accordingly, the directive stated 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, somewhat greater or somewhat lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with modest growth in M2 and M3 over coming months.

On the day of the meeting, the Board of Governors approved a  $\frac{3}{4}$  percentage point rise in the discount rate, to a level of  $4\frac{3}{4}$  percent. The increase in the discount rate was made effective immediately and was passed through fully to interest rates in the market for reserves. Open market operations during the intermeeting period were conducted with a view to maintaining the tighter policy stance implemented immediately after the meeting, and the federal funds rate remained near  $5\frac{1}{2}$  percent. Adjustment plus seasonal borrowing, reflecting the usual late-autumn pattern of ebbing demand for seasonal credit, declined over the inter-

meeting period; actual borrowing was close to anticipated levels.

Short-term interest rates rose considerably over the period after the November meeting. These rates had increased before the meeting in anticipation of a policy tightening move, but the size of the move was larger than expected and rates firmed a little further as a result. Over the remainder of the intermeeting interval, short-term rates responded to incoming economic data, for a time rising in reaction to indications of continuing strength in economic activity and later retracing a portion of these increases in response to favorable news on inflation. Rates on private money-market instruments with very short maturities also were lifted somewhat in anticipation of the usual year-end pressures. Long-term rates declined slightly over the intermeeting period. The more favorable inflation data, together with the relatively aggressive tightening action, apparently were viewed by many market participants as indicating that monetary policy would be sufficiently firm to hold inflation in check. The revelations in early December of financial difficulties in Orange County, California and concerns about their potential spread had a disruptive effect on financial markets, notably those for municipal securities, but aside from the securities of the affected communities, the disruption generally was brief. Most major indexes of equity prices fell, on balance, over the intermeeting period.

The trade-weighted value of the dollar in terms of the other G-10 currencies increased further over the intermeeting period, with the dollar gaining about equally against the mark and the yen. The unexpected size of the monetary policy move in November, the economic news received over the period, and the growing expectation that policy would be tightened again before long all

appeared to contribute to the dollar's rise.

Growth of M2 resumed in November after several months of decline. M2's expansion largely reflected sizable inflows to small time deposits and retail money market funds that in part might have been associated with accelerated outflows from bond mutual funds and reduced inflows to stock mutual funds. M3 growth slowed a little in November as some investors shifted funds from institution-only money market accounts, whose opportunity costs had widened after the November policy tightening, into direct holdings of securities. For the year through November, M2 grew at a rate at the bottom of the Committee's range for 1994 and M3 at a rate in the lower half of its range for the year. Total domestic nonfinancial debt had continued to expand at a moderate rate in recent months, and through October (latest data) this debt measure had grown at a rate in the lower half of its monitoring range.

The staff forecast prepared for this meeting suggested that growth of economic activity would slow markedly over the next few quarters and then would average less than the rate of increase in the economy's potential output over the remainder of the forecast horizon. In the staff's judgment, the economy currently was operating beyond its long-run noninflationary capacity, and the forecast assumed that monetary policy would not accommodate any continuing tendency for aggregate demand to expand at a pace that could foster sustained higher inflation. Growth of consumer spending was expected to decline substantially in response to slower income growth, higher borrowing costs, and reductions in household net worth associated with lower asset values. Business outlays for new equipment were projected to be

damped considerably by slower growth in sales, higher financing costs, and declining profits. Homebuilding also was expected to soften in response to higher financing costs, but the relatively favorable cash-flow affordability of housing was anticipated to act as a partial offset to those increased costs. The projected robust pace of economic activity abroad was expected to bolster export demand. With the economy having exceeded its noninflationary potential in the staff's judgment, wage and price inflation was projected to pick up for a period before turning down as pressures on productive resources eased.

In the Committee's discussion of current and prospective economic developments, members referred to continuing indications of robust expansion in employment, output, and spending and to very high and rising levels of resource utilization. They saw scant evidence at this point of any moderation in the growth of overall economic activity, including little apparent response thus far in interest-sensitive sectors of the economy to earlier policy tightening actions. Several observed that much of the expansionary momentum in the economy was likely to carry into at least the early part of next year, with potential inflationary consequences, but a number also commented that appreciable slowing during the year to a more sustainable and less inflationary pace remained a reasonable expectation. It was likely that much of the restraint from the policy firming actions implemented this year had not yet been experienced; those actions had reversed an accommodative policy that had been in place through early 1994, the effects of which probably were still being felt in the latter part of 1994. The members acknowledged that the timing and extent of the slowing in the expansion were subject to considerable uncertainty. However, with the

economy now operating at or even slightly above its noninflationary potential, price and wage pressures were likely to build unless the anticipated slowing occurred relatively soon. Key measures of inflation including consumer prices, wages, and producer prices of finished goods did not display any evident uptrend at this juncture, but this could reflect a delay in the adjustment of inflation to capacity constraints and possibly some greater productivity and flexibility in the economy than had been assumed.

In the course of the Committee's discussion, members reported on regional business conditions, which continued to exhibit local variations ranging from modest expansion in some areas to robust growth in others. Reflecting widespread strength in new orders, manufacturing firms outside the defense industry typically were operating at high levels of capacity utilization, and there were numerous anecdotal reports of tightening labor markets. As they had at earlier meetings, members remarked that despite the increases that had occurred in interest rates, financial conditions remained generally supportive of vigorous economic activity. Some noted that the financial markets were displaying a great deal of resilience and in particular that they had on balance weathered fairly readily the recent financial problems of a number of local governments and private corporations that had experienced large unanticipated losses on their investments. Banking institutions remained aggressive in their efforts to extend loans to businesses and consumers.

In their comments on developments in key sectors of the economy, members noted that consumer spending had increased briskly in recent months amid indications of favorable consumer sentiment that in turn undoubtedly reflected



the rapid growth in employment and income. It was still too early to form reliable estimates of retail sales in the current holiday season. The anecdotal reports pointed to seasonal increases ranging from moderate to strong in various regions, but some members emphasized that sales volumes were being buttressed by unusual promotional efforts, including relatively large discounts. Some members also commented that consumer debt was growing rapidly and that increased debt levels were likely to exert a retarding effect on consumer spending, especially if consumer loan rates were to be adjusted more fully upward to reflect increases in market interest rates. Rates on adjustable home mortgages were moving higher to catch up with market rates, and these increases along with the wealth effects from losses suffered on bond and stock holdings were likely to damp spending. Up to now, however, the members saw few signs of any moderation in the growth of consumer spending, including little apparent effect from somewhat higher interest rates on normally interest-sensitive spending for motor vehicles and other consumer durables.

Business fixed investment, which was contributing substantially to the current strength of the expansion, was likely to remain a positive factor in sustaining the overall growth of the economy during the year ahead. Even so, as the expansion matured and growth in final demand tended to moderate, business investment could be expected to soften. As in the case of consumer spending, however, there were few signs of any slowing in the current data or anecdotal reports. Indeed, members saw growing indications of some improvement in nonresidential construction activity as brisk economic expansion tended to absorb increasing amounts of previously vacant commercial and industrial space

and prices of such facilities tended to firm. In the homebuilding sector, the latest available data did not indicate any weakening in housing construction despite the rise in mortgage interest rates. However, anecdotal reports from different parts of the country suggested that the single-family sector might be weakening. At the same time, construction of multifamily units continued to exhibit strength in a number of areas, and this sector appeared to be on a gradual uptrend as falling vacancy rates brought increases in rents. On balance, some modest softening in overall housing construction was seen as likely in response to the rise that had occurred in mortgage interest rates.

Inventory investment was cited as another sector of the economy that probably would exert a negative influence on economic activity over the year ahead, though inventory developments are always subject to a great deal of uncertainty. The strength of inventory investment in recent quarters reflected efforts to accommodate rapid growth in final demand and avoid disruptions to production in a period when supply delivery times were tending to lengthen. Inventory accumulation might remain elevated for a while longer, but as the projected slowing in the growth of final demand began to materialize, business firms were likely to curtail the growth of their inventories, perhaps sharply for some period, in order to maintain desired inventory-to-sales ratios.

The government sector constituted another source of considerable uncertainty in the outlook for 1995. Members referred to major fiscal policy initiatives that were likely to be considered in the new Congress, and they discussed possible short- and long-term effects on the economy. However, the shape of any legislation was still to be determined and it was not possible at this point to

gauge its effects on government or private spending. On the other hand, spending by state and local governments was clearly trending higher and was likely to provide a mild impetus to the overall expansion; the financial difficulties of some local governments undoubtedly would serve to curb their spending but were not seen at this point as having any significant effect on the growth in overall expenditures by state and local governments.

With regard to the external sector of the economy, members continued to anticipate strengthening markets for U.S. exports over the year ahead. Projected growth in exports would be stimulated by the further expansion of economic activity in major U.S. trading partners and by the delayed effects of the weakening of the dollar that had occurred on balance over the course of 1994. Some members cited anecdotal indications of stronger foreign demand for agricultural and other goods produced in the United States.

Despite the evidence of vigorous expansion in overall economic activity and very high levels of resource use, broad measures of inflation in markets for finished goods and overall wage inflation had been on the low side of expectations recently. Anecdotal reports continued to point to very strong competition in most markets for final goods, and business firms continued to encounter widespread resistance in their efforts to increase prices as the costs of their raw materials and other inputs moved higher. Likewise, no uptrend currently was discernible in broad measures of wages even though labor markets were widely described as tight and labor shortages appeared to have increased further recently in some parts of the country. While examples of upward pressures on wages could be found in a number of industries, such as construc-

tion where there were pronounced shortages of skilled labor in many local areas, most business firms were strongly resisting sizable increases in their wages and were making use of "hiring bonuses" and "performance bonuses" instead of permanently higher wages to attract or retain workers. At the same time, job insecurities, including the potential loss of health and pension benefits, appeared to be holding down labor mobility and demands for higher compensation. However, many members commented that rising pressures on capacity, should they persist or intensify, could be expected to foster greater inflation at some point. Indeed, there were numerous reports of business plans to raise prices early in the new year, and a number of members commented that inflation probably would worsen somewhat over the near term. The subsequent behavior of prices and wages would depend importantly on fiscal and monetary policy developments, the extent of inflationary expectations among businesses and consumers, and the degree of pressure that further economic expansion would exert on capacity in various industries and occupations. Given their projections of some moderation in the business expansion and assuming appropriate fiscal and monetary policies, the members generally felt that any added inflation emerging in 1995 would likely be mild and could subside gradually during the year.

In the Committee's discussion of policy for the intermeeting period ahead, a majority of the members agreed on the desirability of maintaining an unchanged policy posture at least through the beginning of 1995. Monetary policy had been tightened considerably in a series of steps starting in February, and much of the restraint stemming from those policy moves had not yet been felt in the economy. This

was especially true with regard to the effects of the latest policy moves in August and November, which accounted for half the total tightening. In the circumstances, a pause seemed warranted to give the Committee more time to assess the underlying strength of the economy and the impact of previous monetary restraint. This would provide a firmer basis for gauging the appropriate scope and timing of any further monetary restraint that might be needed to contain inflation. The level of real short-term interest rates, which had risen considerably this year and were now significantly positive, the uniformly sluggish behavior of the monetary aggregates, and the recent appreciation of the dollar might indicate that policy was now better positioned to restrain incipient inflation. It was noted that the Committee might have gained some leeway to maintain an unchanged policy without adverse expectational effects in light of the relatively large policy tightening implemented just a few weeks ago and the publication of favorable price and wage data that probably had alleviated, at least temporarily, concerns about future inflation. A number of members also commented that financial markets might tend to be a bit unsettled over the balance of the year as a result of the expected year-end adjustments along with the uncertainty about the effects and incidence of the sizable market losses incurred by some investors in 1994. In these circumstances, where there did not appear to be an urgent need for a further policy move, a number of members viewed conditions in financial markets as arguing for a steady policy course pending a reassessment early next year.

A few members expressed a preference for some additional tightening of policy at this meeting. In their view, the considerable strength of the economic

expansion and the high level of resource utilization argued for further monetary restraint to counter inflationary pressures; immediate action also would moderate inflationary expectations by reinforcing the credibility of the System's anti-inflationary effort. All but one of these members indicated, however, that they could accept an unchanged directive that was biased toward possible firming during the intermeeting period.

On the issue of possible adjustments to policy during the period until the next meeting, a majority of the members expressed a preference for an asymmetric directive tilted toward restraint. While most of these members preferred not to tighten policy at this point, they believed that the need for further monetary restraint was highly likely, though it would remain contingent on the tenor of the new information, including data on holiday retail sales, that would begin to arrive shortly after the turn of the year. Should the need for more restraint become apparent, it would be desirable in this view for the appropriate policy move to be made promptly to arrest any worsening of inflation and inflationary expectations, thereby minimizing the cumulative policy tightening that would be required and the ultimate cost of bringing inflation under control. The Committee always had the option of adjusting its policy during intermeeting periods even under a symmetric directive, but the balance of risks in the outlook argued in the view of these members for a policy reaction to new information that was best characterized by an asymmetric directive.

The other members who favored an unchanged policy preferred a symmetric directive. In their view, the information that would be released in the weeks immediately ahead was not likely to depart sufficiently from current expect-

tations to warrant a policy tightening move during the intermeeting period. Moreover, current forecasts were subject to some risks in both directions. Those in the direction of appreciably greater-than-projected slowing in the expansion might have a relatively low probability, at least over the quarters immediately ahead, but that risk could not be ruled out and argued for a cautious approach to any further tightening. Accordingly, the Committee should wait until the next scheduled meeting when more information, possibly including a better assessment of the outlook for fiscal policy, would be available for evaluating the need for any further firming of monetary policy. One member expressed the view that it would be desirable to make any further short-run policy moves in the context of the Committee's long-run strategy to be considered at the next meeting. Despite their preferences, these members said that they would not dissent from an asymmetric directive.

At the conclusion of the Committee's discussion, all but one of the members indicated that they could support a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward the 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 somewhat 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 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 a further pickup in economic growth in recent months. Nonfarm payroll employment rose sharply in November, and the civilian unemployment rate declined to 5.6 percent. Industrial production registered another large increase in November and capacity utilization moved up further from already high levels. Retail sales have continued to rise rapidly. Housing starts increased appreciably in November. Orders for non-defense capital goods point to a continued strong expansion in spending on business equipment; permits for nonresidential construction have been trending higher. The nominal deficit on U.S. trade in goods and services widened somewhat in October from its average rate in the third quarter. Prices of many materials have continued to move up rapidly, but broad indexes of prices for consumer goods and services have increased moderately on average over recent months.

On November 15, 1994, the Board of Governors approved an increase from 4 to 4½ percent in the discount rate, and in line with the Committee's decision the increase was allowed to show through fully to interest rates in reserve markets. In the period since the November meeting, short-term interest rates have risen considerably while long-term rates have declined slightly. The trade-weighted value of the dollar in terms of the other G-10 currencies recovered further over the intermeeting period.

Growth of M2 resumed in November after several months of decline, while M3 expanded moderately further. For the year through November, M2 grew at a rate at the bottom of the Committee's range for 1994 and M3 at a rate in the lower half of its range for the year. Total domestic nonfinancial debt has continued to expand at a moderate rate in recent months and for the year-to-date it has grown at a rate in the lower half of its 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 reaffirmed the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1993 to the fourth quarter of 1994. The Committee anticipated that developments contributing to unusual velocity increases could persist during the year and that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was maintained at 4 to 8 percent for the year. For 1995, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1994 to the fourth quarter of 1995, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the associated monitoring range for growth of domestic nonfinancial debt at 3 to 7 percent for 1995. 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, somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with modest growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Broaddus, Forrestal, Jordan, Kelley, Lindsey, and Parry and Mses. Phillips and Yellen. Vote against this action: Mr. LaWare.

Mr. LaWare dissented because he favored an immediate policy tightening action. In his opinion, the expansion remained quite strong, with high and increasing levels of utilization in labor and capital markets, and he saw a

serious risk of rising inflation. In the circumstances, he also feared that a failure by the Committee to take restraining action could heighten inflationary expectations by raising concerns about the System's commitment to the objective of sustainable, noninflationary economic growth.

### Temporary Increase in Reciprocal Currency Agreement with the Bank of Mexico

At a meeting conducted via a telephone conference on December 30, 1994, the Committee approved a temporary increase from \$3 billion to \$4½ billion in the System's reciprocal currency (swap) agreement with the Bank of Mexico; it was understood that all drawings, including those under the permanent tranche of the System's swap agreement with the Bank of Mexico, would be subject to a determination that appropriate terms and conditions had been met. The U.S. Treasury also increased its swap facility with the Bank of Mexico by \$1½ billion to \$4½ billion, thereby raising the total for official U.S. facilities to \$9.0 billion. The increases were in response to recent financial developments in Mexico. The Committee was informed at this meeting that the Bank of Canada would be considering an increase in its own Can\$1.0 billion facility with the Bank of Mexico, and that additional official financing assistance was being negotiated with the other G-10 central banks and the Bank of Spain.

Votes for this action: Messrs. Greenspan, McDonough, Blinder, Jordan, Kelley, LaWare, Lindsey, Melzer, and Parry and Ms. Yellen. Vote against this action: Mr. Broaddus. Absent and not voting: Mr. Forrestal and Ms. Phillips. Mr. Melzer voted as alternate for Mr. Forrestal.

Mr. Broaddus dissented because he continued to question the desirability of the System's foreign exchange market intervention and therefore the desirability of maintaining or enlarging the swap arrangements that facilitate them. In his view continued System participation in such operations with the U.S. Treasury presented an unacceptable risk of reducing the System's credibility and its ability to conduct monetary policy effectively. He felt this risk was particularly high in this instance. Moreover, as at the March 22, 1994, meeting of the Committee, he had serious concerns about the appropriateness of the foreign exchange operations this particular enlargement would support. In his view, the expansion of this arrangement was equivalent in many respects to a fiscal policy initiative of a kind that should be explicitly authorized by the Congress.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, January 31–February 1, 1995.

The meeting adjourned at 12:45 p.m.

Donald L. Kohn  
Secretary

## *Consumer and Community Affairs*

In 1994 the Division of Consumer and Community Affairs continued to devote considerable resources to concerns about community development and reinvestment, access to credit by minorities and low-income households, and possible discrimination in mortgage lending. The Board published for comment, in conjunction with other federal agencies that regulate financial institutions, a revised proposal to provide greater guidance to institutions on the regulations that implement the Community Reinvestment Act. The Community Affairs staffs of the Board and the Federal Reserve Banks made numerous presentations to bank executives, community groups, and other organizations concerning community investment and fair lending.

These matters are discussed below, along with other actions by the Board in the areas of community affairs and consumer protection.

### **CRA Reform**

In 1993 President Clinton directed the relevant federal regulatory agencies to reform the implementation of the Community Reinvestment Act (CRA) by developing new regulations, supervisory procedures, and standards for assessing the CRA performance of financial institutions.<sup>1</sup> In response to the publication in December 1993 of proposed amendments to the agencies' CRA regulations

(including the Board's Regulation BB), the agencies collectively received more than 6,700 public comments, a record volume for an interagency regulatory proposal.

Following a review of the comments and further analysis of practical consequences associated with the proposal, the agencies published a revised version in October 1994. The public comment period closed in November, and at year's end the agencies anticipated completing the CRA rules in early 1995. The proposal is intended to emphasize performance in lending, service, and investment rather than an institution's process of addressing its responsibilities under the law; promote consistency in assessments; and reduce unnecessary compliance burdens for institutions covered by the CRA.

### **Fair Lending**

The member agencies of the Federal Financial Institutions Examination Council (FFIEC) continued with the fair lending activities described in their joint Interagency Policy Statement on Fair Lending Initiatives, issued in June 1993.<sup>2</sup> They developed and conducted fair lending seminars in Chicago, San Francisco, and Washington, D.C., for senior executives of financial institutions. The seminars were designed to enhance the familiarity of industry leaders with fair lending regulations and to make lenders better aware of policies and practices that may result in the

1. Participating agencies in the CRA reform effort are the Board, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).

2. The member agencies are the Board, the FDIC, the National Credit Union Administration (NCUA), the OCC, and the OTS.

unlawful treatment of applicants. The seminars drew more than 900 executives from banks and thrift institutions. The agencies also jointly issued (along with the Department of Housing and Urban Development, the Department of Justice, and the Federal Trade Commission) a policy statement on lending discrimination and a series of questions and answers on the Fair Housing Act and the Equal Credit Opportunity Act.

The Board and the Community Affairs offices at each of the Federal Reserve Banks also conducted programs to facilitate constructive responses by financial institutions to their communities' credit needs; these programs combined education, information, research, and technical assistance. In response to continuing concerns about discrimination in lending, the Community Affairs programs at the Reserve Banks intensified efforts to develop and deliver educational and informational programs designed to help banks ensure equal access to credit.

The Cleveland Reserve Bank helped coordinate the Cleveland Residential Housing and Mortgage Credit Project, an ongoing community-wide effort to bring together key representatives from business, government, and local communities to identify and remove barriers to equal access to credit. Throughout the year, task groups focused on critical aspects of the lending process, such as contact with lenders, the activities of real estate agents, appraisal issues, and processes in the secondary market. The program will continue in 1995.

The Community Affairs programs of the Boston, Chicago, and San Francisco Reserve Banks jointly produced a video, *Closing the Gap: A Guide to Equal Opportunity Lending*. Based on a publication developed by the Boston Reserve Bank in 1993 and designed primarily as a training tool, the video features ten

"best practices" that banks can use to help ensure that loan applicants are treated equitably. The Reserve Banks sent the video to the senior management of all state member banks and bank holding companies and made it available to others upon request. Nearly 7,000 copies were distributed in 1994. The video also was used in fair lending workshops sponsored by Reserve Bank Community Affairs programs and was broadcast to bankers on the American Financial Skylink, the American Bankers Association's satellite communications network.

Multiple sessions of fair lending seminars for bankers and others were sponsored by the Boston, Richmond, Atlanta, Kansas City, Dallas, and San Francisco Reserve Banks. The Minneapolis and Kansas City Reserve Banks jointly sponsored several sessions of a workshop, entitled "Lending in Indian Country—Cultural and Legal Issues," for bankers and Native American representatives; and the San Francisco Reserve Bank co-sponsored, with the National Center for American Indian Enterprise Development, several sessions of a seminar entitled "Resolving Legal Issues When Lending on Indian Reservations."

## **HMDA Data and Fair Lending**

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. Since January 1993, independent mortgage companies with lower assets are also covered if they originated 100 or more home purchase loans in the



preceding calendar year. One consequence of the expanded coverage, as shown by data released in 1994, is that the number of independent mortgage companies that reported HMDA data for calendar year 1993 increased more than three-fold from the previous year—to a total of 962 companies.

Covered lenders collect and submit to their supervisory agency geographic information about the property related to a loan or a loan application. They report on 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 (HUD) and member agencies of the FFIEC.

The FFIEC prepared almost 36,000 disclosure statements for the more than 9,650 lenders that reported HMDA data for calendar year 1993. In August 1994, individual institutions made these disclosure statements public. The FFIEC also prepared aggregate reports that contain data for all lenders in a given metropolitan statistical area (MSA); these reports became available in October 1994 at a central depository in each of the nation's 341 MSAs. HMDA data have been available to the public on paper, microfiche, magnetic reels and cartridges, and PC diskettes; to enhance public access, the FFIEC in 1994 added CD-ROM to the available formats.

The HMDA data for 1993 covered more than 15.4 million home loans and applications.<sup>3</sup> The 1993 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 brackets. For neighborhoods, the rate of loan denial generally increased with an increase in the proportion of minority residents.

For HMDA purposes, the only financial characteristic of applicants that lenders report is income, and analysis shows that income accounts for some, but not all, of the variations in loan disposition rates among racial groups. Even after controlling for income, white applicants for conventional home loans in all income groups had lower rates of denial than black or Hispanic applicants.

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 of fair lending laws.

Mortgage originators—as well as institutions in the secondary market for mortgages, such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)—have in recent years initiated a variety of affordable home loan programs intended to benefit lower-income and minority households and neighborhoods. A year-to-year comparison of the HMDA data suggests these programs may be making a difference: For calendar year 1992, the number of conventional home purchase loans extended to lower-income applicants increased 27 percent from the year before, compared with a 10 percent increase for higher income households. The changes in lending from 1992 to 1993 were even larger. Excluding the

3. A summary of the 1993 HMDA data appears in Glenn B. Canner and Wayne Passmore, "Home Purchase Lending in Low-Income Neighborhoods and to Low-Income Borrowers," *Federal Reserve Bulletin*, vol. 81 (February 1995), pp. 71–103.

data reported by the newly covered mortgage companies, the number of loans to lower-income households in 1993 rose 38 percent, while loans to higher-income households rose only 8 percent. Among racial or ethnic groups, the number of loans to black households increased 36 percent, and to Hispanic households 25 percent, compared with an increase of 18 percent for white households.

### Assessing Compliance with Fair Lending Laws

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 the institution, in applying its lending criteria, has implemented standards consistently and fairly and whether any exceptions suggest differential 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 computer-based system for obtaining customized HMDA reports. Developed by the Board in consultation with the other agencies, the system enables examiners to obtain a more complete picture of an institution's mortgage lending record than was readily available to them in the past. Comments by examiners led to improvements in the system in 1994.

In 1994 the Federal Reserve began using a new statistical analysis system to aid in the fair lending examination of large-volume mortgage lenders. The

new system helps examiners determine the significance of race in a bank's lending decisions through a regression analysis of the HMDA data recorded by the institution on its Loan/Application Register. Examiners then supplement the results of the analysis with other information drawn from actual loan files to identify specific cases that may need further review and possible discussions with bank management.

### Other Uses of HMDA Data

Since 1990 the HMDA data reported by lenders have included information about the race, sex, and income of borrowers and loan applicants. For loans sold, lenders also identify secondary-market purchasers by type of entity. These expanded data provide 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.<sup>4</sup>

Under its statutory responsibility to oversee housing activities, HUD uses the expanded HMDA data to help assess the effort of government-sponsored entities like Fannie Mae and Freddie Mac to attain HUD goals for supporting mortgages for low- and moderate-income families and for properties in central cities. HUD also makes extensive use of the HMDA data as one component of its fair lending examinations. The data assist in targeting lenders for further investigation and in the investigation of specific allegations of lending discrimination filed with HUD or with certain

4. 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, and Canner and Passmore, "Home Purchase Lending."

state or local agencies. HMDA data also are being used as part of a large-scale investigation in three metropolitan areas where HUD is testing for fair lending compliance.

In 1994 the FFIEC for the first time acquired data on mortgage insurance transactions from the nation's eight private mortgage insurance (PMI) companies. The companies voluntarily provided the data, covering transactions for the fourth quarter of 1993, for compilation and public release by the FFIEC on behalf of their national trade association, Mortgage Insurance Companies of America.<sup>5</sup> For 1994 the PMI companies will submit data for the full year. Along with HMDA data, the PMI data are made available for public review at central depositories in each MSA, and are available on magnetic tape, PC diskette, and CD-ROM through the FFIEC.

### Accuracy of Data

The important uses of the HMDA data make accuracy a critical issue. The FFIEC's processing software is programmed to identify errors in the data submitted by lenders for correction before disclosure statements and MSA reports are prepared. During the years that lenders have submitted their HMDA data line by line, the quality has improved considerably. The proportion of 1993 loan records containing detected errors was less than 0.5 percent, down from about 4.4 percent in 1991.

In other efforts to ensure the accuracy of HMDA data, the Board in 1994 amended Regulation C to require the

following actions of lenders, beginning in 1996:

- Keep quarterly records of HMDA data, thereby allowing the agencies to catch data collection problems earlier in the year and to release data for the full year more promptly
- Submit machine-readable HMDA data (for example, on a PC diskette or magnetic tape) to their supervisory agencies, because the quality of such data has been superior to the quality of submissions on paper. Institutions that report fewer than twenty-five entries are exempt from this requirement.

In addition, the agencies, through the FFIEC, revised their *Guide to HMDA Reporting—Getting It Right!* to conform its listings to the latest boundaries of MSAs, as officially determined by the Office of Management and Budget.

### Community Development

During 1994 the Board issued regulations that clarified and enhanced the capacity of state member banks and bank holding companies to make community development investments. In December the Board issued final regulations governing community development investments by state member banks; the regulations implement provisions of the Depository Institutions Disaster Relief Act of 1992 that amend the Federal Reserve Act. Simultaneously, the Board issued a revised policy statement to clarify the community development investment options of bank holding companies and to streamline the application process.

In conjunction with the Reserve Banks, the Board published a revised *Directory of Bank Holding Company Community Development Corporations*.

5. A study of the data, conducted jointly by staff members of the Board's Division of Consumer and Community Affairs and Division of Research and Statistics, is in Glenn B. Canner, Wayne Passmore, and Monisha Mittal, "Private Mortgage Insurance," *Federal Reserve Bulletin*, vol. 80 (October 1994), pp. 883-99.

Several Reserve Banks actively assisted banks and holding companies in making community development investments.

The Philadelphia, Richmond, Atlanta, St. Louis, Kansas City, Dallas, and San Francisco Reserve Banks sponsored educational meetings and seminars for bankers and others on community development finance, affordable housing finance, and lending to small and minority-owned businesses. The Boston Reserve Bank sponsored training programs on the Community Reinvestment Act for bank directors and senior officers; most of the other Reserve Banks sponsored at least one major conference on community development or reinvestment topics.

Regarding specialized topics, the Chicago Reserve Bank helped develop a seminar to familiarize bankers with the financing of exports for small businesses. The Boston Reserve Bank co-sponsored a seminar for lenders and community representatives concerning the new federal Empowerment Zones/Enterprise Communities initiative. Financing earthquake relief was the topic of a seminar for lenders presented by the San Francisco Reserve Bank, HUD, and the Federal Home Loan Bank of San Francisco. The Atlanta Reserve Bank and the Martin Luther King, Jr., Center for Nonviolent Social Change together conducted a series of seminars for bankers and community representatives on building community partnerships.

Overall, during 1994 the Reserve Bank Community Affairs programs sponsored or co-sponsored more than 180 conferences, seminars, and informational meetings on fair lending, community development, and reinvestment topics. Community Affairs staff members from the Board and the Reserve Banks also made more than 400 presentations at events sponsored by banking,

governmental, business, and community organizations.

Community Affairs programs responded to a growing demand for technical assistance and advice on community development and reinvestment matters. Technical assistance helps financial institutions and their communities develop particular programs to address recognized needs; in many cases, it helps individual institutions strengthen the programs they undertake in fulfillment of their responsibilities under the Community Reinvestment Act. During 1994 the Federal Reserve's Community Affairs officers and staff members held more than 500 meetings with bankers, community groups, business representatives, and others to help them better understand and participate in community development finance.

The Federal Reserve's Community Affairs programs in 1994 also provided other information to bankers, small business, and community groups to further partnerships for community development. The Philadelphia Reserve Bank published *Community Improvements*, a pictorial guide to more than eighty examples of bank-assisted community and economic development projects in the Philadelphia District.

The New York Reserve Bank published *The Credit Process: A Guide for Small Business Owners*, which features information on sources and types of funding for new businesses, advice on preparing business plans and loan requests (noting what lenders will review), and a summary of other resources available to small businesses. The New York Reserve Bank and other Reserve Banks distributed more than 100,000 copies during 1994. The Atlanta Reserve Bank issued a compendium of financing programs conducted by each of the six states in its District.

Community Affairs newsletters are increasingly important to the Reserve Banks in their effort to keep financial institutions informed about community development and community reinvestment. In 1994 the New York Reserve Bank began publishing *Bank Links*, and the Cleveland Reserve Bank published its first issue of *Community Reinvestment Forum*. All twelve Reserve Banks now publish community development newsletters, reaching a combined distribution of more than 53,000 bankers, community representatives, government officials, bank regulators, and others.

Members of the Board's Community Affairs staff conducted and promoted research on the community credit delivery system. They worked with staff members of the Board's Division of Research and Statistics on the first major study of the disposition of applications submitted to private mortgage insurers (see note 5).

In 1994, Community Affairs staff members taught courses for consumer examiners on community development finance and community contacts; for senior commercial examiners, they conducted eight training sessions for senior commercial examiners to help them understand the financing of affordable housing and of community development projects.

## Other Regulatory Matters

The Board took the following other actions with regard to consumer and community affairs regulations.

### Regulation C (Home Mortgage Disclosure)

In addition to the changes to Regulation C discussed above in regard to HMDA data, the Board adopted other amend-

ments that revised reporting rules for home improvement loans and refinancings. At the same time, the Board deferred action on issues related to the treatment of requests handled under prequalification programs. Questions have been raised, for example, about the reporting of denials and the data to be entered in such cases for loan amount, loan type, and property location. The Board's notice of the amendments in the *Federal Register* advised institutions that for 1994 and 1995 they need not report action taken on prequalification requests.

The Board also proposed amendments to conform Regulation C to requirements for mortgage data collection, applicable to bank and thrift institutions with assets greater than \$250 million, that were being offered under the CRA reform initiative.

### Regulation E (Electronic Fund Transfers)

In February the Board amended Regulation E to apply coverage to electronic benefit transfer (EBT) programs established by federal, state, and local governments. Under these programs, agencies paying benefits issue access cards and personal identification numbers to recipients. With the cards, recipients can obtain benefits such as food subsidies and payments under the Aid to Families with Dependent Children and Supplemental Security Income programs through automated teller machines and point-of-sale terminals.

The amendments apply to EBT programs most provisions of Regulation E, including the rules on liability for unauthorized transfers and resolution of errors. Thus, recipients of government benefits will receive essentially the same protections as consumers using deposit accounts for electronic transfers.

This rulemaking directly affects government agencies that administer EBT programs and indirectly affects depository institutions and other private-sector entities.

The Board delayed application of the rules until March 1, 1997, as requested by a federal EBT task force that represents all the major federal agencies with benefit programs. The task force is developing a nationwide system for electronic delivery of government benefits and asked for the three-year delay so that agencies could implement these EBT programs in compliance with Regulation E.

In February the Board also published a proposal to make mostly technical revisions to Regulation E after a review pursuant to the Board's regulatory improvement policy. The proposal's substantive changes include revisions to the existing exemptions for transfers relating to securities or commodities and for preauthorized transfers to or from accounts at small institutions.

In November the Board adopted an interim rule that, as of December 1, 1994, receipts issued at automated teller machines no longer have to uniquely identify the consumer's account or card. This change will help protect consumers and financial institutions against fraudulent fund withdrawals. At year-end, the Board expected to take final action in early 1995 on whether to make the interim rule final.

### Regulation M (Consumer Leasing)

In January the Board extended the period for public comment on possible amendments to Regulation M, which implements the Consumer Leasing Act. The Board expects to publish proposed amendments by mid-1995 to simplify

the regulation and lessen its burden on business without diminishing consumer protections in leasing arrangements.

### Regulation Z (Truth in Lending)

In November the Board published for comment proposed amendments to Regulation Z to implement changes made to the Truth in Lending Act by the Riegle Community Development and Regulatory Improvement Act of 1994. The law imposes new disclosure requirements and substantive limitations on mortgages bearing high rates or high fees. The law also imposes new disclosure requirements to assist consumers in comparing the cost of reverse mortgage transactions, in which homeowners (typically the elderly) receive periodic disbursements and the creditor relies on the ultimate sale of the home for repayment.

The Board also temporarily amended Regulation Z, on three occasions, as allowed under the Depository Institutions Disaster Relief Act of 1993. The actions declared that conditions for borrowers in disaster-affected communities in California, Texas, Alabama, Georgia, and Florida represented bona fide personal financial emergencies; borrowers seeking to "cash out" some equity in their home through a new lender could thereby do so more quickly because they fit the requirement in Regulation Z that only in a personal financial emergency can these borrowers waive the three-day right to rescind the transaction.

In December the Board published a notice requesting comments on whether consumers would benefit from greater flexibility in waiving the right to a rescission period on transactions with new creditors to refinance or consolidate home-secured loans if no new debt

is involved. The Riegle Community Development and Regulatory Improvement Act of 1994 directs the Board to seek comment and then make recommendations to the Congress. Currently, if the transaction is with the existing lender, the right of rescission does not apply at all to a refinancing if no new debt is incurred. But if a new creditor is involved in the refinancing, consumers have the three-day right to rescind and may not waive the right unless a bona fide personal financial emergency exists, even if no new debt is incurred.

### Regulation DD (Truth in Savings)

In January the Board extended the comment period on a proposal published in December 1993 to revise Regulation DD. Under the proposed revisions, financial institutions would be required to use an "internal rate of return" formula to calculate the annual percentage yield (APY) on deposit accounts; the yield would thus 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 May the Board withdrew the December proposal and issued in its place a proposal specifying that once interest is credited to an account, it becomes part of the principal. The proposal also provided a rule applicable to accounts in which consumers are given the choice of leaving interest in the account or taking interest by check or transfer. Under the proposal, institutions would have to compound at least as frequently as they allowed consumers to receive interest credited by check or transfer. The proposed revisions also would have the effect of producing an APY that reflects the time value of money.

In July the Board extended the comment period on the May proposal. At the same time, the Board published an alternative approach for APY calculations that would allow institutions to disclose an APY equal to the contract interest rate on time accounts with maturities greater than one year that do not compound interest but pay interest at least annually. At year-end, the Board expected to take final action on the proposal early in 1995.

### Interpretations

In 1994 the Board continued to offer legal interpretations and guidance through its official staff commentaries. The commentaries apply and interpret the requirements of the regulations and are a substitute for individual staff interpretations.

In August the Board issued the first commentary to Regulation DD. It incorporates much of the guidance provided when the regulation was adopted, and addresses other questions raised since that time.

In December the Board proposed revisions to the commentary to Regulation Z (Truth in Lending). The proposed revisions would clarify regulatory provisions or provide further guidance on issues of general interest, such as the treatment of various fees and taxes associated with loans secured by real estate, including charges by third parties, and a creditor's responsibilities when investigating a claim of unauthorized use of a credit card. The Board also proposed revisions to the commentary to Regulation B (Equal Credit Opportunity). It addressed issues such as credit scoring systems, disparate treatment, special-purpose credit programs, and marital status discrimination.

## **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 compliance costs and consumer benefits related to EFT services. During 1994, the Board amended Regulation E with regard to electronic benefit transfer (EBT) programs and receipts from automated teller machines (ATMs) (see Regulation E, above, under Other Regulatory Matters).

EBT programs have not yet expanded much beyond the pilot-program stage, and reliable estimates of compliance costs are not available. At the time the amendments bringing EBT programs under the liability rules of Regulation E were approved, government program agencies expressed concern about the potential cost. However, the one EBT program that operates under Regulation E liability rules has recorded loss rates no greater than those of financial institutions for electronic fund transfers and lower than loss rates for paper-based benefit programs. If compliance costs for EBT programs are similar to those of electronic transactions at financial institutions, coverage under Regulation E should not significantly inhibit the growth of EBT programs.

Aside from regulatory changes that potentially benefit consumers receiving public benefits or reduce compliance burdens, the economic effects of the Electronic Fund Transfer Act increased because of continued growth in the use of EFT services. During the 1990s the proportion of U.S. households using EFT services has grown at an annual rate of about 2.5 percent. About 84 percent of households now have one or more EFT features on accounts at financial institutions.

ATMs are the most widely used EFT service. Nearly two-thirds of all households currently have ATM access cards, and most of the nation's depository institutions offer consumers access to ATMs. Access to ATMs has been enhanced by the operation 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 8 percent in the past year, from about 642 million in 1993 to about 694 million in 1994. During the same period, the number of ATMs rose about 15 percent, to 109,000.

Direct deposit is used by more than half of all U.S. households. Direct deposit is particularly widespread in the public sector, involving more than half the number of all social security payments and two-thirds the number of all federal salary and retirement payments. Direct deposit is less common in the private sector, but it has grown substantially in recent years. The proportion of households receiving a direct deposit of any kind grew about 5.4 percent per year during the 1990s.

Point-of-sale systems account for a small share of EFT services, but their use continued to grow rapidly in 1994. The number of transactions on point-of-sale systems rose about 43 percent from the preceding year, to 52 million per month; the number of point-of-sale terminals rose about 75 percent, to 343,000.

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 would have been provided in the absence of regulation. The available evidence pro-



vides no evidence of serious consumer problems with electronic transactions at this time. In 1994 about 90 percent of depository institutions examined by federal agencies were in full compliance with Regulation E. Statistics indicate that the institutions not in full compliance generally had fewer than five violations. The violations primarily involved failure to provide all required disclosures to consumers.

The Board's database of consumer complaints and inquiries is another source of information on potential problems. In 1994, sixty-one of the complaints processed involved electronic transactions. The System forwarded thirty-four complaints that did not involve state member banks to other agencies for resolution. Investigation of the remaining twenty-seven complaints did not show any violation of the act or regulation.

### Compliance Examinations

The Federal Reserve System has maintained a program of specialized examinations of state member banks for compliance with consumer protection laws since 1977. Passage of the Federal Deposit Insurance Corporation Improvement Act of 1991 expanded the Federal Reserve's authority to enforce consumer laws beyond state member banks to include certain types of foreign banking organizations.<sup>6</sup> The Federal Reserve began conducting compliance examinations of foreign banking organizations in the first quarter of 1992. The

degree to which foreign banking organizations conduct activities covered by consumer protection laws and regulations varies, but often these institutions conduct far fewer such activities than a typical state member bank.

During the 1994 reporting period, from July 1, 1993, to June 30, 1994, Federal Reserve examiners conducted 865 examinations for compliance with the consumer laws: 658 for state member banks and 207 for foreign banking organizations.

The examinations are conducted by the consumer affairs unit within each of the twelve Federal Reserve Bank examination departments. 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.

An important aspect of the Federal Reserve's compliance program is examiner training. Federal Reserve examiners attend several training sessions for CRA, fair lending, and consumer compliance during their career. New examiners attend the Board's three-week basic consumer compliance school; examiners with eighteen to twenty-four months of field experience attend the Board's week-long advanced compliance school, two-week fair lending school (new in 1994), and one-week class in advanced CRA examination techniques.<sup>7</sup> As in the case of the two-week fair lending school, new classes are incorporated into the training program when needed.

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6. The Federal Reserve System is responsible for enforcing consumer laws in the case of 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).

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7. The Board did not offer the advanced CRA examination techniques class during 1994 because of the ongoing CRA reform effort. The class will be offered again after a new CRA regulation is adopted.

Examiner training is supplemented by the Reserve Banks through regular departmental staff meetings and through special training sessions. In addition, the Board's resident examiner program provides examiners (sixteen of them in 1994) with the opportunity to get a System perspective through working at the Board for several weeks; they observe how the division works, how policies are developed, and how Board staff members work with other agencies that supervise financial institutions.

During 1994 the Federal Reserve System conducted two basic consumer compliance schools for sixty-two students, three advanced consumer compliance schools for forty-four students, and two fair lending schools for seventy-one students.

The FFIEC is the interagency coordinating body charged with development of uniform examination principles, standards, and report forms (see note 2 for membership of the FFIEC). In 1994 the member agencies of the FFIEC collaborated to revise examination procedures to reflect changes in consumer laws and regulations. They adopted changes to examination procedures related to the Real Estate Settlement Procedures Act and the treatment of loans with subordinate liens. The FFIEC agencies also agreed to revised examination procedures reflecting technical changes in the Expedited Funds Availability Act and regulations governing exception-based check holds.

## Agency Reports on Compliance with Consumer Regulations

Data from the member agencies of the FFIEC and from other federal supervisory agencies indicate that compliance with the consumer regulations—the Equal Credit Opportunity Act, the Con-

sumer Leasing Act, and the Electronic Fund Transfer Act—have remained at levels similar to those reported for 1993. A small decline in the level of compliance with the Truth in Lending Act was reported and a slight improvement was noted for compliance with the Expedited Funds Availability Act. This section summarizes these compliance data for the reporting period July 1, 1993, to June 30, 1994.<sup>8</sup>

### Equal Credit Opportunity Act (Regulation B)

The level of full compliance with the Equal Credit Opportunity Act (ECOA) remained relatively stable at approximately 61 percent in the 1993 and 1994 reporting periods.<sup>9</sup> The agencies reported that 72 percent of the institutions examined in 1994 that were not in full compliance with Regulation B had between one and five violations (the lowest frequency category), compared with 77 percent in 1993. The most frequent violations involved the failure to take the following actions:

- Provide a written notice of adverse action that contains a statement of the action taken, the name and address of the creditor, an ECOA notice, and the name and address of the federal agency that enforces compliance
- Notify the applicant of the action taken within the time-frames specified in the regulation

8. Not all the federal agencies that supervise financial institutions use the same method to compile compliance data. However, the data support the general conclusions presented here.

9. 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.

- Give a statement of reasons for adverse action which is specific and indicates the principal reasons for the credit denial or other adverse action.

- Follow the prescribed form of the ECOA notice

- Request information for monitoring purposes about race or national origin, sex, marital status, and age on credit applications primarily for the purchase or refinancing of a principal residence.

The Board issued two written agreements involving violations of Regulation B. The OTS issued seven formal enforcement actions involving Regulation B. The FDIC issued nine formal enforcement actions involving consumer compliance regulations without distinguishing which of those actions involved Regulation B.

The Federal Trade Commission (FTC) continued its enforcement efforts under the ECOA and issued a new consumer brochure on mortgage credit discrimination. The FTC worked with other government agencies and with creditor and consumer organizations to increase awareness and compliance with regard to the ECOA. The FTC obtained a consent decree resolving allegations that a financier of mobile homes discriminated on the basis of marital status. In addition, the FTC worked with the Department of Justice to obtain a consent decree resolving allegations that a mortgage company discriminated on the basis of race and national origin.

The Farm Credit Administration reported a substantial level of compliance with the ECOA. The most frequent violations it found involved the failure to provide applicants with timely notification of action taken on loan applications and the failure to obtain monitoring information.

The other agencies that enforce the ECOA—the Department of Transpor-

ation, the Small Business Administration, the Packers and Stockyards Administration (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 compliance with Regulation E, the same level of compliance reported for 1993. The following five rules were the most frequently violated provisions of Regulation E:

- Provide, at the time a consumer contracts for an EFT service or before the first transfer is made, a written statement outlining the terms and conditions of the electronic fund transfer service

- Provide a notice of the procedures for resolving alleged errors at least once each calendar year

- Provide to customers a statement of all required information at least quarterly, or monthly if EFT activity occurred

- Investigate and resolve alleged errors promptly

- Follow required procedures after determining that no error occurred.

The OTS issued one formal enforcement action involving Regulation E. The FTC reported ongoing litigation with one telemarketing company that allegedly failed to obtain written authorization from consumers for preauthorized transfers. The Securities and Exchange Commission examines broker-dealer organizations for compliance with the EFT act; it found no violations.

## Consumer Leasing (Regulation M)

The FFIEC agencies reported substantial compliance with Regulation M, which implements the consumer leasing provisions of the Truth in Lending Act. As in the 1993 reporting period, more than 99 percent of examined institutions were found to be in full compliance with the regulation. The violations noted by the agencies involved the failure to adhere to specific disclosure requirements detailed in the regulation.

The FTC updated a publication on vehicle leasing and issued a publication for businesses explaining recent amendments to the Consumer Leasing Act, regarding required disclosures for radio lease advertisements.

## Truth in Lending Act (Regulation Z)

The FFIEC agencies reported that 48 percent of examined institutions were in full compliance with Regulation Z, compared with 49 percent in 1993. The Board, the NCUA, the FDIC, and the OTS showed decreases in compliance, while the OCC reported an increase. Agencies indicated that of the examined financial institutions not in full compliance, 56 percent were in the low-frequency category (between one and five violations), down from 62 percent in 1993.

The most frequently observed violations of Regulation Z were 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 an obligation; and the failure to disclose that the creditor has a security interest in the property being purchased or in other identified property.

The Board issued one written agreement involving violations of Regulation Z. The OTS issued twelve formal enforcement actions. Under the Interagency Enforcement Policy on Regulation Z, 529 institutions supervised by the Board, the FDIC, the OCC, and the OTS refunded \$6.8 million on 137,504 accounts in 1994; in 1993 roughly \$5.9 million was refunded on 28,786 accounts. The large increase in the number of reimbursed accounts is attributable to the FDIC's requiring one bank to make restitution on a large number of credit card accounts.

The FTC issued a complaint against a department store for several credit reporting and collection practices alleged to violate Regulation Z. It also cited the store for violating Regulation Z rules that apply when a consumer declares some charges on a credit card bill to have been unauthorized. In such cases, according to the FTC, the store imposed improper requirements on consumers; held consumers liable even when the department store did not conduct a reasonable investigation of claims; and failed to inform cardholders in writing of its reasons when it concluded that there were no unauthorized charges.

## Community Reinvestment Act (Regulation BB)

The CRA requires the Board to assess the CRA performance of state member banks during regular compliance examinations and to take the CRA record into account, along with other factors, when acting on applications from state member banks and bank holding companies.

The Federal Reserve System maintains a three-faceted program for enforcing and fostering better bank performance under the CRA:

- Examination of institutions to assess compliance
- Dissemination of information on community development techniques to bankers and the public through Community Affairs offices at the Reserve Banks
- CRA analyses performed while processing applications from banks and bank holding companies.

Federal Reserve examiners review the performance of state member banks in community revitalization and other relevant areas to assess CRA compliance. When appropriate, examiners suggest ways to improve CRA performance.

For the reporting period of July 1, 1993, through June 30, 1994, the Federal Reserve conducted 643 CRA examinations.<sup>10</sup> During the period, 5 institutions were rated as being in "substantial noncompliance" with the CRA; 14 were rated as "needs to improve" in meeting community credit needs, 493 as "satisfactory," and 131 as "outstanding."

### Expedited Funds Availability Act (Regulation CC)

The FFIEC agencies reported a slight improvement in the level of compliance with Regulation CC for the 1994 reporting period: 75.1 percent of examined institutions were in full compliance with the act, compared with 74.1 percent in 1993. The agencies reported that of the institutions not in full compliance, 75.5 percent were in the low-frequency category (between one and five violations). The following five rules were the most frequently violated provisions of Regulation CC:

- Provide next-day availability for required items
- Provide two-day availability for local checks
- Adequately train employees and provide procedures to ensure compliance
- Follow special procedures for large deposits
- Post the availability policy at locations where employees accept deposits.

The OTS issued two formal enforcement actions involving Regulation CC.

### Unfair and Deceptive Acts or Practices (Regulation AA)

The three financial regulatory agencies with responsibility for enforcing Regulation AA's Credit Practices Rule reported that the majority of banks examined were in compliance. During the 1994 reporting period, slightly less than 99 percent of examined banks were found to be in full compliance with the regulation. The most frequent violation involved the failure to provide a clear and conspicuous disclosure to a guarantor on a credit obligation.

### Applications

During 1994, the Federal Reserve System acted on eighty-seven bank and bank holding company applications that involved CRA protests or adverse CRA ratings.<sup>11</sup> In addition, the System reviewed seventeen applications dealing with fair lending and other issues related to compliance with consumer regulations. In 1993, ninety-eight applications involved CRA issues and four involved compliance issues.

10. Foreign banking organizations and Edge Act and agreement corporations (see note 6) accounted for 207 of the institutions examined for compliance with consumer laws; they are not subject to the CRA.

11. Twenty-five applications that involved the CRA and other compliance issues were pending as of year-end 1994.

Among the eighty-seven applications acted on in 1994 that involved CRA concerns, thirty-two involved adverse CRA ratings, fifty were protested on CRA grounds, and five involved both adverse ratings and protests. In comparison, the previous year's ninety-eight applications involved forty with adverse CRA ratings, forty-five that were protested, and thirteen with both adverse ratings and protests.

During 1994 the Board acted on applications involving two bank holding companies that were subject to fair lending investigations by the Department of Justice. The first (also protested on CRA grounds) involved Shawmut National Corporation (Hartford and Boston) seeking to acquire New Dartmouth Bank (Manchester, New Hampshire). In April the Board reconsidered an earlier action and approved Shawmut's application.<sup>12</sup> Among the new facts reviewed by the Board in its reconsideration were a resolution of the Justice Department's allegations involving discriminatory lending practices by Shawmut's mortgage company, lending data demonstrating the effectiveness of Shawmut's initiatives to improve its lending record to minority and low- and moderate-income borrowers, the results of Shawmut's substantial efforts to improve the accuracy of its HMDA data, and the responsiveness of its management to CRA-related issues.

In September the Board approved applications by Barnett Banks, Inc. (Jacksonville, Florida), to acquire Loan America Financial Corporation (Miami Lakes, Florida) and certain Florida assets of Glendale Federal Bank, FSB (Glendale, California). The Board ap-

proved Barnett's applications knowing the conclusion of a Justice Department investigation of compliance with federal fair lending statutes by Barnett and several of its subsidiaries. At the time the Board acted, however, the Justice Department was not able to provide the Board with the evidentiary materials compiled in its investigation, and the department had not filed a formal action in court. The Board found that, on the basis of the facts of record available to it, the convenience and needs factor, including the CRA records of Barnett's subsidiary banks, and the managerial factor were consistent with approval.

## Consumer Complaints

The Board and the Federal Reserve Banks investigate complaints against state member banks and forward to appropriate enforcement agencies complaints that involve other creditors or businesses. The Federal Reserve also tracks complaints about unregulated practices.

### Complaints about State Member Banks

In 1994 the System received 2,518 complaints: 2,150 by mail, 350 by telephone, and 18 in person. The Federal Reserve investigated and resolved the 1,177 complaints that were against state member banks. The System also received 2,143 oral and written inquiries about consumer credit and banking policies and practices. In responding to these complaints and inquiries, staff members at the Board and at the Reserve Banks gave specific explanations of laws, regulations, and banking practices and provided printed materials on the general issues.

Of the 1,177 complaints against state member banks, about 64 percent

12. In November 1993, by a vote of three to three, the Board did not approve the Shawmut application (see Board of Governors, *80th Annual Report, 1993*, p. 215).

involved loan functions: of these, one-eighth (8 percent of all complaints) alleged discrimination on a prohibited basis, and the rest (56 percent of all complaints) 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 23 percent of the 1,177 complaints involved disputes about interest on deposits and general deposit account practices. The remaining 13 percent concerned disputes about electronic fund transfers, trust services, and miscellaneous bank practices.

### Unregulated Practices

Under section 18(f) of the Federal Trade Commission Act, the Board monitors complaints about banking practices not subject to existing regulations to focus on those that may be unfair or deceptive. Two categories each accounted for up to 5 percent of the 1,653 complaints received in 1994: denial of credit card applications based on credit history (89) and miscellaneous unregulated practices

involving real estate loans (54). Each of these categories accounts for a small number (4 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 to a lack of borrowing experience when assessing the applicant's creditworthiness. Complaints in the miscellaneous category covered a wide range of issues, including failure by the lender to close on a mortgage loan by the agreed settlement date and property appraisal values.

### Complaints Referred to HUD

In 1994 the Federal Reserve referred twenty-four complaints to HUD in accordance with a June 1992 memorandum of understanding between HUD and the bank regulatory agencies that encourages cooperation in the investigation of complaints alleging unlawful discrimination in housing. Investigations completed by the Federal Reserve in

### Consumer Complaints to the Federal Reserve System Regarding State Member Banks and Other Institutions, by Subject, 1994

Subject	State member banks	Other institutions <sup>1</sup>	Total
Regulation B (Equal Credit Opportunity)	84	56	140
Regulation E (Electronic Fund Transfers)	27	26	53
Regulation Q (Interest on Deposits)	4	14	18
Regulation Z (Truth in Lending)	151	194	345
Regulation BB (Community Reinvestment)	6	5	11
Regulation CC (Expedited Funds Availability)	25	45	70
Regulation DD (Truth in Savings)	25	24	49
Fair Credit Reporting Act	41	72	113
Fair Debt Collection Practices Act	16	12	28
Fair Housing Act	8	3	11
Flood insurance	6	0	6
Holder in due course	1	2	3
Real Estate Settlement Procedures Act	1	9	10
Unregulated practices	782	871	1,653
<b>Total</b>	<b>1,177</b>	<b>1,341</b>	<b>2,518</b>

1. Complaints against these institutions were referred to the appropriate enforcement agencies.

fourteen of the twenty-three complaints revealed no evidence of discrimination; nine investigations were pending at year-end.

## Consumer Advisory Council

The Consumer Advisory Council met in March, June, and November 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 organizations, financial institutions, academia, and state and local government. Council meetings are open to the public. Among the topics the council considered during 1994 were reform of the CRA, mandatory arbitration, fair lending matters, sale of mutual funds and other uninsured investment products by insured depository institutions, the waiver of consumers' right of rescission for certain loans, and Truth in Savings proposals regarding the calculation of the annual percentage yields on deposit accounts.

### Consumer Complaints to the Federal Reserve System, by Function and Resolution, 1994

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 <sup>1</sup> .....	32	2	14	9	0	0	7
Information furnished to complainant <sup>2</sup> .....	97	7	59	19	3	3	6
Bank legally correct							
No reimbursement or accommodation .....	537	53	279	129	17	10	49
Reimbursement or accommodation—goodwill <sup>3</sup> .....	91	2	50	26	4	0	9
Bank error							
No reimbursement .....	54	6	36	8	0	0	4
Reimbursement .....	91	2	50	26	4	0	9
Factual dispute <sup>4</sup> .....	39	3	13	20	0	0	3
Possible bank violation <sup>5</sup> .....	12	4	6	1	0	0	1
Matter in litigation <sup>6</sup> .....	11	1	6	2	0	2	0
Customer error .....	23	0	12	9	0	0	2
Pending, December 31 .....	98	16	57	12	0	3	10
Total, state member banks							
Number .....	1,117	98	663	267	27	19	105
Percent .....	100	9	53	24	2	2	10
Complaints referred to other agencies .....	1,341	76	734	321	34	13	163
<b>Total</b> .....	<b>2,518</b>	<b>174</b>	<b>1,397</b>	<b>586</b>	<b>61</b>	<b>32</b>	<b>268</b>

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 appeared to be legally correct but chose 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. After the Federal Reserve determined that a state member bank had possibly violated a law or regulation, the bank took corrective measures voluntarily or as indicated by the Federal Reserve.

6. Parties are seeking resolution through the courts.



All three council meetings featured discussion of issues related to CRA reform, including such alternative measures of local-investment performance as a market-share test, an asset-based test, and a loan-to-deposit ratio standard for streamlined examinations of small banks. The council also discussed the role of examiners in the performance evaluation. The council members agreed on the need for an interagency program of training for examiners developed by the FFIEC with input from the public. They concluded that interagency cooperation is crucial in (1) developing a context within which examiners should assess an institution's performance and (2) developing a method for coordinating the collection and sharing of baseline data.

In March the council's Depository and Delivery Systems Committee reviewed the Board's proposal to modify certain requirements for calculating an annual percentage yield (APY) and recommended that it be withdrawn (see the discussion of Regulation DD above, under "Other Regulatory Matters"). The committee suggested that, instead, covered financial institutions consider giving an appropriate advertising notice stating that some minor variations in the APY could occur as a result of periodic interest payments.

In June the council's Community Affairs and Housing Committee identified key elements of successful programs that provide counseling on home ownership. This project was undertaken in part because the CRA reform proposal identifies home ownership counseling by financial institutions as an activity that would count as a positive factor under the service test. Committee members found that key elements were (1) ongoing efforts to draw individuals into the programs, (2) credit report reviews and other activities to prequalify

individuals for the program, (3) training in home ownership (covering motivation and intellectual and emotional preparation, budget and financial management skills, home selection criteria, insurance needs, and the purchase process), and (4) a commitment to work with the prospective homebuyer, one on one, until a home has been purchased, regardless of how long it takes.

Roundtable discussions, known as the Members Forum and held at each council meeting, gave council members the opportunity through the year to offer the Board their views on visible signs of an economic recovery within their industries or local economies.

### **Testimony and Legislative Recommendations**

In February the Board testified before the House Committee on Banking, Finance and Urban Affairs on matters relating to CRA reform; in March the Board testified before the same committee on the sale of mutual funds by banks. Also in February the Board submitted written recommendations to the committee on proposed legislation governing credit and charge cards.

Regarding the CRA reform proposal, the Board testified about the following steps the agencies were taking to communicate more clearly with banks and thrift institutions regarding agency expectations for CRA performance:

- Creating a more numerically driven system for assessing CRA performance in three elements: lending, services, and investments
- Requiring the collection of data on the number, amount, and geographic location of small business, small farm, and some consumer loans to use in the assessments

- Providing for streamlined review of small institutions
- Permitting institutions to submit their CRA plan in advance for approval by their regulator as an alternative to being evaluated under the general assessment scheme
- Specifying the regulatory sanctions that might result from noncompliance with the regulation.

The Board also discussed interagency guidelines regarding bank sales of mutual funds and other nondeposit investment products. Under the guidelines, banks must take the following actions:

- Standardize the basic disclosures that banks provide customers—they must at a minimum indicate that the product is not insured by the FDIC, that it is not a deposit or other obligation of (and is not guaranteed by) the selling depository institution, and that it is subject to investment risks, including possible loss of the principal amount invested
- Ensure that sales and other activities relating to nondeposit investment products are conducted in a physical location distinct from the area where retail deposits are taken, except in very limited situations where physical considerations prevent it
- Bar tellers and other employees in the deposit-taking area from making investment recommendations or accepting orders for nondeposit investment products. Tellers and other employees not authorized to sell nondeposit investment products may refer customers only to individuals who are specifically trained to sell nondeposit investment products.

In February the Board submitted comments to the House committee regarding

proposed legislation on credit and charge cards. Because the legislation was driven, in part, by concerns about the level of credit card rates, the Board wanted the committee to have some current background on credit card pricing and profitability.

## **Recommendations of Other Agencies**

Each year the Board asks the agencies with enforcement responsibilities under Regulations B, E, M, Z, CC, and AA for recommendations of changes to the regulations or underlying statutes. In 1994 the FTC and the OCC made recommendations.

The FTC sees an expansion of leasing transactions in the marketplace and encourages the Board to continue its regulatory review of lease requirements under Regulation M. In addition, the FTC believes that a review of Regulation Z would help ensure that the requirements are up-to-date, clear, and simple without diminishing important consumer protections, including those regarding creative financing.

The OCC believes that the Congress should consider alternatives to current consumer protection laws that could provide disclosures at least as useful as the current ones but less burdensome to depository institutions. The OCC encourages the Board likewise to consider changes to the implementing regulations that would achieve the same end. The OCC believes that the Congress should also consider modifications to the referral requirements in the ECOA. For example, mandatory referrals could be limited to particular prohibited bases, the Department of Justice could relieve a particular agency of the mandatory referral requirement, or referral could be waived if detected violations stem from self-assessments. ■

## Litigation

During 1994 the Board of Governors was a party in twenty-two lawsuits, the same number as in 1993. Seven lawsuits were filed in 1994, two of which raised questions under the Bank Holding Company Act. A total of nine cases were pending at year-end 1994.

### Bank Holding Company Act— Review of Board Actions

*Scott v. Board of Governors*, No. 94-0104 (D. District of Columbia, filed January 21, 1994), was a petition for review of a Board order approving the application of Society Corporation, Cleveland, Ohio, to merge with Key-Corp, Albany, New York (80 *Federal Reserve Bulletin* 253). The case was dismissed with prejudice on December 7, 1994.

*National Title Resource Agency v. Board of Governors*, No. 94-2050 (8th Circuit, filed April 28, 1994), is a petition for review of a Board order, issued under section 4 of the Bank Holding Company Act, approving the application of Norwest Corp., of Minneapolis, Minnesota, to acquire Double Eagle Financial Corp., of Phoenix, Arizona, and its subsidiary and thereby engage in title insurance agency activities and real estate settlement services (80 *Federal Reserve Bulletin* 453). On January 10, 1995, the court affirmed the Board's order.

### 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 assessed 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.

*First National Bank of Bellaire v. Board of Governors*, No. H-93-1708 (S.D. Texas, filed June 8, 1993), was an action to enjoin possible enforcement actions by the Board of Governors and other bank regulatory agencies. On March 8, 1994, the District Court granted the agencies' motion to dismiss.

*Board of Governors v. Oppedard*, No. 93-3706 (8th Circuit, filed November 1, 1993), was an appeal of a District Court order that appellant Oppedard comply with a previous order that required compliance with a Board order for removal, prohibition, and civil money penalty. On July 6, 1994, the Court of Appeals affirmed the District Court order (29 F.3d 627).

In *CBC, Inc. v. Board of Governors*, No. 93-1458 (U.S. Supreme Court, filed March 17, 1994), petitioners sought review of a civil money penalty assessed 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 Tenth Circuit Court of Appeals on November 30, 1993 (13 F.3d 404), and the petition for *certiorari* was denied on June 6, 1994 (114 S. Ct. 2163).

*Board of Governors v. MacCallum*, No. 94 Civ. 5652 (WK) (S.D. New York, filed August 3, 1994), was an action to freeze assets of an individual pending

administrative adjudication of a civil money penalty assessed by the Board. On August 3, 1994, the court issued an order temporarily restraining the transfer or disposition of the individual's assets. The order was lifted on December 22, 1994, upon completion of the underlying enforcement action.

In *Cavallari v. Board of Governors*, No. 94-4183 (2d Circuit, filed October 17, 1994), a former outside counsel to a national bank seeks review of a Board order of prohibition. The case, which was consolidated with a petition to review enforcement orders issued by the Comptroller of the Currency (*Cavallari v. OCC*, No. 94-4151), is pending.

In *DLG Financial Corp. v. Board of Governors*, No. 94-891 (U.S. Supreme Court, filed November 14, 1994), appellants seek review of an order of the Fifth Circuit Court of Appeals (29 F.3d 993) affirming two actions: an order, obtained by the Board in connection with a pending enforcement action, that freezes appellants' assets; and the District Court's dismissal of appellants' claims seeking an injunction and damages against the Board and the Federal Reserve Bank of Dallas relating to the same enforcement action. The case is pending.

## Other Actions

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 release, to a private litigant, of confidential examination material. The subpoena was issued in a shareholder derivative suit against the Fleet/Norstar Financial

Groups. On June 26, 1992, the Court of Appeals affirmed the District Court order in part, but it also 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. 92-1056 (D. District of Columbia, filed May 4, 1992), the plaintiff alleged discriminatory practices under the Age Discrimination in Employment Act. The court granted the Board's motion for summary judgment on November 29, 1994.

In *re Subpoena Duces Tecum*, Misc. No. 92-0365 (D. District of Columbia, filed August 25, 1992), was a subpoena enforcement case in which plaintiffs sought 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 FDIC. 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 (11 F.3d 217). On November 23, 1994, the District Court ordered the production of a limited amount of factual material to the plaintiff.

In *Adams v. Greenspan*, No. 93-0167 (D. District of Columbia, filed January 27, 1993), the plaintiff, a former employee, alleged a violation of the Civil Rights Act of 1964 and the Rehabilitation Act of 1973 concerning termination of employment. The case was dismissed after settlement on November 18, 1994.

In *Amann v. Prudential Home Mortgage Co. et al.*, No. 93-10320 WD (D. Massachusetts, filed February 12, 1993), plaintiff alleged fraud and breach of contract arising out of a home mortgage. The action was dismissed on June 21, 1994.

*Bennett v. Greenspan*, No. 93-1813 (D. District of Columbia, filed April 20, 1993), is an employment discrimination action. A jury verdict for the plaintiff was rendered on October 13, 1994. The Board's motion for a new trial on the issue of damages was denied on January 9, 1995.

In *Kubany v. Board of Governors*, No. 93-1428 (D. District of Columbia, filed July 9, 1993), the plaintiff challenged a Board determination under the Freedom of Information Act. On July 19, 1994, the court granted the Board's motion to dismiss.

*In re Subpoena Duces Tecum*, Misc. Nos. 93-261 and 93-260 (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*, No. 94-4020 (10th Circuit, filed January 14, 1994), is an appeal of a dismissal of 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. On September 16, 1994, the court denied the appeal (36 F.3d 1105).

*Beckman v. Greenspan*, No. CV 94-41 BCG-RWA (D. Montana, filed April 13, 1994), is an action against the Board and others seeking damages for alleged violations of constitutional and common law rights. The case is pending.

*Scott v. Board of Governors*, No. 94-4117 (10th Circuit, filed April 28, 1994), is an appeal of dismissal of action against the Board and others for damages and injunctive relief for alleged constitutional and statutory violations caused by issuance of Federal Reserve notes. The action was dismissed on July 21, 1994.

*Jackson v. Board of Governors*, No. 94-16789 (9th Circuit, filed September 22, 1994), is an action for violation of a prisoner's civil rights. The action was dismissed on December 1, 1994.

*In re Subpoena Duces Tecum*, No. 94-MS-214 (D. District of Columbia, filed June 27, 1994), is a subpoena enforcement case in which the plaintiff in a class action suit alleging securities fraud seeks examination reports and internal Board memorandums. The Board's opposition to the subpoena was filed on July 8, 1994; the case is pending. ■

## *Legislation Enacted*

The Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994, the Riegle Community Development and Regulatory Improvement Act of 1994, and the Bankruptcy Amendments of 1994 directly affect the Federal Reserve System or the institutions it regulates.

### **Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994**

The Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994, Public Law 103–328, was enacted on September 29, 1994. It covers interstate acquisitions by bank holding companies; interstate bank mergers; interstate branching by domestic and international banks; related aspects of reporting, regulatory examination, and preemption of state law; and miscellaneous other matters.

#### **Interstate Bank Holding Companies**

The act amends the Bank Holding Company Act to permit the Board of Governors, as of September 29, 1995, to allow bank holding companies that are adequately capitalized and managed to acquire banks outside their home states, generally regardless of state laws to the contrary. States may, however, restrict acquisitions of banks in existence for less than five years.

The act prohibits an interstate acquisition under this provision if it would give to the applicant, together with its affiliated insured depository institutions, control of more than 10 percent of the total

deposits of insured depository institutions in the United States or control of 30 percent or more of total deposits in any state in which both an insured depository institution affiliated with the applicant and any bank to be acquired maintain a home office or branch. States may impose caps different from 30 percent if they do not discriminate against out-of-state institutions. In determining whether to approve an application under this provision, the Board must consider the applicant's record under the Community Reinvestment Act (CRA) and applicable state community reinvestment laws. Federal or state antitrust laws will continue to apply to proposed acquisitions.

The Board may approve acquisitions of troubled banks without regard to deposit caps, state laws restricting acquisitions of recently organized banks, or performance under federal and state community reinvestment laws.

#### **Interstate Bank Mergers**

The act amends the Federal Deposit Insurance Act to permit mergers beginning June 1, 1997, between adequately capitalized insured banks with different home states. States may exclude themselves from this provision before that date by expressly prohibiting mergers with all out-of-state banks. Interstate mergers may be approved before June 1, 1997, if the home state of each bank involved has passed a law expressly permitting such mergers and the law applies equally to all out-of-state banks; such laws may contain conditions that do not discriminate against out-of-state

institutions, are not preempted by federal law, and do not apply after May 31, 1997.

Interstate merger transactions that involve a branch of an insured bank but not the entire bank are also authorized if permitted by the state in which the branch is located.

The federal and state deposit caps applicable to interstate expansion by bank holding companies also apply to interstate bank mergers other than mergers involving only affiliated banks. States may restrict interstate mergers of banks in existence for less than five years. Federal or state antitrust laws will continue to apply to proposed merger transactions.

In determining whether to approve an application for initial entry into a state, the responsible federal banking agency must consider the CRA records of the applicant and of any bank that would be an affiliate of the resulting bank; the agency must also consider the record of the applicant under applicable state community reinvestment laws. In proposals not involving initial entry, the agencies may review community reinvestment performance in accordance with earlier practices.

The responsible federal agency may approve an interstate merger of a troubled bank without regard to deposit caps; performance under federal and state community reinvestment laws; adequacy of capital or management skills; or state laws that restrict mergers of recently organized banks, prohibit interstate branch acquisitions, or exclude the state from interstate mergers.

A bank resulting from an interstate merger may, subject to approval of the appropriate federal banking agency, continue to operate the banking offices it operated before the merger and may acquire or establish additional branches anywhere any bank involved in the

transaction could have done so in the absence of the transaction.

Effective June 1, 1997, a national bank may not acquire, establish, or operate branches outside its home state or outside states where it already has a branch except as permitted by the interstate banking statute. Any national bank that relocates its main office to another state after May 31, 1997, may retain and operate branches within its former home state only to the extent that (1) it would be authorized to acquire, establish, or operate them if it had had no branches in that state, or (2) the branches had been acquired in an interstate merger, or (3) the branches had been acquired after May 31, 1997, in transactions assisted by the Federal Deposit Insurance Corporation (FDIC).

States retain the right to supervise, regulate, and examine the operations of the banks they charter, including the establishment and maintenance of branches. In addition, branches of an out-of-state national bank will be subject to the host state's laws regarding community reinvestment, consumer protection, fair lending, and intrastate branching to the extent that such laws apply to branches of banks chartered by that state; however, such state laws will not apply when preempted by federal law or when the Office of the Comptroller of the Currency (OCC) finds (after public notice and comment) that such laws would have a discriminatory effect on the national bank branch. State laws applicable to a branch of a national bank will be enforced by the OCC with respect to that branch.

The regulatory agencies may permit an out-of-state bank to establish de novo branches in any state that adopts legislation expressly permitting all banks to establish such branches and the out-of-state bank complies with the requirements (other than deposit caps) that

apply to the interstate acquisition by merger of an existing branch. Any such out-of-state bank shall have the same authority to establish, acquire, and operate other branches that it would have if it had not established such a *de novo* branch.

The Riegle-Neal act also amends the Home Owners' Loan Act to clarify the fact that it does not affect certain state constitutional provisions exempting homesteads from foreclosure or forced sale.

### Interstate Branching by International Banks

The Riegle-Neal act amends the International Banking Act to permit foreign banks, subject to the approval of the Board of Governors and other appropriate bank regulators, to establish and operate branches or agencies regulated under federal or state law outside their home states to the extent permitted national or state banks with the same home state as the foreign bank. The Board and, as appropriate, the OCC must determine that the foreign bank's capital resources are equivalent to the resources required of a domestic bank and must consult with the Secretary of the Treasury (Treasury) regarding capital adequacy. The foreign bank shall also comply with the state's requirements for establishing a *de novo* interstate branch and shall have the same authority to establish, acquire, and operate other branches that it would if it had not established such a *de novo* interstate branch.

The act requires the FDIC and the OCC to review their regulations under section 6 of the International Banking Act to ensure that foreign banking organizations do not receive unfair competitive advantages over domestic ones, keeping in mind the importance of improving the availability of credit to all

sectors of the economy, including international trade finance. The act also prohibits a branch or agency of a foreign bank from managing, through a branch or agency located outside the United States, any activity that a domestic bank is not permitted to manage at a branch or agency located outside the United States. Regulations of the Board and the FDIC under this provision are to be uniform.

The act clarifies the fact that foreign bank branches, agencies, and commercial lending companies are subject to the same federal and state consumer protection laws as national or state banks doing business in the same state. The CRA would continue to apply to any branch that results from the acquisition of an insured bank or branch by a foreign bank in a state in which the foreign bank did not previously have a branch, except for branches that accept only those deposits permissible for Edge Act corporations.

### Examinations

The act provides a moratorium on fees under the International Banking Act for examinations of branches, agencies, affiliates, and representative offices commenced before July 25, 1997.

State bank supervisors may examine in-state branches of out-of-state insured state banks and undertake the same enforcement actions that would be permitted if the branches were banks chartered by their state. State bank supervisors from two or more states may enter into cooperative agreements to facilitate supervision of state banks with interstate branches.

### Deposit Production and Community Reinvestment

The act requires the federal banking agencies to prescribe uniform regula-



tions prohibiting the use of interstate branching authority primarily for deposit production, including guidelines to ensure that out-of-state branches meet the credit needs of their communities. If the loan-to-deposit ratio of an out-of-state bank in the host state is less than half the ratio for all host-state banks, the regulations must require a determination as to whether such branches are meeting credit needs. The act specifies a variety of business, financial, and regulatory factors that the agency must consider in making its determination.

The act amends the CRA to require separate state-by-state performance evaluations of insured depository institutions with branches in two or more states and separate evaluations for multi-state metropolitan areas in which the bank has branches.

The act establishes procedures for community input when an interstate bank proposes to close a branch in a low- or moderate-income area, but the procedures may not affect the authority of an interstate bank to close a branch or the timing of the closing.

### Preemption of State Laws

The act does not affect the authority of a state or subdivision to use any constitutional method of taxing a branch, domestic or foreign bank, bank holding company, or affiliate (including nondiscriminatory franchise taxes or other non-property taxes), nor does it affect certain federal limitations on state usury laws.

The federal banking agencies must solicit and consider public comments before concluding that federal law preempts the application to a national bank of any state law regarding community reinvestment, consumer protection, fair lending, or the establishment of intra-state branches. These requirements also apply to any determination by the OCC

that applying host state laws to an interstate branch as if it were a bank chartered by such host state would have a discriminatory effect. The act provides certain exceptions to the requirements regarding public notice and comment.

The act also amends the Consolidated Farm and Rural Development Act so that loans guaranteed under section 310B are no longer subject to state usury laws, although states may exclude themselves from the provision within three years of enactment of the act.

The act permits the FDIC to file certain tort suits in regard to a failed depository institution for which it has been appointed conservator or receiver even if the state's statute of limitations for such suit expired up to five years before the FDIC's appointment.

### Reports

The Board must conduct seven annual surveys of retail services provided by insured depository institutions and of the fees charged for such services and report the results to the Congress.

Treasury must study the strengths and weaknesses of the U.S. financial services system and the adequacy of the existing regulatory structure to prevent unfair, discriminatory, or anticompetitive practices. Treasury must develop recommendations for improvements that avoid risk to taxpayers and control systemic risk.

### Silver Coins

The act authorizes 2.8 million \$1 silver commemorative coins to be produced in five series for the benefit of five organizations. The coins will be legal tender, and their sale price will include a \$10 surcharge to benefit the Organizing Committee for the Special Olympic Games, the National Community Ser-

vice Trust, the National Fund for the Botanic Garden, the endowment of the Robert F. Kennedy Memorial, and the Association of Graduates of the Military Academy.

## **Riegle Community Development and Regulatory Improvement Act of 1994**

The Riegle Community Development and Regulatory Improvement Act of 1994, Public Law 103-325, was enacted on September 23, 1994. Title I-A is the Community Development and Financial Institutions Act of 1994; title I-B is the Home Ownership and Equity Protection Act of 1994.

Title II-A is the Small Business Loan Securitization and Secondary Market Enhancement Act of 1994; title II-B encourages the enhancement access to capital for small businesses.

Title III relates to paperwork reduction and regulatory improvement. Title IV is the Money Laundering Suppression Act of 1994. Title V is the National Flood Insurance Reform Act of 1994, and title VI deals with oversight hearings and technical amendments.

### **Title I-A**

Title I-A, the Community Development and Financial Institutions Act of 1994, establishes the Community Development Financial Institutions Fund as a wholly owned government corporation under an administrator appointed by the President and confirmed by the Senate. The goal of the act and the fund is to create a national network of financial institutions accountable to residents of their investment area or targeted population, including metropolitan, rural, and Native American communities. The new community development institutions are to aid the economic advancement of

their areas or populations by helping to fulfill their unmet needs for loans and equity investments. These new community development institutions, either alone or in partnership with a community partner, may apply to the new fund for assistance on projects that are consistent with the requirements of the act.

The fund may provide up to \$5 million to any community development financial institution and its subsidiaries over three years and may provide an additional \$3.75 million over the same period for a subsidiary or affiliate set up to serve an investment area or targeted population outside the state and metropolitan statistical area already served. The fund provides technical assistance, equity investments, deposits, credit union shares, loans, and grants. Equity investments by the fund in any community development institution may not exceed 50 percent of the institution's equity and must be in the form of transferable nonvoting shares. The fund may sell its equity investments and loans at any time. Other than technical assistance, all assistance must be at least 50 percent matched.

The act authorizes a minimum of \$382 million over four years, with two-thirds of the funds (after administrative expenses) earmarked for the new community development financial institutions and one-third for the section 114 program under which depository institutions receive credit against deposit insurance premiums for private investment in targeted activities in qualified distressed communities.

The fund must develop standards of financial responsibility for assisted institutions other than federally insured or examined depository institutions or their holding companies. Before it awards assistance to, or imposes sanctions on, any federally supervised depository institution or its holding company, the

fund must consult with the appropriate bank regulatory agency. The fund may not sanction any such institution if the agency objects on grounds of safety and soundness or of enforcement procedure and proposes an alternative sanction. Before requesting information directly from such an institution, the fund shall attempt to obtain it from the appropriate agency, but in no case may the fund request examination reports.

The act also authorizes \$10 million for the Community Development Credit Union Revolving Loan Fund for the 1995-98 period.

### Title I-B

Title I-B, the Home Ownership and Equity Protection Act of 1994, amends the Truth in Lending Act to provide additional protection to consumers who are subject to unfair terms on home equity or second mortgage loans on principal residences through home improvement contractors, banks, or finance companies. The act does not apply to first mortgages, reverse mortgages, or open-end credit plans.

For the types of loans it targets, the act defines those that are "high-rate" or "high-fee." A high-rate loan has an interest rate that is more than 10 percentage points higher than yields on comparable Treasury bonds; a high-fee loan assesses points and fees in excess of 8 percent of the loan amount or \$400, whichever is the greater (subject to adjustment by the Board of Governors after two years). For such loans, the act requires specific disclosures that the borrower could lose his or her home for failure to meet the loan obligations and is not obligated to sign the agreement. The act also requires disclosure of financial details of the loans, including, for variable rate loans, disclosure of the monthly payment at current interest

rates and at the maximum interest rate allowed under the Competitive Equality Banking Act. The consumer has a three-year right of rescission if the disclosures are not made three business days before consummation of the transaction.

A pattern or practice of lending based on the value of collateral without regard to the consumers' ability to repay is prohibited. Other restrictions on high-rate or high-fee mortgages are that the interest rate on them may not rise by virtue of default on the loan; they may not require balloon payments if their term is less than five years, nor negative amortization, nor more than two payments consolidated and paid in advance from loan proceeds; and they may not be payable directly to a home improvement contractor. With certain exceptions, no such mortgage loan may be subject to a prepayment penalty, including any method of computing a refund of unearned scheduled interest less favorable to the consumer than the actuarial method. Inclusion of any of the above terms is deemed a failure of required disclosure and creates the right of rescission. The act authorizes the Board to exempt from these prohibitions specific mortgage products that strengthen home ownership and equity protection and to prohibit unfair, deceptive, or abusive practices in connection with mortgage loans or refinancings.

Title I-B amends the Truth in Lending Act, adding to its civil liability provisions the requirement that a lender's failure to comply with title I-B's required disclosures (including the use of terms deemed a failure of required disclosure) creates an obligation to refund all finance charges and fees paid by the mortgagor. Under the amendments, the disclosure provisions may be enforced by state attorneys general, although the responsible federal agency

may intervene, remove the case to federal district court, and file an appeal. The act also eliminates holder-in-due-course protection for assignees of such mortgages, thereby subjecting them to all claims and defenses assertable against the originator, unless the assignee can prove that a reasonable person exercising due diligence could not have discovered that the mortgage was a high-rate or high-fee mortgage.

The act also regulates disclosure with respect to reverse mortgages, defined as nonrecourse mortgages against a principal dwelling in which payment of principal, interest, and shared appreciation or equity is not due except upon default, transfer of the dwelling, death of the consumer, or the consumer's ceasing to occupy the residence as a principal dwelling. Included in the required financial disclosures are three estimates of the total cost of the mortgage, each based on a different loan term, the longest of which is to be specified by the Board of Governors.

The Board of Governors must issue regulations implementing this subtitle by March 22, 1995. In addition, the Board must assess the adequacy of consumer protections under the Truth in Lending Act with respect to open-end credit transactions and whether an index more appropriate than Treasury securities is available for the floating rate disclosure trigger in that act. In addition, the Board shall conduct hearings within three years and regularly thereafter on the adequacy of consumer protections and related issues in the market for home equity loans.

## Title II-A

Title II-A, the Small Business Loan Securitization and Secondary Market Enhancement Act of 1994, removes impediments to securitizing loans that

have been extended to small businesses. Under the act, a small-business-related security is (1) rated in one of the four highest categories by at least one nationally recognized rating agency, (2) represents an interest in one or more promissory notes on, or leases of, personal property that are either the obligation of a small business or secured by such an interest, and (3) has payments of principal that are related to payments or projected payments on the underlying notes or leases.

To facilitate the development of a forward trading and delivery market in such securities, the act exempts from margin regulations certain agreements for delayed delivery of the securities.

The act authorizes national banks, federal savings associations, and federal credit unions to purchase small-business-related securities for their own account without limitation on amount but subject to regulations on minimum issue size. The act also extends to such securities the provisions of the Secondary Mortgage Market Enhancement Act except in states that pass legislation to exclude themselves from the provisions that apply to state law.

The act specifies certain accounting procedures to be followed by depository institutions and federal banking agencies. Among these provisions is the requirement that statements filed with the agencies must apply generally accepted accounting principles to the transfer with recourse of small business loans or leases. In addition, qualified insured depository institutions must provide reserves against estimated liabilities from with-recourse transfers of such loans or leases that are accounted for as sales; such institutions are permitted, however, to include only the retained amount of recourse in their risk-weighted assets for capital adequacy purposes.

For purposes of prompt corrective action, the capital condition of an insured institution is to be calculated without regard to the accounting principles or capital requirements for securitized small business loans. The federal banking agencies, which are permitted to create alternative provisions that do not increase the amount of capital required for transfer with recourse of small business loans and leases, have 180 days from enactment to promulgate final regulations for such transfers.

The Board of Governors and the Securities and Exchange Commission (SEC) must evaluate, among other things, the effect of the act on businesses generally, on businesses in low-income and moderate-income areas or owned by minorities and women, and on community development efforts. The study is to be reported to the Congress within two, four, and six years of enactment.

## Title II-B

Title II-B, Small Business Capital Enhancement, encourages states to implement programs that help banks and other depository institutions provide small businesses with access to loans. It authorizes \$50 million to be administered, if appropriated, by the Community Development Financial Institutions Fund.

Effective January 6, 1996, a state with a legal financial commitment to a capital access fund of at least \$0.50 per resident may apply to participate in, and be partially reimbursed by, the fund. Participating states may enter into participation agreements with appropriate financial institutions (as determined after consultation with the relevant federal banking agency). The act specifies the permitted scope of the participation agreements, the reports that participat-

ing states must file with the fund, and the conditions of reimbursement to the states.

## Title III

Title III, Paperwork Reduction and Regulatory Improvement, enacts changes to current law to reduce the regulatory burden on insured depository institutions and their customers and calls for studies in areas where the regulatory burden might be further reduced. One provision specifies that the federal banking agencies shall make new regulations take effect at the start of the calendar quarter following publication unless dictated otherwise by an act of the Congress, or provisions of the Administrative Procedure Act, or the findings of the agency (including, in the case of the Board, the exigencies of monetary policy).

In addition, each federal banking agency and the National Credit Union Administration Board must establish an independent appeals process for material supervisory decisions and create safeguards to protect appellants from retribution. Material supervisory determinations do not include the appointment of a conservator, receiver, or liquidating agent or a decision to take prompt corrective action. The agencies must also each appoint an ombudsman and develop alternative processes for resolving disputes.

In the two years commencing September 23, 1994, the federal banking agencies must review their regulations and written policies to improve efficiency, reduce unnecessary costs, eliminate unwarranted constraints on credit availability, and remove inconsistent, outmoded, and duplicative requirements, particularly with regard to regulations for real estate lending. In that regard, the act directs the Board of Gov-

ernors to seek ways to simplify the disclosures on variable rate mortgages that it requires under the Truth in Lending Act to make them more meaningful to consumers and to report to the Congress within two years of completing its work.

#### *Unified Regulations, Examinations, and Call Reports*

The federal banking agencies are to make uniform their regulations and guidelines implementing common statutes and supervisory policies, eliminate duplicative requests for information in connection with applications and notices, and harmonize their requirements regarding publication and notice. Moreover, within two years of enactment, the agencies are to establish a system for determining in most situations which federal regulator shall be the lead agency responsible for managing a unified examination of each insured depository institution and its affiliates. The agencies must report annually to the Congress on this system and their progress in implementing it.

The act also specifically liberalizes the conditions, laid down in the Federal Deposit Insurance Act, that permit the extension of the period between full, on-sight examinations of insured institutions from the normal twelve months to as long as eighteen months; it adds a limitation, however, that prohibits an extension of time between examinations for any institution that is subject to a formal enforcement proceeding or order by its primary regulator or the FDIC.

The federal banking agencies must jointly develop a system in which Reports of Condition and Income (Call Reports) and bank holding company reports can be filed with the agencies and made available to the public electronically and make recommendations to the Congress within one year of enactment for legislation to enhance

efficiency for filers and users. Also, the agencies must, in a manner consistent with safety and soundness, develop a single form for the filing of core information that is to be submitted to more than one agency, simplify the instructions for such reports, and eliminate all unwarranted supplemental noncore information. The act also eliminates the requirement for the publication of Call Reports, although the reports remain otherwise available to the general public.

#### *Holding Companies*

For qualified transactions, the act expedites the formation of a bank holding company by replacing the application to the Board with a thirty-day notice to the Board. The transaction qualifies for the notice process if the existing bank is adequately capitalized, proportionate ownership is preserved (except for the exercise of dissenting shareholders' rights), the holding company meets the Board's capital standards, and the holding company neither acquires another bank nor engages in any activity other than controlling the bank as a result of the reorganization.

For acquisitions of shares in certain companies so closely related to banking or to managing or controlling banks as to be considered a proper incident thereto, the act replaces the current application procedure with a sixty-day notice procedure. The Board may, by regulation, provide shorter notice periods and may extend the notice period for an additional ninety days in the case of activities not previously approved by regulation. And the act eliminates the requirement that bank holding companies obtain Board approval in advance for mergers or acquisitions of savings associations by subsidiary banks; under the Bank Merger Act, these transactions are already subject to review by

the primary regulator of the surviving bank.

The act similarly exempts from registration with the SEC the formation of bank or savings association holding companies if the rights of the security holders and the underlying assets and liabilities are unchanged (except for nominal changes from dissenter's rights or fractional shares).

#### *Payment of Interest on Reserves*

The Board of Governors, in consultation with the FDIC and the National Credit Union Administration, must study whether an effective monetary policy requires insured institutions to maintain reserves; consider whether paying a market rate of interest on reserves, either to the institutions or to the deposit insurance funds, would be appropriate; and calculate the income lost by institutions now required to hold non-interest-bearing reserves and the effect of the requirement on their ability to compete with nonbank providers of financial services. The results of the Board's study—as well as an estimate to be prepared jointly by congressional and executive branch research on the budgetary effect of such interest payments—are to be reported to the Congress within 180 days of enactment.

#### *Other Provisions*

Title III reduces, from two thirds to a majority, the number of the directors of national banks required to reside in the state, territory, or district where the bank is located. In other provisions, title III makes modifications, not mentioned above, to the Bank Secrecy Act, the Bank Service Corporation Act, the Depository Institutions Management Interlocks Act, the Expedited Funds Availability Act, the Fair Credit Reporting Act, the Federal Deposit Insurance Act, the FDIC Improvement Act, the

Federal Reserve Act, the Real Estate Settlement Procedures Act of 1974, the Truth in Lending Act, and the Truth in Savings Act.

#### Title IV

The goal of title IV, the Money Laundering Suppression Act of 1994, is to reduce the number of transactions reports by depository institutions by 30 percent, mainly by requiring Treasury to exempt institutions from reporting on transactions that have little or no law enforcement value. Under the act, Treasury may also exempt transactions with qualified business customers that maintain active transaction accounts; the criteria for qualification, to be determined by Treasury, may include descriptions of types of qualifying business or a list of specific businesses that fail to qualify. Treasury must report to the Congress within 180 days of enactment on the progress made toward the goal and must further report to the Congress on progress after the end of each of the first five calendar years following enactment.

The act adds checks, drafts, notes, money orders, and other similar negotiable instruments drawn on or by a foreign financial institution to the list of monetary instruments subject to record keeping and reporting requirements.

Among its additional provisions, title IV calls on the federal banking agencies, Treasury, and law enforcement agencies to sharpen and streamline their procedures for sharing information; requires money transmitting businesses to register with Treasury; adds casinos with revenues in excess of \$1 million (including those operated under the Indian Gaming Regulatory Act) to the definition of financial institution for purposes of the money laundering statutes; expands the application of civil penalties and adds criminal penalties with

regard to certain money laundering activities; encourages states to enact uniform laws regulating nondepository businesses that cash checks, transmit funds, and so on; and orders a study by the Comptroller General of the United States concerning the role of cashiers checks in money laundering schemes.

## Title V

Under title V, the National Flood Insurance Reform Act of 1994, federal agencies that accept applications for funds to restore flood-damaged structures cannot waive the requirement that current applicants who have received such assistance in the past must have been covered by flood insurance at the time of the loss for which they now seek assistance.

In addition, to assure that areas of flood hazard are identified, that maps of such areas are readily available, and that mortgages on structures built in those areas carry the proper flood insurance, title V, among other provisions, establishes procedures for more extensive coordination among regulatory agencies, public and private lenders, and the Federal Emergency Management Agency and tighter flood-related requirements in property sales, loan originations, and loan servicing.

As of September 23, 1995, the Federal National Mortgage Association and the Federal Home Loan Mortgage Association must have procedures in place to assure that loans they purchase carry flood insurance if the loans relate to property in designated flood hazard areas for which national insurance is available.

As of the date of enactment, lenders and loan servicers must buy flood insurance coverage at the expense of the borrower for any property in an area that is or has become a designated flood hazard area if the borrower fails to obtain such

coverage within forty-five days' notice. Within one year of enactment, lenders that require any escrowing on a loan that requires flood insurance must also require the escrowing of flood insurance premiums on that loan.

The act provides for reasonable fees to be collected by lenders and loan servicers in making certain determinations regarding the flood-related requirements of a particular loan and likewise establishes penalties for violations of the act by lenders or sellers.

## Bankruptcy Amendments of 1994

The Bankruptcy Amendments of 1994, Public Law 103-394, were enacted on October 22, 1994. This law makes numerous adjustments to the balance among the various classes of debtors, owners and management in bankruptcy proceedings.

One provision of particular interest amends the definition of "swap agreement" under the Bankruptcy Code. The code provides special protection for certain rights of participants in swap agreements, including the rights of termination, set-off, and netting in forward foreign exchange contracts.

The amendment adds spot foreign exchange contracts to the coverage afforded forward contracts. Because netting agreements among market participants usually include spot foreign exchange contracts as well as forward contracts, this provision confirms the understanding of market participants that closing out, setting off, and netting such spot contracts is valid under the Bankruptcy Code. ■



## *Banking Supervision and Regulation*

During 1994 the U.S. commercial banking system reported record earnings for the third consecutive year, as general economic conditions continued to improve both domestically and abroad. These robust earnings reflected continued progress by the industry in reducing nonperforming loans and their related costs, while generally maintaining net interest revenues. In addition, renewed growth in commercial lending and continuing strong demand for consumer loans produced a solid expansion of bank loan portfolios and ended a multi-year period of credit constraint.

In this generally favorable environment, the number and assets of failed commercial banks continued to decline, reaching the lowest levels since the early 1980s. Similarly, the number and assets of problem banks continued to decline sharply. These trends, combined with progress by the industry to strengthen its asset quality while maintaining its overall capital ratios, reflect favorably on the industry's condition and its ability to meet the nation's financial needs.

Despite the industry's general strength, pockets of weakness persisted, particularly in Southern California. The majority of commercial bank failures for 1994 occurred in Southern California where many banks continued to have asset quality problems.

In addition, rising market interest rates throughout most of 1994 increased pressure on bank net interest margins and had particularly adverse effects on the market values of the industry's trading and investment portfolios. Rising rates and other market uncertainties also

sharply reduced the trading revenues of most money center banks from their exceptionally high levels of 1993. These developments underscored the importance of sound risk management practices at banks and other participants in financial markets.

The expansion of the securities activities of U.S. banks for trading and for investment purposes and the increasing complexity of financial products typified by derivative instruments necessitated the Federal Reserve's placing greater emphasis on risk management practices at banks and bank holding companies. Through its own efforts and through activities conducted in cooperation with other U.S. and foreign supervisory authorities, the Federal Reserve took important steps in 1994 to augment its oversight of market risks. The Federal Reserve adopted a new Trading Activities Manual, and issued other advisories to its examiners and regulated institutions to strengthen industry practices and clarify supervisory standards.

The Federal Reserve, along with other banking agencies, took steps to adjust and strengthen the risk-based capital standards during 1994 in the areas of market risk and interest rate risk. The Board also addressed issues related to mutual funds, structured notes, and netting arrangements for capital purposes; and it continued the process of implementing the Foreign Bank Supervision Enhancement Act of 1991, including the development and implementation of a comprehensive program for supervising foreign banking organizations in the United States.

## Scope of Responsibilities for Supervision and Regulation

The Federal Reserve is the 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 safe and sound operation and their compliance with laws and regulations, including the Bank Secrecy Act and consumer and civil rights laws.<sup>1</sup> The Federal Reserve also examines the following specialized activities of these institutions: electronic data processing, fiduciary activities, mutual fund activities, government securities dealing and brokering, municipal securities dealing, securities clearing activities, and securities underwriting and dealing through special subsidiaries.

The Federal Reserve also has responsibility 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 organizations in the United States.<sup>2</sup> The Foreign Bank

Supervision Enhancement Act of 1991 increased the Federal Reserve'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; it also undertakes enforcement and other supervisory actions.

#### *Examinations and Inspections*

The on-site review is an integral part of ensuring the safety and soundness of financial institutions. 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 man-

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. 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.

agement, including internal policies, controls, 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 1994, 980 state-chartered banks belonged to the Federal Reserve System, an increase of 8 from year-end 1993. These banks represented about 9 percent of all insured commercial banks and held about 21 percent of all insured commercial bank assets.

Federal Reserve examination guidelines are fully consistent with section 10 of the Federal Deposit Insurance Act as amended by section 111 of the Federal Deposit Insurance Corporation Improvement Act of 1991 and by the Riegle Community Development and Regulatory Improvement Act of 1994.

In conformance with legislated and internal examination guidelines, state member banks were examined as required in 1994. Altogether, the Reserve Banks conducted 693 examinations (some of them jointly with the state agencies), and state banking departments conducted 316 independent required examinations. Reserve Bank officials held 291 meetings with directors of large state member banks and those that displayed significant weaknesses as required under Federal Reserve examination guidelines.

#### *Bank Holding Companies*

At year-end 1994 the number of bank holding companies totaled 6,019, a decline of 92 from the preceding year. These organizations controlled about 7,805 insured commercial banks and held approximately 94 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, and 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 consult the examination reports of the federal and state banking authorities that have primary responsibility for the supervision of these banks. In 1994, the Federal Reserve inspected 1,926 bank holding companies. Altogether, Federal Reserve examiners conducted 1,984 bank holding company inspections and state examiners conducted 51 independent inspections. During 1994, Reserve Bank officials held 348 meetings with the boards of directors of bank holding companies to discuss supervisory concerns.

#### **Enforcement Actions, Civil Money Penalties, and Significant Criminal Referrals**

In 1994 the Federal Reserve Banks recommended, and members of the Board's staff initiated and worked on, 174 formal enforcement cases involving 399 separate actions such as written agreements, cease and desist orders, removal and prohibition orders, civil money penalties and prompt corrective action directives. Of these, 56 cases involving 117 actions were completed by year-end. Of particular note was the completion of a formal action, in conjunction with the Securities and Exchange Commission and the Commodities Futures

Trading Commission, addressing the deficiencies of a money center bank's leveraged derivatives business.

All final enforcement actions issued by the Board of Governors and all written agreements executed by the Federal Reserve Banks in 1994 are available to the public. Besides formal enforcement actions, the Federal Reserve Banks completed 128 informal enforcement actions, such as memoranda of understanding, commitment letters, and board resolutions.

In 1994 the staff of the Division of Banking Supervision and Regulation forwarded 529 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 banking organizations regarding electronic data processing, fiduciary activities, government securities dealing and brokering, municipal securities dealing, securities clearing, and securities underwriting and dealing through so-called section 20 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 (EDP) 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. During 1994, the Federal Reserve conducted 330 EDP examinations. The

Federal Reserve also was the lead agency on three examinations of large Multiregional Data Processing Services examined on an interagency basis 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 \$5.7 trillion of discretionary and nondiscretionary assets in various fiduciary capacities. This group of institutions includes 291 state-chartered member banks and trust companies and 71 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 and control procedures, and risk management, (2) an assessment 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 1994, Federal Reserve examiners conducted 186 on-site trust examinations of state member banks and trust companies, which held approximately \$3 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 and four state branches of foreign banks have notified

the Board that they are currently government securities dealers or brokers that are not exempt from Treasury's regulations. During 1994 the Federal Reserve conducted twenty-eight 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 1994, the Federal Reserve examined all three of the clearing agencies and twenty-four of the banks that deal in municipal securities.

#### *Securities Subsidiaries of Bank Holding Companies*

Section 20 of the Banking Act of 1933 (the Glass-Steagall Act) prohibits the affiliation of a member bank with a company that is "engaged principally" in underwriting or dealing in securities. The Board in 1987 approved proposals by banking organizations to underwrite and deal on a limited basis in specified classes of bank "ineligible" securities (that is, commercial paper, municipal revenue bonds, conventional residential mortgage-related securities, and securitized consumer loans) in a manner consistent with 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 subsequently 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 1994 thirty-six bank holding companies had so-called section 20 subsidiaries authorized to underwrite and deal in ineligible securities. Of these, sixteen could underwrite any debt or equity security; four could underwrite any debt security; and sixteen 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 thirty such inspections in 1994.

#### *Transfer Agents*

Federal Reserve examiners also conduct examinations of state member banks and bank holding companies that are registered transfer agents. Among other things, transfer agents counter-sign and monitor the issuance of securities, register their transfer, and exchange or convert such securities. During 1994, Federal Reserve examiners conducted on-site examinations at 93 of the 195 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 as a whole. 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 an examination rating model, which is used to track the overall financial condition of individual organizations.

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 banking 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 1994, the Federal Reserve examined all seventy six 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 1994, the Federal Reserve conducted full-scope and targeted-scope examinations of ten foreign branches of state member banks and thirty-one 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 5 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 1994, 277 foreign banks from 61 countries operated 494 state-licensed branches and agencies of which 33 are insured by the Federal Deposit Insurance Corporation, as well as 73 branches and agencies licensed by the Office of the Comptroller of the Currency, of which 8 have FDIC insurance. These foreign banks also directly owned 12 Edge Act corporations and 4 commercial lending companies. In addition, they held an equity interest of at least 25 percent in 85 U.S. commercial banks. Altogether, these U.S. offices of foreign banks control approximately 21 percent of U.S. banking assets. These foreign banks also operated 139 representative offices. An additional 100 foreign banks operated in the United States solely through a representative office.

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 736 such offices during 1994.

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 for the establishment of branches, agencies, commercial lending company subsidiaries, and representative offices by foreign banks in the United States.

In 1994, applications by 21 banks from 13 foreign countries were approved to establish branches, agencies, and representative offices.

#### *Representative Offices*

FBSEA gave the Board supervisory responsibility, including examination authority, over the activities of representative offices of foreign banks. As of year-end 1994, 246 representative offices of foreign banks were registered with the Federal Reserve System.

#### *Joint Program for Supervising the U.S. Operations of Foreign Banking Organizations*

A cooperative effort among the state and federal banking supervisory agencies has been developed over the past two years to provide a more comprehensive framework for supervising the U.S. operations of foreign banking organizations (FBOs). This program has taken supervisory concepts and methods in use for more than a decade and adapted them to a framework that will process and distribute supervisory information to all U.S. supervisors in a logical, uniform, and timely manner.

The program consists of two major parts. The first segment of the program, which is focused primarily on those FBOs that have multiple U.S. entities, is

intended to better coordinate the efforts of the various domestic supervisory agencies through the development of a supervision strategy for the total U.S. operations of individual FBOs. As part of this process, the U.S. banking agencies will communicate more fully with each other regarding the individual U.S. operations which they examine and supervise.

The second part of the program consists of a review of the financial and operational profile of each FBO in order to assess the general ability of an FBO to support its U.S. operations and to determine what risks, if any, the FBO poses through its U.S. operations. This process, which is separate and distinct from the supervisory process conducted by the FBO's home country supervisor, is intended to reach basic conclusions regarding the strength of support that individual FBOs can provide to their U.S. operations. Together, the two processes will provide critical uniform information to the U.S. supervisors that will be used in determining the extent to which supervisory follow-up action is warranted for one or more U.S. offices of an FBO.

#### *Examination Manual*

Over the past two years, the U.S. state and federal banking agencies have worked together to develop a manual for conducting individual examinations of the U.S. branches and agencies of FBOs.

It is expected that the manual will serve as a primary, comprehensive reference source for examination guidelines and procedures for both examiners and the foreign banking community in the United States. The manual is to be available to the public in the first quarter of 1995 and will be updated periodically to reflect new or revised supervisory policies and procedures.

#### *Technical Assistance*

In 1994 the System provided staff members for a number of technical assistance missions and training sessions on bank supervisory matters at numerous central banks in countries of the former Soviet Union, in Eastern Europe, and in the Caribbean and Latin America.

### **Supervisory Policy**

The Board amended its guidelines on risk-based capital and leverage and released for public comment some other proposals in that area. The Board also issued several other statements of guidance, some in association with the Basle Supervisors' Committee.

#### **Risk-Based Capital Standards**

The risk-based capital requirements adopted by the Board in 1989 remained in effect in 1994. These requirements implement the international risk-based capital standards that were proposed by the Basle Committee on Banking Regulation and Supervisory Practices (Basle Supervisors' Committee) and endorsed by the Group of Ten (G-10) countries in July 1988. The standards include a framework for calculating risk-adjusted assets and assigning the assets to broad categories based primarily on credit risk. Banking organizations are expected to maintain capital equal to at least 8 percent of their risk-adjusted assets.

To supplement the risk-based capital standards, the Board in 1990 also issued leverage guidelines setting forth minimum ratios of capital to total assets to be used in the assessment of an institution's capital adequacy.

#### *Amendments*

During 1994 the Board adopted amendments to its risk-based and leverage capital guidelines in the following areas.



*Securities available for sale.* The Board adopted a final amendment, effective December 31, 1994, that generally directs state member banks and bank holding companies to not include in regulatory capital the "net unrealized holding gains (or losses) on securities available for sale," the common stockholders' equity account created by the Financial Accounting Standards Board's issuance of Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (SFAS 115). Net unrealized losses on marketable equity securities (that is equity securities with readily determinable fair values), however, are to continue to be deducted from tier 1 capital. This amendment has, for purposes of calculating the risk-based and leverage capital ratios, the effect of valuing available-for-sale securities at amortized cost, rather than at fair value.

*Bilateral netting.* The Board adopted a final rule, effective December 31, 1994, expanding the recognition of bilateral netting arrangements for risk-based capital purposes. This final amendment implements a recent revision to the Basle Accord permitting the recognition of such arrangements. Under the amendment, state member banks and bank holding companies with qualifying, enforceable netting arrangements may net (that is, offset) the positive and negative market values of interest and exchange rate contracts in determining the current exposure portion of the credit equivalent amount of such contracts included in risk-weighted assets.

*Deferred tax assets.* On December 14, 1994, the Board adopted a final rule amending the risk-based capital and leverage guidelines for state member

banks and bank holding companies to limit the amount of certain deferred tax assets that may be included in (that is, not deducted from) tier 1 capital for risk-based and leverage capital purposes. The capital rule was developed in response to SFAS 109, "Accounting for Income Taxes," and is consistent with recommendations set forth by the Federal Financial Institutions Examination Council. Under the amendment, deferred tax assets that can be realized only if an institution earns taxable income in the future are limited for regulatory capital purposes to the amount that the institution expects, based on its projection of taxable income, to realize within one year of the quarter-end report date or 10 percent of tier 1 capital, whichever is less. Deferred tax assets that can be realized from taxes paid in prior carryback years would generally not be limited. This amendment is to become effective April 1, 1995.

*Concentration of credit risk and risks of nontraditional activities.* On December 15, 1994, the Board, together with the other banking regulatory agencies, issued a final rule implementing portions of section 305 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). The final rule amends the risk-based capital standards by explicitly identifying concentrations of credit risk and certain risks arising from nontraditional activities, as well as an institution's ability to manage these risks, as important factors in assessing an institution's overall capital adequacy. This amendment is to become effective on January 17, 1995.

#### *Proposals*

During 1994 the Board issued for public comment several proposals with regard to its risk-based capital standards.

*Recourse.* On May 25, 1994, the Board, along with the other regulatory banking agencies, published in the Federal Register a notice of proposed rulemaking (NPR) and an advance notice of proposed rulemaking (ANPR) requesting public comment on various recourse issues. The proposed rulemaking would lower the risk-based capital requirement for assets sold with low levels of recourse. The advance notice of proposed rulemaking outlined an alternative approach to deal comprehensively with the capital treatment of recourse transactions and securitizations. The comment period ended on July 25, 1994.

Subsequently, on September 23, 1994, the Riegle Community Development and Regulatory Improvement Act was enacted. Section 350 of the act requires the federal banking agencies to issue regulations limiting the amount of risk-based capital an insured depository institution can be required to hold for assets transferred with recourse to the maximum amount of recourse for which the institution is contractually liable. The regulations are required to be in effect by March 22, 1995. A more specific proposal responding to comments on the ANPR and taking into account subsequent staff analysis is also expected to be issued in 1995.

*Derivatives transactions.* On August 24, 1994, the Board issued a proposal for public comment based on proposed revisions to the Basle Accord addressing various issues relating to the capital treatment of off-balance sheet derivative transactions. The Board's proposal would revise and expand the set of conversion factors used to calculate the potential future exposure of derivative contracts and recognize the effects of bilateral netting arrangements in the calculation of potential future exposure for derivative contracts subject to qualify-

ing bilateral netting arrangements. The comment period for the proposal ended in October 1994. A final amendment is expected in 1995 after revisions to the Basle Accord have been endorsed.

*Country transfer risk.* Following an announcement by the G-10 governors in July 1994 that they intended to modify the Basle Accord in 1995 with regard to country transfer risk, the Federal Reserve Board, in conjunction with the Office of the Comptroller of the Currency, on October 14, 1994, proposed a revision to their respective risk-based capital standards. The revision, like the proposed modification to the accord, would retain the OECD-based group of countries as the principle criterion for preferential risk-weight status but would exclude for five years any country that reschedules its external sovereign debt. The modification to the accord and the risk-based capital standards was proposed to ensure that membership in the OECD-based group of countries coincides with relatively low transfer risk in order for a country to be eligible for preferential capital treatment. The Board expects to issue a final revision sometime in 1995 after a final revision to the Basle Accord is endorsed.

*Interest rate risk.* Section 305 of FDICIA requires the bank regulatory agencies to incorporate interest rate risk in the risk-based capital framework. Accordingly, in September 1993 the Board issued a proposal for incorporating such risk into the assessment of capital adequacy. The approach taken in the proposal sought 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. The Board has been working with the other bank-

ing agencies to analyze the public comments and refine the proposal. The banking agencies expect to publicize a revised and enhanced approach to section 305 later in 1995.

### Retail Sales of Nondeposit Investment Products

The federal banking agencies issued a joint statement on February 15, 1994, "Retail Sales of Nondeposit Investment Products," which provides comprehensive guidance regarding such sales on the premises of depository institutions. The interagency statement, which unifies and supersedes the separate statements issued by the banking agencies in 1993, is designed to ensure that adequate disclosures are made to consumers regarding the investment characteristics and risks of nondeposit investment products. The disclosures are also intended to make sure that consumers understand that these investments are not insured by the federal government or the issuing banking organization.

The interagency statement applies to depository institutions, including state member banks, and branches and agencies of foreign banks under the Board's supervision. It emphasizes the importance of adopting comprehensive policies and procedures governing sales programs. Specifically, it addresses disclosure and advertising; separation of sales programs from deposit-related activities; compensation, training, and supervision of employees; and sales practice and suitability issues. The statement also addresses third-party arrangements, including the responsibilities of third parties that conduct retail sales programs on depository institution premises.

In May the Federal Reserve issued finalized examination procedures that address the guidelines contained in the

interagency statement. It is anticipated that the examination procedures will be updated as additional information about industry practices is obtained from examiners and as the federal banking agencies issue additional guidance on the subject.

On January 3, 1995, the banking agencies that were party to the interagency statement entered into an "Agreement in Principle" with the National Association of Securities Dealers (NASD). The agreement calls for the interagency coordination of the supervision and examination of bank-affiliated broker-dealers subject to the joint jurisdiction of a banking agency and the NASD. The agreement is intended to avoid duplication of supervisory efforts, lessen the burden on the broker-dealers and enhance the overall supervisory process.

### Structured Note Guidance

Recognizing the growing use of structured notes by banking organizations, the Federal Reserve issued guidance on these instruments to examiners through a supervisory letter. The guidance emphasized the need for examiners to ensure that banking organizations that hold structured notes do so according to their own investment policies and procedures and with a thorough understanding of the risks and price sensitivity of these instruments under a broad range of market conditions. As experience has shown, some of these instruments can expose investors to significant losses as interest rates, foreign exchange rates, and other market indexes change. While alerting the industry and Federal Reserve examiners to the potential risk in structured notes, the statement also acknowledged that these instruments can be appropriate investment products for banks where adequate risk manage-

ment systems are in place and where the institution fully understands its overall risk profile and the risk profile of its individual investments.

### Derivatives Activities

The Federal Reserve and the Basle Supervisors Committee (BSC) have a number of initiatives under way to ensure that institutions involved in derivative and capital markets activities follow safe and sound management practices, maintain adequate capital levels, and report the results of these activities in a transparent manner. In 1994, the BSC issued guidance on sound management practices for derivative activities and moved forward on proposals to revise the capital requirements for equity, commodity, and long-dated derivative contracts. Also, the Federal Reserve is continuing to work with the BSC to develop an international supervisory reporting framework for off-balance-sheet derivatives. These activities also included consultation with international working groups on various initiatives regarding the adequacy of derivative activities' disclosures and appropriate application of accounting standards for both public and supervisory purposes. In 1995, the Federal Reserve and the BSC plan to expand these initiatives and develop additional guidance on derivatives. In addition, the Federal Reserve is working with other agencies to develop possible approaches for improving the accounting and disclosure standards for derivative activities.

### Real Estate Appraisals

On June 7, 1994, the Board and the other banking agencies issued a final rule amending their appraisal regulations. The amendments furthered federal financial and public policy interests by

reducing regulatory burden while requiring appraisals when necessary to protect the safety and soundness of financial institutions or otherwise advance public policy. The final rule increases to \$250,000 the threshold at or below which appraisals are not required pursuant to title XI of Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), expands and clarifies existing exemptions from the agencies' appraisal requirement, and identifies additional circumstances in which appraisals are not required. The final rule also amends existing requirements governing appraisal content and the use of appraisals prepared by other financial services institutions.

On October 27, 1994, the agencies issued conforming revisions to their appraisal and evaluation guidelines. These guidelines address supervisory matters relating to appraisals and evaluations used to support real estate-related financial transactions and provide guidance to examining personnel and federally regulated institutions about prudent appraisal and evaluation policies, practices, and standards.

During 1994 the Board, in conjunction with the other banking and thrift regulatory agencies, issued orders granting relief from certain real estate appraisal requirements for areas affected by three different major natural disasters. The relief was granted to areas affected by the January 1994 California earthquake, the July 1994 flooding in the southeastern United States, and the October 1994 flooding in and around Houston, Texas. The Board acted under provisions of the Depository Institutions Disaster Relief Act of 1992.

### National Information Center

In 1994 the Board's Division of Banking Supervision and Regulation assumed

overall responsibility for the National Information Center (NIC). The NIC, a database shared by the Reserve Banks and maintained at the Board of Governors, comprises structure data for banks, nonbanks, and holding companies; financial information, such as Call Report data for banks and FR-Y report data for bank holding companies; and supervisory information. The NIC database enables end-users to analyze institutional structures, together with applicable financial information, and any supervisory data associated with the institution.

Critical steps were taken to implement the Supervisory Information System (SIS) as part of the NIC mainframe environment during 1994. The SIS system also contains supervisory data on institutions regulated by other banking agencies, such as state nonmember banks and national banks. A significant improvement to the SIS was the addition of international data for U.S. holding companies and foreign banking organizations with activities in the United States. Board and Reserve Bank staff developed a new software release of the systems during 1994, completed user documentation that outlined procedures for the input of supervisory data, and conducted training seminars for staff members throughout the System.

During 1994 the Board continued to implement an executive information tool for the personal computer called the Federal Reserve Examination Database (FRED). This application enables end-users to conduct on a personal computer complex institutional analyses employing all of the information contained within the NIC.

### Staff Training

The Supervisory Education Program is charged with effectively training staff

members with supervisory or regulatory responsibilities at the Reserve Banks, the Board of Governors and state banking departments. The program covers the four disciplines of bank supervision: bank examinations, bank holding company inspections, surveillance and monitoring activities, and the applications process. The program provides cross training at basic, intermediate, and advanced levels. Classes may be conducted in Washington, D.C., or at regional locations and may be held jointly with regulators of other financial institutions. Training is extended to staff members of the Division of Banking Supervision and Regulation as well as to staff members of other divisions whose activities involve the System's supervisory and regulatory processes. Students from supervisory counterparts in foreign countries also attend on a space-available basis. The objective of the program is to provide students with an increased awareness and knowledge of the total supervision and regulation process, including the interrelationships of the four functional areas, thus providing a higher degree of potential substitutability among staff members.

The System participates in Federal Financial Institutions Examination Council (FFIEC) training and, to a limited extent, in the training offered by certain other regulatory agencies. Activities include developing and implementing basic and advanced training in various emerging issues as well as in such specialized areas as trust activities, international banking, electronic data processing, activities of municipal securities dealers, off-balance-sheet risk, payment systems risk, white collar crime, preparation and presentation of testimony, income property lending, management, and instructor training. It also co-hosts the World Bank Seminar for students from developing countries.

During 1994 the Federal Reserve conducted a variety of schools and seminars, and Federal Reserve staff participated in several courses offered by co-sponsored agencies, as shown in the accompanying table.

In 1994 the Federal Reserve trained 3,402 persons in System schools, 1,219 in schools sponsored by the FFIEC, and 176 in other schools for a total of 4,927 students including 130 representatives from foreign central banks. The number of student days of training in 1994 was 25,036, compared with 26,938 in 1993 and 20,555 in 1992.

The Federal Reserve System also gave scholarship assistance to the states

for training their examiners in Federal Reserve and FFIEC schools. Through this program 672 state examiners were trained; 390 in Federal Reserve courses, 278 in FFIEC programs, and 4 in other courses. The Federal Reserve continued its joint core supervision schools with the FDIC with respect to the three core schools attended by newly hired examination and inspection staff.

Every staff member wishing to obtain an examiner's commission is required to demonstrate mastery of the core curriculum and other specialty areas by passing the Core Proficiency Examination. In 1994, fifty-seven staff members took the examination and fifty-two passed.

Training Programs for Banking Supervision and Regulation, 1994

Program	Number of sessions	
	Total	Regional
<i>Schools or seminars conducted by the Federal Reserve</i>		
ETS I, Introduction to examinations	11	3
ETS II, Financial institution analysis	17	8
ETS III, Loan analysis	15	13
ETS IV, Bank management	6	1
Effective writing for banking supervision staff	24	26
Management skills	20	9
Conducting meetings with management	27	17
Real estate lending seminar	9	2
Senior lending seminar	4	1
Senior forum for current banking and regulatory issues	4	..
Bank operations	8	5
Bank holding company applications	2	..
Bank holding company inspection	10	6
Basic entry-level trust	1	..
Advanced trust	1	..
Consumer compliance examination I	2	..
Consumer compliance examination II	3	..
Advanced CRA examination techniques	..	..
Fair lending	2	..
Advanced EDP examination	1	..
EDP continuing education	1	..
Capital markets seminar	7	7
Section 20 securities seminar	4	..
Seminar for senior supervisors of foreign central banks <sup>1</sup>	2	1
<i>Other agencies conducting courses<sup>2</sup></i>		
Federal Financial Institutions Examination Council	67	19
Federal Deposit Insurance Corporation or Office of the Comptroller of the Currency	9	1
Federal Bureau of Investigation <sup>3</sup>	2	2

NOTE. ETS is Examiner Training School; CRA is the Community Reinvestment Act; EDP is electronic data processing.

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.

## Federal Financial Institutions Examination Council

In November 1994 the Federal Reserve and the other federal banking agencies announced, under the auspices of the FFIEC, improvements to disclosures of off-balance-sheet derivatives that are reported in bank Call Reports. Under the enhanced framework, banks will report gross or notional amounts of derivative contracts, broken down by class of instrument (for example futures, forwards, swaps, and options), type of risk exposure (for example interest rate, foreign exchange, equity, and commodity), maturity, and use of the instruments (for example trading and other than trading). Information will also be collected on the gross positive and negative fair values of derivatives broken down by type of risk exposure and use of the instruments. In addition, information will be collected on the net credit exposure (reflecting legally enforceable bilateral netting contracts) and the potential future exposure, and on the earnings effect of derivatives on bank trading revenues and net interest margins.

In November 1994 the FFIEC also announced several deletions to existing items and other revisions to the Call Report. These deletions, effective as of the March 31, 1995, reporting date, reflect the results of a comprehensive review of the information collected in Call Reports for the purpose of eliminating items no longer considered necessary. Based on this review, more than twenty items were removed from the Call Report. In addition, new items were added to permit the agencies to more effectively monitor bank investments in high-risk mortgage securities and structured notes, sales of mutual funds and annuities, and other areas.

During 1994 the FFIEC issued clarifications to the December 1991 "Super-

visory Policy Statement on Securities Activities." The guidance clarifies that, consistent with SFAS 115, collateralized mortgage obligations (CMOs) may be reported as held-to-maturity assets at amortized cost. The FFIEC also issued guidance on issues arising from the adoption, for regulatory reporting purposes, of SFAS 114, "Accounting by Creditors for Impairment of a Loan." The guidance clarifies that SFAS 114 sets forth an estimation technique for calculating part of the general loan loss allowance, and thus, allowances calculated under SFAS 114 may continue to be included in tier 2 capital, subject to current limitations. The guidance also reaffirms existing supervisory policies on nonaccrual of interest income and classification of certain collateralized lending arrangements.

During 1994 the FFIEC also revised the supplement to the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (FFIEC 002) to reflect SFAS 115 and to maintain consistency with the bank Call Report.

## Regulation of the U.S. Banking Structure

The Board administers the Bank Holding Company Act, the Bank Merger Act, and the Change in Bank Control Act for bank holding companies and state member banks. In doing so, the Federal Reserve acts on a variety of proposals that directly or indirectly affect the structure of U.S. banking at the local, regional, and national levels. The Board also has primary responsibility for regulating the international operations of domestic banking organizations and the overall U.S. banking operations of foreign banks, whether conducted directly through a branch or agency or indirectly through a subsidiary commercial lending company. 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 or notice filed by a bank holding company, the Federal Reserve considers such factors 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 1994 the Federal Reserve acted on 1,303 bank holding company and related applications or notices. The Federal Reserve approved 298 proposals

to organize bank holding companies; approved 108 proposals to merge existing bank holding companies; approved 296 bank acquisitions by existing bank holding companies; approved 566 requests by existing companies to acquire nonbank firms engaged in activities closely related to banking; and approved 35 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

Bank Holding Company Decisions by the Federal Reserve, Domestic Applications, 1994

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 .....	22	0	0	0	4	272	0	298
Merger of holding company .....	15	0	0	0	9	84	0	108
Retention of bank .....	0	0	0	0	0	0	0	0
Acquisition								
Bank .....	43	0	0	0	23	230	0	296
Nonbank .....	126	0	0	0	33	265	142	566
Bank service corporation .....	0	0	0	0	5	0	3	8
Other .....	4	0	22	0	1	0	0	27
<b>Total .....</b>	<b>210</b>	<b>0</b>	<b>22</b>	<b>0</b>	<b>75</b>	<b>851</b>	<b>145</b>	<b>1,303</b>



also consider the views of certain other agencies on the competitive factors involved in the transaction.

During 1994, the Federal Reserve approved 124 merger applications. As required by law, each merger is described in this REPORT (in table 16 of the Statistical Tables section).

When the Federal Deposit Insurance Corporation, the Office of the Comptroller of Currency, or the Office of Thrift Supervision has jurisdiction over a merger, the Federal Reserve is asked to comment on the competitive factors to ensure 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 ensure consistency in administering the act. The Federal Reserve submitted 991 reports on competitive factors to the other federal banking agencies in 1994.

### 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 position, 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 1994 the Federal Reserve acted on 167 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, or a change in control, is effected by an order or announcement. Orders state the decision along with the essential facts of the application or notice 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 announcements 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. These target dates promote efficiency at the Board and the Reserve Banks and reduce the burden on applicants. The time allowed for a decision ranges from thirty to sixty days, depending on the type of application. During 1994, 94 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 1994, 86 percent of the applications processed were acted on under delegated authority. The Board continued its efforts during the year to streamline its processing procedures.

## Recent Legislation

The Riegle Community Development and Regulatory Improvement Act of 1994 (CDR Act) makes certain revisions to the procedures that bank holding companies must follow to gain approval of bank and nonbank acquisition proposals under the Bank Holding Company Act. Specifically, the CDR Act (1) establishes a prior notice procedure that replaces the application process for all proposals by bank holding companies to engage in nonbanking activities; (2) establishes a streamlined notice procedure for the formation of a new bank holding company as part of a reorganization by the existing shareholders of a bank; and (3) eliminates the need for prior Board approval of certain "Oakar" transactions whereby a bank acquires a thrift institution or assets and deposits of a thrift institution.

The CDR Act also permits the Board, when it has obtained the consent of the Department of Justice, to shorten from thirty days to fifteen days the post-

approval waiting period during which the Department of Justice may file a court challenge to a bank acquisition proposal on competitive grounds. On October 27, 1994, the Board issued interim rules implementing related changes to the Board's application procedures and requested public comment on the rules. The comment period ended on December 5, 1994. Final rules are expected to be adopted in 1995.

## Board Policy Decisions and Developments in Bank-Related and Nonbanking Activities

On July 6, 1994, the Board requested public comment on a proposal to provide an alternative to the current revenue test used to measure whether a section 20 subsidiary is in compliance with the "engaged principally" criterion of section 20 of the Glass-Steagall Act. Section 20 prohibits a member bank from being affiliated with a company that is "engaged principally" in underwriting and dealing in ineligible securities. Specifically, the Board sought comment on whether asset values or sales volume data, or a combination of both measures, should be used as a new alternative test. The comment period ended September 9, 1994. No final action has been taken.

During 1994 the Board approved several proposals involving securities underwriting and dealing activities and modifications to related firewalls, principally pertaining to the cross-marketing of bank-eligible securities. In addition, the Board permitted a foreign bank, through its section 20 subsidiary, to trade for its own account in derivatives based on nonfinancial commodities.

In 1994 the Board also approved a mutual holding company to acquire a majority, but less than 100 percent interest in a savings bank converting from

mutual to stock form. The Board's approval relied on a number of commitments, including the mutual holding company's agreement to make prior application to the Board for approval to waive any dividends declared by the subsidiary bank.

During the year, the Board approved several bank holding company applications raising fair lending issues, including two involving investigations by the Department of Justice.

Pending at year-end 1994 were several applications with broad policy implications involving Texas banks seeking to convert to a new type of Texas charter that would permit partnership-type tax treatment.

### Applications by State Member Banks

State member banks must obtain the permission of the Federal Reserve to open new domestic branches, to make investments in bank premises that exceed 100 percent of capital stock, and to add to their capital bases from sales of subordinated debt. State member banks must also give six months' notice of their intention to withdraw from membership in the Federal Reserve, although the notice period may be shortened or eliminated in specific cases.

### Stock Repurchases by Bank Holding Companies

A bank holding company sometimes purchases its own shares from its shareholders. When the company borrows the money to buy the shares, the transaction increases the debt of the bank holding company and simultaneously decreases its equity. Relatively 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 1994, the Federal Reserve reviewed fifty-three 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 1994, the Board approved the opening of 18 foreign branches of 11 banks.

By the end of 1994, 105 member banks were operating 724 branches in foreign countries and overseas areas of the United States; 79 national banks were operating 634 of these branches,

and 26 state member banks were operating the remaining 90 branches.

In addition, 23 nonmember banks were operating 44 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 1994 the Federal Reserve approved three new agreement corporations. At year-end, there were seventy-six Edge Act and agreement corporations, which together had thirty-two 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 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 activities. Since 1982 the Federal Reserve has acted affirmatively on notifications by forty-eight bank holding 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.

### 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 1994, forty-four state member banks, most of which are small or medium-sized, were registered with the Board under the Securities Exchange Act.

### Bank Secrecy Act

The Currency and Foreign Transactions Reporting Act (the Bank Secrecy Act) was originally designed as a means to create and maintain records of various financial transactions that otherwise would not be identifiable in an effort to trace the proceeds of illegal activities. 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 and prevention 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 1994 the Federal Reserve tested and finalized new Bank Secrecy Act examination procedures for use during regularly scheduled and targeted Bank Secrecy Act examinations of financial institutions under its supervision. Various examinations resulted in the issuance of cease and desist orders for failure to establish an internal program that ensures compliance with the requirements of the Bank Secrecy Act.

The Federal Reserve, through its appointed representative, continued to provide expertise and guidance to the Bank Secrecy Act Advisory Council, a committee created by congressional mandate to propose additional anti-money laundering measures to be taken under the Bank Secrecy Act; through the Special Investigations and Exam-

inations Section, the Board has, among other matters, assisted in the investigation of money laundering activities and provided training in anti-money laundering measures to designated staff members at each Reserve Bank responsible for reviewing compliance procedures under the Bank Secrecy Act.

The Federal Reserve also provided assistance to law enforcement agencies conducting criminal investigations under the Bank Secrecy Act.

The Federal Reserve has participated extensively in the Financial Action Task Force, which in 1994 provided training in anti-money laundering measures to numerous foreign governments.

### 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 (SEC), 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 Office of Thrift Supervision, according to the jurisdiction involved. At the end of 1994, 691 lenders were registered under Regulation G, and 275 came under the Board's supervision. Of these 275, the Federal Reserve regularly inspects 203 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 1994, Federal Reserve examiners inspected 102 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 1994 the OTC list was revised in February, May, August, and November. The November OTC list contained 4,056 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 1994 the foreign list was revised in February, May, August, and November. The November foreign list contained 688 stocks.

In October 1994 the Board announced the adoption of amendments to Regulation T, effective November 25, 1994, regarding the payment period for securities purchases and the status of government securities transactions. The amendments are part of the Board's review of Regulation T and respond to the rule-making by the SEC concerning settlement of securities transactions and congressional action concerning government securities. One amendment specifies that customers must meet initial margin calls or make full cash payment for securities purchased at a broker-dealer within two business days of the standard settlement period. This amendment reflects the October 1993 adoption by the SEC of a rule, to become effective in June 1995, that will shorten the existing standard settlement period of five days after trade date to three days (T+3). Thus, when the SEC's T+3 standard settlement period goes into effect, Regulation T will be in conformity. The other amendments address transactions involving U.S. government securities. In particular, the amendments lessen the regulatory burden of Regulation T on participants in the government securities markets by providing exemptions to Regulation T for most transactions involving government securities.

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 two new agreements in 1994.

In 1994 the Securities Regulation Section of the Board's Division of Banking Supervision and Regulation issued forty-three 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.

### 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 1994, 4,115 banks were members of the Federal Reserve System, a decrease of 223 from the previous year-end. Member banks operated 36,622 branches on December 31, 1994, a net increase of 1,058 for the year.

Member banks accounted for 38 percent of all commercial banks in the United States and for 67 percent of all commercial banking offices; the figures for year-end 1993 were 39 percent of banks and 67 percent of banking offices. ■

Loans by State Member Banks to their Executive Officers, 1993-94

Period	Number	Amount (dollars)	Range of interest rates charged (percent)
<i>1993</i>			
October 1-December 31 .....	728	23,962,000	3.0-21.0
<i>1994</i>			
January 1-March 31 .....	689	19,485,000	4.0-21.0
April 1-June 30 .....	821	28,359,000	3.0-21.0
July 1-September 30 .....	844	39,577,000	4.8-21.0

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 Planning and Review Section and assigning supervision of its work to the Board's Committee on Banking Supervision and Regulation.

The purposes of the regulatory improvement and simplification function are to ensure that the economic consequences for small business are considered when regulations are written, to afford interested parties the opportunity to participate in designing regulations and comment on them, and to ensure that regulations are written in simple and clear language. Staff members continually review regulations for their adherence to these objectives.

During 1994 the Board took a variety of actions to reduce the regulatory burden on supervised institutions. These included raising the dollar-amount threshold above which real estate transactions require a property appraisal, relaxing restrictions on bank holding companies and their subsidiaries and affiliates desiring to market packages of products and services to customers, and permitting netting of some exchange rate and interest rate contracts for capital requirements.

At year-end 1994, staff members were reviewing Regulations E (Electronic Fund Transfers), M (Consumer Leasing), T (Credit by Brokers and Dealers), and U (Credit by Banks for the Purpose of Purchasing or Carrying Margin Stocks). Arising from these ongoing

reviews were Board actions in 1994 to modify Regulation E (allowing banks to truncate account numbers on automated teller machine receipts) and amend Regulation T (exempting from the regulation most transactions in government securities).

### **Requirements for Real Estate Appraisals**

In June the Federal Reserve and the other federal banking agencies enacted amendments to the regulations governing real estate appraisals. Among other changes, the amendments increased to \$250,000 the loan transaction amount above which appraisals are required; expanded and clarified the type of transactions that are exempt from the appraisal requirement; and narrowed the type of transactions for which evaluations are required. In addition, the amendments revised the requirements governing the content of appraisals and the use of appraisals prepared by other financial services institutions.

### **Relaxation of Restrictions on Bank Holding Companies**

Section 106 of the Bank Holding Company Act prohibits, with certain exceptions, tying the sale of bank products to one another. In July the Federal Reserve enacted a rule to extend the exceptions by allowing bank and nonbank affiliates of bank holding companies to offer package discounts on traditional bank products available from the affiliates. The new rule also permits bank holding company affiliates to offer a discount on securities brokerage services (a nonbank



product) to a customer who obtains a traditional bank product from an affiliate.

In December the Board further extended the exception to permit a bank holding company or its nonbank subsidiary to offer a discount on any of its products or services on condition that the customer obtain any other product or service from that company or from any of its nonbank affiliates. Thus, as of year-end 1994, the rule carried no Board-imposed restrictions on tying when no bank is involved in the arrangement and the products are separately available for purchase by the customer. At the same time the Board proposed to establish a competitive "safe harbor" for banks, permitting them to offer a discount on any product or package of products if a customer maintains a combined minimum balance in deposits and other products specified by the bank. Board action on this proposal is expected in early 1995.

### **Netting Arrangements**

In December the Federal Reserve amended its risk-based capital guidelines to recognize the risk-reducing benefits of netting arrangements. The amendment provided that, for capital purposes, institutions regulated by the Board could net the positive and negative market values of interest and exchange rate contracts subject to a qualifying, legally enforceable bilateral netting contract in order to calculate one current exposure for that netting contract.

### **Receipts for ATM Transactions**

Receipts for transactions at automated teller machines (ATMs) have been instrumental in some cases of fraud. In these cases, criminals have been able to

observe a customer's personal identification number as the customer enters it at an ATM; if the customer leaves the receipt at the ATM, the criminal then can manufacture and use a counterfeit ATM card bearing the valid account number that was printed on the receipt.

In response to the problem, the Federal Reserve in November adopted a change to its Electronic Fund Transfers regulation permitting financial institutions more flexibility in identifying customer accounts on receipts from ATMs. The change will allow institutions to truncate the account number printed on receipts, thereby helping to protect customers and financial institutions against fraudulent withdrawals.

In February the Board also published for comment some other revisions arising from review of Regulation E. The current regulation closely follows the minimum requirements of the law; most revisions would clarify and simplify the text of the regulation, reorganize and consolidate related material, and delete obsolete provisions. The commentary would be revised to follow the more usable format of the commentaries of other regulations. These changes would reduce burden somewhat by making the regulation and commentary more understandable; a few of the proposals would also make minor substantive changes.

### **Government Securities Transactions**

In October the Board amended Regulation T (Credit by Brokers and Dealers) to effectively exempt from the regulation most transactions involving government securities. Government securities are subject to another regulatory system, implemented by the Department of the Treasury; the system was established on an interim basis by the Government Securities Act of 1986 and made perma-

ment by the Government Securities Act Amendments of 1993.

The amendments to Regulation T exclude from the regulation those broker-dealers who limit themselves to transactions in government securities. For general broker-dealers, the amendments create a new bookkeeping account in which to effect customer transactions in government securities without regard to other provisions of the regulation. ■

## *Federal Reserve Banks*

In 1994 the Federal Reserve Banks passed several major milestones on the way to consolidating mainframe data processing operations at three data centers. Four Reserve Banks completed the shift of applications that process funds transfers and book-entry securities transfers; as a result the three centers now provide that processing for eleven Banks. In addition, the shift of District-unique workloads to the centers, completed by four Banks in 1993, was finished by six more in 1994; the remaining two, New York and San Francisco, continued the process. The head offices of the Richmond and Dallas Banks are the sites for two of the data centers, and the third site is the New York Bank's East Rutherford (New Jersey) Operations Center. All three are managed by Federal Reserve Automation Services (FRAS).

Several centralized applications began processing under FRAS in 1994. All twelve Reserve Banks finished converting to the new centralized Integrated Accounting System and the new billing application, and four finished converting to the new centralized Planning and Control System. Four Reserve Banks began using two other new centralized applications, one for Fedwire funds transfers and the other for the monitoring of account balances; in addition, the New York Bank has implemented these two new applications in its local data center, and the seven remaining Reserve Banks expect to convert to them during 1995. Development work continued on software for a new centralized automated clearinghouse system and for a new national transfer system for book-entry securities.

During 1994 FRAS continued to deploy Fednet, the new national communications network that is replacing the current FRCS-80 backbone network and the twelve District networks. The unified Fednet network will provide a standard level of service as well as improved reliability, security, and disaster recovery capabilities for the Reserve Banks and for the depository institutions that use Federal Reserve services. The Fednet circuit switching infrastructure was installed in 1993. In 1994, all depository institutions that had Fedline dial connections began using national dial center 1-800 telephone services to access Reserve Bank electronic services. In addition, the Boston Reserve Bank converted internal users, as well as depository institutions that had leased-line connections, to Fednet services. The process of connecting all Reserve Banks and depository institutions that have leased-line connections is continuing.

In other developments, the same-day settlement amendments to Regulation CC, which became effective in January, resulted in a substantial decline in the number of checks collected by the Reserve Banks. To support same-day settlement and to improve the efficiency of check processing generally, the Reserve Banks in 1994 introduced several new products, including same-day settlement presentment services and image-enhanced electronic check products.

This chapter details 1994 results in Federal Reserve priced services and reports on examinations, income and expenses, holdings of securities and loans, and major construction activity at the Federal Reserve Banks.

## 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 of the direct and indirect costs of providing services to depository institutions as well as imputed costs reflecting 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. The imputed costs are referred to as the private-sector adjustment factor (PSAF). Over the past ten years the Federal Reserve System has recovered 101.6 percent of its costs, including the PSAF.

In 1994 the revenue from priced services operations was \$734.4 million, other income was \$32.8 million, and costs were \$781.2 million, resulting in negative net revenue of \$14.0 million and a recovery rate of 98.2 percent of costs, including the PSAF.<sup>1</sup> In 1993 the System had negative net revenue of \$63.4 million and recovered 92.4 percent of costs. In 1992 the System had net revenue of \$25.2 million and recovered 103.4 percent of costs.<sup>2</sup>

### Check Collection

Under new same-day settlement rules, which became effective on January 3,

1994, the number of checks cleared through the Federal Reserve's commercial check service declined 13.3 percent, to 16.5 billion (see accompanying table). For the year, the service had revenues of \$556.8 million. Operating expenses and imputed costs (interest on float, interest on debt, sales taxes, and the assessment for insurance from the Federal Deposit Insurance Corporation) totaled \$589.0 million, for a loss on operations of \$32.2 million. Net income on clearing balances was \$25.6 million.<sup>3</sup>

The new settlement provisions, implemented through Regulation CC, enable a collecting bank to receive same-day settlement if it presents checks directly to the paying bank by 8:00 a.m. (local time of the paying bank). The resulting overall decline of 13.3 percent in the volume of checks deposited for collection with the Reserve Banks consisted of a 35.7 percent decline in fine-sort deposits, which require the depositing bank to presort items by paying bank, and a 4.8 percent decline in all other check deposits.

At the same time, the Federal Reserve Banks implemented new services designed to facilitate same-day settlement. For instance, a paying bank may now designate a Federal Reserve office as a presentment point for its same-day-settlement items; the Reserve Banks also offer information products that enable those banks to continue to provide timely cash management information to their corporate customers.

The Federal Reserve continued to encourage the use of electronics to improve the efficiency of check processing. During the year, all of the Reserve Banks began to offer basic electronic

1. See the pro forma statements at the end of this chapter. *Other income* is the revenue from investment of clearing balances net of earnings credits, an amount known as net income on clearing balances. *Costs* are the sum of operating expenses, imputed costs, imputed income taxes, and targeted return on equity. *Net revenue* is revenue plus net income on clearing balances, minus cost.

2. For 1993, excluding the one-time effect of a change in accounting principle, the System had net revenue of \$10.7 million and recovered 101.4 percent of costs, including the PSAF. Financial results for 1993 and 1992 have been revised from last year's REPORT.

3. See the pro forma income statement for Federal Reserve priced services, by service.

check presentment and local truncation services.

In electronic check presentment, a paying bank agrees to accept as legal presentment an electronic file containing electronic information about each check instead of the paper checks, which are subsequently delivered to the paying bank.

Under local truncation services, the Reserve Banks microfilm the checks drawn on an institution, store the paper checks for up to ninety days before destroying them, and retain the microfilm images for seven years. During 1994 nearly 647 million checks were presented to paying banks electronically, an increase of approximately 162 percent over the 1993 level. The Reserve Banks also began making it possible for depository institutions to request adjustments of check transactions via electronic transmissions.

The Federal Reserve continued to develop and test medium- and high-speed imaging technologies for processing both government and commercial checks. During the year, two Reserve Banks introduced image-enhanced commercial check products that allow paying banks that use truncation or other electronic check presentment products

to obtain images of checks for their information-processing needs.

### Funds Transfer and Net Settlement

The Fedwire funds transfer service and the net settlement service together had revenues of \$88.0 million and income, after operating expenses and imputed costs, of \$2.5 million. Net income on clearing balances was \$3.6 million.

#### Funds Transfer

The number of Fedwire funds transfers originated increased 3.4 percent, to 73.6 million (72.0 million value transfers and 1.6 million nonvalue messages).

In February 1994 the Board of Governors announced a plan to expand the operating hours of the Fedwire on-line funds transfer service, from ten hours (8:30 a.m. to 6:30 p.m. eastern time) to eighteen (12:30 a.m. to 6:30 p.m. eastern time). The additional operating hours are expected to aid private-sector initiatives to reduce settlement risk in foreign exchange markets; they will also eliminate an operational barrier to innovation in privately provided payment and settlement services.

### Activity in Federal Reserve Priced Services, 1994, 1993, and 1992

Thousands of items except as noted

Service	1994	1993	1992	Percentage change	
				1993-94	1992-93
Commercial checks .....	16,479,161	19,008,808	19,052,928	-13.3	-2
Funds transfers .....	73,611	71,199	69,803	3.4	2.0
Commercial ACH .....	1,805,095	1,544,848	1,326,632	16.8	16.5
Definitive safekeeping .....	..	17	41	-100.0	-58.5
Noncash collection .....	643	1,020	1,636	-37.0	-37.7
Securities transfers .....	3,663	3,604	3,266	1.6	10.4
Cash transportation .....	53	65	282	-18.5	-77.0

NOTE. Activity in *commercial checks* is defined as the total number of commercial checks collected, including both processed and fine-sort items; in *funds transfers*, the number of basic transactions originated; in *ACH*, the total number of commercial items processed; in

*definitive safekeeping*, the average number of issues or receipts maintained; in *noncash collection*, the number of items on which fees are assessed; in *securities*, the number of basic transfers originated on line; and in *cash transportation*, the number of armored-carrier stops.

Initially, the extended hours were to begin in early 1997. The effective date was delayed when, in December, the Board announced a plan to expand the format of Fedwire funds transfers. To allow more time for design of the new format, it also delayed implementation of the longer operating day until the fourth quarter of 1997. The exact date of implementation for the new hours will be announced one year in advance.

The expanded format for Fedwire funds transfers will reduce manual interventions in the transfers. It also will eliminate the need to truncate payment-related information when forwarding payment orders through Fedwire to other large-value transfer systems. Further, the new format will enable depository institutions to include the additional information about the originator and beneficiary of a transfer required under regulations of the Department of the Treasury. The new format must be implemented by the end of 1997.

### *Net Settlement*

The Federal Reserve provides net settlement services to more than 150 local, private-sector clearing and settlement arrangements and to 4 such arrangements that operate nationwide. These arrangements enable participants to settle their net positions either via Fedwire funds transfers using special settlement accounts at Federal Reserve Banks or via accounting entries, which are posted to participants' reserve or clearing accounts by Federal Reserve Banks.

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 ACH and the National Clearinghouse Association, process and net small-dollar transactions associated, respectively, with automated clearinghouse and check payments. The majority of local arrangements are check clearinghouses.

In 1994 the Reserve Banks processed about 500,000 net settlement entries for local netting arrangements; the value of these entries was about \$800 billion.

### Automated Clearinghouse

The Reserve Banks processed 1.8 billion commercial transactions through the automated clearinghouse (ACH) during the year, an increase of 16.8 percent over 1993 volume. The service had revenues of \$64.3 million and a loss, after operating expenses and imputed costs, of \$6.5 million. Net income on clearing balances was \$2.6 million.

The Federal Reserve's campaign to institute an all-electronic ACH was completed. All depository institutions that use commercial ACH services had established electronic connections by July 1993. During 1994, depository institutions that use only government ACH services were required by Treasury to establish electronic connections with the Federal Reserve Banks. An all-electronic ACH provides users with greater security, enhanced contingency and disaster-recovery capabilities, and increased efficiency. In particular, the all-electronic ACH ensures that ACH transactions are available to receiving depository institutions by the opening of business on the settlement date.

Development work continued on software to support ACH services in the Federal Reserve's new consolidated data processing environment. The new software will allow more deposit and delivery options. It will also allow customers

to trace items or files electronically, check the status of a file in process, and obtain limited information from the Federal Reserve's database on other ACH participants.

### Noncash Collection

The number of noncash collection items (maturing coupons and bonds) processed by the Reserve Banks decreased 37.0 percent, to 643,000. The service had revenues of \$3.9 million and a loss, after operating expenses and imputed costs, of \$1.2 million. Net income on clearing balances was \$0.2 million.

During the year, the Reserve Banks continued consolidating noncash operations. By late 1996 only two Federal Reserve sites will conduct noncash processing—the Cleveland Bank and the Jacksonville Branch of the Atlanta Bank. The New York and Chicago Banks will continue to present noncash items payable through members of the clearinghouses located in those two cities.

### Book-Entry Securities

The Federal Reserve processed 3.7 million transfers of government agency securities during the year, a 1.6 percent increase over 1993 volume. The service had revenues of \$15.2 million and a loss, after operating expenses and imputed costs, of \$0.4 million. Net income on clearing balances was \$0.6 million.

In December 1994 the Board requested comment on the potential benefits, costs, and market implications of expanding the availability of the Fedwire book-entry securities service for on-line activity beyond the current hours of 8:30 a.m. to 2:30 p.m. for transfers and 8:30 a.m. to 3:00 p.m. for reversals. The Board also requested comment on new service capabilities that would give

banks the option of participating in earlier Fedwire securities hours and that would allow them to control their use of intraday credit during expanded and core business hours. In addition, the Board requested comment on establishing a firm closing time for the Fedwire book-entry securities transfer service, beginning in January 1996. Comments were due by April 28, 1995.

The Federal Reserve Bank of Chicago offers to all depository institutions the secondary-market purchase or sale of securities that are book-entry-eligible at the Federal Reserve.

### Fiscal Agency Services

As fiscal agent for the Department of the Treasury, the Federal Reserve Banks provide book-entry services for Treasury debt issues. In 1994 the Reserve Banks processed 9.3 million book-entry Treasury securities transfers.

The Federal Reserve continues to operate Treasury Direct, the safekeeping system for book-entry Treasury securities owned by individuals who use Treasury as custodian. Treasury Direct has grown to more than 1.4 million accounts with a total par value of more than \$77.9 billion. During 1994 the Reserve Banks processed 2.4 million applications from Treasury Direct customers to purchase securities. The Reserve Banks also processed more than 1.4 million competitive and noncompetitive bids of customers seeking to buy securities in Treasury auctions.

In 1994 the Reserve Banks inscribed 57 million savings bonds for over-the-counter, payroll, and other types of transactions. The Reserve Banks have been consolidating their savings bond operations at five sites: the Buffalo Branch of the New York Bank, the Pittsburgh Branch of the Cleveland Bank, and the Richmond, Minneapolis, and

Kansas City Banks. Residual processing is still being performed in the Boston, Atlanta, and Chicago Districts. Consolidation should be completed during 1996.

The Federal Reserve is helping Treasury implement its Electronic Federal Tax Deposit System, which is designed to modernize the collection of federal taxes from businesses and quarterly filers. Under the new system, Treasury will receive tax payments one day sooner and will be able to manage its cash flow more efficiently.

### Currency and Coin

In 1994 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. 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. Together, the cash services had revenues of \$6.1 million and income, after operating expenses and imputed costs, of less than \$0.05 million. Net income on clearing balances was \$0.3 million.

The Federal Reserve supplies currency and coin to the public by servicing the needs of depository institutions throughout the nation. The value of currency and coin in circulation increased 9 percent in 1994 and exceeded \$400 billion at year-end.

The Reserve Banks continued to work closely with Treasury and other agencies to deter counterfeiting and laundering of U.S. currency. Work continued on a new currency design, and a study is under way to better understand the use of U.S. currency outside the country.

By year-end 1994, the Reserve Banks had installed 51 new high-speed currency processors. The Reserve Banks plan to install a total of 132 of these processors, with completion expected by year-end 1997.

### Float

Federal Reserve float increased in 1994 to a daily average of \$479 million, up from \$349 million in 1993, largely because of severe weather during the first quarter of 1994. The cost of Federal Reserve float associated with priced services is recovered each year through fees for priced services.

### Examinations

Section 21 of the Federal Reserve Act requires the Board of Governors to “order an examination of each Federal reserve bank” at least once per year. The Board assigns the responsibility to its Division of Reserve Bank Operations and Payment Systems. In 1994 the Board engaged the services of a public accounting firm to audit, beginning in 1995, the year-end balance sheets of two or three Reserve Banks each year, completing audits of all twelve Banks over a five-year period; the division will continue to perform annual financial examinations of the other Reserve Banks during that period.

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 the Bank. The recently contracted public accounting firm, beginning at year-end 1994 and continuing through



1999, will also certify the balance sheet for the System Open Market Account and for foreign currency operations for participated accounts of the twelve Reserve Banks. Copies of these reports are furnished to the FOMC.

The examination program used by the division is reviewed annually 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 1994 and 1993.

Income was \$20,911 million in 1994 (including \$734 million in revenue from priced services) and \$18,914 million in 1993. Expenses totaled \$1,942 million in 1994 (\$1,571 million in operating expenses, \$224 million in earnings credits granted to depository institutions, and \$147 million in assessments for expenditures by the Board of Governors) versus \$1,798 million in 1993. The Board of Governors also assessed \$368 million for the cost of currency in

1994. Unreimbursed services to Treasury cost \$34 million.

In addition, the profit and loss account showed a net profit of \$2,398 million. The profit was primarily a result of realized and unrealized gains on assets denominated in foreign currencies. These profits were partially offset by losses on the sales of securities from the System Open Market portfolio. Statutory dividends to member banks totaled \$212 million, \$17 million more than in 1993. 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 Treasury in the form of interest on Federal Reserve notes totaled \$20,470 million, compared with \$15,987 million in 1993. The payments consist of all net income after the deduction of dividends and of \$282 million, 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 the income and expenses of each Federal Reserve

### Income, Expenses, and Distribution of Net Earnings of Federal Reserve Banks, 1994 and 1993

Millions of dollars

Item	1994	1993
Current income .....	20,911	18,914
Current expenses .....	1,796	1,658
Operating expenses <sup>1</sup> .....	1,572	1,475
Earnings credits granted .....	224	183
Current net income .....	19,115	17,256
Net addition to (deduction from, - ) current net income .....	2,398	-201
Cost of unreimbursed services to Treasury .....	34	29
Assessments by the Board of Governors .....	515	496
For expenditures of Board .....	147	140
For cost of currency .....	368	356
Net income before payments to Treasury .....	20,964	16,530
Dividends paid .....	212	195
Transferred to surplus .....	282	348
Payments to Treasury (interest on Federal Reserve notes) .....	20,470	15,987

NOTE. Components may not sum to totals because of rounding.

1. Includes a net periodic credit for pension costs of \$75.6 million in 1994 and \$131.4 million in 1993.

Bank for 1994, and table 7 shows a condensed statement for each Bank for the years 1914 through 1994. A detailed account of the assessments and expenditures of the Board of Governors appears in the next chapter, Board of Governors Financial Statements.

### Holdings of Securities and Loans

Average daily holdings of securities and loans by the Reserve Banks during 1994 were \$354,001 million, an increase of \$33,473 million over 1993 (see accompanying table). From 1993 to 1994, such holdings of U.S. government securities increased \$33,393 million, and such holdings of loans increased \$80 million.

The average rate of interest on holdings of U.S. government securities increased, from 5.27 percent in 1993 to 5.44 percent in 1994, and the average rate of interest on loans increased, from 3.08 percent to 4.39 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 through 1994.

### Federal Reserve Bank Premises

Construction of the new headquarters building for the Minneapolis Bank began in 1994, as did expansion and renovation of the current headquarters building of the Cleveland Bank. In addition, multiyear renovation programs continued at the Kansas City Bank's Oklahoma City Branch and the San Francisco Bank's Branches in Seattle, Portland, and Salt Lake City.

The Board approved a multiyear renovation program for the New York Bank's headquarters building. It also approved projects to renovate the cash departments at several Reserve Banks in preparation for installation of new currency-processing equipment. In addition, long-range planning studies were conducted for several Reserve Bank facilities.

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, 1992-94

Millions of dollars except as noted

Item and year	Total	U.S. government securities <sup>1</sup>	Loans <sup>2</sup>
<i>Average daily holdings<sup>3</sup></i>			
1992 .....	283,104	282,927	177
1993 .....	320,528	320,347	181
1994 .....	354,001	353,740	261
<i>Earnings</i>			
1992 .....	17,342	17,336	6
1993 .....	16,896	16,891	6
1994 .....	19,259	19,247	11
<i>Average interest rate (percent)</i>			
1992 .....	6.13	6.13	3.43
1993 .....	5.27	5.27	3.08
1994 .....	5.44	5.44	4.39

1. Includes federal agency obligations.

2. Does not include indebtedness assumed by the Federal Deposit Insurance Corporation.

3. Based on holdings at opening of business.

## Pro Forma Financial Statements for Federal Reserve Priced Services

Pro Forma Balance Sheet for Priced Services, December 31, 1994, 1993, and 1992

Millions of dollars

Item	1994	1993	1992
<i>Short-term assets (Note 1)</i>			
Imputed reserve requirement on clearing balances .....	400.3	<b>624.8</b>	<b>582.8</b>
Investment in marketable securities .....	3,602.7	<b>5,623.2</b>	<b>5,245.2</b>
Receivables .....	60.6	67.4	66.6
Materials and supplies .....	10.2	9.9	6.5
Prepaid expenses .....	15.5	17.2	12.3
Items in process of collection .....	<u>2,316.7</u>	<u>3,458.6</u>	<u>4,062.4</u>
Total short-term assets .....	6,406.0	9,801.1	<b>9,975.8</b>
<i>Long-term assets (Note 2)</i>			
Premises .....	377.6	385.4	378.5
Furniture and equipment .....	168.4	<b>209.3</b>	176.2
Leases and leasehold improvements .....	8.6	<b>16.8</b>	<b>50.2</b>
Prepaid pension costs .....	<u>205.4</u>	<u>191.1</u>	<u>150.2</u>
Total long-term assets .....	<u>760.0</u>	<u>802.5</u>	<u>755.1</u>
<b>Total assets</b> .....	7,166.0	<b>10,603.6</b>	<b>10,730.9</b>
<i>Short-term liabilities</i>			
Clearing balances and balances arising from early credit of uncollected items .....	4,133.1	<b>7,029.9</b>	<b>8,813.4</b>
Deferred-availability items .....	2,186.6	<b>2,676.7</b>	<b>1,077.0</b>
Short-term debt .....	<u>86.3</u>	<u>94.5</u>	<u>85.3</u>
Total short-term liabilities .....	6,406.0	9,801.1	<b>9,975.8</b>
<i>Long-term liabilities</i>			
Obligations under capital leases .....	.6	.0	.1
Long-term debt .....	170.5	<b>202.3</b>	<b>200.5</b>
Postretirement benefits obligation .....	<u>140.5</u>	<u>122.4</u>	<u>.....</u>
Total long-term liabilities .....	<u>311.6</u>	<u>324.7</u>	<u>200.6</u>
<b>Total liabilities</b> .....	6,717.6	<b>10,125.8</b>	<b>10,176.3</b>
Equity .....	<u>448.4</u>	<u>477.8</u>	<u>554.5</u>
<b>Total liabilities and equity (Note 3)</b> ..	7,166.0	<b>10,603.6</b>	<b>10,730.9</b>

NOTE. Amounts in bold are restatements due to errors in previously reported data. Components may not sum to totals because of rounding.

The priced services financial statements consist of these tables and the accompanying notes.

## Pro Forma Income Statement for Federal Reserve Priced Services, 1994, 1993, and 1992

Millions of dollars

Item	1994	1993	1992
Revenue from services provided			
to depository institutions (Note 4) .....	734.4	757.3	758.4
Operating expenses (Note 5) .....	<u>693.0</u>	<u>673.7</u>	<u>622.6</u>
Income from operations .....	41.4	<b>83.6</b>	<b>135.8</b>
Imputed costs (Note 6)			
Interest on float .....	18.6	10.6	14.5
Interest on debt .....	18.9	21.3	19.8
Sales taxes .....	10.8	<b>9.4</b>	<b>12.3</b>
FDIC insurance .....	<u>15.8</u>	<u>64.1</u>	<u>67.3</u>
Income from operations after imputed costs .....	-22.7	<b>22.8</b>	<b>68.5</b>
Other income and expenses (Note 7)			
Investment income on clearing balances ...	241.2	187.8	180.2
Earnings credits .....	<u>208.4</u>	<u>170.6</u>	<u>177.8</u>
Income before income taxes .....	10.1	<b>40.0</b>	<b>70.9</b>
Imputed income taxes (Note 8) .....	<u>3.1</u>	<u>11.8</u>	<u>20.8</u>
Income before cumulative effect of a change in accounting principle .....	7.0	<b>28.2</b>	<b>50.0</b>
Cumulative effect on previous years from retroactive application of accrual method of accounting for postretirement benefits (net of \$31.1 million tax) (Note 9) .....	...	<b>-74.1</b>	...
<b>Net income</b> (Note 10) .....	7.0	<b>-45.9</b>	<b>50.0</b>
MEMO: Targeted return on equity (Note 11) ..	21.0	17.5	24.9

NOTE. Amounts in bold are restatements due to errors in previously reported data. Components may not sum to totals because of rounding.

The priced services financial statements consist of these tables and the accompanying notes.

Pro Forma Income Statement for Federal Reserve Priced Services, by Service,  
1994, 1993, and 1992

Millions of dollars

Item	Total	Com- mercial check collection	Funds transfer and net settlement	Com- mercial ACH	Definitive safe- keeping	Noncash collection	Book- entry securities	Cash services
1994								
Revenue from operations ....	734.4	556.8	88.0	64.3	...	3.9	15.2	6.1
Operating expenses (Note 5) .....	<u>693.0</u>	<u>536.0</u>	<u>80.4</u>	<u>66.3</u>		<u>4.8</u>	<u>14.7</u>	<u>5.9</u>
Income from operations .....	41.4	20.8	7.6	-2.0		-8	.6	.1
Imputed costs (Note 6) .....	<u>64.1</u>	<u>53.0</u>	<u>5.1</u>	<u>4.5</u>		<u>4</u>	<u>.9</u>	<u>.1</u>
Income from operations after imputed costs .....	-22.7	-32.2	2.5	-6.5		-1.2	-4	.0
Other income and expenses, net (Note 7) .....	<u>32.8</u>	<u>25.6</u>	<u>3.6</u>	<u>2.6</u>		<u>2</u>	<u>.6</u>	<u>.3</u>
Income before income taxes ..	10.1	-6.7	6.1	-3.9	...	-1.1	.3	.3
1993								
Revenue from operations ....	757.3	583.2	88.4	58.9	1.5	4.8	14.2	6.3
Operating expenses (Note 5) .....	<b>673.7</b>	<b>514.4</b>	<b>78.5</b>	<b>66.3</b>	<u>3.9</u>	<u>5.5</u>	<b>13.8</b>	<u>6.2</u>
Income from operations .....	<b>83.6</b>	<b>68.8</b>	<b>9.9</b>	<b>-7.4</b>	-2.4	-6	<b>.3</b>	.1
Imputed costs (Note 6) .....	<b>60.8</b>	<b>47.8</b>	<b>5.9</b>	<b>5.1</b>	<u>.3</u>	<u>.5</u>	<b>.9</b>	<u>.3</u>
Income from operations after imputed costs .....	<b>22.8</b>	<b>20.9</b>	<b>4.0</b>	<b>-12.5</b>	<b>-2.7</b>	<b>-1.1</b>	<b>-5</b>	<b>-2</b>
Other income and expenses, net (Note 7) .....	<u>17.2</u>	<u>13.7</u>	<u>1.8</u>	<u>1.2</u>	<u>.0</u>	<u>.1</u>	<u>.3</u>	<u>.1</u>
Income before income taxes ..	<b>40.0</b>	<b>34.6</b>	<b>5.8</b>	<b>-11.3</b>	<b>-2.7</b>	<b>-1.0</b>	<b>-2</b>	<b>-1</b>
1992								
Revenue from operations ....	758.4	576.0	85.6	60.1	3.1	7.5	13.1	12.9
Operating expenses (Note 5) .....	<b>622.6</b>	<b>506.3</b>	<b>67.8</b>	<b>58.9</b>	<u>3.8</u>	<u>8.3</u>	<b>11.3</b>	<u>12.3</u>
Income from operations .....	<b>135.8</b>	<b>69.7</b>	<b>17.8</b>	<b>1.3</b>	<b>-7</b>	<b>-8</b>	<b>1.8</b>	.6
Imputed costs (Note 6) .....	<b>67.3</b>	<b>53.2</b>	<b>6.8</b>	<b>5.1</b>	<u>.4</u>	<u>.8</u>	<b>1.0</b>	<u>.2</u>
Income from operations after imputed costs .....	<b>68.5</b>	<b>16.5</b>	<b>11.0</b>	<b>-3.8</b>	<b>-1.1</b>	<b>-1.6</b>	<b>.8</b>	<b>.4</b>
Other income and expenses, net (Note 7) .....	<u>2.4</u>	<u>2.4</u>	<u>.0</u>	<u>.0</u>	<u>.0</u>	<u>.0</u>	<u>.0</u>	<u>.0</u>
Income before income taxes ..	<b>70.9</b>	<b>18.9</b>	<b>11.0</b>	<b>-3.8</b>	<b>-1.1</b>	<b>-1.6</b>	<b>.8</b>	<b>.4</b>

NOTE. Amounts in bold are restatements due to errors in previously reported data. The Federal Reserve withdrew from the definitive safekeeping service in 1993. Components may not sum to totals because of rounding.

The priced services financial statements consist of these tables and the accompanying notes.

Revenue and Expenses for Commercial Check Collection, by District,  
1994, 1993, and 1992

Millions of dollars

District	Operating revenue	Expenses of operations and of float			Revenue less expense
		Operations	Interest on float	Total	
1994					
Boston .....	30.1	30.3	.8	31.1	-1.0
New York .....	62.1	62.0	3.5	65.5	-3.4
Philadelphia .....	31.3	31.2	3.2	34.4	-3.1
Cleveland .....	32.9	30.5	1.9	32.5	.4
Richmond .....	52.7	48.9	.2	49.1	3.6
Atlanta .....	81.7	72.2	1.7	73.9	7.7
Chicago .....	75.4	69.9	1.5	71.5	3.9
St. Louis .....	24.6	22.8	1.7	24.6	.0
Minneapolis .....	32.6	29.4	.5	29.9	2.7
Kansas City .....	37.1	34.9	1.1	36.0	1.1
Dallas .....	38.9	38.2	1.8	40.0	-1.2
San Francisco .....	57.6	52.9	.5	53.4	4.2
<b>System total</b> .....	<b>556.8</b>	<b>534.0</b>	<b>18.4</b>	<b>552.4</b>	<b>4.4</b>
1993					
Boston .....	34.3	<b>30.1</b>	.6	<b>30.7</b>	<b>3.6</b>
New York .....	69.7	62.5	1.6	64.1	5.6
Philadelphia .....	31.9	<b>27.3</b>	1.0	<b>28.3</b>	<b>3.6</b>
Cleveland .....	32.4	28.0	1.1	29.1	3.3
Richmond .....	55.2	<b>48.3</b>	.7	<b>49.0</b>	<b>6.2</b>
Atlanta .....	77.8	<b>67.2</b>	1.2	<b>68.4</b>	<b>9.4</b>
Chicago .....	79.5	<b>65.6</b>	1.1	<b>66.6</b>	<b>12.9</b>
St. Louis .....	24.1	20.8	.8	21.6	2.5
Minneapolis .....	<b>32.3</b>	<b>27.6</b>	.2	<b>27.8</b>	<b>4.5</b>
Kansas City .....	37.0	<b>31.4</b>	.9	<b>32.3</b>	<b>4.7</b>
Dallas .....	43.1	<b>34.0</b>	1.1	<b>35.1</b>	<b>8.0</b>
San Francisco .....	65.9	<b>55.4</b>	.2	<b>55.6</b>	<b>10.2</b>
<b>System total</b> .....	<b>583.2</b>	<b>512.7</b>	<b>10.5</b>	<b>523.2</b>	<b>60.1</b>
1992					
Boston .....	35.3	<b>30.8</b>	.7	<b>31.5</b>	<b>3.8</b>
New York .....	69.6	65.0	1.6	66.6	3.0
Philadelphia .....	31.2	27.5	1.1	28.6	2.6
Cleveland .....	32.0	28.4	1.1	29.5	2.5
Richmond .....	54.9	<b>48.4</b>	1.6	<b>50.0</b>	<b>4.8</b>
Atlanta .....	76.4	64.0	1.7	65.7	10.7
Chicago .....	76.6	62.6	1.9	64.5	12.1
St. Louis .....	24.0	19.9	1.0	20.9	3.1
Minneapolis .....	31.3	26.7	.4	27.1	4.2
Kansas City .....	36.8	<b>30.6</b>	.8	<b>31.4</b>	<b>5.4</b>
Dallas .....	41.9	<b>35.4</b>	1.4	<b>36.8</b>	<b>5.0</b>
San Francisco .....	66.2	59.5	.8	60.3	5.9
<b>System total</b> .....	<b>576.0</b>	<b>504.9</b>	<b>14.1</b>	<b>519.0</b>	<b>57.0</b>

NOTE. Amounts in bold are restatements due to errors in previously reported data. Components may not sum to totals because of rounding; moreover, certain expenses related to automation consolidation are reported at the System level, and therefore the sum of expenses for the twelve Districts may not equal the System total.

The System totals shown for revenue less expense (last column, bottom row of each panel) differ from the amounts for check collection income before income taxes, shown in the preceding statement, income by service

(second column, last row of each panel), because the statement shown here does not reflect the following items included in the income statement by service: imputed interest on debt, imputed sales taxes, the imputed assessment for Federal Deposit Insurance Corporation (FDIC) insurance, Board expenses for priced services, and net income on clearing balances.

The priced services financial statements consist of these tables and the accompanying notes.

## FEDERAL RESERVE BANKS

## NOTES TO FINANCIAL STATEMENTS FOR PRICED SERVICES

## (1) SHORT-TERM ASSETS

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 is gross Federal Reserve cash items in process of collection (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 non-priced 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.

## (2) LONG-TERM ASSETS

Consists of 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 the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 87, *Employers' Accounting for Pensions* (SFAS 87). Accordingly, the Reserve Banks recognized credits to expenses of \$20.1 million in 1994, \$42.2 million in 1993 (revised), and \$46.1 million in 1992 (revised) and corresponding increases in this asset account.

## (3) LIABILITIES AND EQUITY

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.

## (4) REVENUE

Revenue represents charges to depository institutions for priced services and is realized from each institution through one of two methods: direct charges to an institution's account or charges against its accumulated earnings credits.

## (5) OPERATING EXPENSES

Operating expenses consist of the direct, indirect, and other general administrative expenses of the Reserve Banks for priced services plus the expenses for staff members of the Board of Governors working directly on the development of priced services. The expenses for Board staff members were \$2.7 million in 1994, \$2.3 million in 1993, and \$1.9 million in 1992. The credit to expenses under SFAS 87 (see note 2) is reflected in operating expenses.

The income statement by service reflects revenue, operating expenses, and imputed costs except for income taxes. Total operating expense does not equal the sum of operating expenses for each service because of the effect of SFAS 87. Before 1993 the effect of SFAS 87 was reported only at the System level and was not allocated to individual services. Beginning in 1993 the portion of the credit related to the current year is allocated to individual services. The amortization of the initial effect of implementation remains reflected only at the System level.

## (6) IMPUTED COSTS

Imputed costs consist of interest on float, interest on debt, sales taxes, and the FDIC assessment. 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 the debt assumed necessary to finance priced-service assets. The sales taxes and FDIC assessment that the Federal Reserve would have paid had it been a private-sector firm are among the components of the PSAF (see note 3).

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.

The following list shows the daily average recovery of float by the Reserve Banks for 1994 in millions of dollars:

Total float	763.4
Unrecovered float	26.1
Float subject to recovery	737.3
Sources of recovery of float	
Income on clearing balances	74.0
As-of adjustments	284.8
Direct charges	144.6
Per-item fees	233.9

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 mid-week 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 1994.

#### (7) OTHER INCOME AND EXPENSES

Consists of investment income on clearing balances and the cost of earnings credits. Investment income on clearing balances represents the average coupon-equivalent yield on three-month Treasury bills applied to the total clearing balance maintained, adjusted for the effect of reserve requirements on clearing balances. Expenses for earnings credits 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.

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 each service's ratio of income to total income.

#### (8) INCOME TAXES

Imputed income taxes are calculated at the effective tax rate derived from the PSAF model (see note 3). Taxes have not been allocated by service because they relate to the organization as a whole.

#### (9) POSTRETIREMENT BENEFITS

Effective Jan. 1, 1993, the Reserve Banks implemented SFAS 106, *Employers' Accounting for Postretirement Benefits Other than Pensions*. Accordingly in 1993 the Reserve Banks recognized a one-time cumulative charge of \$105.2 million (revised) to reflect the retroactive application of this change in accounting principle.

#### (10) ADJUSTMENTS TO NET INCOME FOR PRICE SETTING

In setting fees, certain costs are excluded in accordance with the System's overage and shortfalls policy and its automation consolidation policy. Accordingly, to compare the financial results reported in this table with the projections used to set prices, adjust net income as follows (amounts shown are net of tax):

	1994	1993	1992
Net income .....	7.0	-45.9	50.0
Amortization of the initial effect of implementing SFAS 87 .....	-10.5	-10.6	-32.5
Deferred costs of automation consolidation .....	13.6	7.4	1.1
Cumulative effect of retroactive application of SFAS 106 .....	...	74.1	...
Adjusted net income .....	10.1	25.0	18.6

#### (11) RETURN ON EQUITY

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 (see note 3). This amount is adjusted to reflect the deferral, for automation consolidation costs, of \$13.6 million for 1994, \$7.4 million for 1993, and \$1.1 million for 1992. The Reserve Banks plan to recover these amounts, along with a finance charge, by the end of the year 2000. After-tax return on equity has not been allocated by service because it relates to the organization as a whole.



# *Board of Governors Financial Statements*

The financial statements of the Board were audited by Price Waterhouse, independent public accountants, for 1994 and 1993.

## REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Governors of the  
Federal Reserve System

In our opinion, the accompanying balance sheets and the related statements of revenues and expenses and fund balance and of cash flows present fairly, in all material respects, the financial position of the Board of Governors of the Federal Reserve System (the Board) at December 31, 1994 and 1993, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Board's management; our responsibility is to express an opinion on these statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards and *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 audits provide a reasonable basis for the opinion expressed above.

As discussed in Notes 1 and 3 to the financial statements, the Board implemented Statement of Financial Accounting Standard No. 112, *Employers' Accounting for Postemployment Benefits*, effective January 1, 1994, and Financial Accounting Standard No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, effective January 1, 1993.



March 3, 1995

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
BALANCE SHEET

ASSETS	As of December 31,	
	1994	1993
<b>CURRENT ASSETS</b>		
Cash .....	\$14,949,285	\$12,186,714
Accounts receivable .....	1,898,061	1,555,026
Prepaid expenses and other assets .....	1,665,345	1,130,894
<b>Total current assets</b> .....	<b>18,512,691</b>	<b>14,872,634</b>
<b>PROPERTY, BUILDINGS, AND EQUIPMENT, NET (Note 4)</b> .....	<b>54,839,623</b>	<b>50,121,444</b>
<b>Total assets</b> .....	<b>\$73,352,314</b>	<b>\$64,994,078</b>
<b>LIABILITIES AND FUND BALANCE</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable .....	\$ 5,450,877	\$ 5,308,176
Accrued payroll and related taxes .....	3,920,065	2,718,512
Accrued annual leave .....	6,223,919	5,871,643
Capital lease payable (current portion) .....	3,119,522	—
Unearned revenues and other liabilities .....	1,852,614	1,504,663
<b>Total current liabilities</b> .....	<b>20,566,997</b>	<b>15,402,994</b>
<b>CAPITAL LEASE PAYABLE (non-current portion)</b> .....	<b>303,358</b>	<b>—</b>
<b>ACCUMULATED POSTRETIREMENT BENEFIT OBLIGATION (Note 3)</b> .....	<b>16,274,446</b>	<b>15,880,742</b>
<b>ACCUMULATED POSTEMPLOYMENT BENEFIT OBLIGATION (Note 3)</b> .....	<b>1,320,018</b>	<b>—</b>
<b>FUND BALANCE</b> .....	<b>34,887,495</b>	<b>33,710,342</b>
<b>Total liabilities and fund balance</b> .....	<b>\$73,352,314</b>	<b>\$64,994,078</b>

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,	
	1994	1993
<b>BOARD OPERATING REVENUES</b>		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures.....	\$146,866,100	\$140,465,600
Other revenues (Note 5).....	9,134,248	5,452,588
Total operating revenues .....	156,000,348	145,918,188
<b>BOARD OPERATING EXPENSES</b>		
Salaries .....	93,823,248	90,339,090
Retirement and insurance contributions.....	16,147,049	14,945,349
Contractual services and professional fees.....	7,426,406	5,811,359
Depreciation and net losses on disposals.....	7,081,892	7,124,330
Travel .....	4,774,914	4,718,069
Postage and supplies .....	4,163,095	4,207,146
Utilities .....	4,158,650	3,744,162
Repairs and maintenance .....	3,794,986	3,684,542
Equipment and facilities rental.....	3,348,643	2,287,576
Software .....	3,017,536	2,878,660
Printing and binding .....	2,697,789	2,374,942
Other expenses (Note 5).....	3,423,987	3,584,471
Total operating expenses .....	153,858,195	145,699,696
<b>BOARD OPERATING REVENUES OVER EXPENSES .....</b>	<b>2,142,153</b>	<b>218,492</b>
<b>ISSUANCE AND REDEMPTION OF FEDERAL RESERVE NOTES</b>		
Assessments levied on Federal Reserve Banks for currency costs .....	368,187,989	355,947,291
Expenses for currency printing, issuance, retirement, and shipping .....	368,187,989	355,947,291
<b>CURRENCY ASSESSMENTS OVER (UNDER) EXPENSES .....</b>	<b>—</b>	<b>—</b>
<b>TOTAL REVENUES OVER EXPENSES BEFORE EFFECT OF CHANGES IN ACCOUNTING .....</b>	<b>2,142,153</b>	<b>218,492</b>
Less: Effect on prior years (to December 31, 1993) of change in accounting for postemployment benefits (Note 3).....	965,000	—
Less: Effect on prior years (to December 31, 1992) of change in accounting for postretirement benefits (Note 3).....	—	15,066,531
<b>TOTAL REVENUES OVER (UNDER) EXPENSES .....</b>	<b>1,177,153</b>	<b>(14,848,039)</b>
<b>FUND BALANCE, Beginning of year.....</b>	<b>33,710,342</b>	<b>48,558,381</b>
<b>FUND BALANCE, End of year.....</b>	<b>\$ 34,887,495</b>	<b>\$ 33,710,342</b>

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,	
	<u>1994</u>	<u>1993</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Board operating revenues over (under) expenses .....	\$1,177,153	\$(14,848,039)
Adjustments to reconcile operating revenues over (under) expenses to net cash provided by operating activities:		
Effect of change in accounting for postemployment benefits .....	965,000	—
Effect of change in accounting for postretirement benefits .....	—	15,066,531
Depreciation and net losses on disposals .....	7,081,892	7,124,330
Increase in accrued postretirement benefits .....	393,704	814,211
Increase in accrued postemployment benefits .....	355,018	—
(Increase) Decrease in accounts receivable, and prepaid expenses and other assets .....	(877,486)	1,320,057
Increase in accrued annual leave .....	352,276	259,237
Increase (Decrease) in accounts payable .....	142,701	(3,284)
Increase in payroll payable .....	1,201,553	740,461
Increase in unearned revenue and other liabilities .....	347,951	137,786
Net cash provided by operating activities .....	<u>11,139,762</u>	<u>10,611,290</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from disposals of furniture and equipment .....	27,081	3,723
Capital expenditures .....	(8,404,272)	(8,281,471)
Net cash used in investing activities .....	<u>(8,377,191)</u>	<u>(8,277,748)</u>
NET INCREASE IN CASH .....	2,762,571	2,333,542
CASH BALANCE, Beginning of year .....	<u>12,186,714</u>	<u>9,853,172</u>
CASH BALANCE, End of year .....	<u>\$14,949,285</u>	<u>\$ 12,186,714</u>

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 Changes*—Effective January 1, 1994, the Board adopted Statement of Financial Accounting Standards No. 112, *Employers' Accounting for Postemployment Benefits (FAS 112)*. 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 112, prior year financial statements have not been restated.

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.

## (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 1994 and

1993, 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 \$838,800 and \$867,600 in 1994 and 1993, 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 \$3,969,700 in 1994 and \$3,831,700 in 1993.

The Board also provides certain defined benefit health and life insurance for its active employees and retirees under Federal and Board sponsored programs. 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 1994 and 1993 included the following components:

	1994	1993
Service cost (benefits attributed to employee services during the year) .....	\$ 260,677	\$ 248,662
Interest cost on accumulated postretirement benefit obligation .....	1,191,123	1,181,104
Amortization of gains and losses .....	6,542	—
Net periodic postretirement benefit cost .....	<u>\$1,458,432</u>	<u>\$1,429,766</u>

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, 1994 and 1993, is comprised of:

	1994	1993
Retirees .....	\$11,301,461	\$ 9,971,023
Fully eligible active plan participants .....	2,419,656	2,297,911
Other active plan participants .....	4,392,114	5,092,539
	18,113,231	17,361,473
Unrecognized net loss .....	(1,838,785)	(1,480,731)
Liability for accumulated postretirement benefit obligation .....	\$16,274,446	\$15,880,742

The liability for the accumulated postretirement benefit obligation and the net periodic benefit cost was determined using an 7-percent discount rate. Unrecognized losses of \$1,838,785 result from applying a discount rate of 7 percent as of December 31, 1993, and a larger than estimated 1994 cash outlay. 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 1994 to 1995 was 11.0 percent. These rates were assumed to gradually decline to an ultimate rate of 6.0 percent in the year 2004 for the purpose of calculating the December 31, 1994, 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 \$2,113,851 at December 31, 1994, and the net periodic benefit cost by \$167,400 for the year. The assumed salary trend rate for measuring the increase in postretirement benefits related to life insurance was 5.5 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 \$3,510,500 and \$3,353,200 in 1994 and 1993, respectively.

The Board provides certain postemployment benefits to eligible employees after employment but before retirement. Effective January 1, 1994, the Board adopted Statement of Financial Accounting Standards No. 112, Employers' Accounting for Postemployment Benefits (FAS 112), which requires that employers providing postemployment benefits to their employees accrue the cost of such benefits. Prior to January 1994, postemployment benefit expenses were recognized on a pay-as-you-go basis. A one-time charge for the adoption of FAS 112 of \$965,000 was recognized as the cumulative effect of a change in accounting principle in 1994.

(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,	
	1994	1993
Land and improvements ...	\$ 1,301,314	\$ 1,301,314
Buildings .....	65,171,774	64,891,700
Furniture and equipment .....	45,742,097	43,055,132
	112,215,185	109,248,146
Less accumulated depreciation .....	57,375,562	59,126,702
Total property, buildings and equipment .....	\$ 54,839,623	\$ 50,121,444

(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,	
	1994	1993
Other Revenues		
Data processing revenue .....	\$4,058,655	\$3,152,492
National Information Center .....	2,739,014	—
Subscription revenue .....	1,547,628	1,579,653
Reimbursable services to other agencies ..	441,316	319,938
Miscellaneous .....	347,635	400,505
Total other revenues .....	\$9,134,248	\$5,452,588
Other Expenses		
Tuition, registration, and membership fees .....	\$1,116,155	\$1,015,507
Cafeteria operations, net .....	708,394	740,900
Subsidies and contributions ...	676,989	768,186
Miscellaneous .....	922,449	1,059,878
Total other expenses .....	\$3,423,987	\$3,584,471

(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 and, in December 1994, a capital lease for a new mainframe computer. Minimum future commitments under those leases having an initial or remaining noncancelable lease term in excess of one year at December 31, 1994, are as follows:

	Operating	Capital
1995 .....	\$ 3,045,750	\$3,119,522
1996 .....	3,169,926	75,840
1997 .....	3,152,561	75,840
1998 .....	1,748,090	75,840
1999 .....	771,652	75,838
after 1999 .....	116,612	—
	\$12,004,591	\$3,422,880

Rental expenses under the operating leases were \$2,987,500 and \$1,927,600 in 1994 and 1993, 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 1994 and 1993, the Board paid \$197,200 and \$371,200, respectively, in assessments for operating expenses of the Council. These amounts are included in subsidies and contributions for 1994 and 1993. During 1994 and 1993, the Board paid \$125,900 and \$124,500, respectively, for office space subleased from the Council. ■

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# *Statistical Tables*



# I. Detailed Statement of Condition of All Federal Reserve Banks Combined, December 31, 1994

Thousands of dollars

ASSETS		
Gold certificate account .....		11,050,635
Special drawing rights certificate account .....		8,018,000
Coin .....		320,320
<i>Loans and securities</i>		
Loans to depository institutions .....		222,876
Federal agency obligations		
Bought outright .....		3,636,705
Held under repurchase agreement .....		1,025,000
U.S. Treasury securities		
Bought outright		
Bills .....	177,378,390	
Notes .....	144,143,313	
Bonds .....	<u>42,997,536</u>	
Total bought outright .....	364,519,239	
Held under repurchase agreement .....		<u>9,565,000</u>
Total securities .....		<u>374,084,239</u>
Total loans and securities .....		<u>378,968,820</u>
<i>Items in process of collection</i>		
Transit items .....		4,109,320
Other items in process of collection .....		<u>1,089,912</u>
Total items in process of collection .....		5,199,231
<i>Bank premises</i>		
Land .....		167,320
Buildings (including vaults) .....	878,056	
Building machinery and equipment .....	234,938	
Construction account .....	<u>64,378</u>	
Total bank premises .....	1,177,371	
Less depreciation allowance .....		<u>268,258</u>
Bank premises, net .....		909,114
<i>Other assets</i>		
Furniture and equipment .....	1,136,824	
Less depreciation .....	<u>654,735</u>	
Total furniture and equipment, net .....		482,088
Denominated in foreign currencies <sup>1</sup> .....		22,031,496
Interest accrued .....		3,841,600
Premium on securities .....		4,476,244
Overdrafts .....		318,716
Prepaid expenses .....		716,595
Suspense account .....		33,847
Real estate acquired for banking-house purposes .....		25,360
Other .....		<u>336,556</u>
Total other assets .....		<u>32,262,501</u>
Total assets .....		<u><u>436,895,941</u></u>

## I.—Continued

LIABILITIES	
<i>Federal Reserve Notes</i>	
Outstanding (issued to Federal Reserve Banks) .....	454,642,232
Less held by Federal Reserve Banks .....	<u>-73,137,090</u>
<b>Total Federal Reserve notes, net .....</b>	<b>381,505,142</b>
<i>Deposits</i>	
Depository institutions .....	<b>30,788,596</b>
U.S. Treasury, general account .....	<b>7,161,095</b>
Foreign, official accounts .....	<b>250,119</b>
<i>Other deposits</i>	
Officers' and certified checks .....	25,737
International organizations .....	101,899
Other <sup>2</sup> .....	<u>645,963</u>
<b>Total other deposits .....</b>	<b>773,600</b>
Deferred credit items .....	<b>4,458,817</b>
<i>Other liabilities</i>	
Discount on securities .....	3,842,323
Sundry items payable .....	85,285
Suspense account .....	29,022
All other .....	<u>635,289</u>
<b>Total other liabilities .....</b>	<b>4,591,919</b>
<b>Total liabilities .....</b>	<b>429,529,287</b>
CAPITAL ACCOUNTS	
Capital paid in .....	<b>3,683,327</b>
Surplus .....	<b>3,683,327</b>
Other capital accounts <sup>3</sup> .....	<u>0</u>
<b>Total liabilities and capital accounts .....</b>	<b>436,895,941</b>

NOTE. Amounts in boldface type indicate items in the Board's weekly statement of condition of the Federal Reserve Banks.

1. Of this amount \$9,165.9 million was invested in securities issued by foreign governments, and the balance was invested with foreign central banks and the Bank for International Settlements.

2. In closing out the other capital accounts at year-end, the Reserve Bank earnings that are payable to the Treasury are included in this account pending payment.

3. During the year, includes undistributed net income, which is closed out on December 31.

2. Statement of Condition of Each Federal Reserve Bank,  
December 31, 1994 and 1993

Millions of dollars

Item	Total		Boston	
	1994	1993	1994	1993
<b>ASSETS</b>				
Gold certificate account.....	11,051	11,053	553	660
Special drawing rights certificate account.....	8,018	8,018	511	511
Coin.....	320	372	15	10
<i>Loans</i>				
To depository institutions.....	223	94	6	4
Other.....	0	0	0	0
Acceptances held under repurchase agreements.....	0	0	0	0
<i>Federal agency obligations</i>				
Bought outright.....	3,637	4,638	190	274
Held under repurchase agreements.....	1,025	1,025	0	0
<i>U.S. Treasury securities</i>				
Bought outright <sup>1</sup> .....	364,519	332,015	19,082	19,592
Held under repurchase agreements.....	9,565	12,187	0	0
Total loans and securities.....	378,969	349,960	19,278	19,870
Items in process of collection.....	5,199	7,173	293	353
Bank premises.....	1,076	1,055	93	91
<i>Other assets</i>				
Denominated in foreign currencies <sup>2</sup> .....	22,031	22,339	797	793
All other.....	10,231	10,000	450	460
Interdistrict Settlement Account.....	0	0	-2,202	-2,195
<b>Total assets.....</b>	<b>436,896</b>	<b>409,971</b>	<b>19,788</b>	<b>20,553</b>
<b>LIABILITIES</b>				
Federal Reserve notes.....	381,505	343,925	17,747	17,254
<i>Deposits</i>				
Depository institutions.....	30,789	34,951	1,214	2,555
U.S. Treasury, general account.....	7,161	14,809	0	0
Foreign, official accounts.....	250	386	5	5
Other.....	774	397	31	15
Total deposits.....	38,973	50,543	1,250	2,575
Deferred credit items.....	4,459	6,210	284	326
Other liabilities and accrued dividends <sup>3</sup> .....	4,592	2,489	228	152
<b>Total liabilities.....</b>	<b>429,529</b>	<b>403,168</b>	<b>19,509</b>	<b>20,307</b>
<b>CAPITAL ACCOUNTS</b>				
Capital paid in.....	3,683	3,401	139	123
Surplus.....	3,683	3,401	139	123
Other capital accounts.....	0	0	0	0
<b>Total liabilities and capital accounts.....</b>	<b>436,896</b>	<b>409,971</b>	<b>19,788</b>	<b>20,553</b>
<b>FEDERAL RESERVE NOTE STATEMENT</b>				
Federal Reserve notes outstanding (issued to Bank).....	454,642	409,265	22,868	19,706
Less: Held by Bank.....	73,137	65,339	5,121	2,452
<b>Federal Reserve notes, net.....</b>	<b>381,505</b>	<b>343,925</b>	<b>17,747</b>	<b>17,254</b>
<i>Collateral for Federal Reserve notes</i>				
Gold certificate account.....	11,051	11,053	...	...
Special drawing rights certificate account.....	8,018	8,018	...	...
Other eligible assets.....	0	0	...	...
U.S. Treasury and federal agency securities.....	362,437	324,854	...	...
<b>Total collateral.....</b>	<b>381,505</b>	<b>343,925</b>	...	...

For notes, see end of table.

2.—Continued

New York		Philadelphia		Cleveland		Richmond	
1994	1993	1994	1993	1994	1993	1994	1993
4,134	3,753	393	399	660	701	902	899
2,808	2,808	303	303	556	556	652	652
19	11	19	15	17	21	56	67
0	9	17	8	0	0	0	65
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
1,344	1,602	142	176	229	312	291	362
1,025	1,025	0	0	0	0	0	0
134,693	114,654	14,256	12,583	22,978	22,303	29,138	25,898
9,565	12,187	0	0	0	0	0	0
146,627	129,477	14,416	12,766	23,207	22,614	29,428	26,325
649	789	332	445	269	275	392	502
137	140	47	47	46	37	134	139
6,267	6,474	737	858	1,449	1,289	1,481	1,537
4,160	4,529	353	306	529	512	902	835
5,853	12,726	2,232	921	-1,332	-3,321	-867	598
<b>170,653</b>	<b>160,707</b>	<b>18,833</b>	<b>16,060</b>	<b>25,400</b>	<b>22,684</b>	<b>33,080</b>	<b>31,553</b>
151,608	134,964	16,733	13,026	22,542	20,161	28,847	28,035
7,105	6,969	1,491	2,248	1,814	1,556	2,782	2,357
7,161	14,809	0	0	0	0	0	0
149	288	5	5	9	8	9	10
261	196	26	7	41	14	70	32
14,677	22,261	1,523	2,261	1,864	1,578	2,862	2,398
551	747	32	432	222	340	447	477
1,843	798	183	114	257	158	332	186
<b>168,678</b>	<b>158,769</b>	<b>18,511</b>	<b>15,832</b>	<b>24,885</b>	<b>22,237</b>	<b>32,487</b>	<b>31,096</b>
988	969	161	114	258	224	296	229
988	969	161	114	258	224	296	229
0	0	0	0	0	0	0	0
<b>170,653</b>	<b>160,707</b>	<b>18,833</b>	<b>16,060</b>	<b>25,400</b>	<b>22,684</b>	<b>33,080</b>	<b>31,553</b>
174,495	157,408	18,463	14,472	26,124	23,474	35,331	34,012
22,888	22,444	1,690	1,446	3,581	3,313	6,484	5,978
<b>151,608</b>	<b>134,964</b>	<b>16,773</b>	<b>13,026</b>	<b>22,542</b>	<b>20,161</b>	<b>28,847</b>	<b>28,035</b>
...	...	...	...	...	...	...	...
...	...	...	...	...	...	...	...

2. Statement of Condition of Each Federal Reserve Bank,  
December 31, 1994 and 1993—Continued

Millions of dollars

Item	Atlanta		Chicago	
	1994	1993	1994	1993
<b>ASSETS</b>				
Gold certificate account .....	542	509	1,217	1,186
Special drawing rights certificate account .....	318	318	1,036	1,036
Coin .....	46	55	23	32
<i>Loans</i>				
To depository institutions .....	28	1	18	1
Other .....	0	0	0	0
Acceptances held under repurchase agreements .....	0	0	0	0
<i>Federal agency obligations</i>				
Bought outright .....	163	189	417	539
Held under repurchase agreements .....	0	0	0	0
<i>U.S. Treasury securities</i>				
Bought outright <sup>1</sup> .....	16,293	13,507	41,758	38,585
Held under repurchase agreements .....	0	0	0	0
Total loans and securities .....	16,484	13,697	42,193	39,124
Items in process of collection .....	753	775	509	674
Bank premises .....	64	61	112	113
<i>Other assets</i>				
Denominated in foreign currencies <sup>2</sup> .....	2,073	2,120	2,527	2,531
All other .....	423	380	1,069	960
Interdistrict Settlement Account .....	1,871	2,185	-1,048	1,743
<b>Total assets</b> .....	<b>22,573</b>	<b>20,101</b>	<b>47,638</b>	<b>47,400</b>
<b>LIABILITIES</b>				
Federal Reserve notes .....	18,053	14,960	42,265	41,541
<i>Deposits</i>				
Depository institutions .....	3,018	3,617	3,397	4,022
U.S. Treasury, general account .....	0	0	0	0
Foreign, official accounts .....	13	13	16	16
Other .....	29	2	148	81
Total deposits .....	3,060	3,632	3,561	4,118
Deferred credit items .....	561	736	496	679
Other liabilities and accrued dividends <sup>3</sup> .....	217	132	479	282
<b>Total liabilities</b> .....	<b>21,891</b>	<b>19,461</b>	<b>46,800</b>	<b>46,620</b>
<b>CAPITAL ACCOUNTS</b>				
Capital paid in .....	341	320	419	390
Surplus .....	341	320	419	390
Other capital accounts .....	0	0	0	0
<b>Total liabilities and capital accounts</b> .....	<b>22,573</b>	<b>20,101</b>	<b>47,638</b>	<b>47,400</b>
<b>FEDERAL RESERVE NOTE STATEMENT</b>				
Federal Reserve notes outstanding (issued to Bank) .....	23,368	19,797	48,257	45,621
Less: Held by Bank .....	5,315	4,837	5,992	4,081
<b>Federal Reserve notes, net</b> .....	<b>18,053</b>	<b>14,960</b>	<b>42,265</b>	<b>41,541</b>

NOTE. Components may not sum to totals because of rounding.

1. Includes securities loaned—fully guaranteed by U.S. Treasury securities pledged with Federal Reserve Banks—and excludes securities sold and scheduled to be bought back under matched sale-purchase transactions.

2. Valued monthly at market exchange rates.

3. Includes exchange-translation account reflecting the monthly revaluation at market exchange rates of foreign-exchange commitments.

## 2.—Continued

St. Louis		Minneapolis		Kansas City		Dallas		San Francisco	
1994	1993	1994	1993	1994	1993	1994	1993	1994	1993
429	392	230	243	436	409	453	510	1,102	1,392
168	168	186	186	199	199	377	377	904	904
23	22	21	15	22	21	28	42	33	61
89	1	11	4	20	1	0	0	33	0
0	0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0	0
145	164	80	106	156	176	138	199	343	542
0	0	0	0	0	0	0	0	0	0
14,497	11,723	8,028	7,600	15,637	12,592	13,786	14,219	34,373	38,761
0	0	0	0	0	0	0	0	0	0
14,731	11,888	8,119	7,710	15,813	12,769	13,924	14,418	34,749	39,303
195	246	380	465	370	583	513	511	544	1,555
30	31	46	35	54	51	157	158	156	151
481	512	589	585	830	795	1,594	1,550	3,207	3,295
334	271	196	181	361	292	343	380	1,111	895
4,308	1,857	-1,897	-1,004	-1,929	1,442	-1,303	-2,831	-3,685	-12,122
<b>20,698</b>	<b>15,387</b>	<b>7,870</b>	<b>8,418</b>	<b>16,154</b>	<b>16,561</b>	<b>16,086</b>	<b>15,115</b>	<b>38,122</b>	<b>35,433</b>
19,229	14,006	6,553	7,048	13,948	14,511	12,917	12,097	31,024	26,323
941	907	612	677	1,336	1,233	2,140	2,021	4,938	6,791
0	0	0	0	0	0	0	0	0	0
3	3	4	4	5	5	10	10	21	21
22	9	15	5	23	11	26	4	80	21
966	919	631	686	1,365	1,249	2,176	2,034	5,039	6,833
158	215	380	435	358	427	332	381	640	1,016
175	99	110	67	205	118	168	112	395	272
<b>20,528</b>	<b>15,238</b>	<b>7,673</b>	<b>8,236</b>	<b>15,876</b>	<b>16,305</b>	<b>15,592</b>	<b>14,623</b>	<b>37,098</b>	<b>34,443</b>
85	74	98	91	139	128	247	246	512	495
85	74	98	91	139	128	247	246	512	495
0	0	0	0	0	0	0	0	0	0
<b>20,698</b>	<b>15,387</b>	<b>7,870</b>	<b>8,418</b>	<b>16,154</b>	<b>16,561</b>	<b>16,086</b>	<b>15,115</b>	<b>38,122</b>	<b>35,433</b>
21,908	16,735	8,043	8,219	15,280	16,022	16,819	16,082	43,685	37,716
2,679	2,729	1,491	1,171	1,333	1,511	3,902	3,986	12,662	11,393
<b>19,229</b>	<b>14,006</b>	<b>6,553</b>	<b>7,048</b>	<b>13,948</b>	<b>14,511</b>	<b>12,917</b>	<b>12,097</b>	<b>31,024</b>	<b>26,323</b>

## 3. Federal Reserve Open Market Transactions, 1994

Millions of dollars

Type of transaction	Jan.	Feb.	Mar.	Apr.
<b>U.S. TREASURY SECURITIES</b>				
<i>Outright transactions (excluding matched transactions)</i>				
<i>Treasury bills</i>				
Gross purchases .....	0	1264	900	1,101
Gross sales .....	0	0	0	0
Exchanges .....	28,986	28,709	33,163	28,881
Redemptions .....	0	0	0	0
<i>Others within 1 year</i>				
Gross purchases .....	0	0	147	209
Gross sales .....	0	0	0	0
Maturity shift .....	0	4,063	0	2,316
Exchanges .....	-639	-1,985	-3,605	-907
Redemptions .....	0	0	0	0
<i>1 to 5 years</i>				
Gross purchases .....	0	0	1,413	2,817
Gross sales .....	0	0	0	0
Maturity shift .....	776	3,447	0	1,607
Exchanges .....	639	1,145	3,605	907
<i>5 to 10 years</i>				
Gross purchases .....	0	0	1,103	1,117
Gross sales .....	0	0	0	0
Maturity shift .....	-776	-616	0	709
Exchanges .....	0	550	0	0
<i>More than 10 years</i>				
Gross purchases .....	0	0	618	896
Gross sales .....	0	0	0	0
Maturity shift .....	0	0	0	0
Exchanges .....	0	325	0	0
<i>All maturities</i>				
Gross purchases .....	0	1,264	4,181	6,140
Gross sales .....	0	0	0	0
Redemptions .....	616	0	0	440
<i>Matched transactions</i>				
Gross purchases .....	133,468	124,270	155,625	120,512
Gross sales .....	132,872	124,125	155,950	120,393
<i>Repurchase agreements</i>				
Gross purchases .....	25,818	33,693	38,490	19,741
Gross sales .....	29,348	37,425	38,115	25,041
Net change in U.S. Treasury securities .....	-3,550	-2,323	4,232	519
<b>FEDERAL AGENCY OBLIGATIONS</b>				
<i>Outright transactions</i>				
Gross purchases .....	0	0	0	0
Gross sales .....	0	0	0	0
Redemptions .....	202	102	108	180
<i>Repurchase agreements</i>				
Gross purchases .....	2,600	3,277	3,160	728
Gross sales .....	3,106	3,636	3,170	878
Net change in agency obligations .....	-708	-461	-118	-330
<b>Total net change in System Open Market Account .....</b>	<b>-4,258</b>	<b>-2,784</b>	<b>4,114</b>	<b>189</b>

NOTE. Sales, redemptions, and negative figures reduce holdings of the System Open Market Account; all other figures increase such holdings. Components may not sum to totals because of rounding.

## 3.—Continued

May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
1,395	4,143	0	1,610	0	518	6,109	444	17,484
0	0	0	0	0	0	0	0	0
29,807	39,484	29,559	36,281	29,668	29,361	36,543	29,883	380,326
0	0	0	0	0	0	0	0	0
155	0	0	0	151	450	0	125	1,238
0	0	0	0	0	0	0	0	0
5,413	1,197	1,692	6,131	961	460	1,790	0	0
917	-3,192	-1,626	-4,089	-2,203	0	-5,795	0	0
0	0	0	0	0	0	0	0	0
0	0	0	0	2,530	0	200	2,208	9,168
0	0	0	0	0	0	0	0	0
-3,449	-1,197	-1,692	-5,506	-837	-460	-1,123	0	0
-917	3,192	1,626	2,889	2,203	0	4,192	0	0
0	0	0	0	938	0	0	660	3,818
0	0	0	0	0	0	0	0	0
-1,510	0	0	-549	-125	0	-278	0	0
0	0	0	750	0	0	1,603	0	0
0	0	0	0	840	0	0	1,252	3,606
0	0	0	0	0	0	0	0	0
-453	0	0	-76	0	0	-389	0	0
0	0	0	450	0	0	0	0	0
155	4,143	0	1,610	4,459	968	6,309	4,689	35,314
0	0	0	0	0	0	0	0	0
0	0	302	0	0	979	0	0	2,337
135,533	133,075	126,677	169,018	151,029	136,556	148,425	166,648	1,700,836
135,796	133,939	125,181	170,356	151,589	137,242	147,858	166,007	1,701,309
21,517	10,059	28,085	44,948	4,975	17,088	35,456	29,406	309,276
17,112	4,405	35,374	41,199	9,354	15,613	32,561	26,351	311,898
5,691	8,933	-6,095	4,022	-479	778	9,771	8,385	29,882
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
70	58	20	63	31	62	70	37	1,002
4,195	580	9,472	8,491	3,620	2,868	8,615	5,090	52,696
2,895	1,300	8,702	8,109	4,982	2,838	7,360	5,720	52,696
1,230	-778	750	319	-1,393	-32	1,185	-667	-1,002
<b>6,921</b>	<b>8,155</b>	<b>-5,345</b>	<b>4,341</b>	<b>-1,872</b>	<b>746</b>	<b>10,956</b>	<b>7,718</b>	<b>28,880</b>



4. Federal Reserve Bank Holdings of U.S. Treasury and Federal Agency Securities,  
December 31, 1992-94

Millions of dollars

Description	December 31			Change	
	1994	1993	1992	1993-94	1992-93
<b>U.S. TREASURY SECURITIES</b>					
<b>Held outright</b> <sup>1</sup> .....	<b>372,561</b>	<b>339,583</b>	<b>303,435</b>	<b>32,978</b>	<b>36,148</b>
<i>By remaining maturity</i>					
<i>Bills</i>					
1-91 days .....	98,129	90,186	79,988	7,943	10,198
92 days to 1 year .....	87,291	77,749	70,231	9,542	7,518
<i>Notes and bonds</i>					
1 year or less .....	34,978	35,423	37,758	-445	-2,335
More than 1 year through 5 years .....	90,031	79,826	68,750	10,205	11,076
More than 5 years through 10 years .....	27,552	24,659	18,903	2,893	5,756
More than 10 years .....	34,845	31,739	27,805	3,106	3,934
<i>By type</i>					
Bills .....	185,420	167,936	150,219	17,484	17,717
Notes .....	144,143	132,076	118,179	12,067	13,897
Bonds .....	42,998	39,572	35,037	3,426	4,535
<b>Repurchase agreements</b> .....	<b>9,565</b>	<b>12,187</b>	<b>7,463</b>	<b>-2,622</b>	<b>4,724</b>
<b>MSPs, foreign accounts</b> .....	<b>8,041</b>	<b>7,568</b>	<b>8,424</b>	<b>473</b>	<b>-856</b>
<b>MSPs, in the market</b> .....	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>FEDERAL AGENCY SECURITIES</b>					
<b>Held outright</b> <sup>1</sup> .....	<b>3,637</b>	<b>4,638</b>	<b>5,413</b>	<b>-1,001</b>	<b>775</b>
<i>By remaining maturity</i>					
1 year or less .....	1,737	1,823	2,064	-86	-241
More than 1 year through 5 years .....	1,387	2,105	2,511	-718	-406
More than 5 years through 10 years .....	488	569	696	-81	-217
More than 10 years .....	25	142	142	-117	0
<i>By issuer</i>					
Held outright .....	3,637	4,638	5,412	-1,001	-774
Federal Farm Credit Banks .....	1,050	1,201	1,296	-151	-95
Federal Home Loan Banks .....	796	1,249	1,766	-453	-517
Federal Land Banks .....	66	66	66	0	0
Federal National Mortgage Association .....	1,725	2,005	2,167	-280	-162
U.S. Postal Service .....	0	0	0	0	0
Washington Metropolitan Area Transit Authority .....	0	117	117	-117	0
General Services Administration .....	0	0	0	0	0
<b>Repurchase agreements</b> .....	<b>1,025</b>	<b>1,025</b>	<b>631</b>	<b>0</b>	<b>394</b>

NOTE. Components may not sum to totals because of rounding.

1. Excludes the effects of temporary transactions—repurchase agreements and matched sale-purchase agreements (MSPs).

## 5. Number and Annual Salaries of Officers and Employees of Federal Reserve Banks, December 31, 1994

Federal Reserve Bank (including branches)	President	Other officers		Employees			Total	
	Salary (dollars)	Number	Salaries (dollars)	Number		Salaries (dollars)	Number	Salaries (dollars)
				Full-time	Part-time			
Boston .....	167,500	58	5,656,800	1,104	198	44,033,572	1,361	49,857,872
New York .....	217,000	187	22,021,780	3,937	67	159,996,214	4,192	182,234,994
Philadelphia .....	194,000	57	5,264,675	1,183	56	37,712,521	1,297	43,171,196
Cleveland .....	173,800	48	4,636,280	1,286	75	40,975,494	1,410	45,785,574
Richmond .....	168,400	75	6,677,700	1,861	127	58,122,847	2,064	64,968,947
Atlanta .....	223,600	78	6,957,625	2,229	55	69,370,801	2,363	76,552,026
Chicago .....	193,000	105	9,613,250	2,270	58	81,132,904	2,434	90,939,154
St. Louis .....	199,000	51	4,373,300	996	98	31,313,621	1,146	35,885,921
Minneapolis .....	184,000	51	4,576,850	1,137	119	37,360,078	1,308	42,120,928
Kansas City .....	168,600	56	4,956,900	1,533	102	48,428,547	1,692	53,554,047
Dallas .....	170,400	58	5,136,600	1,440	51	46,427,191	1,550	51,734,191
San Francisco .....	241,080	89	9,451,900	2,256	83	87,086,917	2,429	96,779,897
Federal Reserve Automation Service .....		25	2,550,000	452	4	21,577,195	481	24,127,195
<b>Total .....</b>	<b>2,300,380</b>	<b>938</b>	<b>91,873,660</b>	<b>21,684</b>	<b>1,093</b>	<b>763,537,902</b>	<b>23,727</b>	<b>857,711,942</b>

## 6. Income and Expenses of Federal Reserve Banks, 1994

Dollars

Item <sup>1</sup>	Total	Boston	New York	Philadelphia	Cleveland
<b>CURRENT INCOME</b>					
Loans .....	11,451,765	120,337	605,303	162,271	137,807
U.S. Treasury and federal agency securities .....	19,247,074,249	1,035,627,770	7,062,943,725	741,805,133	1,227,039,616
Foreign currencies .....	894,500,875	32,311,828	255,017,462	30,174,859	58,356,750
Priced services .....	734,434,991	39,895,330	101,971,655	39,055,693	45,499,574
Other .....	23,280,497	438,010	18,225,155	511,054	401,259
<b>Total</b> .....	<b>20,910,742,377</b>	<b>1,108,393,275</b>	<b>7,438,763,300</b>	<b>811,709,010</b>	<b>1,331,435,006</b>
<b>CURRENT EXPENSES</b>					
Salaries and other personnel expenses .....	944,920,187	56,068,356	196,203,006	50,387,881	49,201,442
Retirement and other benefits <sup>2</sup> .....	187,162,458	16,525,760	55,751,627	15,725,445	13,502,945
Fees .....	27,575,957	1,242,715	4,992,712	484,548	1,657,240
Travel .....	42,598,270	2,194,912	5,991,764	2,251,001	2,287,996
Software expenses .....	49,315,104	1,974,356	10,002,097	2,029,984	1,841,212
Postage and other shipping costs .....	78,557,899	4,559,126	11,044,154	3,575,590	6,064,350
Communications .....	9,904,033	454,588	2,012,721	419,309	776,526
Materials and supplies .....	55,642,796	3,049,682	10,237,995	3,467,055	3,147,270
<i>Building expenses</i>					
Taxes on real estate .....	26,681,714	3,614,636	4,347,904	1,867,562	1,465,662
Property depreciation .....	47,938,118	3,724,751	8,002,578	2,100,187	2,117,727
Utilities .....	31,645,531	2,724,623	6,320,932	2,976,331	1,877,055
Rent .....	29,463,710	680,241	12,973,873	354,159	355,762
Other .....	25,584,876	647,282	5,074,716	1,443,785	759,222
<i>Equipment</i>					
Purchases .....	7,748,282	212,500	1,664,397	320,268	273,846
Rentals .....	30,497,363	559,597	5,275,273	651,514	944,156
Depreciation .....	129,680,117	4,142,715	20,265,464	5,602,209	4,546,422
Repairs and maintenance .....	69,539,516	4,546,252	10,908,975	3,378,430	4,058,804
Earnings-credit costs .....	223,623,378	14,492,606	50,935,940	26,331,165	12,381,212
Other .....	41,445,945	2,398,038	7,760,585	1,383,971	2,948,146
Shared costs, net <sup>3</sup> .....	-8,427	5,189,184	2,100,213	8,299,718	8,245,703
Recoveries .....	-49,955,735	-9,381,171	-6,586,910	-3,099,775	-2,472,694
Expenses capitalized <sup>4</sup> .....	-3,266,552	-223,564	-18,008	-185,435	-315,556
<b>Total</b> .....	<b>2,006,294,540</b>	<b>119,397,185</b>	<b>425,262,108</b>	<b>129,764,902</b>	<b>115,664,448</b>
Reimbursements .....	-210,966,197	-10,872,323	-43,915,081	-18,540,342	-19,524,831
Net expenses .....	1,795,328,343	108,524,862	381,347,027	111,224,560	96,139,617

For notes see end of table.

## 6.—Continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
343,008	494,320	993,816	2,163,233	4,162,092	1,360,596	297,759	611,223
1,518,935,701	834,211,891	2,199,668,608	737,665,726	425,703,449	794,847,621	749,205,127	1,919,419,883
60,179,649	84,183,313	102,461,570	19,591,450	23,864,206	33,554,134	64,548,577	130,257,077
62,684,004	98,146,246	98,049,361	31,044,338	42,442,616	48,063,890	49,451,009	78,131,275
556,485	369,556	917,915	173,124	313,113	132,808	305,767	936,251
<b>1,642,698,846</b>	<b>1,017,405,326</b>	<b>2,402,091,270</b>	<b>790,637,871</b>	<b>496,485,476</b>	<b>877,959,049</b>	<b>863,808,239</b>	<b>2,129,355,709</b>
99,771,610	84,805,710	99,602,062	42,365,910	45,520,899	56,557,572	55,425,373	109,010,366
26,214,572	24,520,053	27,086,283	13,039,245	11,224,125	17,249,540	14,707,212	27,262,496
11,514,202	1,033,191	900,061	572,218	1,621,141	801,260	1,285,179	1,471,490
5082,791	4,244,869	5,010,872	2,032,010	2,784,300	2,934,677	2,889,822	4,902,256
19,997,993	1,722,141	4,278,412	1,550,692	1,465,044	620,634	1,024,256	2,808,283
7,228,865	10,431,098	9,464,009	3,941,318	5,830,365	6,121,255	4,569,037	5,728,732
1,080,412	1,085,133	792,643	544,558	573,068	794,130	756,087	614,858
6,647,627	5,659,885	5,864,842	3,198,774	2,226,063	3,410,405	3,520,298	5,212,900
2,225,152	1,653,805	4,075,397	466,093	1,142,673	817,788	2,364,443	2,640,599
5,337,327	3,830,213	5,236,287	2,253,537	867,708	3,269,235	4,802,424	6,396,144
3,195,531	2,200,612	2,260,465	1,570,841	965,054	1,450,054	2,495,851	3,608,182
7,724,761	3,419,479	1,979,022	393,176	765,617	360,366	1,224,407	232,847
2,596,436	2,527,942	5,532,700	844,645	757,560	888,823	1,891,196	2,620,569
691,813	772,582	1,268,260	227,140	777,422	476,973	442,845	620,236
2,805,054	1,964,123	13,070,025	653,774	1,003,038	824,373	838,056	1,908,380
53,835,370	6,160,159	14,886,073	2,196,948	3,416,960	2,263,032	4,221,544	8,143,221
12,396,989	7,104,438	11,263,207	2,217,237	2,873,420	1,894,915	2,775,780	6,121,069
13,602,462	12,822,589	43,386,374	4,865,480	5,388,886	9,729,331	10,150,839	19,536,494
4,868,700	3,834,591	5,219,182	1,721,992	1,560,621	2,553,768	2,911,279	4,285,072
-77,255,676	14,882,358	-11,187,200	9,767,110	4,839,823	1,837,226	13,407,330	6,865,684
-11,650,370	-2,436,378	-3,076,173	-1,298,992	-890,743	-704,311	-4,365,567	-3,992,651
-985,637	-318,585	-177,022	-49,166	-403,474	-461,510	-95,331	-33,264
<b>196,925,984</b>	<b>191,920,008</b>	<b>246,735,781</b>	<b>93,065,540</b>	<b>94,309,570</b>	<b>126,689,536</b>	<b>126,242,360</b>	<b>215,963,963</b>
-16,949,397	-15,630,676	-20,324,772	-11,155,769	-13,213,124	-16,617,685	-8,164,126	-16,058,071
179,976,587	176,289,332	226,411,009	81,909,771	81,096,446	110,071,851	118,078,234	199,905,892

## 6. Income and Expenses of Federal Reserve Banks, 1994—Continued

Dollars

Item <sup>1</sup>	Total	Boston	New York	Philadelphia	Cleveland
<b>PROFIT AND LOSS</b>					
Current net income .....	19,115,414,033	999,868,414	7,133,063,119	700,484,451	1,235,295,386
<i>Additions to and deductions from (-) current net income<sup>5</sup></i>					
Net profit on foreign exchange .....	2,422,626,091	87,608,162	689,950,602	81,003,004	159,216,132
Other additions .....	167,302	20,757	42,821	3,411	33,927
Total additions .....	2,422,793,393	87,628,919	689,993,424	81,006,415	159,250,059
Losses on sales of U.S. Treasury and federal agency securities .....	-24,285,820	-1,237,875	-9,095,296	-955,915	-1,510,117
Other deductions .....	-568,357	-9,425	-71,358	-1,915	-5,063
Total deductions .....	-24,854,177	-1,247,300	-9,166,654	-957,830	-1,515,180
Net addition to current net income .....	2,397,939,216	86,381,619	680,826,769	80,048,585	157,734,879
Cost of unreimbursed Treasury services .....	34,077,119	1,582,808	3,234,295	1,977,891	1,964,554
<i>Assessments by Board</i>					
Board expenditures <sup>6</sup> .....	146,866,100	5,334,800	41,453,600	5,139,600	9,693,400
Cost of currency .....	368,187,068	18,471,633	144,484,979	13,944,751	21,583,556
Net income before payment to U.S. Treasury .....	20,964,222,962	1,060,860,792	7,624,717,014	759,470,794	1,359,788,755
Dividends paid .....	212,090,446	7,849,562	58,789,295	8,328,151	14,283,474
Payments to U.S. Treasury (interest on Federal Reserve notes) .....	20,470,010,815	1,036,570,880	7,546,939,469	703,722,593	1,311,506,031
Transferred to surplus .....	282,121,700	16,440,350	18,988,250	47,370,050	33,999,250
Surplus, January 1 .....	3,401,205,000	122,966,000	968,644,500	113,722,800	223,528,800
Surplus, December 31 .....	3,683,326,700	139,436,350	987,632,750	161,092,850	257,528,050

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

2. The effect of the 1987 implementation of the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 87, *Employers' Accounting for Pensions* (SFAS 87), 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 SFAS 87 on the Reserve Banks was a reduction in expenses of \$75,646,845.

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 and losses on the sale of Reserve Bank buildings, counterfeit currency that is not charged back to the depositing institution, and stale Reserve Bank checks that are written off.

6. For additional details, see the last five pages of the preceding section: Board of Governors Financial Statements.

## 6.—Continued

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
1,462,722,259	841,115,994	2,175,680,261	708,728,100	415,389,029	767,887,197	745,730,004	1,929,449,817
162,752,518	227,876,525	277,694,924	52,906,366	64,706,751	91,171,971	175,247,308	352,491,827
22,196	2,914	3,849	53	761	5,876	28,434	2,304
162,774,714	227,879,439	277,698,773	52,906,420	64,707,511	91,177,848	175,275,742	352,494,131
-1,950,982	-1,105,682	-2,773,780	-988,263	-530,487	-1,066,735	-893,336	-2,177,351
-15,049	-407,261	-14,980	-6,880	-5,681	-6,959	-11,044	-12,741
-1,966,031	-1,512,943	-2,788,760	-995,143	-536,168	-1,073,694	-904,380	-2,190,092
160,808,682	226,366,495	274,910,012	51,911,277	64,171,343	90,104,154	174,371,362	350,340,039
4,152,969	3,400,380	4,178,104	1,821,363	2,326,810	2,570,802	2,111,552	4,755,590
10,122,800	13,789,600	16,877,600	3,224,000	3,925,500	5,500,400	10,489,600	21,315,200
30,012,475	16,015,448	44,471,199	14,993,718	7,544,729	15,534,956	12,949,921	28,179,703
1,579,242,698	1,034,277,061	2,385,063,370	740,600,296	465,763,333	834,385,193	894,550,293	2,225,503,363
15,506,612	19,776,874	24,284,767	4,764,528	5,684,644	7,930,022	14,637,864	30,254,653
1,495,895,736	993,406,487	2,331,628,353	725,337,918	452,660,839	815,269,571	879,116,729	2,177,906,210
67,840,350	21,093,700	29,150,250	10,497,850	7,417,850	11,185,600	795,700	17,342,500
228,493,650	319,923,400	389,865,100	74,277,000	90,843,950	127,999,350	246,035,500	494,874,950
296,334,000	341,017,100	419,015,350	84,774,850	98,261,800	139,184,950	246,831,200	512,217,450

## 7. Income and Expenses of Federal Reserve Banks, 1914-94

Dollars

Federal Reserve Bank and period	Current income	Net expenses	Net additions or deductions (-)	Assessments by Board of Governors	
				Board expenditures	Costs of currency
<i>All Banks</i>					
1914-15 .....	2,173,252	2,018,282	5,875	302,304	.....
1916 .....	5,217,998	2,081,722	-193,001	192,277	.....
1917 .....	16,128,339	4,921,932	-1,386,545	237,795	.....
1918 .....	67,584,417	10,576,892	-3,908,574	382,641	.....
1919 .....	102,380,583	18,744,815	-4,673,446	594,818	.....
1920 .....	181,296,711	27,548,505	-3,743,907	709,525	.....
1921 .....	122,865,866	33,722,409	-6,314,796	741,436	.....
1922 .....	50,498,699	28,836,504	-4,441,914	722,545	.....
1923 .....	50,708,566	29,061,539	-8,233,107	702,634	.....
1924 .....	38,340,449	27,767,886	-6,191,143	663,240	.....
1925 .....	41,800,706	26,818,664	-4,823,477	709,499	.....
1926 .....	47,599,595	24,914,037	-3,637,668	721,724	1,714,421
1927 .....	43,024,484	24,894,487	-2,456,792	779,116	1,844,840
1928 .....	64,052,860	25,401,233	-5,026,029	697,677	805,900
1929 .....	70,955,496	25,810,067	-4,861,642	781,644	3,099,402
1930 .....	36,424,044	25,357,611	-93,136	809,585	2,175,530
1931 .....	29,701,279	24,842,964	311,451	718,554	1,479,146
1932 .....	50,018,817	24,456,755	-1,413,192	728,810	1,105,816
1933 .....	49,487,318	25,917,847	-12,307,074	800,160	2,504,830
1934 .....	48,902,813	26,843,653	-4,430,008	1,372,022	1,025,721
1935 .....	42,751,959	28,694,965	-1,736,758	1,405,898	1,476,580
1936 .....	37,900,639	26,016,338	485,817	1,679,566	2,178,119
1937 .....	41,233,135	25,294,835	-1,631,274	1,748,380	1,757,399
1938 .....	36,261,428	25,556,949	2,232,134	1,724,924	1,629,735
1939 .....	38,500,665	25,668,907	2,389,555	1,621,464	1,356,484
1940 .....	43,537,805	25,950,946	11,487,697	1,704,011	1,510,520
1941 .....	41,380,095	28,535,547	720,636	1,839,541	2,588,062
1942 .....	52,662,704	32,051,226	-1,568,208	1,746,326	4,826,492
1943 .....	69,305,715	35,793,816	23,768,282	2,415,630	5,336,118
1944 .....	104,391,829	39,659,496	3,221,880	2,296,357	7,220,068
1945 .....	142,209,546	41,666,453	-830,007	2,340,509	4,710,309
1946 .....	150,385,033	50,493,246	-625,991	2,259,784	4,482,077
1947 .....	158,655,566	58,191,428	1,973,001	2,639,667	4,561,880
1948 .....	304,160,818	64,280,271	-34,317,947	3,243,670	5,186,247
1949 .....	316,536,930	67,930,860	-12,122,274	3,242,500	6,304,316
1950 .....	275,838,994	69,822,227	36,294,117	3,433,700	7,315,844
1951 .....	394,656,072	83,792,676	-2,127,889	4,095,497	7,580,913
1952 .....	456,060,260	92,051,063	1,583,988	4,121,602	8,521,426
1953 .....	513,037,237	98,493,153	-1,058,993	4,099,800	10,922,067
1954 .....	438,486,040	99,068,436	-133,641	4,174,600	6,489,895
1955 .....	412,487,931	101,158,921	-265,456	4,194,100	4,707,002
1956 .....	595,649,092	110,239,520	-23,436	5,339,800	5,603,176
1957 .....	763,347,530	117,931,908	-7,140,914	7,507,900	6,374,195
1958 .....	742,068,150	125,831,215	124,175	5,917,200	5,973,240
1959 .....	886,226,116	131,848,023	98,247,253	6,470,600	6,384,083
1960 .....	1,103,385,257	139,893,564	13,874,702	6,533,700	7,455,011
1961 .....	941,648,170	148,253,719	3,481,628	6,265,100	6,755,756
1962 .....	1,048,508,335	161,451,206	-55,779	6,654,900	8,030,028
1963 .....	1,151,120,060	169,637,656	614,835	7,572,800	10,062,901
1964 .....	1,343,747,303	171,511,018	725,948	8,655,200	17,229,671
1965 .....	1,559,484,027	172,110,934	1,021,614	8,576,396	23,602,856
1966 .....	1,908,499,896	178,212,045	996,230	9,021,600	20,167,481
1967 .....	2,190,403,752	190,561,166	2,093,876	10,769,596	18,790,084
1968 .....	2,764,445,943	207,677,768	8,519,996	14,198,198	20,474,404
1969 .....	3,373,360,559	237,827,579	-557,553	15,020,084	22,125,657

For notes see end of table.

## 7.—Continued

Dividends paid	Payments to U.S. Treasury			Transferred to surplus (section 13b)	Transferred to surplus (section 7)
	Franchise tax	Under section 13b	Interest on Federal Reserve notes		
217,463	...	...	...	...	...
1,742,775	...	...	...	...	...
6,804,186	1,134,234	...	...	...	1,134,234
5,540,684	...	...	...	...	48,334,341
5,011,832	2,703,894	...	...	...	70,651,778
5,654,018	60,724,742	...	...	...	82,916,014
6,119,673	59,974,466	...	...	...	15,993,086
6,307,035	10,850,605	...	...	...	-659,904
6,552,717	3,613,056	...	...	...	2,545,513
6,682,496	113,646	...	...	...	-3,077,962
6,915,958	59,300	...	...	...	2,473,808
7,329,169	818,150	...	...	...	8,464,426
7,754,539	249,591	...	...	...	5,044,119
8,458,463	2,584,659	...	...	...	21,078,899
9,583,911	4,283,231	...	...	...	22,535,597
10,268,598	17,308	...	...	...	-2,297,724
10,029,760	...	...	...	...	-7,057,694
9,282,244	2,011,418	...	...	...	11,020,582
8,874,262	...	...	...	...	-916,855
8,781,661	...	...	...	-60,323	6,510,071
8,504,974	...	297,667	...	27,695	607,422
7,829,581	...	227,448	...	102,880	352,524
7,940,966	...	176,625	...	67,304	2,616,352
8,019,137	...	119,524	...	-419,140	1,862,433
8,110,462	...	24,579	...	-425,653	4,533,977
8,214,971	...	82,152	...	-54,456	17,617,358
8,429,936	...	141,465	...	-4,333	570,513
8,669,076	...	197,672	...	49,602	3,554,101
8,911,342	...	244,726	...	135,003	40,327,237
9,500,126	...	326,717	...	201,150	48,409,795
10,182,851	...	247,659	...	262,133	81,969,625
10,962,160	...	67,054	...	27,708	81,467,013
11,523,047	...	35,605	75,283,818	86,772	8,366,350
11,919,809	...	...	166,690,356	...	18,522,518
12,329,373	...	...	193,145,837	...	21,461,770
13,082,992	...	...	196,628,858	...	21,849,490
13,864,750	...	...	254,873,588	...	28,320,759
14,681,788	...	...	291,934,634	...	46,333,735
15,558,377	...	...	342,567,985	...	40,336,862
16,442,236	...	...	276,289,457	...	35,887,775
17,711,937	...	...	251,740,721	...	32,709,794
18,904,897	...	...	401,555,581	...	53,982,682
20,080,527	...	...	542,708,405	...	61,603,682
21,197,452	...	...	524,058,650	...	59,214,569
22,721,687	...	...	910,649,768	...	-93,600,791
23,948,225	...	...	896,816,359	...	42,613,100
25,569,541	...	...	687,393,382	...	70,892,300
27,412,241	...	...	799,365,981	...	45,538,200
28,912,019	...	...	879,685,219	...	55,864,300
30,781,548	...	...	1,582,118,614	...	-465,822,800
32,351,602	...	...	1,296,810,053	...	27,053,800
33,696,336	...	...	1,649,455,164	...	18,943,500
35,027,312	...	...	1,907,498,270	...	29,851,200
36,959,336	...	...	2,463,628,983	...	30,027,250
39,236,599	...	...	3,019,160,638	...	39,432,450



## 7. Income and Expenses of Federal Reserve Banks, 1914-94—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 <sup>1</sup>	81,869,800	170,674,979
1988.....	19,526,431,297	1,205,960,134	-516,910,320	84,410,500	164,244,653
1989.....	22,249,275,725	1,332,160,712	1,254,613,365 <sup>2</sup>	89,579,700	175,043,736
1990.....	23,476,603,651	1,349,725,812	2,099,328,472 <sup>2</sup>	103,752,200	193,006,998
1991.....	22,553,001,815	1,429,322,157	405,729,320 <sup>2</sup>	109,631,000	261,316,379
1992.....	20,235,027,938	1,474,530,523	-987,787,687 <sup>3</sup>	128,955,300	295,400,692
1993.....	18,914,250,574	1,657,799,914	-230,267,919 <sup>3</sup>	140,465,600	355,947,291
1994.....	20,910,742,377	1,795,328,343	2,363,862,097	146,866,100	368,187,068
<b>Total, 1914-94.....</b>	<b>366,849,386,662</b>	<b>26,780,703,683</b>	<b>6,904,700,849</b>	<b>1,990,264,608</b>	<b>3,616,413,132</b>
<i>Aggregate for each Bank, 1914-94</i>					
Boston.....	19,721,814,195	1,747,859,086	226,881,331	72,417,786	215,736,802
New York.....	114,987,696,856	5,462,947,836	1,994,078,541	531,626,786	1,080,753,442
Philadelphia.....	14,037,353,810	1,471,141,310	249,722,297	91,343,418	145,970,429
Cleveland.....	24,063,149,468	1,711,019,383	344,664,111	140,409,590	227,052,130
Richmond.....	29,057,482,677	2,259,879,715	406,912,980	113,037,976	322,245,965
Atlanta.....	15,844,256,263	2,429,002,738	639,722,208	162,670,360	193,196,778
Chicago.....	50,273,094,107	3,480,599,004	834,386,003	266,659,372	474,256,122
St. Louis.....	12,083,136,160	1,361,511,006	142,337,562	57,436,872	130,746,943
Minneapolis.....	6,815,176,737	1,255,824,402	195,585,548	57,803,215	66,812,619
Kansas City.....	14,923,146,218	1,722,782,334	242,731,626	81,558,909	154,586,951
Dallas.....	19,577,905,034	1,633,745,271	564,744,325	136,152,773	189,508,731
San Francisco.....	45,465,175,138	2,901,277,332	1,062,934,317	279,147,551	415,546,220
<b>Total.....</b>	<b>366,849,386,662</b>	<b>26,780,703,683<sup>4</sup></b>	<b>6,904,700,850</b>	<b>1,990,264,608</b>	<b>3,616,413,132</b>

NOTE. Components may not sum to totals because of rounding.

1. For 1987 and subsequent years, includes the cost of services provided to the Treasury by Federal Reserve Banks for which reimbursement was not received.

2. Data are revised to reflect services provided to the Treasury by the Federal Reserve for which reimbursement was not received.

3. The \$3,811,998,899 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 \$3,683,326,698 on December 31, 1994.

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
212,090,446	...	...	20,470,010,815	...	282,121,700
<b>3,162,502,473</b>	<b>149,138,300</b>	<b>2,188,893</b>	<b>334,240,881,175</b>	<b>-3,657</b>	<b>3,811,998,899<sup>3</sup></b>
126,007,520	7,111,395	280,843	17,629,615,508	135,411	149,531,175
867,219,942	68,006,262	369,116	108,603,281,839	-433,412	1,024,889,321
157,468,551	5,558,901	722,406	12,239,157,360	290,661	175,423,072
235,746,864	4,842,447	82,930	21,817,908,296	-9,906	270,761,843
175,356,162	6,200,189	172,493	26,285,360,734	-71,517	302,213,808
243,446,192	8,950,561	79,264	13,100,343,576	5,491	346,283,640
417,453,547	25,313,526	151,045	46,008,691,703	11,682	434,344,104
93,146,584	2,755,629	7,464	10,490,001,265	-26,515	89,894,478
88,746,226	5,202,900	55,615	5,434,113,418	64,874	102,139,013
127,696,431	6,939,100	64,213	12,928,933,679	-8,674	143,324,900
205,867,288	560,049	102,083	17,725,549,149	55,337	251,108,678
424,347,165	7,697,341	101,421	41,977,924,647	-17,089	522,084,867
<b>3,162,502,473</b>	<b>149,138,300</b>	<b>2,188,893</b>	<b>334,240,881,175</b>	<b>-3,657</b>	<b>3,811,998,899</b>

## 8. Acquisition Costs and Net Book Value of Premises of Federal Reserve Banks and Branches, December 31, 1994

Dollars

Federal Reserve Bank or Branch	Acquisition costs				Net book value	Other real estate <sup>3</sup>
	Land	Buildings (including vaults) <sup>1</sup>	Building machinery and equipment	Total <sup>2</sup>		
BOSTON .....	22,073,501	86,496,803	6,304,076	117,874,379	93,337,982	...
NEW YORK .....	20,354,440	98,090,019	46,600,282	165,044,740	133,018,170	..
Buffalo .....	887,844	2,693,268	2,767,406	6,348,518	4,076,438	..
PHILADELPHIA .....	2,251,556	54,371,039	5,903,704	62,526,299	47,273,050	..
CLEVELAND .....	2,298,643	19,392,191	6,967,450	28,658,284	21,991,102	..
Cincinnati .....	2,246,599	14,027,505	8,238,036	24,512,139	11,507,150	..
Pittsburgh .....	1,658,376	9,721,591	4,351,756	15,731,723	12,082,351	..
RICHMOND .....	6,683,808	62,159,743	18,248,290	87,091,841	74,194,784	...
Baltimore .....	6,476,335	27,138,811	3,842,189	37,457,335	28,531,403	...
Charlotte .....	3,129,645	27,402,251	4,737,485	35,269,381	31,088,523	...
ATLANTA .....	1,209,360	15,497,334	4,319,451	21,026,145	15,870,536	13,086,575
Birmingham .....	3,197,830	2,285,364	2,056,693	7,539,887	5,510,358	..
Jacksonville .....	1,665,439	16,910,785	2,851,236	21,427,459	18,430,309	48,365
Miami .....	3,717,791	12,214,933	2,719,389	18,652,113	13,713,980	...
Nashville .....	592,342	1,692,767	2,360,915	4,646,024	2,375,406	...
New Orleans .....	3,371,446	4,894,869	2,602,700	10,869,015	7,645,806	...
CHICAGO .....	4,565,008	113,679,679	20,287,785	138,532,472	104,017,798	..
Detroit .....	797,734	4,468,358	5,149,902	10,415,994	8,228,700	..
ST. LOUIS .....	700,378	15,689,558	5,298,206	21,688,142	17,893,469	...
Little Rock .....	1,148,492	2,460,257	1,003,022	4,611,771	3,503,279	..
Louisville .....	700,075	2,859,819	1,131,238	4,691,132	3,624,622	..
Memphis .....	1,135,623	4,216,382	2,280,473	7,632,478	5,075,611	...
MINNEAPOLIS .....	9,524,866	36,836,953	7,851,532	54,213,351	35,591,897	...
Helena .....	1,954,514	9,064,373	501,857	11,520,744	10,677,318	...
KANSAS CITY .....	1,829,420	16,261,220	11,638,819	29,729,459	21,081,258	149,948
Denver .....	3,187,962	5,457,054	3,185,925	11,830,941	8,715,060	...
Oklahoma City .....	646,386	7,952,791	861,305	9,460,482	7,622,491	..
Omaha .....	6,534,583	10,987,009	1,401,083	18,922,675	16,401,411	1,412,500
DALLAS .....	29,102,860	110,804,261	11,969,538	151,876,659	145,114,050	10,533,831
El Paso .....	262,477	1,425,210	404,946	2,092,633	1,850,112	...
Houston .....	2,205,500	4,161,578	1,150,965	7,518,043	6,801,918	...
San Antonio .....	482,284	2,735,961	1,669,052	4,887,297	3,631,392	...
SAN FRANCISCO .....	15,599,928	67,649,956	18,105,346	101,355,230	80,090,925	...
Los Angeles .....	3,891,887	50,756,229	8,847,166	63,495,282	53,566,199	...
Portland .....	415,924	6,226,586	2,267,971	8,910,481	8,140,590	128,644
Salt Lake City .....	494,556	5,005,637	2,441,387	7,941,581	6,890,668	...
Seattle .....	324,772	5,745,131	2,619,622	8,689,525	7,267,888	...
<b>Total .....</b>	<b>167,320,184</b>	<b>942,433,273</b>	<b>234,938,201</b>	<b>1,344,691,658</b>	<b>1,076,434,008</b>	<b>25,359,862</b>

NOTE. Components may not sum to totals because of rounding.

1. Includes expenditures for construction at some offices, pending allocation to appropriate accounts.

2. Excludes charge-offs of \$17,698,968 before 1952.

3. 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, 1991-94

Operation	1994	1993	1992	1991
<i>Millions of pieces (except as noted)</i>				
Loans (thousands) .....	8	6	8	11
Currency received and counted .....	20,166	20,768	20,166	19,711
Currency verified and destroyed .....	7,244	7,376	7,506	6,254
Coin received and counted .....	6,950	7,690	8,660	9,462
Checks handled				
U.S. government checks .....	470	480	493	503
Postal money orders .....	200	192	181	166
All other .....	16,479	19,009	19,053	18,743
Government securities transfers <sup>1</sup> .....	13	12 <sup>r</sup>	12 <sup>r</sup>	11 <sup>r</sup>
Transfer of funds .....	72	70	68	65
Automated clearinghouse transactions				
Commercial .....	1,805	1,545	1,327	1,119
Government .....	574	555	531	521
Food stamps redeemed .....	4,229	4,198	4,183	3,439
<i>Millions of dollars</i>				
Loans .....	22,853	20,760	29,427	64,597
Currency received and counted .....	277,685	290,989	277,681	265,473
Currency verified and destroyed .....	76,620	79,599	96,744	77,496
Coin received and counted .....	1,045	1,143	1,275	1,354
Checks handled				
U.S. government checks .....	504,479	534,236	588,311	610,106
Postal money orders .....	23,764	22,207	20,188	17,716
All other .....	12,079,107	14,066,518	13,241,785	12,164,175
Government securities transfers <sup>1</sup> .....	144,702,226	146,220,304 <sup>r</sup>	139,675,710 <sup>r</sup>	116,315,973 <sup>r</sup>
Transfer of funds .....	211,201,540	207,629,814	199,175,034	192,254,895
Automated clearinghouse transactions				
Commercial .....	7,420,499	6,710,035 <sup>r</sup>	6,530,731 <sup>r</sup>	5,549,171 <sup>r</sup>
Government .....	948,984	885,011	859,774	723,426
Food stamps redeemed .....	21,867	21,661	21,452	17,888

1. Beginning with this *Annual Report*, "Government securities transfers" replaces the previous time series that included "Issues, redemptions, and exchanges of U.S. Treasury and federal agency securities." This change was

made to enable consistent time series reporting for the fiscal area, where complex definitional changes have occurred over the reported years.

<sup>r</sup> Revised.

10. Federal Reserve Bank Interest Rates on Loans to Depository Institutions,  
December 31, 1994

Reserve Bank	Adjustment credit <sup>1</sup>	Seasonal credit <sup>2</sup>	Extended credit <sup>3</sup>	
			First thirty days of borrowing	After thirty days of borrowing
All Federal Reserve Banks .....	4.75	5.90	4.75	6.40

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. As of May 20, 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) 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.

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 50 basis points above the discount rate applicable to adjustment credit. In no case will the rate be less than the basic discount rate plus 50 basis points. The flexible rate is reestablished on the first business day of each two-week reserve maintenance period. At the discretion of the Federal Reserve Bank, the discount rate applicable to adjustment credit may be charged on extended-credit loans that are outstanding less than thirty days.

## 11. Reserve Requirements of Depository Institutions, December 31, 1994

Type of deposit <sup>1</sup>	Requirements	
	Percent of deposits	Effective date
<i>Net transaction accounts</i> <sup>2</sup>		
\$0 million–\$51.9 million .....	3	12-20-94
More than \$51.9 million <sup>3</sup> .....	10	12-20-94
Nonpersonal time deposits <sup>4</sup> .....	0	12-27-90
Eurocurrency liabilities <sup>5</sup> .....	0	12-27-90

NOTE. Required reserves must be held in the form of deposits with Federal Reserve Banks or vault cash. Non-member 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 the Monetary Control Act of 1980, depository institutions include commercial banks, mutual savings banks, savings and loan associations, credit unions, agencies and branches of foreign banks, and Edge Act corporations.

1. Under the Garn–St Germain Depository Institutions Act of 1982, the Board adjusts the amount of reservable liabilities subject to a 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 made in the event of a decrease. On December 20, 1994, the exemption was raised from \$4.0 million to \$4.2 million. The exemption applies only to accounts that would be subject to a 3 percent reserve requirement.

2. 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 savings deposits, not transaction accounts.

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 20, 1994 for institutions reporting quarterly and weekly, the amount was increased from \$51.9 million to \$54.0 million.

3. 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.

4. For institutions that report weekly, the reserve requirement on nonpersonal time deposits with an original maturity of less than 1½ years was reduced from 3 percent to 1½ percent for the maintenance period that began 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.

5. The reserve requirement on Eurocurrency 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

Percent of market value

Effective date	Margin stocks	Convertible bonds	Short sales, T only <sup>1</sup>
1934, Oct. 1	25-45	...	...
1936, Feb. 1	25-55	...	...
Apr. 1	55	...	...
1937, Nov. 1	40	...	50
1945, Feb. 5	50	...	50
July 5	75	...	75
1946, Jan. 21	100	...	100
1947, Feb. 21	75	...	75
1949, Mar. 3	50	...	50
1951, Jan. 17	75	...	75
1953, Feb. 20	50	...	50
1955, Jan. 4	60	...	60
Apr. 23	70	...	70
1958, Jan. 16	50	...	50
Aug. 5	70	...	70
Oct. 16	90	...	90
1960, July 28	70	...	70
1962, July 10	50	...	50
1963, Nov. 6	70	...	70
1968, Mar. 11	70	50	70
June 8	80	60	80
1970, May 6	65	50	65
1971, Dec. 6	55	50	55
1972, Nov. 24	65	50	65
1974, Jan. 3	50	50	50

NOTE. 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.

1. 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  
in the United States, by Class of Bank, June 30, 1994 and 1993

Millions of dollars, except as noted

Item	Total	Member banks			Nonmember banks
		Total	National	State	
1994					
ASSETS					
Loans and investments .....	2,791,613	2,045,606	1,584,366	461,240	746,006
Gross loans .....	1,960,770	1,451,030	1,145,621	305,409	509,740
Net loans .....	1,955,838	1,448,050	1,143,315	304,735	507,788
Investments .....	830,843	594,576	438,745	155,831	236,266
U.S. Treasury and federal agency securities .....	347,977	229,126	175,691	53,435	118,851
Other .....	482,865	365,451	263,054	102,396	117,415
Cash assets, total .....	191,828	152,670	113,515	39,155	39,158
LIABILITIES					
Deposits, total .....	2,352,622	1,691,911	1,317,001	374,910	660,711
Interbank .....	38,612	31,384	22,708	8,676	7,228
Other transaction .....	782,168	581,690	447,626	134,064	200,478
Other nontransaction .....	1,828,562	1,285,994	1,012,928	273,066	542,567
Equity capital .....	299,628	222,197	167,131	55,066	77,431
Number of banks .....	10,646	4,141	3,176	965	6,505
1993					
ASSETS					
Loans and investments .....	2,589,870	1,887,794	1,469,753	418,042	702,075
Gross loans .....	1,829,438	1,348,353	1,066,900	281,453	481,085
Net loans .....	1,822,958	1,344,383	1,064,094	280,289	478,575
Investments .....	760,431	539,441	402,853	136,588	220,990
U.S. Treasury and federal agency securities .....	620,802	445,162	335,583	109,579	175,640
Other .....	139,629	94,279	67,270	27,009	45,350
Cash assets, total .....	184,692	143,022	111,510	31,512	41,670
LIABILITIES					
Deposits, total .....	2,332,011	1,679,328	1,320,692	358,636	652,683
Interbank .....	45,563	37,562	27,695	9,867	8,001
Other demand .....	742,565	549,807	431,990	117,817	192,758
Other time and savings .....	1,832,291	1,294,208	1,025,253	268,955	538,083
Equity capital .....	276,260	202,190	154,966	47,224	74,070
Number of banks .....	11,117	4,395	3,426	969	6,722

NOTE. Components may not sum to totals because of rounding.



14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—  
Year-End 1918–94, and Month-End 1994

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding								Gold stock <sup>4</sup>	Special drawing rights certificate account	Treasury currency outstanding <sup>5</sup>
	U.S. Treasury and federal agency securities			Loans	Float <sup>1</sup>	All other <sup>2</sup>	Other Federal Reserve assets <sup>3</sup>	Total			
	Total	Bought outright	Held under repurchase agreement								
1918.....	239	239	0	1,766	199	294	0	2,498	2,873	...	1,795
1919.....	300	300	0	2,215	201	575	0	3,292	2,707	...	1,707
1920.....	287	287	0	2,687	119	262	0	3,355	2,639	...	1,709
1921.....	234	234	0	1,144	40	146	0	1,563	3,373	...	1,842
1922.....	436	436	0	618	78	273	0	1,405	3,642	...	1,958
1923.....	134	80	54	723	27	355	0	1,238	3,957	...	2,009
1924.....	540	536	4	320	52	390	0	1,302	4,212	...	2,025
1925.....	375	367	8	643	63	378	0	1,459	4,112	...	1,977
1926.....	315	312	3	637	45	384	0	1,381	4,205	...	1,991
1927.....	617	560	57	582	63	393	0	1,655	4,092	...	2,006
1928.....	228	197	31	1,056	24	500	0	1,809	3,854	...	2,012
1929.....	511	488	23	632	34	405	0	1,583	3,997	...	2,022
1930.....	739	686	43	251	21	372	0	1,373	4,306	...	2,027
1931.....	817	775	42	638	20	378	0	1,853	4,173	...	2,035
1932.....	1,855	1,851	4	235	14	41	0	2,145	4,226	...	2,204
1933.....	2,437	2,435	2	98	15	137	0	2,688	4,036	...	2,303
1934.....	2,430	2,430	0	7	5	21	0	2,463	8,238	...	2,511
1935.....	2,431	2,430	1	5	12	38	0	2,486	10,125	...	2,476
1936.....	2,430	2,430	0	3	39	28	0	2,500	11,258	...	2,532
1937.....	2,564	2,564	0	10	19	19	0	2,612	12,760	...	2,637
1938.....	2,564	2,564	0	4	17	16	0	2,601	14,512	...	2,798
1939.....	2,484	2,484	0	7	91	11	0	2,593	17,644	...	2,963
1940.....	2,184	2,184	0	3	80	8	0	2,274	21,995	...	3,087
1941.....	2,254	2,254	0	3	94	10	0	2,361	22,737	...	3,247
1942.....	6,189	6,189	0	6	471	14	0	6,679	22,726	...	3,648
1943.....	11,543	11,543	0	5	681	10	0	12,239	21,938	...	4,094
1944.....	18,846	18,846	0	80	815	4	0	19,745	20,619	...	4,131
1945.....	24,252	24,252	0	249	578	2	0	15,091	20,065	...	4,339
1946.....	23,350	23,350	0	163	580	1	0	24,093	20,529	...	4,562
1947.....	22,559	22,559	0	85	535	1	0	23,181	22,754	...	4,562
1948.....	23,333	23,333	0	223	541	1	0	24,097	24,244	...	4,589
1949.....	18,885	18,885	0	78	534	2	0	19,499	24,427	...	4,598
1950.....	20,778	20,725	53	67	1,368	3	0	22,216	22,706	...	4,636
1951.....	23,801	23,605	196	19	1,184	5	0	25,009	22,695	...	4,709
1952.....	24,697	24,034	663	156	967	4	0	25,825	23,187	...	4,812
1953.....	25,916	25,318	598	28	935	2	0	26,880	22,030	...	4,894
1954.....	24,932	24,888	44	143	808	1	0	25,885	21,713	...	4,985
1955.....	24,785	24,391	394	108	1,585	29	0	26,507	21,690	...	5,008
1956.....	24,915	24,610	305	50	1,665	70	0	26,699	21,949	...	5,066
1957.....	24,238	23,719	519	55	1,424	66	0	25,784	22,781	...	5,146
1958.....	26,347	26,252	95	64	1,296	49	0	27,755	20,534	...	5,234
1959.....	26,648	26,607	41	458	1,590	75	0	28,771	19,456	...	5,311
1960.....	27,384	26,984	400	33	1,847	74	0	29,338	17,767	...	5,398
1961.....	28,881	30,478	159	130	2,300	51	0	31,362	16,889	...	5,585
1962.....	30,820	28,722	342	38	2,903	110	0	33,871	15,978	...	5,567
1963.....	33,593	33,582	11	63	2,600	162	0	36,418	15,513	...	5,578
1964.....	37,044	36,506	538	186	2,606	94	0	39,930	15,388	...	5,405

For notes see end of table.

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Federal Reserve Bank of St. Louis

## 14.—Continued

Factors absorbing reserve funds											
Cur- rency in cir- cu- la- tion	Trea- sury cash hold- ings <sup>6</sup>	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve ac- counts <sup>3</sup>	Re- quired clear- ing bal- ances	Other Federal Reserve li- a- bil- ities and capital <sup>3</sup>	Member bank reserves <sup>7</sup>			
		Trea- sury	For- eign	Other				With Federal Reserve Banks	Cur- rency and coin <sup>8</sup>	Re- quired <sup>9</sup>	Ex- cess <sup>9</sup>
4,951	288	51	96	25	118	0	0	1,636	0	1,585	51
5,091	385	51	73	28	208	0	0	1,890	0	1,822	68
5,325	218	57	5	18	298	0	0	1,781	0	0	0
4,403	214	96	12	15	285	0	0	1,753	0	1,654	99
4,530	225	11	3	26	276	0	0	1,934	0	0	0
4,757	213	38	4	19	275	0	0	1,898	0	1,884	14
4,760	211	51	19	20	258	0	0	2,220	0	2,161	59
4,817	203	16	8	21	272	0	0	2,212	0	2,256	-44
4,808	201	17	46	19	293	0	0	2,194	0	2,250	-56
4,716	208	18	5	21	301	0	0	2,487	0	2,424	63
4,686	202	23	6	21	348	0	0	2,389	0	2,430	-41
4,578	216	29	6	24	393	0	0	2,355	0	2,428	-73
4,603	211	19	6	22	375	0	0	2,471	0	2,375	96
5,360	222	54	79	31	354	0	0	1,961	0	1,994	-33
5,388	272	8	19	24	355	0	0	2,509	0	1,933	576
5,519	284	3	4	128	360	0	0	2,729	0	1,870	859
5,536	3,029	121	20	169	241	0	0	4,096	0	2,282	1,814
5,882	2,566	544	29	226	253	0	0	5,587	0	2,743	2,844
6,543	2,376	244	99	160	261	0	0	6,606	0	4,622	1,984
6,550	3,619	142	172	235	263	0	0	7,027	0	5,815	1,212
6,856	2,706	923	199	242	260	0	0	8,724	0	5,519	3,205
7,598	2,409	634	397	256	251	0	0	11,653	0	6,444	5,209
8,732	2,213	368	1,133	599	284	0	0	4,026	0	7,411	6,615
11,160	2,215	867	774	586	291	0	0	12,450	0	9,365	3,085
15,410	2,193	799	793	485	256	0	0	13,117	0	11,129	1,988
20,499	2,303	579	1,360	356	339	0	0	12,886	0	11,650	1,236
25,307	2,375	440	1,204	394	402	0	0	14,373	0	12,748	1,625
28,515	2,287	977	862	446	495	0	0	15,915	0	14,457	1,458
28,952	2,272	393	508	314	607	0	0	16,139	0	15,577	562
28,868	1,336	870	392	569	563	0	0	17,899	0	16,400	1,499
28,224	1,325	1,123	642	547	590	0	0	20,479	0	19,277	1,202
27,600	1,312	821	767	750	106	0	0	16,568	0	15,550	1,018
27,741	1,293	668	895	565	714	0	0	17,681	0	16,509	1,172
29,206	1,270	247	526	363	746	0	0	20,056	0	19,667	389
30,433	1,270	389	550	455	777	0	0	19,950	0	20,520	-570
30,781	761	346	423	493	839	0	0	20,160	0	19,397	763
30,509	796	563	490	441	907	0	0	18,876	0	18,618	258
31,158	767	394	402	554	925	0	0	19,005	0	18,903	102
31,790	775	441	322	426	901	0	0	19,059	0	19,089	-30
31,834	761	481	356	246	998	0	0	19,034	0	19,091	-57
32,193	683	358	272	391	1,122	0	0	18,504	0	18,574	-70
32,591	391	504	345	694	841	0	0	18,174	310	18,619	-135
32,869	377	485	217	533	941	0	0	17,081	2,544	18,988	637
33,918	422	465	279	320	1,044	0	0	17,387	2,544	18,988	96
35,338	380	597	247	393	1,007	0	0	17,454	3,262	20,071	645
37,692	361	880	171	291	1,065	0	0	17,049	4,099	20,677	471
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 1918–94 and Month-End 1994—Continued

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding							Gold stock <sup>4</sup>	Special drawing rights certificate account	Treasury currency outstanding <sup>5</sup>	
	U.S. Treasury and federal agency securities			Loans	Float <sup>1</sup>	All other <sup>2</sup>	Other Federal Reserve assets <sup>3</sup>				Total
	Total	Bought outright <sup>10</sup>	Held under repurchase agreement <sup>11</sup>								
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 <sup>3</sup>	0	183	3,440	64	2,743	64,584	10,367	...	6,852
1970.....	62,142	62,142	0	335	4,261	57	1,123	67,918	10,732	400	7,147
1971.....	70,804	69,481	1,323	39	4,343	261	1,068	76,515	10,132	400	7,710
1972.....	71,230	71,119	111	1,981	3,974	106	1,260	78,551	10,410	400	8,313
1973.....	80,495	80,395	100	1,258	3,099	68	1,152	86,072	11,567	400	8,716
1974.....	85,714	84,760	954	299	2,001	999	3,195	92,208	11,652	400	9,253
1975.....	94,124	92,789	1,335	211	3,688	1,126	3,312	102,461	11,599	500	10,218
1976.....	104,093	100,062	4,031	25	2,601	991	3,182	110,892	11,598	1,200	10,810
1977.....	111,274	108,922	2,352	265	3,810	954	2,442	118,745	11,718	1,250	11,331
1978.....	118,591	117,374	1,217	1,174	6,432	587	4,543	131,327	11,671	1,300	11,831
1979.....	126,167	124,507	1,660	1,454	6,767	704	5,613	140,705	11,172	1,800	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	163,659	11,148	4,618	13,786
1983.....	160,795	159,203	1,592	918	1,605	418	8,728	172,464	11,121	4,618	15,732
1984.....	169,627	167,612	2,015	3,577	833	0	12,347	186,384	11,096	4,618	16,418
1985.....	191,248	186,025	5,223	3,060	988	0	15,302	210,598	11,090	4,718	17,075
1986.....	221,459	205,454	16,005	1,565	1,261	0	17,475	241,760	11,084	5,018	17,567
1987.....	231,420	226,459	4,961	3,815	811	0	15,837	251,883	11,078	5,018	18,177
1988.....	247,489	240,628	6,861	2,170	1,286	0	18,803	269,748	11,060	5,018	18,799
1989.....	235,417	233,300	2,117	481	1,093	0	39,631	276,622	11,059	8,518	19,628 <sup>r</sup>
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	21,017 <sup>r</sup>
1992.....	308,518	300,424	8,094	675	3,350	0	30,278	342,820	11,056	8,018	21,452 <sup>r</sup>
1993.....	349,865	336,653	13,212	94	963 <sup>r</sup>	0	33,394	384,316 <sup>r</sup>	11,053	8,018	22,101 <sup>r</sup>
1994.....	378,746	368,156	10,590	223	740	0	33,441	413,150	11,051	8,018	22,912

14.—Continued

Factors absorbing reserve funds											
Cur- rency in cir- cu- la- tion	Treasury cash hold- ings <sup>6</sup>	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve ac- counts <sup>3</sup>	Re- quired clear- ing bal- ances	Other Federal Reserve lia- bilities and capital <sup>3</sup>	Member bank reserves <sup>7</sup>			
		Treasury	For- eign	Other				With Federal Reserve Banks	Cur- rency and coin <sup>8</sup>	Re- quired <sup>9</sup>	Ex- cess <sup>9,12</sup>
42,056	760	668	150	355	211	0	0	18,447	4,163	22,848	-238
44,663	1,176	416	174	588	-147	0	0	19,779	4,310	24,321	-232
47,226	1,344	1,123	135	563	-773	0	0	21,092	4,631	25,905	-182
50,961	695	703	216	747	-1,353	0	0	21,818	4,921	27,439	-700
53,950	596	1,312	134	807	0	0	1,919	22,085	5,187	28,173	-901
57,903	431	1,156	148	1,233	0	0	1,986	24,150	5,423	30,033	-460
61,068	460	2,020	294	999	0	0	2,131	27,788	5,743	32,496	1,035
66,516	345	1,855	325	840	0	0	2,143	25,647	6,216	32,044	98 <sup>12</sup>
72,497	317	2,542	251	1,419 <sup>11</sup>	0	0	2,669	27,060	6,781	35,268	-1,360
79,743	185	2,113	418	1,275 <sup>11</sup>	0	0	2,935	25,843	7,370	37,011	-3,798
86,547	483	7,285	353	1,090	0	0	2,968	26,052	8,036	35,197	-1,103 <sup>14</sup>
93,717	460	10,393	352	1,357	0	0	3,063	25,158	8,628	35,461	-1,535
103,811	392	7,114	379	1,187	0	0	3,292	26,870	9,421	37,615	-1,265
114,645	240	4,196	368	1,256	0	0	4,275	31,152	10,538	42,694	-893
125,600	494	4,075	429	1,412	0	0	4,957	29,792	11,429	44,217	-2,835
136,829	441	3,062	411	617	0	0	4,671	27,456	13,654	40,558	675
144,774	443	4,301	505	781	0	117	5,261	25,111	15,576	42,145	-1,442
154,908	429	5,033	328	1,033	0	436	4,990	26,053	16,666	41,391	1,328
171,935	479	3,661	191	851	0	1,013	5,392	20,413	17,821	39,179	-945
183,796	513	5,316	253	867	0	1,126	5,952	20,693			
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	↑	↑	↑
260,456 <sup>r</sup>	450	6,217	589	1,298	0	1,618 <sup>r</sup>	8,486	36,713	n.a.	n.a.	n.a.
286,965	561	8,960	369	242	0	1,963	8,147	36,695	↓	↓	↓
307,759 <sup>r</sup>	636	17,697	968	1,706	0	3,945 <sup>r</sup>	8,113	25,467 <sup>r</sup>	↓	↓	↓
334,706 <sup>r</sup>	508	7,492	206	372	0	5,897 <sup>r</sup>	7,984	26,181 <sup>r</sup>	↓	↓	↓
365,299 <sup>r</sup>	377	14,809	386	397	0	6,332 <sup>r</sup>	9,292	28,614 <sup>r</sup>	↓	↓	↓
403,762	335	7,161	250	876	0	4,239	11,959	26,550	↓	↓	↓

## 14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–94, and Month-End 1994—Continued

Millions of dollars

Period	Factors supplying reserve funds										
	Federal Reserve Bank credit outstanding							Gold stock <sup>4</sup>	Special drawing rights certificate account	Treasury currency outstanding <sup>5</sup>	
	U.S. Treasury and federal agency securities			Loans	Float <sup>1</sup>	All other <sup>2</sup>	Other Federal Reserve assets <sup>3</sup>				Total
	Total	Bought outright <sup>10</sup>	Held under repurchase agreement <sup>11</sup>								
1994											
Jan. ...	345,608	336,432	9,176	122	2,440	0	33,940	382,110	11,053	8,018	22,160
Feb. ...	342,824	337,739	5,085	48	687	0	32,031	375,590	11,053	8,018	22,232
Mar. ...	346,937	341,487	5,450	463	543	0	33,372	381,315	11,052	8,018	22,324
Apr. ...	347,126	347,126	0	234	208	0	34,171	381,739	11,053	8,018	22,382
May ...	354,047	348,342	5,705	240	550	0	32,080	386,917	11,052	8,018	22,461
June ...	362,203	351,564	10,639	701	636	0	32,799	396,339	11,052	8,018	22,534
July ...	356,858	352,738	4,120	458	22	0	33,659	390,997	11,052	8,018	22,604
Aug. ...	361,198	352,947	8,251	494	540	0	32,030	394,262	11,054	8,018	22,660
Sept. ...	359,326	356,816	2,510	504	339	0	33,482	393,651	11,054	8,018	22,730
Oct. ...	360,072	356,057	4,015	264	571	0	34,837	395,744	11,053	8,018	22,786
Nov. ...	371,029	362,864	8,165	144	346	0	31,349	402,868	11,051	8,018	22,842
Dec. ...	378,746	368,156	10,590	223	740	0	33,441	413,150	11,051	8,018	22,912

NOTE. For a description of figures and discussion of their significance, see *Banking and Monetary Statistics, 1941–1970* (Board of Governors of the Federal Reserve System, 1976), pp. 507–23. Components may not sum to totals because of rounding.

... Not applicable.

n.a. Not available.

r Revised.

1. Beginning in 1960, figures reflect a minor change in concept; see *Federal Reserve Bulletin*, vol. 47 (February 1961), p. 164.

2. Principally acceptances and, until August 21, 1959, industrial loans, authority for which expired on that date.

3. 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 is reported as "Other Federal Reserve accounts"; thereafter, "Other Federal Reserve assets" and "Other Federal Reserve liabilities and capital" are shown separately.

4. Before January 30, 1934, includes gold held in Federal Reserve Banks and in circulation.

5. 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*.

6. Coin and paper currency held by the Treasury, as well as any gold in excess of the gold certificates issued to the Reserve Bank.

7. Beginning in November 1979, includes reserves of member banks, Edge Act corporations, and U.S. agencies and branches of foreign banks. Beginning on November 13, 1980, includes reserves of all depository institutions.

Beginning in 1984, data on "Currency and coin" and "Required" and "Excess" reserves changed from daily to biweekly basis.

8. Between December 1, 1959, and November 23, 1960, part was allowed as reserves; thereafter all was allowed.

9. 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											
Currency in circulation	Treasury cash holdings <sup>6</sup>	Deposits, other than reserves, with Federal Reserve Banks			Other Federal Reserve accounts <sup>3</sup>	Required clearing balances	Other Federal Reserve liabilities and capital <sup>3</sup>	Member bank reserves <sup>8</sup>			
		Treasury	Foreign	Other				With Federal Reserve Banks	Currency and coin <sup>8</sup>	Required <sup>9</sup>	Excess <sup>9,12</sup>
360,919	378	21,541	257	255	0	6,229	9,759	24,003	↑	↑	↑
364,947	365	4,886	191	373	0	6,223	10,337	29,571	↑	↑	↑
369,038	370	6,181	454	316	0	6,624	10,618	29,110	↑	↑	↑
370,701	378	7,965	171	312	0	6,540	10,189	26,934	↑	↑	↑
377,939	361	5,675	174	278	0	6,053	10,836	27,132	↑	↑	↑
382,159	353	9,356	604	286	0	5,681	11,825	27,677	↑	↑	↑
382,244	352	3,683	182	244	0	5,512	11,394	29,061	n.a.	n.a.	n.a.
386,010	368	5,994	188	289	0	5,350	10,864	26,932	↓	↓	↓
385,516	363	6,848	342	318	0	4,916	12,012	25,138	↓	↓	↓
389,604	363	5,164	223	392	0	4,522	12,584	24,749	↓	↓	↓
396,703	389	5,348	230	302	0	4,347	11,133	26,328	↓	↓	↓
403,762	335	7,161	250	876	0	4,239	11,959	26,550	↓	↓	↓

10. 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.

11. Beginning December 1, 1966, includes federal agency obligations held under repurchase agreements and beginning September 29, 1971, includes federal agency issues bought outright.

12. 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.

13. 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.

14. Adjusted to include waivers of penalties for reserve deficiencies, in accordance with change in Board policy effective November 19, 1975.

## 15. Number of Banking Offices in the United States, December 31, 1993 and 1994

Type of office, number, and change	Total	Commercial banks <sup>1</sup>						State-chartered savings banks <sup>2</sup>	
		Total	Member <sup>3</sup>			Nonmember		Insured	Non- insured
			Total	National	State	Insured	Non- insured <sup>4</sup>		
<b>BANKS</b>									
Number, Dec. 31, 1993 ..	11,751	11,242	4,339	3,360	979	6,613	290	509	0
<i>Changes during 1994</i>									
New banks .....	65	65	21	16	5	27	17	0	0
Ceased banking operation <sup>5</sup> .....	-58	-56	-20	-19	-1	-25	-11	-2	0
Banks converted into branches <sup>6</sup> .....	-545	-523	-237	-191	-46	-286	0	-22	0
Other <sup>7</sup> .....	53	13	12	-34	46	-2	3	40	0
Net change .....	-485	-501	-224	-228	4	-286	9	16	0
<b>Number, Dec. 31, 1994 ..</b>	<b>11,266</b>	<b>10,741</b>	<b>4,115</b>	<b>3,132</b>	<b>983</b>	<b>6,327</b>	<b>299</b>	<b>525</b>	<b>0</b>
<b>BRANCHES AND ADDITIONAL OFFICES</b>									
Number, Dec. 31, 1993 ..	55,891	52,865	35,560	27,853	7,707	17,215	90	3,026	0
<i>Changes during 1994</i>									
De novo .....	2,270	2,057	1,279	995	284	776	2	213	0
Banks converted into branches .....	545	539	349	298	51	190	0	6	0
Discontinued .....	-1,016	-940	-696	-518	-178	-243	-1	-76	0
Other <sup>7</sup> .....	416	334	130	98	32	204	0	82	0
Net change <sup>7</sup> .....	2,215	1,990	1,062	873	189	927	1	225	0
<b>Number, Dec. 31, 1994 ..</b>	<b>58,106</b>	<b>54,855</b>	<b>36,622</b>	<b>28,726</b>	<b>7,896</b>	<b>18,142</b>	<b>91</b>	<b>3,251</b>	<b>0</b>

NOTE. Preliminary. Final data will be available in the *Annual Statistical Digest, 1994*, forthcoming.

1. Includes nondeposit trust companies, private banks, industrial banks, and nonbank banks. Member institutions are those that are members of the Federal Reserve System.

2. Formerly called mutual savings banks.

3. As of Dec. 31, 1988, includes noninsured trust companies that are members of the Federal Reserve System.

4. Includes one workout national bank.

5. Includes five banks that converted into thrift institutions.

6. Includes three banks that converted into thrift institution branches.

7. Includes interclass changes and sales of branches.

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities  
Approved by the Board of Governors, 1994

**Crestar Bank, Richmond, Virginia to merge with NVR Federal Savings Bank, McLean, Virginia<sup>1</sup>**

SUMMARY REPORT BY THE ATTORNEY GENERAL (12-22-93)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2-3-94)

The applicant has assets of \$10.9 billion; the target has assets of \$521.1 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.

**First Bank, Creve Coeur, Missouri, through First Heritage Interim Bank, St. Louis, Missouri to merge with Heritage National Bank, St. Louis, Missouri**

SUMMARY REPORT BY THE ATTORNEY GENERAL (2-2-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2-9-94)

The applicant has assets of \$710.4 million; the target has assets of \$60.8 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.

**First Interstate Bank of California, Los Angeles, California to merge with San Diego Trust & Savings Bank, San Diego, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL (11-1-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2-16-94)

The applicant has assets of \$20.5 billion; the target has assets of \$1.9 billion. 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.

**Premier Bank and Trust, Elyria, Ohio to acquire assets and liabilities of the Worthington branch of Jefferson Savings Bank, West Jefferson, Ohio**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3-18-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2-16-94)

The applicant has assets of \$498.1 million; the target has assets of \$4.9 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.

**BancFirst, Oklahoma City, Oklahoma to merge with First City Bank, Tulsa, Oklahoma**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3-8-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (2-17-94)

The applicant has assets of \$738.0 million; the target has assets of \$40.0 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 MD, Bethesda, Maryland to merge with Annapolis Federal Savings Bank, Annapolis, Maryland**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3-8-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3-4-94)

The applicant has assets of \$884.2 million; the target has assets of \$329.1 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.

**1st United Bank, Boca Raton, Florida to merge with Suburban Bank, Lake Worth, Florida**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3-8-94)

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.



16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities  
Approved by the Board of Governors, 1994—Continued

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3-9-94)**

The applicant has assets of \$124.0 million; the target has assets of \$164.2 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.

**Fairfax Bank & Trust Company, Fairfax, Virginia to merge with Federal Savings Association of Virginia, Falls Church, Virginia**

**SUMMARY REPORT BY THE ATTORNEY GENERAL**  
No report received. Request for report on the competitive factors was dispensed with, as authorized by the Bank Merger Act, to permit the Federal Reserve System to act immediately to safeguard the depositors of Federal Savings Association of Virginia.<sup>2</sup>

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3-11-94)**

The applicant has assets of \$164.8 million; the target has assets of \$1.7 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

**First Community Bank, Forest, Virginia to acquire the assets and liabilities of the Moneta branch of First Union National Bank of Virginia, Roanoke, Virginia**

**SUMMARY REPORT BY THE ATTORNEY GENERAL (3-18-94)**

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (3-31-94)**

The applicant has assets of \$83.9 million; the target has assets of \$10.9 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 three Ohio branches of Citizens Federal Bank, Miami, Florida**

**SUMMARY REPORT BY THE ATTORNEY GENERAL (3-18-94)**

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4-12-94)**

The applicant has assets of \$6.9 billion; the target has assets of \$44.2 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.

**The Sun City Bank, Sun City, Arizona to acquire the assets and liabilities of the Sun City branch of First National Bank of Arizona, Phoenix, Arizona**

**SUMMARY REPORT BY THE ATTORNEY GENERAL (4-8-94)**

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4-13-94)**

The applicant has assets of \$28.1 million; the target has assets of \$17.9 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.

**Citizens Trust Bank, Atlanta, Georgia to acquire assets and liabilities of the main office of Southern Federal Savings Association of Georgia, Atlanta, Georgia**

**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 (4-22-94)**

The applicant has assets of \$118.0 million; the target has assets of \$14.4 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

**Chemical Bank and Trust Company, Midland, Michigan to acquire assets and liabilities of the Edenville branch of First of America Bank—Mid Michigan, NA, Bay City, Michigan**

2. In such cases 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."

## 16.—Continued

SUMMARY REPORT BY THE ATTORNEY GENERAL (3-18-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (5-3-94)

The applicant has assets of \$530.1 million; the target has assets of \$267.0 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.

**Fairfax Bank & Trust Company, Fairfax, Virginia to merge with Commonwealth Federal Savings Bank, Manassas, 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 (5-6-94)

The applicant has assets of \$174.4 million; the target has assets of \$29.7 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

**Signet Bank/Virginia, Richmond, Virginia to merge with Pioneer Federal Savings Bank, Chester, Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (4-29-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (5-12-94)

The applicant has assets of \$9.0 billion; the target has assets of \$391.8 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 Piedmont Federal Savings Association, Manassas, 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 (5-13-94)

The applicant has assets of \$12.2 billion; the target has assets of \$165.1 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

**The Peoples Bank & Trust Company, Selma, Alabama to acquire assets and liabilities of the Selma branch of Altus FSB, Mobile, Alabama**

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 (5-20-94)

The applicant has assets of \$278.9 million; the target has assets of \$10.1 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

**Chemung Canal Trust Company, Elmira, New York to acquire the assets and liabilities of Bath, Painted Post, and Watkins Glen branches of Columbia Banking, FSA, Rochester, 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 (6-3-94)

The applicant has assets of \$412.9 million; the target has assets of \$46.7 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

**Wellington State Bank, Wellington, Texas to merge with First National Bank in Wheeler, Wheeler, Texas**

SUMMARY REPORT BY THE ATTORNEY GENERAL (4-29-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (6-16-94)

The applicant has assets of \$35.7 million; the target has assets of \$36.3 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.

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities  
Approved by the Board of Governors, 1994—Continued

**Farmers & Merchants Savings Bank, Manchester, Iowa to acquire assets and liabilities of the Cedar Rapids branch of United Federal Savings Association of Iowa, Des Moines, Iowa**

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  
(6-24-94)

The applicant has assets of \$45.2 million; the target has assets of \$2.4 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

**Hawkeye Bank, Des Moines, Iowa to acquire assets and liabilities of the Waukonda branch of United Federal Savings Association, Des Moines, Iowa**

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  
(6-24-94)

The applicant has assets of \$242.7 million; the target has assets of \$700 thousand. 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 acquire assets and liabilities of one branch of Ukrainian Federal Savings & 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  
(6-24-94)

The applicant has assets of \$76.3 million; the target has assets of \$18.7 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

**Ambassador Bank of the Commonwealth, Allentown, Pennsylvania to acquire assets and liabilities of one branch of Lafayette Bank, Easton, Pennsylvania**

SUMMARY REPORT BY THE ATTORNEY GENERAL  
(6-8-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(7-6-94)

The applicant has assets of \$104.8 million; the target has assets of \$8.5 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.

**Mid-Peninsula Bank, Palo Alto, California to merge with WesCal National Bank, San Mateo, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL  
(7-1-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(7-25-94)

The applicant has assets of \$138.8 million; the target has assets of \$32.3 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 of Kentucky, Inc., Louisville, Kentucky (formerly Fifth Third Bank of Central Kentucky, Lexington, Kentucky) to merge with The Cumberland Federal Savings Bank, Louisville, Kentucky**

SUMMARY REPORT BY THE ATTORNEY GENERAL  
(8-8-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(7-27-94)

The applicant has assets of \$302 million; the target has assets of \$709 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 University State Bank, Tampa, Florida**

SUMMARY REPORT BY THE ATTORNEY GENERAL  
(6-8-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(8-10-94)

## 16.—Continued

The applicant has assets of \$758.3 million; the target has assets of \$19.8 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.

**United Bank of Philadelphia, Philadelphia, Pennsylvania to acquire assets and liabilities of the West Girard branch of Central Pennsylvania Savings Association, FA, Shamokin, Pennsylvania**

SUMMARY REPORT BY THE ATTORNEY GENERAL (8-16-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (8-22-94)

The applicant has assets of \$92.1 million; the target has assets of \$7.5 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.

**Minden Bank & Trust Company, Minden, Louisiana to acquire assets and liabilities of the Minden branch of Oak Tree Federal Savings Bank, New Orleans, Louisiana**

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 (8-29-94)

The applicant has assets of \$165.6 million; the target has assets of \$5.7 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

**Bank of Fresno, Fresno, California to merge with Mineral King National Bank, Visalia, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL (9-21-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9-21-94)

The applicant has assets of \$775.9 million; the target has assets of \$187.8 million. The parties do not operate in the same market. The banking fac-

tors and considerations relating to the convenience and needs of the community are consistent with approval.

**Crestar Bank, Richmond, Virginia to merge with Second National Federal Savings Association, Salisbury, Maryland**

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 (9-16-94)

The applicant has assets of \$12.1 billion; the target has assets of \$15.6 million. The RTC has recommended immediate action by the Federal Reserve to prevent the probable failure of the target.

**Premier Bank & Trust, Elyria, Ohio to acquire assets and liabilities of the Avon and Sheffield Lake branches of Charter One Bank, FSB, Cleveland, Ohio**

SUMMARY REPORT BY THE ATTORNEY GENERAL (8-16-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9-19-94)

The applicant has assets of \$495.8 million; the target has assets of \$21.2 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 Interstate Bank of California, Los Angeles, California to merge with Sacramento Savings Bank, Sacramento, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL (7-1-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9-22-94)

The applicant has assets of \$20.1 billion; the target has assets of \$3.0 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.

**Barnett Bank of Palm Beach County, West Palm Beach, Florida to acquire assets and liabilities**

## 16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1994—Continued

### *ties of eight branches of Glendale Federal Bank, FSB, Glendale, California*

SUMMARY REPORT BY THE ATTORNEY GENERAL (7-1-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9-29-94)

The applicant has assets of \$2.8 billion; the target has assets of \$413.0 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.

### **Barnett Bank of Pasco County, Port Richey, Florida to acquire assets and liabilities of two branches of Glendale Federal Bank, FSB, Glendale, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL (7-1-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9-29-94)

The applicant has assets of \$1.1 billion; the target has assets of \$113.0 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.

### **Barnett Bank of Pinellas County, St. Petersburg, Florida to acquire assets and liabilities of six branches of Glendale Federal Bank, FSB, Glendale, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL (7-1-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9-29-94)

The applicant has assets of \$3.2 billion; the target has assets of \$317.0 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.

### **Barnett Bank of Southwest Florida, Sarasota, Florida to acquire assets and liabilities of one branch of Glendale Federal Bank, FSB, Glendale, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL (7-1-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9-29-94)

The applicant has assets of \$2.0 billion; the target has assets of \$34.0 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.

### **Barnett Bank of Tampa, Tampa, Florida to acquire assets and liabilities of nine branches of Glendale Federal Bank, FSB, Glendale, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL (7-1-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (9-29-94)

The applicant has assets of \$2.6 billion; the target has assets of \$406.0 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 Damascus branch of Bank of Baltimore, Baltimore, Maryland**

SUMMARY REPORT BY THE ATTORNEY GENERAL (9-21-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10-6-94)

The applicant has assets of \$608.1 million; the target has assets of \$8.9 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.

### **Manufacturers and Traders Trust Company, Buffalo, New York to acquire assets and liabilities of seven branches of Chemical Bank, New York, New York, located in Orange and Rockland counties**

SUMMARY REPORT BY THE ATTORNEY GENERAL (6-8-94)

The proposed transaction would not be significantly adverse to competition.

## 16.—Continued

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10-12-94)**

The applicant has assets of \$8.9 billion; the target has assets of \$163.8 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.

**Manufacturers and Traders Trust Company, Buffalo, New York to merge with Citizens Savings and Loan Association, the successor by merger to Citizens Savings Bank, FSB, Ithaca, New York**

**SUMMARY REPORT BY THE ATTORNEY GENERAL (6-8-94)**

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10-12-94)**

The applicant has assets of \$8.9 billion; the target has assets of \$449.0 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.

**Commercial Bank of Florida, Miami, Florida to acquire the assets and liabilities of five Florida branches of Cartaret Federal Savings Bank, Newark, New Jersey**

**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 (10-14-94)**

The applicant has assets of \$258.0 million; the target has assets of \$131.2 million. The RTC has recommended immediate action by the Federal Reserve System to prevent the probable failure of the target.

**Fifth Third Bank, Cincinnati, Ohio to merge with Mutual Federal Savings Bank of Miamisburg, Miamisburg, Ohio**

**SUMMARY REPORT BY THE ATTORNEY GENERAL (10-18-94)**

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (10-28-94)**

The applicant has assets of \$7.2 billion; the target has assets of \$86.1 million. The parties operate in the same market. The banking factors and consid-

erations relating to the convenience and needs of the community are consistent with approval.

**First Bank North, Freeport, Illinois to acquire the assets and liabilities of the DeKalb branch of Home Federal Savings & Loan Association, of Elgin, Elgin, Illinois**

**SUMMARY REPORT BY THE ATTORNEY GENERAL (8-30-94)**

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11-7-94)**

The applicant has assets of \$208.6 million; the target has assets of \$13.5 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.

**ValliWide Bank, Fresno, California to merge with Bank One Fresno, National Association, Fresno, California**

**SUMMARY REPORT BY THE ATTORNEY GENERAL (10-18-94)****BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11-14-94)**

The applicant has assets of \$540.0 million; the target has assets of \$166.0 million. The parties compete 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 Ridgewood branch of The Chase Manhattan Bank, New York, New York**

**SUMMARY REPORT BY THE ATTORNEY GENERAL (9-29-94)**

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE (11-22-94)**

The applicant has assets of \$11.3 billion; the target has assets of \$26.0 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 Jefferson Savings and Loan Association, FA, Warrenton, Virginia**

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities  
Approved by the Board of Governors, 1994—Continued**SUMMARY REPORT BY THE ATTORNEY GENERAL**  
(10-18-94)

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE**  
(11-23-94)

The applicant has assets of \$12.2 billion; the target has assets of \$294.6 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.

**Integra Bank/North, Titusville, Pennsylvania to acquire the assets and liabilities of the Bradford branch of Bucktail Bank & Trust Company, Emporium, Pennsylvania****SUMMARY REPORT BY THE ATTORNEY GENERAL**  
(11-23-94)

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE**  
(11-23-94)

The applicant has assets of \$2.8 billion; the target has assets of \$5.2 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.

**Chemung Canal Trust Company, Elmira, New York to merge with Owego National Bank, Owego, New York****SUMMARY REPORT BY THE ATTORNEY GENERAL**  
(11-3-94)

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE**  
(11-28-94)

The applicant has assets of \$444.7 million; the target has assets of \$39.1 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.

**First Security Bank, Fort Upton, Colorado to acquire assets and liabilities of seven Colorado branches of World Savings & Loan Association, Oakland, California****SUMMARY REPORT BY THE ATTORNEY GENERAL**  
(10-18-94)

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE**  
(11-28-94)

The applicant has assets of \$140.7 million; the target has assets of \$174.0 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.

**Humboldt Bank, Eureka, California to acquire assets and liabilities of three branches of U.S. Bank of California, Sacramento, California****SUMMARY REPORT BY THE ATTORNEY GENERAL**  
(10-27-94)

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE**  
(11-30-94)

The applicant has assets of \$136.0 million; the target has assets of \$30.5 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.

**Integra Bank/Pittsburgh, Pittsburgh, Pennsylvania to merge with Lincoln Savings Bank, Carnegie, Pennsylvania****SUMMARY REPORT BY THE ATTORNEY GENERAL**  
(9-21-94)

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE**  
(12-2-94)

The applicant has assets of \$7.7 billion; the target has assets of \$264 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 of America—West Michigan, Grand Rapids, Michigan to acquire assets and liabilities of the Grand Rapids branch of Great Lakes Bancorp, FSB, Ann Arbor, Michigan****SUMMARY REPORT BY THE ATTORNEY GENERAL**  
(11-4-94)

The proposed transaction would not be significantly adverse to competition.

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE**  
(12-5-94)

The applicant has assets of \$1.2 billion; the target has assets of \$11.9 million. The parties operate in

## 16.—Continued

the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Vail Bank, Vail, Colorado to acquire assets and liabilities of the Vail branch of Colorado Community First State Bank, Vail, Colorado**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10-27-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-7-94)

The applicant has assets of \$75.0 million; the target has assets of \$6.0 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.

**Dakota County State Bank, Mendota Heights, Minnesota to merge with The Phalen Bank, St Paul, Minnesota**

SUMMARY REPORT BY THE ATTORNEY GENERAL (12-14-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-13-94)

The applicant has assets of \$46.0 million; the target has assets of \$14.2 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 Independent Bank, Manassas, Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10-18-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-14-94)

The applicant has assets of \$12.2 billion; the target has assets of \$90.3 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 Interstate Bank of California, Los Angeles, California to merge with Bank of A. Levy, Ventura, California**

SUMMARY REPORT BY THE ATTORNEY GENERAL (10-18-94) The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-20-94)

The applicant has assets of \$22.1 billion; the target has assets of \$625.0 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 Cleveland Interim Bank, the successor to Cleveland Federal Bank, a Savings Bank, Shelby, North Carolina**

SUMMARY REPORT BY THE ATTORNEY GENERAL (12-14-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-22-94)

The applicant has assets of \$4.2 billion; the target has assets of \$87.9 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 Ameribank, Inc., Welch, West Virginia**

SUMMARY REPORT BY THE ATTORNEY GENERAL (11-23-94)

The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (12-22-94)

The applicant has assets of \$693.7 million; the target has assets of \$77.8 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 Plant State Bank, Plant City, Florida**

SUMMARY REPORT BY THE ATTORNEY GENERAL (12-8-94)

The proposed transaction would not be significantly adverse to competition.



16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities  
Approved by the Board of Governors, 1994—Continued

**BASIS FOR APPROVAL BY THE FEDERAL RESERVE  
(12-28-94)**

The applicant has assets of \$827.7 million; the target has assets of \$42.4 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, and the convenience and needs of the community to be served were consistent with approval.

Institution <sup>1</sup>	Assets (millions of dollars)	Date of approval
WesBanco Bank Wheeling, Wheeling, West Virginia .....	397	3-1-94
<i>Merger</i>		
WesBanco Bank Wellsburg, Inc., Wellsburg, West Virginia .....	55	
Omnibank Southeast, Denver, Colorado .....	208	3-18-94
<i>Merger</i>		
Omnibank Denver, Denver, Colorado .....	22	
Omnibank Leetsdale, Denver, Colorado .....	22	
United Jersey Bank Hackensack, New Jersey .....	6,176	4-12-94
<i>Merger</i>		
United Jersey Bank—Central, South Brunswick, New Jersey .....	3,496	
United Jersey Bank—South, NA, Cherry Hill, New Jersey .....	1,236	
Centura Bank, Rocky Mount, North Carolina .....	3,937	4-19-94
<i>Merger</i>		
Mid-South Bank and Trust Company, Sanford, North Carolina .....	232	
Wilmington Trust of Pennsylvania, West Chester, Pennsylvania .....	131	4-29-94
<i>Merger</i>		
Wilmington Trust Company (one branch only), Wilmington, Delaware .....	4,600	
First State Bank of Taos, Taos, New Mexico .....	145	5-2-94
<i>Merger</i>		
First State Bank of Santa Fe, Santa Fe, New Mexico .....	23	
Bank of Fresno, Fresno, California .....	526	5-23-94
<i>Merger</i>		
Merced Bank of Commerce, Merced, California .....	64	
First Virginia Bank—Shenandoah Valley, Woodstock, Virginia .....	184	5-24-94
<i>Merger</i>		
First Virginia Bank of Augusta, Staunton, Virginia .....	86	
First Virginia Bank—Planters, Bridgewater, Virginia .....	119	

## 16.—Continued

Institution <sup>1</sup>	Assets (millions of dollars)	Date of approval
The Bank of Mid-Jersey, Bordentown, New Jersey .....	421	5-24-94
<i>Merger</i>		
Mount Holly State Bank, Mount Holly, New Jersey .....	127	
Fleet Bank of New York, Albany, New York .....	9,607	6-1-94
<i>Merger</i>		
Fleet Bank, Melville, New York .....	2,795	
M&I Marshall & Ilsley Bank, Milwaukee, Wisconsin .....	2,829	6-28-94
<i>Merger</i>		
Valley Bank Milwaukee, Milwaukee, Wisconsin .....	454	
M&I Greater Milwaukee Bank, Milwaukee, Wisconsin .....	94	
M&I Wauwatosa Bank, Wauwatosa, Wisconsin .....	257	
Omnibank Southeast, Denver, Colorado .....	224	7-11-94
<i>Merger</i>		
Omnibank Arvada, Arvada, Colorado .....	50	
Omnibank University Hills, Denver, Colorado .....	32	
Sun Bank of Ocala, Ocala, Florida .....	525	7-18-94
<i>Merger</i>		
Sun Bank of Gainesville, Gainesville, Florida .....	185	
Omnibank Southeast, Denver, Colorado .....	224	8-4-94
<i>Merger</i>		
Omnibank Arapahoe, Englewood, Colorado .....	21	
Rocky Mountain Bank, Billings, Montana .....	24	9-6-94
<i>Merger</i>		
Powder River Bank, Broadus, Montana .....	24	
Security State Bank, Harlem, Montana .....	19	
Rocky Mount Bank of Plains, Plains, Montana .....	27	
First State Bank of Stevensville, Stevensville, Montana .....	26	
WhiteHall State Bank, Whitehall, Montana .....	15	
Old Kent Bank, Elmhurst, Illinois .....	1,600	9-14-94
<i>Merger</i>		
Edgemark Bank—Lombard, Lombard, Illinois		
Merchandise National Bank, Chicago, Illinois		
Edgemark Bank—Rosemont, Rosemont, Illinois (combined assets) ...	289	
First Community Bank, Inc., Princeton, West Virginia .....	452	9-14-94
<i>Merger</i>		
The Flat Top National Bank of Bluefield, Bluefield, West Virginia ..	184	
Peoples Bank of Bluewell, Bluewell, West Virginia .....	45	
First Federal Savings Bank, Bluefield, West Virginia .....	20	
Barton County State Bank, Lamar, Missouri .....	49	9-23-94
<i>Merger</i>		
Citizens State Bank of Nevada, Nevada, Missouri .....	52	

16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities  
Approved by the Board of Governors—Continued

Institution <sup>1</sup>	Assets (millions of dollars)	Date of approval
United Jersey Bank, Hackensack, New Jersey .....	11,754	9-30-94
<i>Merger</i>		
Valley Savings Bank, Closter, New Jersey .....	382	
Capital City Bank (formerly Havana State Bank), Havana, Florida ..	29	10-25-94
<i>Merger</i>		
Capital City First National Bank, Tallahassee, Florida .....	361	
Capital City Second National Bank, Tallahassee, Florida .....	51	
City National Bank, Tallahassee, Florida .....	81	
Industrial National Bank, Tallahassee, Florida .....	57	
Gadsden National Bank, Quincy, Florida .....	38	
First National Bank of Jefferson County, Monticello, Florida .....	24	
Compass Bank, Pensacola, Florida .....	91	11-3-94
<i>Merger</i>		
Compass Bank, FSB Jacksonville, Florida .....	459	
F&M Bank—Massanutten, Harrisonburg, Virginia .....	90	11-18-94
<i>Merger</i>		
F&M Bank—Broadway, Broadway, Virginia .....	64	
Old Kent Bank, Grand Rapids, Michigan .....	4,500	11-21-94
<i>Merger</i>		
Old Kent Bank of Big Rapids, Big Rapids, Michigan		
Old Kent Bank of Cadillac, Cadillac, Michigan		
Old Kent Bank—Central, Owosso, Michigan		
Old Kent Bank—East, Brighton, Michigan		
Old Kent Bank of Gaylord, Gaylord, Michigan		
Old Kent Bank of Grand Haven, Grand Haven, Michigan		
Old Kent Bank—Grand Traverse, Traverse City, Michigan		
Old Kent Bank of Hillsdale, Hillsdale, Michigan		
Old Kent Bank of Holland, Holland, Michigan		
Old Kent Bank of Ludington, Ludington, Michigan		
Old Kent Bank of Petoskey, Petoskey, Michigan		
Old Kent Bank of St. Johns, St. Johns, Michigan		
Old Kent Bank—Southeast, Trenton, Michigan		
Old Kent Bank—Southwest, Kalamazoo, Michigan (combined assets) .	3,900	
Marine Midland Bank, Buffalo, New York .....	16,900	11-21-94
<i>Merger</i>		
Six New York, New York, branches of Hongkong Shanghai Banking Corporation .....	441	
Integra Bank/South, Uniontown, Pennsylvania .....	2,400	12-2-94
<i>Merger</i>		
Branch of Integra Bank/Pittsburgh, Burgettstown, Pennsylvania .....	13	
WesBanco Bank Wheeling, Wheeling, West Virginia .....	445	12-6-94
<i>Merger</i>		
WesBanco Bank Elm Grove, Elm Grove, West Virginia .....	155	

## 16.—Continued

Institution <sup>1</sup>	Assets (millions of dollars)	Date of approval
Westamerica Bank, San Rafael, California .....	1,675	12-8-94
<i>Merger</i>		
Pacific Valley National Bank, Modesto, California .....	171	
United Jersey Bank, Hackensack, New Jersey .....	12,463	12-14-94
<i>Merger</i>		
Palisade Savings Bank, FSB, Ridgefield Park, New Jersey .....	324	

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.

### Mergers Approved Involving a Nonoperating Institution with an Existing Bank

The following transactions have no significant effect on competition; they simply 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 <sup>1</sup>	Assets (millions of dollars) <sup>2</sup>	Date of approval
The Middleburg Bank, Middleburg, Virginia .....	...	1-5-94
<i>Merger</i>		
The Middleburg National Bank, Middleburg, Virginia .....	118	
United Bank of Philadelphia, Philadelphia, Pennsylvania .....	77	5-4-94
<i>Merger</i>		
New Bank Philadelphia, Philadelphia, Pennsylvania .....	...	
Merchants Bank Vicksburg, Vicksburg, Mississippi .....	...	8-24-94
<i>Merger</i>		
Merchants Bank, NA, Vicksburg, Mississippi .....	171	
New Pace American Bank Lawrenceville, Lawrenceville, Virginia ...	...	10-28-94
<i>Merger</i>		
Pace American Bank Lawrenceville, Lawrenceville, Virginia .....	58	

1. Each proposed transaction was to be effected under the charter of the first-named bank. The entries are in chronological order of approval.

2. Where no assets are listed, the bank is newly organized and not in operation.

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*Federal Reserve  
Directories and Meetings*

## Board of Governors of the Federal Reserve System

December 31, 1994

### Members

	<i>Term expires</i>
ALAN GREENSPAN, of New York, <i>Chairman</i> <sup>1</sup> .....	January 31, 2006
ALAN S. BLINDER, of New Jersey, <i>Vice Chairman</i> <sup>1</sup> .....	January 31, 1996
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
JANET L. YELLEN, of California .....	January 31, 2008

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 Bob Stahly Moore, *Special Assistant*  
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 Richard M. Ashton, *Associate*  
*General Counsel*  
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*Counsel*  
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*Counsel*  
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 Molly S. Wassom, *Assistant Director*

1. The designations as Chairman and Vice Chairman expire on March 2, 1996, and June 24, 1998, respectively, unless the service of these members of the Board shall have terminated sooner.

*Board of Governors—Continued*

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 Earl G. Hamilton, *Assistant Director*  
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 Florence M. Young, *Assistant Director*

## *Board of Governors—Continued*

### OFFICE OF THE INSPECTOR GENERAL

Brent L. Bowen, *Inspector General*

Donald L. Robinson, *Assistant Inspector General*

Barry R. Snyder, *Assistant Inspector General*

## *Federal Open Market Committee*

December 31, 1994

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ALAN S. BLINDER, Board of Governors

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JERRY L. JORDAN, President, Federal Reserve Bank of Cleveland

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*Associate Economist*





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MARSHALL N. CARTER

ANTHONY P. TERRACCIANO

ANDREW B. CRAIG, III

The Federal Advisory Council met on February 10–11, May 12–13, September 8–9, and November 3–4, 1994. The Board of Governors met with the council on February 11, May 13, September 9, and November 4, 1994. 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, 1994****Members**

BARRY A. ABBOTT, ESQ., *Director*, Howard, Rice, Nemerovski, Canady, Robertson, Falk & Rabkin, San Francisco, California

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D. DOUGLAS BLANKE, *Director of Consumer Policy*, Office of the Attorney General, St. Paul, Minnesota

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- JOHN E. TAYLOR, *President and Chief Executive Officer*, The National Community Reinvestment Coalition, Washington, D.C.
- MICHAEL W. TIERNEY, *Program Director*, Local Initiatives Support Corporation, Washington, D.C.
- LORRAINE VANETTEN, *Vice President and Community Lending Officer*, Standard Federal Bank of Troy, Troy, Michigan
- GRACE W. WEINSTEIN, *Financial Writer and Consultant*, Englewood, New Jersey
- LILY K. YAO, *President and Chief Executive Officer*, Pioneer Federal Savings Bank, Honolulu, Hawaii
- ROBERT O. ZDENEK, *Senior Program Officer*, Annie E. Casey Foundation, Greenwich, Connecticut

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|--|---|

The Consumer Advisory Council met with members of the Board of Governors on March 24, June 23, and November 3, 1994. The council is composed of academics, state and local government officials, representatives of the financial industry, and repre-

sentatives 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, 1994

### Members

- MALCOLM E. COLLIER, *Chairman and Chief Executive Officer*, First Federal Savings Bank, Lakewood, Colorado
- WILLIAM A. COOPER, *Chairman and Chief Executive Officer*, TCF Bank Savings, fsb, 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 of the Board*, First Federal Savings Bank, Sheridan, Wyoming
- KERRY KILLINGER, *Chairman, President, and Chief Executive Officer*, Washington Mutual Savings Bank, Seattle, Washington

*Thrift Institutions Advisory Council—Continued*

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*, Downey Savings and Loan Association, Newport Beach, California

STEPHEN D. TAYLOR, *President and Chief Executive Officer*, American Savings of Florida, F.S.B., Miami, Florida

JOHN M. TIPPETS, *President and Chief Executive Officer*, American Airlines Employees Federal Credit Union, DFW Airport, Texas

**Officers**

BEATRICE D'AGOSTINO, *President*

CHARLES JOHN KOCH, *Vice President*

The members of the Thrift Institutions Advisory Council met with the Board of Governors on January 28, June 3, and December 16, 1994. 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 and Branches*

December 31, 1994

BANK or Branch	Chairman <sup>1</sup> Deputy Chairman	President First Vice President	Vice President in charge of Branch
BOSTON <sup>2</sup> .....	Jerome H. Grossman Warren B. Rudman	Cathy E. Minehan Paul M. Connolly	
NEW YORK <sup>2</sup> .....	Maurice R. Greenberg David A. Hamburg Joseph J. Castiglia	William J. McDonough James H. Oltman	
Buffalo.....			Carl W. Turnipseed <sup>3</sup>
PHILADELPHIA.....	James M. Mead Donald J. Kennedy	Edward G. Boehne William H. Stone, Jr.	
CLEVELAND <sup>2</sup> .....	A. William Reynolds G. Watts Humphrey, Jr.	Jerry L. Jordan Sandra Pianalto	
Cincinnati.....	John N. Taylor, Jr.		Charles A. Cerino <sup>3</sup>
Pittsburgh.....	Robert P. Bozzone		Harold J. Swart <sup>3</sup>
RICHMOND <sup>2</sup> .....	Henry J. Faison Claudine B. Malone	J. Alfred Broaddus, Jr. Jimmie R. Monhollon	
Baltimore.....	Rebecca Hahn Windsor		Ronald B. Duncan <sup>3</sup>
Charlotte.....	Harold D. Kingsmore		Walter A. Varvel <sup>3</sup>

*Officers of Federal Reserve Banks and Branches—  
Continued*

BANK or Branch	Chairman <sup>1</sup> Deputy Chairman	President First Vice President	Vice President in charge of Branch
ATLANTA.....	Leo Benatar Hugh M. Brown	Robert P. Forrestal Jack Guynn	Donald E. Nelson <sup>3</sup>
Birmingham.....	Shelton E. Allred		Fred R. Herr <sup>3</sup>
Jacksonville.....	Samuel H. Vickers		James D. Hawkins <sup>3</sup>
Miami.....	Dorothy C. Weaver		James T. Curry III
Nashville.....	Paula Lovell		Melvyn K. Purcell
New Orleans.....	Jo Ann Slaydon		Robert J. Musso
CHICAGO <sup>2</sup> .....	Richard G. Cline Robert M. Healey	Michael H. Moskow William C. Conrad	
Detroit.....	J. Michael Moore		Roby L. Sloan <sup>3</sup>
ST. LOUIS.....	Robert H. Quenon John F. McDonnell	Thomas C. Melzer James R. Bowen	
Little Rock.....	Robert D. Nabholz, Jr.		Karl W. Ashman
Louisville.....	Laura M. Douglas		Howard Wells
Memphis.....	Sidney Wilson, Jr.		John P. Baumgartner
MINNEAPOLIS.....	Gerald A. Rauenhorst Jean D. Kinsey	Gary H. Stern Colleen K. Strand	
Helena.....	Lane W. Basso		John D. Johnson
KANSAS CITY.....	Burton A. Dole, Jr. Herman Cain	Thomas M. Hoenig Richard K. Rasdall	
Denver.....	Barbara B. Grogan		Kent M. Scott <sup>3</sup>
Oklahoma City.....	Ernest L. Holloway		David J. France
Omaha.....	Sheila Griffin		Harold L. Shewmaker
DALLAS.....	Cece Smith Roger R. Hemminghaus	Robert D. McTeer, Jr. Tony J. Salvaggio	
El Paso.....	Alvin T. Johnson		Sammie C. Clay
Houston.....	Judy Ley Allen		Robert Smith III <sup>3</sup>
San Antonio.....	Erich Wendl		James L. Stull <sup>3</sup>
SAN FRANCISCO.....	James A. Vohs Judith M. Runstad	Robert T. Parry Patrick K. Barron	
Los Angeles.....	Anita Landecker		John F. Moore <sup>3</sup>
Portland.....	William A. Hilliard		A. Kenneth Ridd
Salt Lake City.....	Gerald R. Sherratt		Andrea P. Wolcott
Seattle.....	George F. Russell, Jr.		Gordon R. G. Werkema <sup>3</sup>

NOTE. A current list of these officers appears each month in the *Federal Reserve Bulletin*.

1. The Chairman of a Federal Reserve Bank serves, by statute, as Federal Reserve Agent.

2. Additional offices of these Banks are located at Lewiston, Maine; Windsor Locks, Connecticut; Utica at

Oriskany, New York; Jericho, New York; East Rutherford, New Jersey; Columbus, Ohio; Charleston, West Virginia; Culpeper, Virginia; Columbia, South Carolina; Indianapolis, Indiana; Milwaukee, Wisconsin; and Des Moines, Iowa.

3. 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 1 and 2, and on December 1 and 2, 1994.

The members of the Executive Committee of the Conference of Chairmen during 1994 were Burton A. Dole, Jr., Chairman; Jerome H. Grossman, Vice Chairman, and James A. Vohs, member.

On December 2, 1994, the Conference elected its Executive Committee for 1995, naming Jerome H. Grossman as Chairman, Cece Smith as Vice Chairman, and A. William Reynolds 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 1994. On March 8, 1994, the Conference elected Robert T. McTeer, President of the Federal Reserve Bank of Dallas, as its Vice Chairman, to replace Richard F. Syron, who resigned as President of the Federal Reserve Bank of Boston. Robert L. Feinberg, of the Federal Reserve Bank of San Francisco, served as its Secretary. Rena DeSisto, of the Federal Reserve Bank of Boston, served as its Assistant Secretary until March 31, 1994, and Helen Holcomb, of the Federal Reserve Bank of Dallas, served as its Assistant Secretary for the balance of the year.

On November 17, 1994, the Conference elected Robert T. McTeer, President of the Federal Reserve Bank of Dallas, as its Chairman for 1995-96 and Thomas M. Hoinig, President of the Federal Reserve Bank of Kansas City, as its Vice Chairman.

## 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.

James H. Oltman, First Vice President of the Federal Reserve Bank of New York, served as Chairman of the Conference in 1994, and Tony J. Salvaggio, First Vice President of the Federal Reserve Bank of Dallas, served as its Vice Chairman. Ethan S. Harris, of the Federal Reserve Bank of New York, served as its Secretary, and Joanna O. Kolson, of the Federal Reserve Bank of Dallas, served as its Assistant Secretary.

On October 11, 1994, the Conference elected Tony J. Salvaggio, First Vice President of the Federal Reserve Bank of Dallas, as its Chairman for 1995, and Sandra Pianalto, First Vice President of the Federal Reserve Bank of Cleveland, 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 organizational affiliation, and the date the director's term expires. Each Federal Reserve Bank has a nine-member board: 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. Annually, the Board of Governors designates one of the Class C directors as chairman of the board and Federal Reserve Agent of each District Bank, and it designates 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*

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
David A. Page .....	President and Chief Executive Officer, Ocean National Bank of Kennebunk, Kennebunk, Maine	1996

*Class B*

Edward H. Ladd .....	Chairman, Standish, Ayer and Wood, Inc., Boston, Massachusetts	1994
Joan T. Bok .....	Chairman, New England Electric System, Westborough, Massachusetts	1995
Stephen L. Brown .....	Chairman and Chief Executive Officer, John Hancock Mutual Life Insurance Company, Boston, Massachusetts	1996

*Class C*

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
John E. Flynn .....	Executive Director, The Quality Connection, East Dennis, Massachusetts	1996

## DISTRICT 2—NEW YORK

*Class A*

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
J. William Johnson .....	Chairman and Chief Executive Officer, The First National Bank of Long Island, Glen Head, New York	1996

*Class B*

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



Term expires  
Dec. 31

DISTRICT 2, *Class B*—Continued

Sandra Feldman .....President, United Federation of Teachers,  
New York, New York 1996

*Class C*

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

David A. Hamburg .....President, Carnegie Corporation of New York,  
New York, New York 1996

BUFFALO BRANCH

*Appointed by the Federal Reserve Bank*

Richard H. Popp .....Operating Partner, Southview Farm,  
Castile, New York 1994

Charles M. Mitschow .....Chairman, Western Region, Marine Midland Bank,  
Buffalo, New York 1994

George W. Hamlin IV .....President and Chief Executive Officer, The  
Canandaigua National Bank and Trust  
Company, Canandaigua, New York 1995

Louise C. Woerner .....Chairman and Chief Executive Officer, HCR,  
Rochester, New York 1996

*Appointed by the Board of Governors*

Donald L. Rust .....Plant Manager, Tonawanda Engine Plant,  
General Motors Powertrain Division, General  
Motors Corporation, Buffalo, New York 1994

F. C. Richardson .....President, Buffalo State College, Buffalo, New York 1995

Joseph J. Castiglia .....President and Chief Executive Officer, Pratt &  
Lambert, Inc., Buffalo, New York 1996

DISTRICT 3—PHILADELPHIA

*Class A*

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

Terry K. Dunkle .....Chairman, United States National Bank,  
Johnstown, Pennsylvania 1996

*Class B*

James A. Hagen .....Chairman, President, and Chief Executive  
Officer, Consolidated Rail Corporation  
(CONRAIL), Philadelphia, Pennsylvania 1994

Term expires  
Dec. 31DISTRICT 3, *Class B*—Continued

David W. Huggins .....	President and Chief Executive Officer, RMS Technologies, Inc., Marlton, New Jersey	1995
J. Richard Jones .....	President and Chief Executive Officer, Jackson-Cross Company, Philadelphia, Pennsylvania	1996

*Class C*

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
Joan Carter .....	President and Chief Operating Officer, United Medical Corporation, Haddonfield, New Jersey	1996

## DISTRICT 4—CLEVELAND

*Class A*

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
Alfred C. Leist .....	Chairman, President, and Chief Executive Officer, The Apple Creek Banking Company, Apple Creek, Ohio	1996

*Class B*

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
Thomas M. Nies .....	President, Cincom Systems, Inc., Cincinnati, Ohio	1996

*Class C*

G. Watts Humphrey, Jr. ....	President, GWH Holdings, Inc., Pittsburgh, Pennsylvania	1994
A. William Reynolds .....	Chairman, GenCorp, Fairlawn, Ohio	1995
Robert Y. Farrington .....	Executive Secretary-Treasurer, Ohio State Building and Construction Trades Council, Columbus, Ohio	1996

## CINCINNATI BRANCH

*Appointed by the Federal Reserve Bank*

Marvin J. Stammen .....	President and Chief Executive Officer, Second National Bank, Greenville, Ohio	1994
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Term expires  
Dec. 31

DISTRICT 4, CINCINNATI BRANCH

*Appointed by the Federal Reserve Bank—Continued*

Jerry W. Carey .....	President and Chief Executive Officer, Union National Bank and Trust Company, Barbourville, Kentucky	1995
C. Wayne Shumate .....	Chairman and Chief Executive Officer, Kentucky Textiles, Inc., Paris, Kentucky	1996
Phillip R. Cox .....	President, Cox Financial Corporation, Cincinnati, Ohio	1996

*Appointed by the Board of Governors*

Raymond A. Bradbury .....	Chairman (Retired), Martin County Coal Corporation, Inez, Kentucky	1994
Eleanor Hicks .....	President, M.I.N.D.S. International, Cincinnati, Ohio	1995
John N. Taylor, Jr. ....	Chairman and Chief Executive Officer, Kurz-Kasch, Inc., Dayton, Ohio	1996

PITTSBURGH BRANCH

*Appointed by the Federal Reserve Bank*

David S. Dahlmann .....	President and Chief Executive Officer, Southwest National Corporation, Greensburg, Pennsylvania	1994
Helen J. Clark .....	Chairman, President, and Chief Executive Officer, Apollo Trust Company, Apollo, Pennsylvania	1995
Randall L. C. Russell .....	President and Chief Executive Officer, Ranbar Technology, Inc., Glenshaw, Pennsylvania	1996
Wesley W. von Schack .....	Chairman, President, and Chief Executive Officer, DQE, Pittsburgh, Pennsylvania	1996

*Appointed by the Board of Governors*

Jack B. Piatt .....	Chairman, Millcraft Industries, Inc., Washington, Pennsylvania	1994
Robert P. Bozzone .....	Vice Chairman of the Board, Allegheny Ludlum Corporation, Pittsburgh, Pennsylvania	1995
Sandra L. Phillips .....	Executive Director, Pittsburgh Partnership for Neighborhood Development, Pittsburgh, Pennsylvania	1996

DISTRICT 5—RICHMOND

*Class A*

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

Term expires  
Dec. 31

## DISCTICT 5, Class A—Continued

Robert M. Freeman .....	Chairman and Chief Executive Officer, Signet Banking Corporation, Richmond, Virginia	1996
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*Class B*

L. Newton Thomas, Jr. ....	Senior Vice President (Retired), ITT/Carbon Industries, Inc., Charleston, West Virginia	1994
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R. E. Atkinson, Jr. ....	Chairman, Dilmar Oil Company, Inc., Florence, South Carolina	1995
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Paul A. DelaCourt .....	Chairman, The North Carolina Enterprise Corporation, Raleigh, North Carolina	1996
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*Class C*

Claudine B. Malone .....	President, Financial & Management Consulting, Inc., McLean, Virginia	1994
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Henry J. Faison .....	Chairman, Faison Associates, Charlotte, North Carolina	1995
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Stephen Brobeck .....	Executive Director, Consumer Federation of America, Washington, D.C.	1996
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## BALTIMORE BRANCH

*Appointed by the Federal Reserve Bank*

F. Levi Ruark .....	Chairman, President, and Chief Executive Officer, The National Bank of Cambridge, Cambridge, Maryland	1994
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Thomas J. Hughes .....	President and Chief Executive Officer, Navy Federal Credit Union, Vienna, Virginia	1994
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Richard M. Adams .....	Chairman and Chief Executive Officer, United Bankshares, Inc., Parkersburg, West Virginia	1995
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Morton I. Rapoport .....	President and Chief Executive Officer, University of Maryland Medical System, Baltimore, Maryland	1996
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*Appointed by the Board of Governors*

Rebecca Hahn Windsor .....	Chairman and Chief Executive Officer, Hahn Transportation, Inc., New Market, Maryland	1994
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Daniel R. Baker .....	President and Chief Executive Officer, Tate Access Floors, Inc., Jessup, Maryland	1995
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Michael R. Watson .....	President, Association of Maryland Pilots, Baltimore, Maryland	1996
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## CHARLOTTE BRANCH

*Appointed by the Federal Reserve Bank*

Dorothy H. Aranda .....	President, Dohara Associates, Inc., Hilton Head Island, South Carolina	1994
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Vacancy .....		1994
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Term expires  
Dec. 31

DISTRICT 5, CHARLOTTE BRANCH

*Appointed by the Federal Reserve Bank—Continued*

David B. Jordan .....	Vice Chairman, Chief Executive Officer, and Director, Security Capital Bancorp, Salisbury, North Carolina	1995
Jim M. Cherry, Jr. ....	President and Chief Executive Officer, Williamsburg First National Bank, Kingstree, South Carolina	1996

*Appointed by the Board of Governors*

Harold D. Kingsmore .....	President and Chief Executive Officer, Graniteville Company, Graniteville, South Carolina	1994
James O. Roberson .....	President and Chief Executive Officer, Research Triangle Foundation of North Carolina, Research Triangle Park, North Carolina	1995
Dennis D. Lowery .....	Chief Executive Officer and Chairman, Continental Ltd., Charlotte, North Carolina	1996

DISTRICT 6—ATLANTA

*Class A*

D. Paul Jones, Jr. ....	Chairman and Chief Executive Officer, Compass Bancshares, Inc., Birmingham, Alabama	1994
W. H. Swain .....	Chairman, First National Bank, Oneida, Tennessee	1995
James B. Williams .....	Chairman and Chief Executive Officer, SunTrust Banks, Inc., Atlanta, Georgia	1996

*Class B*

Victoria B. Jackson .....	President, DSS/ProDiesel, Nashville, Tennessee	1994
J. Thomas Holton .....	Chairman and President, Sherman International Corporation, Birmingham, Alabama	1995
Andre M. Rubenstein .....	Chairman and Chief Executive Officer, Rubenstein Brothers, Inc., New Orleans, Louisiana	1996

*Class C*

Hugh M. Brown .....	President and Chief Executive Officer, BAMSI, Inc., Titusville, Florida	1994
Leo Benatar .....	Chairman and President, Engraph, Inc., Atlanta, Georgia	1995
Daniel E. Sweat, Jr. ....	Program Director, The Atlanta Project, Atlanta, Georgia	1996

BIRMINGHAM BRANCH

*Appointed by the Federal Reserve Bank*

Marlin D. Moore, Jr. ....	Chairman, Pritchett-Moore, Inc., Tuscaloosa, Alabama	1994
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Term expires  
Dec. 31

## DISTRICT 6, BIRMINGHAM BRANCH

*Appointed by the Federal Reserve Bank—Continued*

Columbus Sanders .....	President, Consolidated Industries, Inc., Huntsville, Alabama	1994
J. Stephen Nelson .....	Chairman and Chief Executive Officer, First National Bank, Brewton, Alabama	1995
Julian W. Banton .....	Chairman, President, and Chief Executive Officer, SouthTrust Bank of Alabama, N.A., Birmingham, Alabama	1996

*Appointed by the Board of Governors*

Shelton E. Allred .....	Chairman, President, and Chief Executive Officer, Frit Incorporated, Ozark, Alabama	1994
Patricia B. Compton .....	President, Patco, Inc., Georgiana, Alabama	1995
Donald E. Boomershine .....	President, Better Business Bureau of Central Alabama, Inc., Birmingham, Alabama	1996

## JACKSONVILLE BRANCH

*Appointed by the Federal Reserve Bank*

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
Royce B. Walden .....	Vice President, Ward Bradford & Company, Orlando, Florida	1995
William G. Smith, Jr. ....	President, Capital City First National Bank, Tallahassee, Florida	1996

*Appointed by the Board of Governors*

Samuel H. Vickers .....	Chairman, President, and Chief Executive Officer, Design Containers, Inc., Jacksonville, Florida	1994
Lana Jane Lewis-Brent .....	President, Paul Brent Designer, Inc., Panama City, Florida	1995
Joan Dial Ruffier .....	General Partner, Sunshine Cafes, Orlando, Florida	1996

## MIAMI BRANCH

*Appointed by the Federal Reserve Bank*

Roberto G. Blanco .....	Vice Chairman and Chief Financial Officer, Republic National Bank of Miami, Miami, Florida	1994
E. Anthony Newton .....	President and Chief Executive Officer, Island National Bank and Trust Company, Palm Beach, Florida	1995
Pat L. Tornillo, Jr. ....	Executive Vice President, United Teachers of Dade, Miami, Florida	1996

Term expires  
Dec. 31

DISTRICT 6, MIAMI BRANCH

*Appointed by the Federal Reserve Bank—Continued*

Steven C. Shimp .....President, O-A-K/Florida, Inc., 1996  
Fort Myers, Florida

*Appointed by the Board of Governors*

Dorothy C. Weaver .....President, Intercap Investments, Inc., 1994  
Coral Gables, Florida

R. Kirk Landon .....Chairman and Chief Executive Officer, 1995  
American Bankers Insurance Group,  
Miami, Florida

Michael T. Wilson .....President, Vinegar Bend Farms, Inc., 1996  
Belle Glade, Florida

NASHVILLE BRANCH

*Appointed by the Federal Reserve Bank*

William Baxter Lee III .....Chairman and President, Southeast Services 1994  
Corporation, Knoxville, Tennessee

John E. Seward, Jr. ....President and Chief Executive Officer, The Paty 1994  
Company, Piney Flats, Tennessee

James D. Harris .....President and Chief Executive Officer, Brentwood 1995  
National Bank, Brentwood, Tennessee

Williams E. Arant, Jr. ....President and Chief Executive Officer, First 1996  
National Bank of Knoxville, Knoxville, Tennessee

*Appointed by the Board of Governors*

James E. Dalton, Jr. ....President and Chief Executive Officer, Quorum 1994  
Health Group, Inc., Brentwood, Tennessee

Vacancy ..... 1995

Paula Lovell .....President, Lovell Communications, Inc., 1996  
Nashville, Tennessee

NEW ORLEANS BRANCH

*Appointed by the Federal Reserve Bank*

Kay L. Nelson .....Managing Director, Nelson Capital Corporation, 1994  
New Orleans, Louisiana

Angus R. Cooper .....Chairman and Chief Executive Officer, 1994  
Cooper/T. Smith Corporation, Mobile, Alabama

Thomas E. Walker .....President and Chief Executive Officer, Bank of 1995  
Forest, Forest, Mississippi

Howard C. Gaines .....Chairman and Chief Executive Officer, First National 1996  
Bank of Commerce, New Orleans, Louisiana

*Appointed by the Board of Governors*

Jo Ann Slaydon .....President, Slaydon Consultants and Insight 1994  
Productions and Advertising,  
Baton Rouge, Louisiana

Term expires  
Dec. 31

## DISTRICT 6, NEW ORLEANS BRANCH

*Appointed by the Board of Governors—Continued*

## Lucimarian Tolliver

Roberts .....	President, Mississippi Coast Coliseum Commission, Pass Christian, Mississippi	1995
Victor Bussie .....	President, Louisiana AFL-CIO, Baton Rouge, Louisiana	1996

## DISTRICT 7—CHICAGO

*Class A*

Stefan S. Anderson .....	Chairman, President, and Chief Executive Officer, First Merchants Bank, N.A. and First Merchants Corporation, Muncie, Indiana	1994
Arnold C. Schultz .....	Chairman and President, Grundy National Bank, Grundy Center, Iowa	1995
David W. Fox .....	Chairman and Chief Executive Officer, The Northern Trust Corporation and The Northern Trust Company, Chicago, Illinois	1996

*Class B*

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
A. Charlene Sullivan .....	Associate Professor of Management, Krannert Graduate School of Management, Purdue University, West Lafayette, Indiana	1996

*Class C*

Duane L. Burnham .....	Chairman and Chief Executive Officer, Abbott Laboratories, Abbott Park, Illinois	1994
Richard G. Cline .....	Chairman and Chief Executive Officer, NICOR Inc., Naperville, Illinois	1995
Robert M. Healey .....	Member, Illinois State Labor Relations Board, Chicago, Illinois	1996

## DETROIT BRANCH

*Appointed by the Federal Reserve Bank*

Charles R. Weeks .....	Chairman, President, and Chief Executive Officer, Citizens Banking Corporation, Flint, Michigan	1994
Norman F. Rodgers .....	President and Chief Executive Officer, Hillsdale County National Bank, Hillsdale, Michigan	1995
William E. Odom .....	Chairman and Chief Executive Officer, Ford Motor Credit Company, Dearborn, Michigan	1996
Charles E. Allen .....	President and Chief Executive Officer, Graimark Realty Advisors, Inc., Detroit, Michigan	1996



Term expires  
Dec. 31

DISTRICT 7, DETROIT BRANCH—Continued

*Appointed by the Board of Governors*

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
Florine Mark .....	President and Chief Executive Officer, The WW Group, Farmington Hills, Michigan	1996

DISTRICT 8—ST. LOUIS

*Class A*

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
W. D. Glover .....	Chairman and Chief Executive Officer, First National Bank of Eastern Arkansas, Forrest City, Arkansas	1996

*Class B*

Sandra B. Sanderson-Chesnut .....	President and Chief Executive Officer, Sanderson Plumbing Products, Inc., Columbus, Mississippi	1994
Richard E. Bell .....	President and Chief Executive Officer, Riceland Foods, Inc., Stuttgart, Arkansas	1995
Warren R. Lee .....	President, W. R. Lee & Associates, Inc., Louisville, Kentucky	1996

*Class C*

Robert H. Quenon .....	Mining Consultant, St. Louis, Missouri	1994
John F. McDonnell .....	Chairman, McDonnell Douglas Corporation, St. Louis, Missouri	1995
Veo Peoples, Jr. ....	Partner, Peoples, Hale & Coleman, St. Louis, Missouri	1996

LITTLE ROCK BRANCH

*Appointed by the Federal Reserve Bank*

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
Mahlon A. Martin .....	President, Winthrop Rockefeller Foundation, Little Rock, Arkansas	1996

Term expires  
Dec. 31

## DISTRICT 8, LITTLE ROCK BRANCH

*Appointed by the Federal Reserve Bank—Continued*

James V. Kelley .....	Chairman, President, and Chief Executive Officer, First United Bancshares, Inc., El Dorado, Arkansas	1996
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*Appointed by the Board of Governors*

Robert Daniel Nabholz, Jr. ..	Chief Executive Officer, Nabholz Construction Corporation, Conway, Arkansas	1994
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Betta Carney .....	President and Chief Executive Officer, World Wide Travel Service, Inc., Little Rock, Arkansas	1995
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Janet M. Jones .....	President, The Janet Jones Company, Little Rock, Arkansas	1996
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## LOUISVILLE BRANCH

*Appointed by the Federal Reserve Bank*

Thomas E. Spragens, Jr. ....	President, The Farmers National Bank, Lebanon, Kentucky	1994
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Malcolm B. Chancey, Jr. ....	Chairman and Chief Executive Officer, Liberty National Bank & Trust Company of Kentucky, Louisville, Kentucky	1995
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Robert M. Hall .....	Owner, East Fork Growers, Seymour, Indiana	1996
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Charles D. Storms .....	President and Chief Executive Officer, Red Spot Paint and Varnish Company, Inc., Evansville, Indiana	1996
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*Appointed by the Board of Governors*

Laura M. Douglas .....	Legal Director, Louisville & Jefferson County Metropolitan Sewer District, Louisville, Kentucky	1994
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Daniel L. Ash .....	Consultant, Wenz-Neely Company, Louisville, Kentucky	1995
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John A. Williams .....	Chairman and Chief Executive Officer, Computer Services, Inc., Paducah, Kentucky	1996
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## MEMPHIS BRANCH

*Appointed by the Federal Reserve Bank*

Lewis F. Mallory, Jr. ....	Chairman and Chief Executive Officer, National Bank of Commerce of Mississippi, Starkville, Mississippi	1994
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Anthony M. Rampley .....	President, Chief Executive Officer, and Director, Arkansas Glass Container Corporation, Jonesboro, Arkansas	1995
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Katie S. Winchester .....	President and Director, First Citizens National Bank, Dyersburg, Tennessee	1996
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Benjamin W. Rawlins, Jr. ...	Chairman and Chief Executive Officer, Union Planters Corporation, Memphis, Tennessee	1996
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Term expires  
Dec. 31

DISTRICT 8, MEMPHIS BRANCH—Continued

*Appointed by the Board of Governors*

Sidney Wilson, Jr. ....	Owner, Wilson Automotive Group Inc., Jackson, Tennessee	1994
John V. Myers .....	President, Better Business Bureau, Memphis, Tennessee	1995
Woods E. Eastland .....	President and Chief Executive Officer, Staple Cotton Cooperative Association, Greenwood, Mississippi	1996

DISTRICT 9—MINNEAPOLIS

*Class A*

William W. Strausburg .....	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, MFC First National Bank, Houghton, Michigan	1995
Jerry B. Melby .....	President, First National Bank, Bowbells, North Dakota	1996

*Class B*

Duane E. Dingmann .....	President, Trubilt Auto Body, Inc., Eau Claire, Wisconsin	1994
Dennis W. Johnson .....	President, TMI Systems Design Corporation and TMI Transport Corporation, Dickinson, North Dakota	1995
Clarence D. Mortenson .....	President, M/C Professional Associates, Inc., Pierre, South Dakota	1996

*Class C*

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
David A. Koch .....	Chairman and Chief Executive Officer, Graco, Inc., Golden Valley, Minnesota	1996

HELENA BRANCH

*Appointed by the Federal Reserve Bank*

Nancy M. Stephenson .....	Executive Director, Neighborhood Housing Services, Great Falls, Montana	1994
Donald E. Olsson, Jr. ....	President, Ronan State Bank, Ronan, Montana	1994
Ronald D. Scott .....	President and Chief Executive Officer, The First State Bank of Malta, Malta, Montana	1995

Term expires  
Dec. 31

## DISTRICT 9, HELENA BRANCH—Continued

*Appointed by the Board of Governors*

Lane W. Basso .....	President, Deaconess Medical Center of Billings, Inc., Billings, Montana	1994
Matthew J. Quinn .....	President, Carroll College, Helena, Montana	1995

## DISTRICT 10—KANSAS CITY

*Class A*

Charles I. Moyer .....	Chairman and Chief Executive Officer, First National Bank of Phillipsburg, Phillipsburg, Kansas	1994
William L. McQuillan .....	President, Chief Executive Officer, and Director, City National Bank, Greeley, Nebraska	1995
Lawrence W. Menefee .....	Chairman and Chief Executive Officer, Union Colony Bank, Greeley, Colorado	1996

*Class B*

Frank J. Yaklich, Jr. ....	Deputy Project Manager, Manufacturing Sciences Corporation, Denver, Colorado	1994
W. W. Allen .....	Chairman and Chief Executive Officer, Phillips Petroleum Company, Bartlesville, Oklahoma	1995
Charles W. Nichols .....	Managing Partner, Davison & Sons Cattle Company, Arnett, Oklahoma	1996

*Class C*

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
Colleen D. Hernandez .....	Executive Director, Kansas City Neighborhood Alliance, Kansas City, Missouri	1996

## DENVER BRANCH

*Appointed by the Federal Reserve Bank*

Richard I. Ledbetter .....	President and Chief Executive Officer, First National Bank of Farmington, Farmington, New Mexico	1994
Clifford E. Kirk .....	President and Chief Executive Officer, First National Bank of Gillette, Gillette, Wyoming	1994
Peter I. Wold .....	Partner, Wold Oil & Gas Company, Casper, Wyoming	1995
Peter R. Decker .....	President, Peter R. Decker & Associates, Denver, Colorado	1996

*Appointed by the Board of Governors*

Barbara B. Grogan .....	President, Western Industrial Contractors, Inc., Denver, Colorado	1994
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Term expires  
Dec. 31

DISTRICT 10, DENVER BRANCH

*Appointed by the Board of Governors—Continued*

Sandra K. Woods .....	Vice President, Environmental Health and Safety Systems, Coors Brewing Company, Golden, Colorado	1995
Floyd R. Correa .....	President, Correa Enterprises, Inc., Albuquerque, New Mexico	1996

OKLAHOMA CITY BRANCH

*Appointed by the Federal Reserve Bank*

John Wm. Laisle .....	President and Chief Executive Officer, MidFirst Bank, SSB, Oklahoma City, Oklahoma	1994
C. Kendric Fergeson .....	Chairman and Chief Executive Officer, The National Bank of Commerce, Altus, Oklahoma	1995
Dennis M. Mitchell .....	President, Citizens Bank of Ardmore, Ardmore, Oklahoma	1995
Gordona Duca .....	President and Owner, Gordona Duca, Inc., Realtors, Tulsa, Oklahoma	1996

*Appointed by the Board of Governors*

Victor R. Schock .....	President and Chief Executive Officer, Credit Counseling Centers, Tulsa, Oklahoma	1994
Barry L. Eller .....	Sr. Vice President and General Manager, MerCruiser, Stillwater, Oklahoma	1995
Ernest L. Holloway .....	President, Langston University, Langston, Oklahoma	1996

OMAHA BRANCH

*Appointed by the Federal Reserve Bank*

Donald A. Leu .....	President and Chief Executive Officer, Consumer Credit Counseling Service, Omaha, Nebraska	1994
Thomas H. Olson .....	Chairman, First National Bank, Sidney, Nebraska	1994
Robert L. Peterson .....	Chairman, President, and Chief Executive Officer, IBP, Inc., Dakota City, Nebraska	1995
Bruce R. Lauritzen .....	President, First National Bank of Omaha, Omaha, Nebraska	1996

*Appointed by the Board of Governors*

A. 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
LeRoy W. Thom .....	President, T-L Irrigation Company, Hastings, Nebraska	1996

Term expires  
Dec. 31

## DISTRICT 11—DALLAS

*Class A*

Vacancy .....		1994
Eugene M. Phillips .....	Chairman and President, The First National Bank of Panhandle, Panhandle, Texas	1995
Gayle M. Earls .....	President and Chief Executive Officer, Texas Independent Bank, Dallas, Texas	1996

*Class B*

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
J. B. Cooper, Jr. ....	Farmer, Roscoe, Texas	1996

*Class C*

Cece Smith .....	General Partner, Phillips-Smith Specialty Retail Group, Dallas, Texas	1994
Roger R. Hemminghaus .....	Chairman, President, and Chief Executive Officer, Diamond Shamrock, Inc., San Antonio, Texas	1995
James A. Martin .....	Second General Vice President, International Association of Bridge, Structural, and Ornamental Iron Workers, Austin, Texas	1996

## EL PASO BRANCH

*Appointed by the Federal Reserve Bank*

Hugo Bustamante, Jr. ....	Owner and Chief Executive Officer, CarLube, Inc. and ProntoLube, Inc., El Paso, Texas	1994
Wayne Merritt .....	Chairman and President, Texas National Bank of Midland, Midland, Texas	1995
Ben H. Haines, Jr. ....	President and Chief Operating Officer, First National Bank of Dona Ana County, Las Cruces, New Mexico	1996
Veronica K. Callaghan .....	Vice President and Principal, KASCO Ventures, Inc., El Paso, Texas	1996

*Appointed by the Board of Governors*

Alvin T. Johnson .....	President, Management Assistance Corporation of America, El Paso, Texas	1994
W. Thomas Beard III .....	President, Leoncita Cattle Company, Alpine, Texas	1995
Patricia Z. Holland-Branch ..	President and Director of Design, PZH Contract Design, Inc., El Paso, Texas	1996

Term expires  
Dec. 31

DISTRICT 11, DALLAS—Continued

HOUSTON BRANCH

*Appointed by the Federal Reserve Bank*

Tieman H. Dippel, Jr. ....	Chairman and President, Brenham Bancshares, Inc., Brenham, Texas	1994
J. Michael Solar .....	Managing Partner, Solar & Fernandes, L.L.P., Houston, Texas	1995
Walter E. Johnson .....	President and Chief Executive Officer, Southwest Bank of Texas, Houston, Texas	1996
Judith B. Craven .....	President, United Way of the Texas Gulf Coast, Houston, Texas	1996

*Appointed by the Board of Governors*

Isaac H. Kempner III .....	Chairman, Imperial Holly Corporation, Sugar Land, Texas	1994
Judy Ley Allen .....	Partner and Administrator, Allen Investments, Houston, Texas	1995
Robert C. McNair .....	Chairman and Chief Executive Officer, Cogen Technologies, Inc., Houston, Texas	1996

SAN ANTONIO BRANCH

*Appointed by the Federal Reserve Bank*

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
Juliet V. Garcia .....	President, University of Texas at Brownsville, Brownsville, Texas	1996
Douglas G. Macdonald .....	President, South Texas National Bank, Laredo, Texas	1996

*Appointed by the Board of Governors*

H. B. Zachry, Jr. ....	Chairman and Chief Executive Officer, H. B. Zachry Company, San Antonio, Texas	1994
Carol L. Thompson .....	President, The Thompson Group, Austin, Texas	1995
Erich Wendl .....	President and Chief Executive Officer, Maverick Markets, Inc., Corpus Christi, Texas	1996

DISTRICT 12—SAN FRANCISCO

*Class A*

William E. B. Siart .....	President, First Interstate Bancorp, Los Angeles, California	1994
Carl J. Schmitt .....	Chairman and Chief Executive Officer, University Bank & Trust Company, Palo Alto, California	1995

Term expires  
Dec. 31

## DISTRICT 12, Class A—Continued

Richard L. Mount .....	Chairman, President, and Chief Executive Officer, Saratoga Bancorp, Saratoga, California	1996
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*Class B*

William L. Tooley .....	Chairman, Tooley & Company, Investment Builders, Los Angeles, California	1994
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E. Kay Stepp .....	Principal and Owner, Executive Solutions, Portland, Oregon	1995
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Gary G. Michael .....	Chairman and Chief Executive Officer, Albertson's, Inc., Boise, Idaho	1996
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*Class C*

Judith M. Runstad .....	Partner, Foster Pepper & Shefelman, Seattle, Washington	1994
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Cynthia A. Parker .....	Executive Director, Anchorage Neighborhood Housing Services, Inc., Anchorage, Alaska	1995
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James A. Vohs .....	Chairman and Chief Executive Officer (Retired), Kaiser Foundation Health Plan, Inc. and Kaiser Foundation Hospitals, Oakland, California	1996
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## LOS ANGELES BRANCH

*Appointed by the Federal Reserve Bank*

William S. Randall .....	President, Southwest Region, First Interstate Bank, Phoenix, Arizona	1994
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Antonia Hernandez .....	President and General Counsel, Mexican American Legal Defense and Educational Fund, Los Angeles, California	1994
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Steven R. Sensenbach .....	President and Chief Executive Officer, Vineyard National Bank, Rancho Cucamonga, California	1995
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Thomas L. Stevens, Jr. ....	President, Los Angeles Trade-Technical College, Los Angeles, California	1996
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*Appointed by the Board of Governors*

David L. Moore .....	President, Western Growers Association, Newport Beach, California	1994
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Anne L. Evans .....	Chairman, Evans Hotels, San Diego, California	1995
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Anita Landecker .....	Western Regional Vice President, Local Initiatives Support Corporation, Los Angeles, California	1996
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## PORTLAND BRANCH

*Appointed by the Federal Reserve Bank*

Stuart H. Compton .....	Chairman, Pioneer Trust Bank, N.A., Salem, Oregon	1994
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Elizabeth K. Johnson .....	President, TransWestern, Inc., Scappoose, Oregon	1995
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Cecil W. Drinkward .....	President and Chief Executive Officer, Hoffman Construction Company, Portland, Oregon	1996
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Term expires  
Dec. 31

DISTRICT 12, PORTLAND BRANCH

*Appointed by the Federal Reserve Bank—Continued*

Gerry B. Cameron .....Chairman and Chief Executive Officer, 1996  
U.S. Bancorp, Portland, Oregon

*Appointed by the Board of Governors*

William A. Hilliard .....Editor (Retired), The Oregonian, Portland, Oregon 1994

Carol A. Whipple .....Owner/Manager, Rocking C Ranch, Elkton, Oregon 1995

Ross R. Runkel .....Professor of Law, Willamette University, 1996  
Salem, Oregon

SALT LAKE CITY BRANCH

*Appointed by the Federal Reserve Bank*

June M. Morris .....Chief Executive Officer, Morris Air Corporation, 1994  
Salt Lake City, Utah

Roy C. Nelson .....President, Bank of Utah, Ogden, Utah 1995

Daniel R. Nelson .....Chairman and Chief Executive Officer, 1996  
West One Bancorp, Boise, Idaho

Nancy Mortensen .....Vice President - Marketing, ZCMI, 1996  
Salt Lake City, Utah

*Appointed by the Board of Governors*

Gerald R. Sherratt .....President, Southern Utah University, 1994  
Cedar City, Utah

Richard E. Davis .....President and Chief Executive Officer, 1995  
Salt Lake Convention & Visitors Bureau,  
Salt Lake City, Utah

Constance G. Hogland .....Executive Director, Boise Neighborhood 1996  
Housing Services, Inc., Boise, Idaho

SEATTLE BRANCH

*Appointed by the Federal Reserve Bank*

Thomas E. Cleveland .....Chairman, Enterprise Bank, Bellevue, Washington 1994

Constance L. Proctor .....Partner, Alston, Courtnage, MacAulay & Proctor, 1995  
Seattle, Washington

Tomio Moriguchi .....President, Uwajimaya, Inc., Seattle, Washington 1996

John V. Rindlaub .....Chairman and Chief Executive Officer, Seafirst 1996  
Corporation, Seattle, Washington

*Appointed by the Board of Governors*

William R. Wiley .....Senior Vice President, Science & Technology 1994  
Policy, Battelle Memorial Institute,  
Richland, Washington

Emilie A. Adams .....President and Chief Executive Officer, Better 1995  
Business Bureau Foundation, Seattle, Washington

George F. Russell, Jr. ....Chairman, Frank Russell Company, 1996  
Tacoma, Washington

# Maps of the Federal Reserve System



### LEGEND

*Both pages*

- Federal Reserve Bank city
- ★ Board of Governors of the Federal Reserve System, Washington, D.C.

*Facing page*

- Federal Reserve Branch city
- Branch Boundary

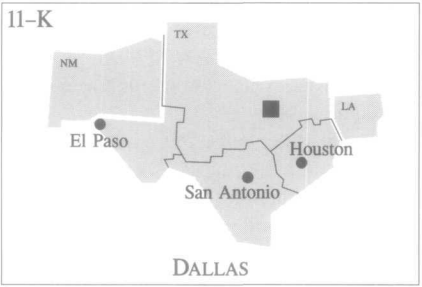
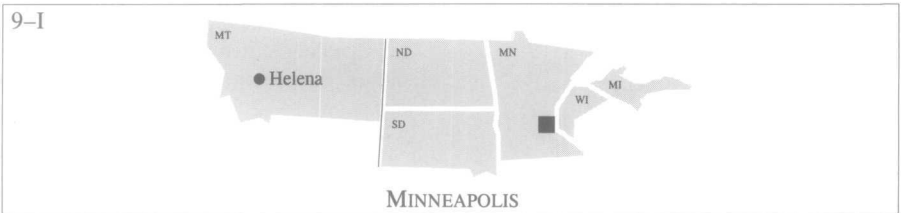
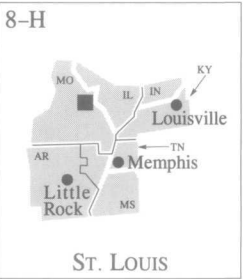
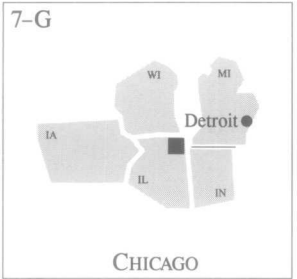
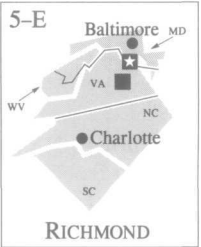
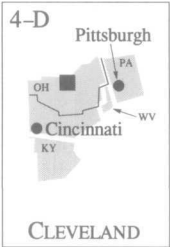
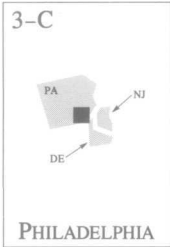
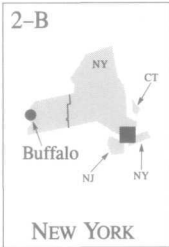
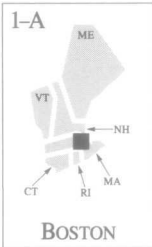
### NOTE

The Federal Reserve officially identifies Districts by number and by Reserve Bank city (shown on both pages) as well as 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 1994.



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