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Remarks before the New York State Bankers Association

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I am delighted to have this opportunity to meet today with bankers from all parts of New York State for the first time as president of the Federal Reserve Bank of New York. My delight, of course, is related to the nature of the occasion—being back home and talking about matters of common interest—not a claim that we meet in entirely happy circumstances.

The past year has seen unparalleled strains on the finances of our state and its leading city. There have already been consequences for all of us and, unless dealt with effectively, there could be national and even international repercussions as well. Other pressures on our banking and financial structure, building up over several years, have become evident in the aftermath of recession. Right in my own bailiwick, the Federal Reserve System has been in the midst of much controversy, with a spate of proposals for far-reaching changes introduced in the Congress.

In a happy contrast to the beginning of last year, there is upward momentum in economic activity. The rate of price increase has diminished from the peaks of 1974. But unemployment remains close to postwar peaks, with only slow declines in prospect. Our economic prospects remain clouded in other important respects. Inflation still looms as a major threat to sustained prosperity, and investment activity is lagging.

From our somewhat different vantage points, we will be dealing together with all of these challenges as far ahead as I can see. In the circumstances, I hardly knew where to begin as I prepared for my remarks today. But that problem was solved for me by the unprecedented barrage of reports in the press these past two weeks about conditions in the banking system and of individual banks within it—reports that could leave in the public mind some totally unwarranted impressions about the stability of the system. That subject is close to my heart and mind, and I am sure to yours as well.

Perhaps I can best approach the matter by simply stating again my own perspectives. There is no doubt that banks—as businesses generally—have been functioning in a more difficult environment than at any earlier time since the Great Depression. A long period of almost uninterrupted growth and prosperity—accompanied by widespread confidence that we had found the means of preventing serious economic setbacks—had encouraged more aggressive, highly competitive behavior by many financial institutions in the 1960's and the early 1970's. The long period of smooth sailing encouraged banks, as others, to leverage their capital more highly, beyond traditional standards. To many in the investment community and elsewhere, aggressive liability management and exploration of new lending areas became the hallmarks of progressive banking; indeed, those slower to move in these directions were often less favored by the market and chided by their customers. The more competitive banking environment was widely and, in important respects, rightly hailed as bringing clear benefits for depositors, borrowers, and investors alike. Yet, it was also true that some of the trends could not be sustained indefinitely, and some mistakes were made. The brutal combination of inflation and recession has now exposed the excesses in a few areas; they need correction and the process is under way.

None of this has been hidden from you or from any

*Midwinter meeting held in New York City on Monday, January 26, 1976.

careful follower of bank reports. I know the actions and statements of the regulatory authorities—and I can speak directly of the Federal Reserve—have reflected their recognition of potential points of stress for some time, sometimes to the discomfort of bank managements. But the danger now is that reports spread in the general press—citing, in part, fragments of examination reports and other internal working papers designed specifically to ferret out and highlight problems—lend a sensationalized air to these matters that seems to me unwarranted. The clear positive signs of the basic health and strength of the banking system are largely ignored, and perspective is lost.

Let me cite again some simple facts that seem to me to reflect in a more balanced way the banking situation. Loan losses did reach a postwar high last year at a multiple of the levels to which we had grown accustomed in more settled times. Even so, for the larger New York banks, the losses can be estimated at about ¾ of 1 percent of loan portfolios. For the leading national and international banks for which I have seen reports, loan write-offs have without exception been matched by fresh provisions to loan loss reserves, maintaining that important element of protection against future contingencies. In fact, every large bank in New York City now has loan loss reserves at a higher level than at the beginning of 1975 averaging almost twice last year's actual losses.

At the same time, the basic earning power of banks appears to have improved significantly. Preliminary indications are that, after making their provisions for loan losses, earnings for the year were maintained by the large banks as a group—although not for every individual bank—above the record levels of 1974. With growth in loans and deposits slowing substantially and retained earnings high in 1975, these banks have also begun to improve their capital ratios.

It would be ironic, indeed, if that kind of broadly favorable and distinctly reassuring information, routinely reported in the financial pages of only a few papers, were to be lost to readers of many newspaper stories that focus, in the name of full disclosure, on the problem areas. The recent publicity—leaning heavily on leaks of internal papers protected by law from unauthorized disclosure—does call attention to important questions about the public's right to know, the privacy and confidentiality necessary to the internal work of the supervisory agencies and the banks themselves, and even the effectiveness with which the supervisory agencies are discharging their responsibilities for the stability of our banking system. These questions demand answers.

Accurate, adequate disclosure of material facts about sizable business firms has long been an accepted concept in the American business system, providing fundamental protection for the investor and ensuring effective discipline through market processes. Standards in that respect have been toughened in recent years, and banks have not been exempt. In a number of instances, banking institutions have voluntarily moved beyond required standards, and the standards have themselves been raised by the efforts of the SEC, the banking authorities, and the accounting and legal professions. Thinking is still evolving in this area, and it seems to me possible that more can be done to provide meaningful, consistent information, without violating the confidentiality of customer relationships or smothering business initiative. Information beyond the purely financial may be relevant when sensitivity to such matters as business ethics, employment practices and standards, and consumer protection is understandably high. I am also convinced that disclosure will be both more meaningful and less burdensome to the extent banks themselves consider, in a forward-looking way, what should and can be done. I welcome the fact that at least a few institutions are prepared to do just that.

These disclosure efforts, developed primarily to protect the investor, inevitably overlap with, but can be distinguished from, the overall responsibilities of the supervisory authorities. The supervisor can help ensure that disclosure standards designed primarily to help the investor are enforced, and that the information is accurate. But the responsibility of the bank supervisor is still broader. Our basic job is not to serve the investment analyst or to serve the stockholder interest, but to protect the interest of the public generally, and the depositors directly, in the integrity and stability of the banking and payments system as a whole. As part of that responsibility, we need to be concerned with the safety and soundness of individual banks, because it has long been recognized that failure of a bank can have repercussions locally, nationally, or even internationally, extending far beyond the impact on the owners and creditors of the particular institution involved. Concerned as we must be with the safety of banks, our responsibilities do not stop with meaningful disclosure to the investor, but extend to developing and enforcing appropriate safeguards against excessive risk.

Given these responsibilities, we are naturally concerned with searching out problem areas. The individual examiner is trained to probe into institutions as far as he can to identify potential problems before they threaten the soundness of the bank and to bring them to the attention both of his superiors and of the bank's management. The examiner should, in the vernacular, "holler and scream" to get his point across. And he will be more successful to the extent banks feel comfortable in volunteering free and full access not just to their records but to their thinking, and the examiner feels free to form judgments partly on the basis of intangibles. All of this demands an atmosphere of confidentiality and mutual trust, because private customer relationships, proprietary information, and public confidence are all deeply involved.

In the end, the measure of how well the examiner does his job is how successfully problems can be identified and resolved before they reach damaging proportions. We have not always been successful—but one of the more interesting statistics I have learned in my new job is the very limited number of loans classified as "substandard" or "doubtful" that ever need to be written off in whole or substantial part after those credits have been identified and bank management seized of the task of following them closely and taking the actions necessary to bolster the credit.

A bank could always avoid mistakes, in the narrowest sense, by drawing back to only those credits that involve no discernible risk, by maintaining tight ceilings on interest rates paid depositors, by maintaining high and rigid capital standards, and by similar devices. But, carried to an extreme, such a course of action would hardly serve the interest of individual institutions and their customers, or more fundamentally, the requirements for an expanding economy dependent on a free flow of bank credit and risk taking. The supervisor, in the end, is not concerned with safety alone, but also with promoting competition and initiative. We want a variety of lending outlets for businesses whose fortunes are never altogether certain. We want savers to earn a reasonable reward. And we want banks to seek out profits, because profits both measure their effectiveness in serving their community and provide the base for growth.

The constant challenge—the dilemma, if you will—of the supervisor is to assure needed safety without stifling initiative and competition. We are helped in resolving that dilemma by the broad array of support that can be made available through the FDIC and the Fed to protect, in the last analysis, the stability of the banking system and the individual depositors. But the first line of defense lies in the soundness of the individual banks—and I frankly do not see how we can maintain the necessary balance in that job if the supervisor and the banks cannot work in confidentiality and mutual trust. Exposure in a public forum of confidential working papers—papers designed to surface potential problem areas—can only destroy that essential condition.

Short of revealing sensitive, confidential information about individual banking institutions and their customers, I welcome considered Congressional and public inquiry into the way we go about our job. As you know, proposals for reorganization of the responsibilities for Federal banking supervision are now being reviewed in the Congress, with their inquiry focusing particularly on the question of some or even complete consolidation of the overlapping supervisory authorities of the FDIC, the Comptroller of the Currency, and the Federal Reserve. The present arrangements grew out of a long period of historical evolution, and follow no clear or obvious principle of administrative organization. There are overlapping and potentially confusing elements. The consequent possibility of inconsistency, and even a competitive instinct, among the agencies has often been cited.

But the system also has enormous strengths and historical logic of its own. It reflects our national suspicion about the danger of concentrated power. It can help encourage a useful measure of innovation. And I suspect it also helps protect against a certain insulation—a bureaucratic arteriosclerosis—that may over time erode ability of a dominating regulatory agency to distinguish between the public interest and its institutional interest.

In responding to the Congressional concern, the Federal Reserve and other supervisory agencies have been rethinking this matter. No consensus has yet emerged. One possibility is that, even under present law, there may well still be areas in which a further degree of coordination—for instance, in examination standards and procedures—could usefully be achieved. I would not myself resist some further consolidation through legislative reorganization, provided—and it is a large proviso—that the Federal Reserve maintains a substantial role in the supervisory and regulatory process.

The proposals sometimes made to insulate monetary policy from supervisory policy would, in my judgment, be a disservice to both. In particular situations, it is easy to imagine that people concerned wholly with bank supervision, and therefore the way particular banking institutions are meeting their responsibilities, might have a different perspective and reach somewhat different conclusions from those concerned wholly with monetary policy, and therefore aggregate economic activity. Both are important. But it doesn't make sense to me to try to resolve these different perspectives by trying to place them in water-tight compartments.

The potential conflicts have to be reconciled. That best can be done, in my judgment, by those who are forced by their responsibilities to recognize the legitimacy of both concerns.

To my mind, decisions on monetary policy will themselves only benefit from the fact that those responsible are forced to involve themselves in the "nitty-gritty" of banking—with a flow of first-hand information about lending policies and trends, the condition of the credit markets, and the capacity of banks and other institutions to respond and adapt to policy initiatives. In other words, I am not a believer in monetary policy from an ivory tower.

The vague charge has often been made of regulatory agencies that they may become a captive of the industry they regulate. Whether that charge has any merit in other areas or not, I suspect this audience could testify rather eloquently that no case to that effect can be made against the Federal Reserve. And I suspect one fundamental reason is that our supervisory and regulatory responsibilities, important as they are, are not our entire "raison d'être". They must be performed in the context of other still larger purposes and responsibilities.

It will not surprise you that I have deep concerns about the nature of other criticism directed at the Federal Reserve in recent months. I am not thinking so much about debates on monetary policy conducted in the press, in the academic community, and most importantly in the Congress. Those debates are natural and even healthy when the economy is troubled. I am thinking rather of what I can only judge as an attack on some of the underlying premises of the Federal Reserve as an institution. I will take my remaining time to talk with you about them, for there are issues here that seem to me fundamental to our economy and even to the nature of our processes of government.

I have lost count of the number of times in recent months that one or another committee of the Congress has been presented with proposals for changes in the structure and organization of the Federal Reserve. What these proposals have in common is that, almost without exception, they seem to be designed, contrary to past intent and tradition, to bring monetary policy much more directly under "political" control.

In approaching this question, I do not want to be misunderstood. The Federal Reserve is a public institution. It is a creature of the Congress, and the Congress is free to change it. Congressional review of our policies and our operations is neither new nor disturbing, even given the pitch of intensity it has reached in recent years. We are, after all, charged with responsibilities of great national importance. We should be—and I think we are—sensitive to the broad national priorities, and aware of the problems and needs of all parts of our country. In that broadest sense, we are a part of the fundamental political processes of the nation.

What is at issue seems to me something else: whether the Federal Reserve should be exposed to—even controlled by—direct, day-to-day and potentially partisan political pressure, whether originating in the Administration, with individual members of the Congress, or elsewhere.

That was not the view of the founders. The Federal Reserve Act was a product of political genius. In going about the job of constructing a central bank, the Congress built a unique institution, without precise parallel in the United States or other countries. Some concepts were, of course, borrowed from earlier experience here and abroad. The genius lay in blending them together in a manner fitted to the vast size, the heterogeneity, and the traditions of the United States.

The structure of the Federal Reserve defies simple description. It is a part of government; yet, it is not an agency like other agencies. It is firmly controlled by public officials; yet, it has been able to draw upon a degree of participation and support from the private sector that is perhaps unique in government. Monetary policy by its nature is a function of the central government; yet, there is regional participation in policy development and implementation.

The original Federal Reserve Act has been amended many times. There was a sweeping modernization in 1935, and the act has been thoroughly reviewed in the Congress a number of times since. But throughout this process, three fundamental and related elements have been retained.

(1) The process of policy formulation and implementation has been protected from partisan and short-term political control and influence. The Congress, in delegating its own Constitutional authority over money, established an independent authority free of executive domination and removed from the immediate pressures of the day-by-day Congressional processes. A number of reinforcing methods have been used to assure that result. Members of the Board of Governors with general supervisory power over the System are appointed for long terms; they share certain important policy responsibilities with the Federal Reserve Banks, whose officials are appointed outside the political process; and the System is self-financed.

(2) Policy and operating responsibility is widely dispersed. Washington is the center, but the System is nourished by roots throughout the country. Awareness of, and sensitivity to, the concern of different regions and different interests have been built into the structure. Thus,

operations are conducted by the twelve Reserve Banks, under the direct supervision of boards of directors drawn from their own region. The Bank officials participate in the process of policy formulation, with the presidents (who must be approved by the Board of Governors) directly represented on the body that formulates open market policies. Members of the Board of Governors themselves are drawn from different regions.

(3) As implied by the previous point, the System has checks and balances within itself. In the end, a single monetary policy must prevail. But a diversity of views can be brought to the policy table—each supported by independent research and filtered through the differing perspectives of different parts of the country and different individuals, by direct contact with the marketplace, with economic decision makers, and with local opinion. A consensus must be reached among men dependent on each other only by the general interest in achieving coherent and intelligent policy.

The Federal Reserve is a living institution—the precise balance of forces within the System, and between the System and other elements of government, is almost always shifting at the margin as needs change and particular personalities come and go. But these constants of independence in judgment, regional participation and decentralization, and internal checks and balances have remained. I believe they have stood the test of time.

I cannot take the position that the Federal Reserve should be exempt from legislative changes—that improvements are not possible. Some of the proposals now before the Congress—and others made in the past—certainly deserve careful hearing. But I do object vigorously to the common thread that runs through many of the current proposals.

For instance, one family of bills would bring the Board of Governors and the individual Federal Reserve Banks within the process of Congressional authorization and appropriation—and with the purse goes the power. With both the Board and Banks already carefully audited, proposals that would subject the System to further audits by the GAO inevitably raise the suspicion that the real intent is to intrude into policy areas. Other bills would drastically shorten the terms of Board members. Power would be centralized by eliminating voting participation of the presidents of the regional Reserve Banks from the Open Market Committee, by abolishing the boards of directors of the regional Banks, and by curbing the ability of the Reserve Banks to attract and retain the kind of exceptionally able career officials that have notably marked the System from its first days.

Taken together, or even in substantial part, these proposals, if adopted, would mark a reversal of the historic judgment of the Congress about the proper role for itself and for the central bank in the conduct of monetary policy. The question must be asked: To what end?

The idea that the basic powers of the Federal Reserve are to be directed toward certain basic, well-established goals of public policy is not at issue. Those goals of stability, growth, and employment—implicit in the Federal Reserve Act and embodied in the Employment Act of 1946—are essentially noncontroversial.

What is bound to be controversial is how best to meet those goals through monetary policy. At best, monetary policy is a complex and difficult mixture of science and art. The results are never certain, and the relevant time horizon may be relatively long.

The Congress, in delegating its ultimate authority, implicitly recognized that policy decisions heavily weighted by their immediate impact and by public appreciation and response may often be distorted and counterproductive. By their nature, decisions on monetary policy must sometimes run against the grain of the illusive hope that more money can be equated with more production or more real welfare. Effective policy takes a high degree of expertise, and continuous attention. While there is a clear need to work with the Administration of the day to the extent possible, there are also times when their judgments need to be sharply challenged. And these considerations all support the continuing validity of the judgment that the decision making should not be conducted directly by those engaged fully in the rough and tumble of the political arena.

The other side of the coin is that the policymaker needs to be sensitive to the broad needs of the economy and continuing national priorities. I have already stated my belief that such sensitivity is built into the organization of the Federal Reserve System. Within that general framework, there are still more opportunities for enlarging our perspective—through, for instance, encouraging appointment of Reserve Board members and Reserve Bank directors from a wide spectrum of our national life. What I fail to see is how narrowing the base of the System—for instance, by abolishing the boards of directors of the Banks or curbing the voice of the Banks themselves—would contribute to that end. Nor do I see how it will help to place Reserve Banks or their officials in a position to be hostages to political fortune through the appropriations process or otherwise, or to undermine their ability to take and defend viewpoints that may not coincide in all respects with the current fashion in Washington. My observation, from an earlier time than when I took my present position, is that individual Reserve Banks have often played an avant-garde role in prodding the System to reexamine the premise of its policies, to explore and experiment with new techniques, and to recognize in its policy making new currents of opinion.

Finally, the proposals to reorganize the System in the name of "responsiveness" seems to me to overlook the effectiveness with which the Congress has learned to exercise its power of review and oversight. Never before have Federal Reserve policies been scrutinized and challenged so continuously and forcefully by the relevant committees. It is a tough process—one that forces the policymaker to think and rethink the premises of his actions and their consistency and effectiveness. A mass of information is diligently supplied in response to the legitimate demands of the Congress and the public to be fully informed both as to the substance of policy and the factors bearing upon the decisions.

Last year saw a potentially important new initiative in this respect. After Congressional prodding, the Federal Reserve undertook to quantify its longer range objectives with respect to important monetary aggregates. I am not one who believes that monetary policy can be reduced to a question of maintaining a given rate of growth in the money supply—the economy is much too complex for that. But at least in present circumstances, when the economy has been so unsettled, this discipline of quantifying can perform an important service in both clarifying our objectives for the public and providing a focus for informed Congressional debate.

The constructive elements in this process would end, and the damage to the basic concept of the Federal Reserve would begin, in my judgment, if the essential base for the independent judgment of the System were to be eroded. That is why I am concerned about the number of proposals in the Congress that would do just that, and why I wanted to leave these thoughts with you on my maiden appearance today. History is, after all, replete with the wreckage of economies that lost sight of monetary discipline. We have had a glimpse of what that process can mean in recent years, not just in the United States but elsewhere.

I readily confess to a special interest in the Federal Reserve. I know that, as we work together in the years ahead, there can be many particular issues upon which our views will diverge, our interests may differ, and new approaches will be needed. Within the Federal Reserve itself, there is ample room for debate and even dissent. I am here today only because I firmly believe the Federal Reserve Bank of New York has played—and can continue to play—a constructive and even vital role in this entire process.

That may sound parochial. But I do not think it parochial to assert that the chances for dealing successfully with our troubled economy this year—and maintaining a healthy economy and banking system through the years ahead—will be enhanced by maintaining the independence and vitality of the Federal Reserve System.

The Business Situation

The latest monthly business statistics confirm that the cyclical recovery in economic activity is continuing and, indeed, suggest that it may have gained a firmer footing in recent months. Perhaps the most striking improvements have been reported in the figures on labor market conditions for December and January. The average workweek rose significantly over this period, and there were large additions to private nonfarm payrolls along with even larger gains in household employment. In addition, the overall unemployment rate plummeted 0.5 percentage point in January to 7.8 percent, the lowest level in over a year. Quite possibly, technical problems of seasonal adjustment overstated the January improvement in joblessness, but there is little doubt that overall labor market conditions have strengthened over the past two months. Other recent reports showed strong and broadly based advances in industrial production and retail sales in December, including an improvement in domestic new car sales that was apparently extended further in January. Some other developments, however, have suggested a more moderate rate of expansion overall, as new orders, housing starts, and the composite index of leading indicators all turned in relatively lackluster performances in December.

In the fourth quarter, the rate of growth of gross national product (GNP) in real terms was much lower than in the previous one. But the third-quarter spurt, largely attributable to a marked slowdown in the pace of inventory liquidation, was clearly unsustainable. Now that the inventory situation has stabilized, the pace of the economic recovery will be closely attuned to the rate of growth of final demand. Hence, the fact that all major spending components contributed to the healthy fourth-quarter gain in real final sales can be regarded as an encouraging sign. Other recent developments, such as the extension of the 1975 tax cut and the heady advance in the stock market, are also reassuring in that they enhance the prospect of further increases in consumption spending in coming months.

GNP AND RELATED DEVELOPMENTS

According to preliminary estimates prepared by the Department of Commerce, the market value of the nation's output of goods and services (GNP) increased at a 12.2 percent annual rate in the fourth quarter. Adjusted for changes in the level of prices, the gain in real GNP amounted to a healthy 5.4 percent. This was less than half the rate of the previous quarter, but that advance was primarily the result of a sharp slowdown in the rate of inventory liquidation. The latest GNP data indicate that the recovery is moving ahead on schedule and that the level of economic activity has regained much of the ground that was lost during the steep recession. As of the fourth quarter, real GNP stood 1.9 percent below the peak attained two years earlier, a vast improvement over the 6.6 percent shortfall recorded in the first quarter of the year. Nevertheless, there is still a great deal of slack within the economy, inasmuch as the potential productive capacity of the economy has continued to grow over the last couple of years. For the manufacturing sector, the Federal Reserve Board's index of capacity utilization stood at 70.8 percent in the fourth quarter, up 3.8 percentage points from the second-quarter trough but 12.5 percentage points below the peak attained in mid-1973.

In addition to the preliminary GNP data for the fourth quarter, the Department of Commerce also released revised estimates of GNP for the period from 1946 to 1975. These revisions were quite extensive and incorporate a number of notable features. First, the revisions include the regular updating of the estimates for 1972 to 1974 that was postponed from July 1975. Second, they incorporate new "bench-mark" information based on a number of recent censuses. Third, the new estimates reflect numerous definitional and classificational changes. The most important is the new estimate of economic depreciation which is designed to measure the loss in productive services of the existing capital stock—valued in both current-dollar and constant-dollar terms. Previously, the quarterly estimates of depreciation in the national income accounts had been based on allowable depreciation charges as defined by the United States tax code and tabulated by the Internal Revenue Service from business tax returns. As a result, these estimates were affected anytime the tax code was changed, and they were valued on a historical cost basis, i.e., in terms of the prices of the capital goods prevailing at the time they had originally been purchased. Fourth, improvements were made in certain statistical estimation procedures, including the incorporation of information obtained in new statistical surveys of inventory accounting methods used by businesses in estimating inventories. Fifth, the base year for the constant-dollar estimates of GNP was updated from 1958 to 1972, and additional information has been used to improve the constant-dollar estimates of construction, producers' purchases of durables equipment, and Government purchases of goods and services. These changes have had a noticeable impact on the recorded rates of growth of real GNP in particular quarters, but they do not appreciably change the cyclical pattern of growth over the postwar period (see Chart I).

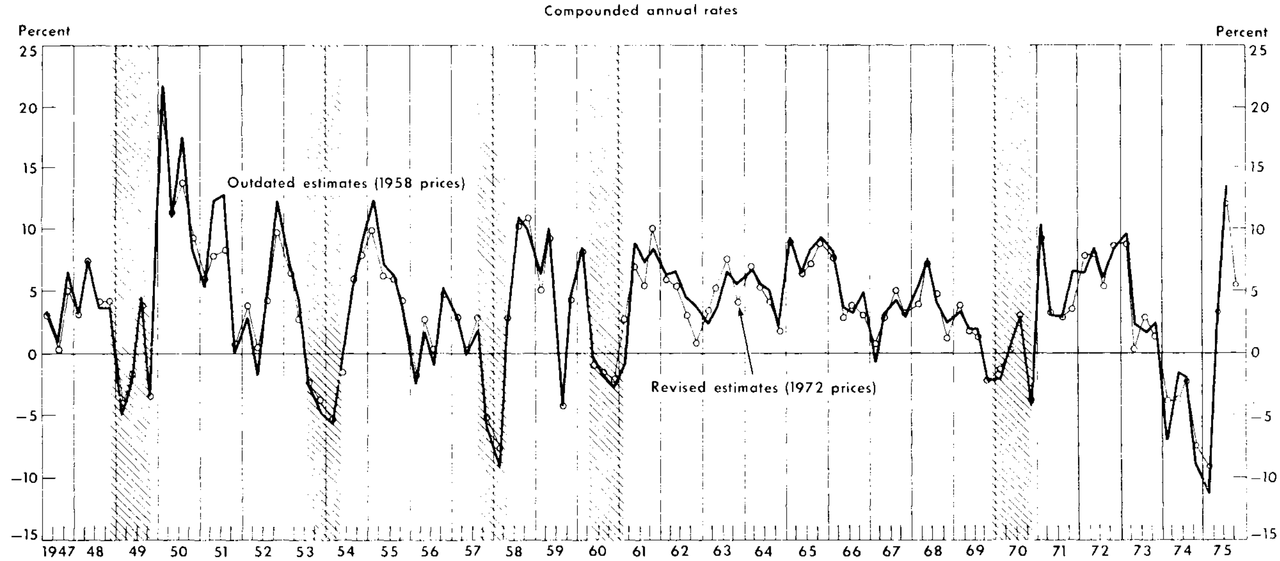
The fourth-quarter gain in real GNP was widely distributed among the spending components (see Chart II). Inventory spending turned positive but added little to the momentum of the recovery. Indeed, the turnabout in inventory spending accounted for only about 6 percent of the total gain in real GNP, unlike the previous quarter when its contribution had amounted to about 60 percent. In the fourth quarter, real final expenditures—equal to GNP less the change in business inventories—increased at a 5 percent annual rate, slightly higher than the gains registered in the two preceding quarters. All major spending components contributed to the latest increase in final sales, including fixed investment spending and net exports which had posted declines in the previous quarter.

Businesses have evidently succeeded in getting out from under the once massive inventory overhang and now seem to be keeping an earnestly tight rein on their inventories. For the first time in a year, businesses actually added to their stocks of inventories in the fourth quarter, although the increase was concentrated in the farm sector. Within the nonfarm business sector, there was a further liquidation of inventories, marking the fourth consecutive quarterly decrease. Yet, in some respects, the most recent decline seems to be of a different ilk than the earlier ones. Accord-

Chart I

ALTERNATIVE ESTIMATES OF THE GROWTH RATE OF REAL GROSS NATIONAL PRODUCT

Compounded annual rates



Note: Shaded areas designate recession periods, as determined by the National Bureau of Economic Research (NBER). The most recent recession has not yet been dated.

Source: United States Department of Commerce, Bureau of Economic Analoysis.

ing to November data, the most recent disaggregated data available, inventories declined in the wholesale trade and retail trade sectors as well as in durable goods manufacturing. In previous months, both trade sectors had been building up their inventories. This sudden turnaround, together with strong end-of-the-quarter retail sales, suggests that much of the fourth-quarter rundown was unintended, i.e., businesses had geared their production rates to sales expectations that turned out to be too low. In any event, the real inventory-to-sales ratio for the nonfarm business sector edged down further in the fourth quarter, declining to the lowest level in two years. This is one of the clearest signs that the inventory correction has run its course. Thus, changes in inventory investment in the months ahead are unlikely to have the amplifying impact on the cyclical swings in economic activity that they have had over the past year and a half or so.

As inventory spending takes on a more passive role in the current cyclical upturn, consumption spending will come to play an increasingly vital role in setting the pace of the recovery. In the fourth quarter, consumption spending increased at a less than vigorous 3.5 percent annual rate in real terms. Most of the advance occurred in December. In the previous months, retail sales had been flat and this sluggishness had given way to widespread concern over the robustness of the recovery. The December upsurge in retail sales allayed these doubts to a large extent. Moreover, the prospects for further increases in consumption spending have been brightened lately by such developments as the extension of the 1975 tax cut, the steady gains in personal income, and the impressive advance staged by the stock market. Taken together, these developments not only provide consumers with the wherewithal for stepping up their spending but also should help allay the uncertainty and hesitancy that consumers may have about the economic outlook.

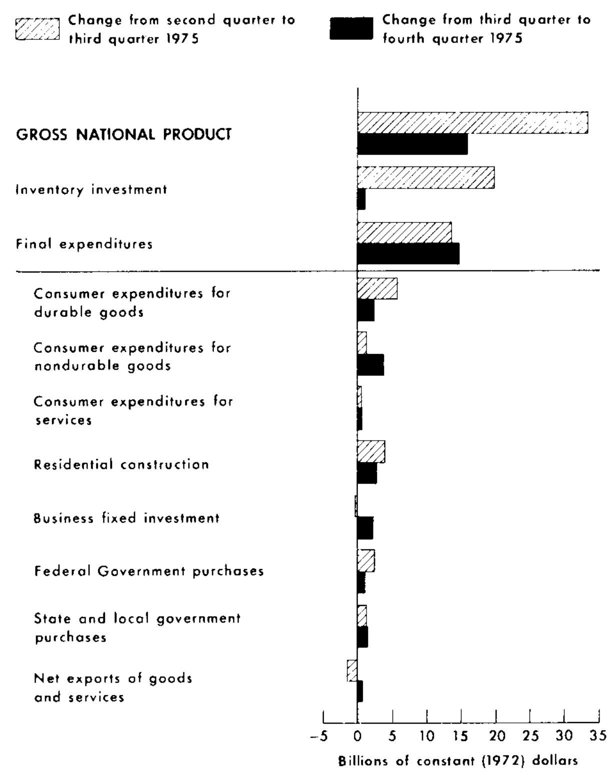
In the fourth quarter, personal income outpaced expenditures and the savings rate inched up to 8.2 percent, relatively high by historical standards. For 1975 as a whole, the savings rate averaged 8.3 percent. In the event that consumers do begin to feel less insecure about the economic environment, the savings rate will probably decline a bit. This would add even further momentum to the recovery.

At the end of the year the residential construction sector was continuing to pull out of its very severe recession, although the recovery path was proving to be a rather bumpy one. In real terms, residential housing expenditures increased at a 30 percent annual rate, off somewhat from the previous quarter's gain. Much of this reflected the pickup in construction of new units. Housing starts

Chart II

RECENT CHANGES IN REAL GROSS NATIONAL PRODUCT AND ITS COMPONENTS

Seasonally adjusted



Source: United States Department of Commerce, Bureau of Economic Analysis.

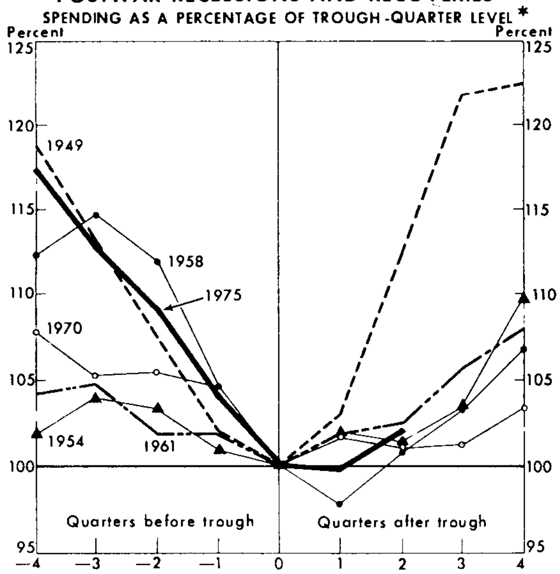
were running at a 1.37 million unit annual rate over the last three months of the year, up slightly from the previous quarter but well above the average 1.03 million rate posted for the first six months of the year. Still, there was less residential construction activity in 1975 than in any year since 1946, and the industry remains in a depressed state.

Yet housebuilders can look forward to a somewhat better year, as conditions have lately improved in the mortgage market. In recent months, mortgage interest rates have come down a bit as mortgage funds have become increasingly abundant. The inflow of deposits to thrift institutions rebounded in 1975 from the sluggish rates of the previous year and a half. The thrift institutions have used these funds, in part, to rebuild their liquidity but have lately channeled an increased proportion into the mortgage market. As a result, growth of their mortgage holdings accelerated between April and October, and then stabilized in November at an annual rate of about 12 percent, the highest since June 1973. At the same time, mortgage interest rates have also reflected the easier conditions. In the January 26 auction, the yield on the Federal National Mortgage Association's insured mortgage commitments was about 90 basis points below the October 7 peak. Mortgage rates on some multiple-family buildings will be lowered even further as a result of a recent action by the Administration. Thus far, construction of multiple-family buildings has staged a very weak comeback. Whereas single-family starts in the fourth quarter of last year had rebounded to better than 75 percent of their 1972 rate, multiple-family starts were at the same time running at only one third of their 1972 rate. To stimulate this sector, the Administration agreed to release $3 billion in funds previously authorized by the Congress—an amount which will enable the Federal Housing Administration to issue mortgages on multifamily buildings at a 7.5 percent interest rate. This infusion of Government funds, along with the increased deposit inflows to thrift institutions, should add impetus to the housing recovery.

Chart III

REAL BUSINESS FIXED INVESTMENT IN SIX POSTWAR RECESSIONS AND RECOVERIES

SPENDING AS A PERCENTAGE OF TROUGH-QUARTER LEVEL *



Note: The National Bureau of Economic Research-dated recession troughs occur in fourth quarter 1949, second quarter 1954, second quarter 1958, first quarter 1961, fourth quarter 1970. The trough quarter for the latest recession has not yet been dated by the NBER. Industrial production bottomed out in the second quarter, which is used as the trough quarter in the chart.

* For each reference cycle the trough-quarter level equals 100 percent.

Source: United States Department of Commerce.

In the fourth quarter, business fixed investment spending advanced in real terms, following six consecutive quarterly declines. The gain amounted to an impressive 9 percent annual rate and reflected increased outlays for both structures and capital equipment. This turnabout follows a protracted and very steep contraction in capital spending and has occurred at about the same time in the current cyclical recovery as in earlier ones (see Chart III).

Nevertheless, there is some doubt whether the fourth-quarter advances in real capital spending will be backed up by subsequent increases in the current year. In particular, the most recent (December) Department of Commerce survey of businesses' planned capital outlays for 1976 points to a modest increase in nominal spending but an outright decline of about 4 percent in real terms. In general, there has been a tendency for surveys of planned capital spending to underestimate the actual increases in the first full year of economic recovery. The Commerce Department's special December survey only dates back to 1970, which means there is no long track record by which to judge its forecasting accuracy. Since its inception, however, this survey has proved to be quite accurate. Still, an outright decline in capital spending at this stage of the current business cycle would indeed be an unusual development. In any event, even if there were a decline in capital spending in 1976, it would probably be too small to undermine the economic recovery, though the recovery would of course be slowed down.

PRICES

Inflationary pressures appeared to let up a bit in the fourth quarter, although the various indicators continued to present a mixed picture that is difficult to interpret. According to the implicit price deflator for GNP, the most comprehensive of the official price indexes, the prices of final goods and services rose at a 6.5 percent annual rate in the fourth quarter, 0.6 percentage point below the advance of the preceding quarter. For the year ended in the fourth quarter, the run-up in the final goods and services prices amounted to 6.4 percent, down from the 11.4 percent increase recorded over 1974. For final goods, the 1975 slowdown in inflation was rather evenly distributed in both consumption and business fixed investment goods. Still, the gap between the rates of inflation for the two classes of goods was rather wide in 1975, as the prices of investment goods rose almost twice as fast as those of consumption goods. While a similar pattern has occurred during past cyclical recoveries, the difference between the growth rates has not been nearly so large. It could be that this unusually large discrepancy in the rates of inflation between consumption and investment goods has contributed in part to the weakness in the outlook for investment spending.

In recent months, the rates of inflation of consumer and wholesale industrial prices have moved in disparate directions. At the retail level, the average level of prices rose at a 6.6 percent annual rate in the fourth quarter, after increasing at an 8.2 percent rate in the earlier three months. On average in the fourth quarter, total consumer prices stood 7.3 percent above a year earlier, high by historical standards but an improvement over the 12.1 percent surge chalked up in 1974. Increases in nonfood commodity prices continued to moderate in the fourth quarter. The advance in retail food prices also slowed down but remained at an unexpectedly rapid rate. At the wholesale level, industrial prices spurted at a 9.2 percent annual rate in the fourth quarter, more than double that of the preceding quarter and the largest quarterly advance of the year. On average in the fourth quarter, industrial wholesale prices were 6 percent above a year earlier in comparison with the 27.3 percent surge recorded over 1974. Most of the fourth-quarter speedup occurred in October and reflected the large price hikes posted for metals and new automobiles. According to recent newspaper accounts, however, it appears that some of these list-price increases may have been trimmed through either discounting or outright price reductions.

LABOR MARKET CONDITIONS

According to the labor market data for recent months, the recovery in economic activity has gained a much firmer footing than it appears to have had late last fall. The number of workers on nonagricultural payrolls spurted by about 360,000 in January, up from the 210,000 advance of the previous month and almost three times as large as the average increment recorded from September to November. The January rise was broadly based, as every major industry grouping except mining increased the size of its work force. At the same time, the average workweek lengthened in both the manufacturing sector and the private nonfarm economy. This is a particularly encouraging development, inasmuch as the average workweek has proved to be a fairly reliable indicator of labor market tightness. According to the separate household survey, employment shot up by 800,000, a huge increase by historical standards. Whereas the gain in employment greatly overshadowed the expansion in the civilian labor force, the overall unemployment rate plummeted by 0.5 percentage point in January to 7.8 percent. This was the largest one-month drop in the jobless rate in sixteen years, but technical problems of seasonal adjustment may have overstated the decline.

The Money and Bond Markets in January

Interest rates continued to fall sharply during the first half of January. The declines were particularly pronounced in short-term rates, with some rates dropping to their lowest levels in more than three years. Forecasts of lower interest rates in the early months of 1976, optimism about the outlook for inflation, and a lower trading range for Federal funds strengthened market demand. At midmonth the rally faltered, amid signs of sustained economic recovery and reemergence of concern over financing the massive Federal deficit. The absence of further declines in the Federal funds rate also prompted a more cautious market tone. In this atmosphere, a reduction in the discount rate by Federal Reserve Banks at midmonth was viewed only as a necessary adjustment to recent declines in other short-term rates and provided only modest support to the market.

Late in the month the Treasury announced its plans for the February refunding operation. Market reaction was favorable, and a substantial amount of new cash was raised. In early February the Treasury sold $9.4 billion of securities to the public to retire $4.3 billion of maturing notes and to raise $5.1 billion in new funds.

Preliminary estimates, which reflect recent revisions, indicate that the narrowly defined money stock (M_1) increased modestly in January after declining in the previous month. At the same time, consumer-type time deposits at commercial banks advanced at a rapid pace and, thus, growth in the more broadly defined money stock (M_2) accelerated sharply. A sizable decrease in the outstanding volume of large negotiable certificates of deposit (CDs) held the bank credit proxy to a small gain.

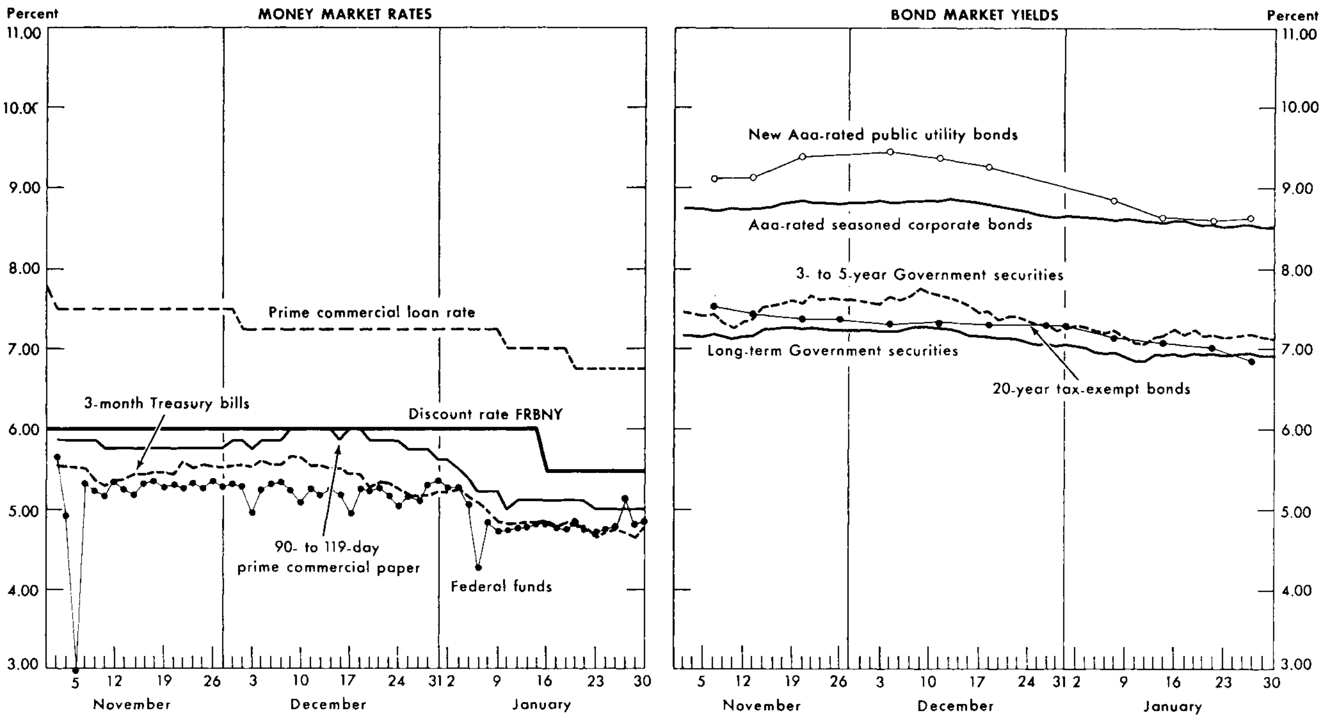
THE MONEY MARKET AND THE MONETARY AGGREGATES

Interest rates on most money market instruments declined sharply during the first half of January, then stabilized at new lower levels (see Chart I). Compared with its average in December, the effective rate on Federal funds fell 33 basis points in January to 4.87 percent, its lowest monthly level since September 1972. Most other short-term interest rates also posted substantial declines. Over the month, the rate on 90- to 119-day dealer-placed commercial paper dropped ⅝ percentage point to 5 percent, while the yield in the secondary market on ninety-day CDs declined about ⅝ percentage point to 5.02 percent. Effective January 19, the Board of Governors of the Federal Reserve System approved a reduction in the discount rate at eleven Federal Reserve Banks, including New York, from 6 percent to 5½ percent, and the remaining Reserve Bank joined in this move on January 22. The action was intended to bring the discount rate into closer alignment with other short-term rates. Even with the discount rate reduction, Federal funds traded at rates generally below the discount rate and the volume of borrowing was modest (see Table I).

Commercial and industrial loans at large commercial banks fell by $3,897 million in the four statement weeks ended January 28. A sharp reduction in bank holdings of bankers' acceptances accounted for part of this decline, however. Loans excluding acceptances showed a decrease of $2,698 million. Over comparable periods in the preceding two years, these loans excluding acceptances were down an average of $3,153 million. Reflecting the easing in other short-term interest rates and the continued sluggish loan demand, most major banks reduced their prime lending rate to 6¾ percent in two ¼ percentage point steps.

In January the Board of Governors announced revision of the money stock and related measures to incorporate data obtained from nonmember banks in the June and September call reports and to revise seasonal adjustment factors. The revisions also reflect adjustments for certain new data relating to cash items in the process of collection, a deduction item in the computation of the demand deposits adjusted series. The "cash items" adjustment affected the money stock measures back to 1966. The major effect of the revisions was to lower slightly the growth of the money stock measures in 1970

Chart I
SELECTED INTEREST RATES
November-January 1976



Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Prime commercial loan rate at most major banks; offering rates (quoted in terms of rate of discount) on 90- to 119-day prime commercial paper quoted by three of the five dealers that report their rates, or the midpoint of the range quoted if no consensus is available; the effective rate on Federal funds (the rate most representative of the transactions executed); closing bid rates (quoted in terms of rate of discount) on newest outstanding three-month Treasury bills.

BOND MARKET YIELDS QUOTED: Yields on new Aaa-rated public utility bonds are based on prices asked by underwriting syndicates, adjusted to make them equivalent to a standard Aaa-rated bond of at least twenty years' maturity; daily averages of yields on seasoned Aaa-rated corporate bonds; daily averages of yields on long-term Government securities (bonds due or callable in ten years or more) and on Government securities due in three to five years, computed on the basis of closing bid prices; Thursday averages of yields on twenty seasoned twenty-year tax-exempt bonds (carrying Moody's ratings of Aaa, Aa, A, and Baa).

Sources: Federal Reserve Bank of New York, Board of Governors of the Federal Reserve System, Moody's Investors Service, Inc., and The Bond Buyer.

and raise slightly the growth in 1972. In addition, changes in the seasonal adjustment factors were larger than usual, particularly for M_1, and resulted in higher levels of the money stock measures for January and lower levels for June. As a consequence, monthly changes in the money stock measures in 1975 are now somewhat smoother than previously estimated. All money stock data in this article reflect these revisions.

According to preliminary data, the monetary aggregates gave a mixed picture in January, with M_1 showing continued weakness and M_2 showing substantial strength. Over the four-week period ended January 28, M_1—private demand deposits adjusted plus currency outside commercial banks—rose 2.6 percent at an annual rate from its average level over the previous four weeks. This brought the growth in M_1 from the four weeks ended thirteen weeks earlier to 3 percent (see Chart II). M_2—M_1 plus time deposits other than large negotiable CDs—on the other hand, benefited from the lower interest rates on money market instruments. Both individual and corporate savers were attracted by the relatively higher rates generally available on small- to medium-size time and savings deposits. As a result, the growth in M_2 accelerated to a 10.4 percent annual rate in the four-week period ended January 28 from its level over the previous four weeks. Over the same period, the adjusted bank credit proxy—total member bank deposits subject to reserve requirements plus certain nondeposit sources of funds—increased

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, JANUARY 1976

In millions of dollars; (+) denotes increase and (—) decrease in excess reserves

Factors	Changes in daily averages— week ended Jan. 7	Jan. 14	Jan. 21	Jan. 28	Net changes
"Market" factors					
Member bank required reserves	— 41	— 395	— 359	+1,084	+ 286
Operating transactions (subtotal)	+ 176	+3,893	— 433	—3,851	— 215
Federal Reserve float	—1,209	— 620	— 443	—	—2,272
Treasury operations*	+ 854	+2,545	— 633	—4,256	—1,490
Gold and foreign account	+ 15	— 60	+ 34	+ 74	+ 63
Currency outside banks	+ 392	+1,854	+ 679	+ 319	+3,244
Other Federal Reserve liabilities and capital	+ 124	+ 174	— 71	+ 12	+ 239
Total "market" factors	+ 132	+3,498	— 792	—2,767	+ 71
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	— 257	3,515	+ 773	+2,551	— 448
Outright holdings:					
Treasury securities	— 516	—1,522	+ 62	+ 238	—1,738
Bankers' acceptances	—	+ 1	— 6	+ 14	+ 9
Federal agency obligations		—	+ 68	+ 172	+ 240
Repurchase agreements:					
Treasury securities	+ 184	—1,553	+ 620	+1,727	+ 978
Bankers' acceptances	+ 60	— 305	+ 14	+ 202	— 29
Federal agency obligations	+ 15	— 136	+ 15	+ 198	+ 92
Member bank borrowings	— 186	— 27	+ 108	— 94	— 199
Seasonal borrowings†	— 2	— 1	—	— 1	— 4
Other Federal Reserve assets‡	+ 35	— 87	— 41	+ 249	+ 156
Total	— 408	—3,629	+ 840	+2,706	— 491
Excess reserves‡§	— 276	— 131	+ 48	— 61	— 420

	Daily average levels				Monthly averages‖
Member bank:					
Total reserves, including vault cash‡§	35,531	35,813	36,220	35,075	35,660
Required reserves	35,232	35,627	35,986	34,902	35,437
Excess reserves§	299	186	234	173	223
Total borrowings	71	44	152	58	81
Seasonal borrowings†	10	9	9	8	9
Nonborrowed reserves	35,460	35,769	36,068	35,017	35,579
Net carry-over, excess or deficit (—)¶	208	127	66	42	111

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† Included in total member bank borrowings.
‡ Includes assets denominated in foreign currencies.
§ Adjusted to include waivers of penalties for reserve deficiencies in accordance with the Regulation D change effective November 19, 1975.
‖ Average for four weeks ended January 28, 1976.
¶ Not reflected in data above.

at only a 1.3 percent rate, as CDs registered a substantial decline when banks allowed rates to drop in view of continued weak loan demand.

In mid-January, the Federal Reserve adopted a new long-term target range for M_1 growth, left the ranges for the broader monetary aggregates unchanged, and advanced by one quarter the yearly period over which the ranges apply. The M_1 range for the period from the fourth quarter of 1975 to the fourth quarter of 1976 was widened to 4½-7½ percent from the previous 5-7½ percent range for the period from the third quarter of 1974 to the third quarter of 1975. The change was prompted by the recent transfer of an estimated $2 billion of corporate funds from checking to savings accounts at commercial banks. These transfers followed the November change of banking regulations allowing partnerships and corporations to hold commercial savings accounts of up to $150,000.

THE GOVERNMENT SECURITIES MARKET

Interest rates on United States Treasury bills continued their recent sharp declines and ended January substantially lower on balance. The declines followed general reductions of other money market rates and continued despite sizable additions to outstanding bills through increases in the regular weekly auctions. Yields on coupon issues, however, reversed course before midmonth, partly retracing early-January declines. Market participants became wary that the rally might have been overdone, especially in view of renewed evidence that economic recovery was well under way and of the continued heavy borrowing needs anticipated by the Treasury. Competition from the enlarged corporate calendar and the normal hesitancy that precedes a refunding announcement may also have been factors.

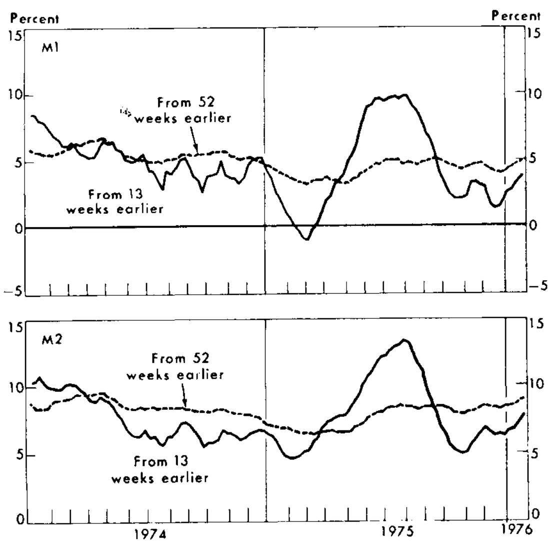
Prices of Treasury coupon issues rose early in January in line with the general improvement in the tone of the money and bond markets. However, the market accorded an unenthusiastic reception to $4.5 billion of Treasury notes during the second week of the month. In that financing, $2 billion of 64-month notes and $2.5 billion of 24-month notes were auctioned to replace $1.6 billion of maturing issues and to raise $2.9 billion of new cash. The average yields on the notes were 7.40 percent and 6.49 percent, respectively. Dealers made slow progress distributing the new notes, and with the February refunding on the horizon coupon prices moved downward.

On January 27 the Treasury announced its expected borrowing needs for the first half of 1976 and its offerings for the February refunding operation. The Treasury expects to borrow $35 billion to $40 billion in the market during the first six months of 1976, with $8.6 billion of this new cash having been raised in January. In its February refunding package, the Treasury made a larger than expected start on the balance of these funds by selling $9.4 billion of securities to retire $4.3 billion of publicly held notes maturing February 15 and to raise $5.1 billion in new cash. In auctions on February 5, the Treasury sold $3 billion of three-year notes at a 7.05 percent yield and $400 million of additional 8¼ percent 29-year 3-month bonds at an 8.09 percent return. In addition, the Treasury announced that it would accept subscriptions for at least $3.5 billion of seven-year notes with 8 percent coupons to be issued at par. The subscription technique, which had not been used in the past six years, caught the market by surprise. The response to it was favorable, however, since the coupon rate was set at an attractive level. Subscriptions were accepted through February 3. The issue turned out to be heavily oversubscribed, with requests totaling $29.2 billion. The Treasury originally announced that all orders up to $500,000 would be fully allotted. Because of the overwhelming response to the issue, orders of only $200,000 were actually met in full and subscriptions over that amount were also allotted $200,000. Even this restrictive approach to subscriptions resulted in an enlargement of the issue to $6 billion in sales to the public.

Chart II

GROWTH OF SELECTED MONEY STOCK MEASURES

Seasonally adjusted annual rates



Note: Growth rates are computed on the basis of four-week averages of daily figures for periods ended in the statement week plotted, 13 weeks earlier and 52 weeks earlier. The latest statement week plotted is January 28, 1976.

M1 = Currency plus adjusted demand deposits held by the public.

M2 = M1 plus commercial bank savings and time deposits held by the public, less negotiable certificates of deposit issued in denominations of $100,000 or more.

Source: Board of Governors of the Federal Reserve System.

Following the Treasury's announcement, prices on outstanding coupon issues changed little, as most participants felt that the financing package was manageable. Over the month, the index of intermediate-term Government securities declined by 14 basis points to 7.14 percent while the index of long-term bond yields fell 13 basis points to 6.92 percent.

Treasury bill rates continued their sharp declines in January, buoyed by easier conditions in the Federal funds market. At the regular weekly bill auctions, rates on new three-month bills dropped almost steadily over the month (see Table II). On January 26, the average issuing rate was 4.76 percent, about 45 basis points below the rate set at the final auction in December and the lowest such rate since the auction of November 6, 1972. One-year bills were auctioned on January 7 at 5.58 percent, down 86 basis points from the yield at the December 10 auction. Rates on most issues ended the month 40 to 50 basis points below levels at the end of December.

In January, yields on Federal agency securities moved in a similar manner to those in the coupon market. A combined total of $1.42 billion of Federal Land Bank bonds was sold during the early part of the month and encountered an excellent reception. The offering consisted of $400 million of 6.60 percent 21-month bonds, $600 million of 7.35 percent 51-month bonds, and $420 million of 7.85 percent twelve-year bonds. These issues raised $347 million in new cash. Another series of agency bonds, involving $1,561 million of farm credit issues, was also sold during the month and raised $100 million in new cash. Investor response to these bonds was somewhat more modest. The issues were $399 million of 5.35 percent six-month Banks for Cooperatives (BC) bonds, $962 million of 5.65 percent nine-month Federal Intermediate Credit Bank bonds, and $200 million of 7.75 percent nine-year eleven-month BC bonds. On January 15, $126.1 million of 7.25 percent Government National Mortgage Association mortgage-backed bonds due in thirty years was priced to yield 8.22 percent on a corporate bond equivalent basis. This offering was immediately sold and traded at a small premium. Finally, on January 22 the Federal National Mortgage Association raised $300 million of new cash during the month through ten-year capital debentures yielding 8.15 percent.

OTHER SECURITIES MARKETS

The corporate bond market continued to rally during the first half of January. Low inventories, a slack forward calendar, and forecasts of lower interest rates in 1976 contributed to the optimistic atmosphere. However, by midmonth, the calendar of scheduled offerings had enlarged, massive Treasury borrowing loomed ahead, and sizable unsold balances of certain aggressively priced issues remained in dealer hands. Consequently, price gains halted, as market participants concentrated on the distribution of large new offerings.

A number of highly rated corporate issues came to market in January at yields appreciably below those available on similar issues in December. Three utilities sold thirty-year first-mortgage bonds, with yields of 8.50 percent on a $55 million Aa-rated issue, 8.83 percent on a $60 million Aa-rated issue, and 8.60 percent on a $100 million Aaa-rated issue. These yields were about 85 to 100 basis points below those on comparably rated securities offered during the previous month. In another major offering, $200 million of 25-year credit corporation debentures rated Aaa by Moody's and AA by Standard & Poor's was sold at a yield of 8.80 percent, about 100 basis points below a similar issue offered in December.

In the municipal market, yields on high quality issues also moved sharply lower over the month. Underwriters, however, continued to be wary of tax-exempt bond issues in view of the Federal legislation, passed the previous June, that holds them responsible for disclosure of information on the issuer. Hence, many state and local governments found it necessary to expand the data available on their financial condition before new issues could be floated. Over the month as a whole, The Bond Buyer index of twenty bond yields on twenty-year tax-exempt bonds fell 44 basis points to 6.85 percent. About a third of the decline, however, reflected a change in the composition of the index.

Prices on New York State-related tax-exempt bonds remained stable during the month in spite of the refinancing problems of certain agencies of New York State and Massachusetts and the suspension of Moody's rating of three New York State agencies. In New York, four agencies needed to raise $128 million by midmonth, mainly to refund maturing issues. However, several New York banks (on a rollover basis) and two state insurance reserve funds agreed to supply the necessary funds. The difficulties of one Massachusetts agency were overcome when the state purchased $60 million of notes that the Housing Finance Agency had been unable to market publicly. A possible solution to the financial problems of New York State agencies in the months to come was proposed during January, as state pension funds may consider buying "moral obligation" bonds of certain state agencies, contingent upon passage of a state constitutional amendment prohibiting further moral obligation borrowing and agreement by the private sector to underwrite the state's short-term borrowing in the spring.

Table II

AVERAGE ISSUING RATES AT REGULAR TREASURY BILL AUCTIONS*

In percent

Maturity	Weekly auction dates—January 1976			
	Jan. 5	Jan. 12	Jan. 19	Jan. 26
Three-month	5.226	4.826	4.783	4.763
Six-month	5.521	5.066	5.046	5.052
	Monthly auction dates—November 1975-January 1976			
	Nov. 13	Dec. 10	Jan. 7	
Fifty-two weeks	6.010	6.439	5.578	

*Interest rates on bills are quoted in terms of a 360-day year, with the discounts from par as the return on the face amount of the bills payable at maturity. Bond yield equivalents, related to the amount actually invested, would be slightly higher.

Trading in Bankers' Acceptances: A View from the Acceptance Desk of the Federal Reserve Bank of New York

By RALPH T. HELFRICH*

The Acceptance Trading Desk at the Federal Reserve Bank of New York is a focal point, not only for System open market operations and foreign investment account activity in bankers' acceptances, but also for banks, dealers, students, and others seeking information about the acceptance area. As the volume of bankers' acceptances outstanding has increased substantially in recent years, the Acceptance Desk has been requested to provide information not readily available elsewhere. Although there is no lack of literature on the bankers' acceptance method of financing or its advantages as a money market instrument, there is a scarcity of printed information about the techniques and procedures followed by the Federal Reserve in its activities in the bankers' acceptance market. To answer some of the more frequent questions asked by the public, this article aims, in addition to providing general information on the acceptance market, to assemble and to put into an easily available form the standards and guidelines used in the daily operations of the Acceptance Desk.

DRAMATIC GROWTH IN OUTSTANDING ACCEPTANCES

Bankers' acceptances are primarily negotiable time drafts drawn to finance the export, import, shipment, or storage of goods, and they are termed "accepted" when a bank assumes the obligation to make payment at maturity. The first significant use of dollar-denominated bankers' acceptances in the United States occurred after the passage of the Federal Reserve Act of 1913. By the late 1920's the volume of acceptances outstanding was over $1.7 billion. During the depression and World War II, acceptances financing international trade declined sharply. There has been, however, a considerable increase in the volume of acceptances outstanding in the United States since World War II. In May 1945 acceptances outstanding totaled $104 million, and by the end of 1973 the total was $8.9 billion (see Table I). During 1974 the amount of acceptances outstanding more than doubled, rising by $9.6 billion to $18.5 billion; a record level of $18.7 billion was registered in March 1975. A substantial portion of the dramatic increase during 1974, and of the postwar growth as well, was related to the use of acceptance financing by Japan to sustain its international trade. As a result of this growth, the acceptance as a short-term credit instrument has gained significance in the money market. Purchases of acceptances by the Federal Reserve provide a supplementary method of conducting open market operations.

Finance bills, also known as working capital acceptances, are not included in the data showing total dollar acceptances outstanding (see Table I). Developed in the late 1960's, these bills are not related to specific trade transactions but are accepted by some banks as a vehicle for extending short-term credit, presumably to provide working capital to the drawer of the draft. In mid-1973, a record $1.5 billion of outstanding finance bills was reported but the imposition of reserve requirements by the Federal Reserve at that point on funds raised through the use of such acceptances prompted a contraction of the market. Finance bills cannot presently be discounted or purchased by the Federal Reserve.

* Ralph T. Helfrich is chief of the Acceptance Division in Open Market Operations and Treasury Issues. The author wishes to acknowledge gratefully the contribution to this work made by his colleagues at the Federal Reserve Bank of New York: Lawrence B. Aiken, Robert L. Cooper, Edward J. Ozog, and Peter D. Sternlight.

Table I

DOLLAR ACCEPTANCES OUTSTANDING*

In millions of dollars

Year-end	Amount
1929	1,732
1939	233
1945	154
1950	394
1955	642
1960	2,027
1965	3.392
1967	4,317
1969	5,451
1970	7,058
1971	7,889
1972	6.898
1973	8,892
1974	18,484
1975	18,727

* Includes acceptances held by Federal Reserve Banks, commercial banks, and others and excludes finance bills, also known as working capital acceptances.

ACCEPTANCE DESK OPERATIONS

Operations at the Federal Reserve's Acceptance Desk consist of two major activities: first, operations undertaken for the System under the direction of the Federal Open Market Committee (FOMC) and, second, operations to invest funds for foreign accounts maintained at the Federal Reserve Bank of New York. Acceptance transactions related to the implementation of monetary policy are an integral part of Federal Reserve open market operations in the securities market. To supply bank reserves, the Federal Reserve purchases United States Treasury obligations, Federal agency securities, and bankers' acceptances either outright to provide a permanent base for monetary growth or under repurchase agreement when there is only a temporary need for reserves. Federal Reserve open market operations are conducted by the Federal Reserve Bank of New York on behalf of the entire Federal Reserve System. As will be discussed at some length, the Desk purchases in the market for System or foreign accounts only prime bankers' acceptances from established dealer firms.

OUTRIGHT PURCHASES. Acceptances are normally purchased each day for the Federal Reserve's own portfolio of outright holdings, which totaled about $725 million in December 1975. Since acceptances are short-term instruments, daily maturities of acceptances from the Federal Reserve's holdings are sizable and the portfolio must be continually replenished to provide its share of a steady base for bank reserves. If there is no reason to affect bank reserves, the Desk replaces the maturities which are scheduled to occur during a bank reserve-accounting week by purchasing approximately equal amounts each trading day during the same reserve period. In each reserve-accounting period, however, the Desk may elect to purchase more or less than its portfolio replacement needs either to supply or to absorb bank reserves in accord with monetary policy objectives. Dealers with which the Desk is authorized to transact business are usually contacted by telephone between 10 and 10:30 each morning and told the approximate amount of purchases the Desk will make. Dealers soon respond with offerings by rate, and under normal circumstances purchases are completed within an hour. Purchases are always awarded on a best rate basis, and most purchases are delivered and paid for on the day of the transaction.

The Desk does not usually ask dealers to specify in advance the names of the banks that created the acceptances the dealer is offering, since the Desk does not attempt to distinguish gradations of quality among the prime bank paper it finds acceptable for purchase. Nevertheless, the market has assigned slightly different values to the money market instruments of different classes of banks. Therefore, to avoid acquiring undue amounts of paper that the market considers to be less attractive to hold, the Desk instructs dealers to offer and to deliver to the Federal Reserve's own account a reasonable mixture of acceptances created by large money center banks, regional banks, and foreign banks.

The Federal Reserve avoids acquiring an unduly large percentage of any bank's total outstanding acceptances by setting limitations on the amount of any individual bank's acceptances which it will buy. If dealers' deliveries of any bank name cause the Federal Reserve's holdings of that name to exceed a reasonable percentage of that bank's outstanding acceptances, the Acceptance Desk will temporarily refuse to accept that name until the holdings are reduced below the acceptable percentage. When a bank learns that the Federal Reserve has stopped buying its acceptances from the dealers, it sometimes inquires as to the reason. Ordinarily, there is no significance to the Federal Reserve's action other than that its holdings of a certain bank's acceptances have grown out of proportion to that bank's activity in the market. There need be no implications regarding the credit standing of the accepting bank involved. It is a temporary situation that will end when the Federal Reserve's holdings are reduced through maturities, normally within a month or so.

REPURCHASE AGREEMENTS. Federal Reserve operations to purchase bankers' acceptances under repurchase agreements serve as an important method of supplying bank reserves for a short time, usually one to seven days. As a rule, dealers maintain fairly sizable inventories of acceptances. These inventories provide opportunities for the Federal Reserve to acquire acceptances under repurchase agreements designed to achieve the money market conditions desired by the monetary authorities. When the Federal Reserve observes a temporary shortage of bank reserves, dealers are contacted by the Desk and informed of the number of days for which the Desk will offer to provide funds under repurchase agreements. Dealers subsequently offer to sell to the Desk an amount of acceptances at specific rates. The Desk has an amount of bank reserves it wishes to supply and, in effect, auctions this amount to dealers at the highest rates. Dealers deliver to the Desk acceptances which have a market value somewhat greater than the dollar amount the Desk pays to dealers, thus providing a margin of excess "collateral". Dealers may terminate a repurchase agreement before maturity, in whole or in part. The repurchase operation at the Acceptance Desk is conducted as a joint operation with the Securities Trading Desk at the Federal Reserve and, consequently, both acceptance dealers and Government securities dealers compete for the amount of funds the Federal Reserve is providing on any given day.

PURCHASES FOR CUSTOMER ACCOUNTS. In recent years many foreign correspondents of the Federal Reserve Bank of New York, mainly other central banks, have found bankers' acceptances an attractive means of employing a portion of their dollar balances maintained in investment accounts at the Federal Reserve. When acting for its customers, the Acceptance Desk usually contacts each dealer at the time that it seeks offerings for the System Open Market Account. Purchases for customer accounts are confined to acceptances created by banks specified by the customer and to maturity ranges specified by the customer. Within these limits, purchases are decided on a best rate basis.

Prior to November 8, 1974, the Federal Reserve guaranteed the acceptances it purchased for its foreign correspondents. The policy of guaranteeing acceptances held by foreign correspondents was developed in the process of working out reciprocal correspondent relationships with other central banks during the early years of the Federal Reserve System. Such guarantees were at that time considered useful in encouraging the development of the bankers' acceptance market. In part, due to the favorable rate spread between acceptances and Treasury bills, foreign correspondent holdings of bankers' acceptances guaranteed by the Federal Reserve increased rapidly during 1974 to a level of about \$2 billion. Against this background, officials of the Federal Reserve concluded that there was no longer justification for extending a guarantee favoring a particular private market instrument or a particular group of investors. Customer holdings receded to around \$300 million in 1975.

AUTHORITY FOR OPERATIONS

Acceptance Desk operations for the Federal Reserve System are governed by directives from the FOMC. The Committee's authorization for domestic open market operations in acceptances stems ultimately from the Federal Reserve Act, Section 12A, Section 13, paragraphs 6, 7, and 12, and Section 14, paragraph 1.

At one time, System operations in acceptances were governed by Regulations B and C of the Board of Governors of the Federal Reserve System, but these were revoked effective April 1, 1974 in order to realign and modernize the rules relating to open market operations. This action recognized that responsibility for open market operations in acceptances rests with the FOMC rather than with the Board of Governors. The FOMC issued new rules which broadened the scope of acceptances eligible for purchase by the Federal Reserve, but Regulation A, as well as the sections of the Federal Reserve Act that define those acceptances eligible for discount at the Federal Reserve, was not changed. As a result, many questions arose concerning the frequently misunderstood term "eligibility". Prior to the revocation of Regulations B and C, Federal Reserve Banks were, subject to certain minor exceptions, permitted to purchase under Section 14 of the act only bankers' acceptances discountable under Section 13, and consequently reference to eligibility could be made with less ambiguity. At present, use of the word eligibility without further clarification is ambiguous since some acceptances eligible for purchase are not eligible for discount and some acceptances eligible for discount are not eligible for purchase (see Table II).

"The new rules issued by the FOMC authorize the Federal Reserve Bank of New York to buy (outright or under repurchase agreement) and sell 'prime' bankers' acceptances—with maturities of up to nine months at the

Table II

PRIME BANKERS' ACCEPTANCES ELIGIBILITY AND RESERVABILITY

Type of bankers' acceptance	Eligible for		Reserves required‡
	Purchase*	Discount†	
Export-import, including shipments between foreign countries:			
Tenor—6 months or less	Yes	Yes§	No
6 months to 9 months	Yes	No	Yes
Domestic shipment, with documents conveying title attached at the time of acceptance:			
Tenor—6 months or less	Yes	Yes§	No
6 months to 9 months	Yes	No	Yes
Domestic shipment, without documents conveying title:			
Tenor—6 months or less	Yes	No	Yes
6 months to 9 months	Yes	No	Yes
Shipment within foreign countries:			
Tenor—any maturity	No	No	Yes
Foreign storage, readily marketable staples secured by warehouse receipt:			
Tenor—6 months or less	No	Yes§	No
6 months to 9 months	No	No	Yes
Domestic storage, readily marketable staples secured by warehouse receipt:			
Tenor—6 months or less	Yes	Yes§	No
6 months to 9 months	Yes	No	Yes
Domestic storage, any goods in the United States under contract of sale or going into channels of trade and secured throughout its life by warehouse receipt:			
Tenor—6 months or less	Yes	No	Yes
6 months to 9 months	Yes	No	Yes
Dollar exchange, required by usages of trade, only in approved countries:			
Tenor—3 months or less	No	Yes	No
3 months to 9 months	No	No	Yes
Finance or working capital, not related to any specific transaction:			
Tenor—any maturity	No	No	Yes

Note: Tenor refers to the full length of time of the acceptance from date of inception to maturity.

* Authorizations announced by the Federal Open Market Committee on April 1, 1974.

† In accordance with Regulation A of the Federal Reserve Act.

‡ In accordance with Regulation D of the Federal Reserve Act.

§ Providing that the maturity of nonagricultural bills at the time of discount is not more than ninety days.

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 are secured throughout their life by a warehouse receipt or similar document conveying title to the underlying goods."[1]

[1] Quoted from Federal Reserve Bank of New York Circular 7366 dated March 27, 1974.

ELIGIBILITY

As mentioned, prior to April 1, 1974, the Federal Reserve's eligibility requirements for the discount or outright purchase of bankers' acceptances were almost synonymous, but since that date it has become very important for those who work with acceptances to know for what an acceptance is eligible. Bankers' acceptances acquired by the Federal Reserve through the discount of such paper or through open market operations are methods of supplying bank reserves. However, as a matter of practice, the Federal Reserve Banks for many years have not discounted paper for member banks. Rather, Federal Reserve Banks will advance funds to member banks if secured by obligations or other paper eligible under the Federal Reserve Act for discount or purchase by Reserve Banks. The principal remaining significance of eligibility for discount, from the Federal Reserve's standpoint, is that bankers' acceptances described in Section 13 of the Federal Reserve Act and eligible for discount are not subject to reserve requirements; i.e., a bank which is a member of the Federal Reserve System and which creates a bankers' acceptance that is sold in the market and that is not described in Section 13 or not eligible for discount must maintain reserves against such an acceptance. While an acceptance may not be eligible for discount, it may be eligible for purchase by the Federal Reserve Bank of New York for its open market operations and, if so, it would also be eligible to secure an advance from the Federal Reserve to a member bank, i.e., secure "borrowing from the discount window".

The FOMC's authorizations, announced on April 1, 1974, changed the type of acceptance the Federal Reserve could purchase, as follows:

(1) Maturities at time of acceptance of more than six months and up to nine months, providing they meet other requirements, are eligible for purchase *but not eligible for discount.*

(2) Domestic shipment acceptances without attached documents conveying title at the time of acceptance are eligible for purchase *but not eligible for discount.* To be discountable, the shipping documents securing title must be in the possession of the bank or its agent at the time of acceptance.

(3) Foreign storage acceptances are not eligible for purchase *but are eligible for discount,* provided the goods are readily marketable staples, are stored in an independent warehouse, and are secured at the time of acceptance by a receipt or other documents conveying title.

(4) Acceptances financing the domestic storage of goods (any goods, not necessarily readily marketable staples) that are 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 documents conveying title to the underlying goods are eligible for purchase *but are not eligible for discount.* To be discountable, the goods must be readily marketable staples and stored in an independent warehouse or subject to governmental control and must be secured at the time of acceptance by a receipt or other document conveying title.

(5) Dollar exchange acceptances are not eligible for purchase *but continue to be eligible for discount.*

As can be seen, therefore, the new rules have separated acceptances, in some instances, into those eligible for purchase and those eligible for discount. Table II defines "eligibility" and "reservability" for various classifications of acceptances.

When dealers make deliveries of the acceptances sold to the Federal Reserve, the Acceptance Division's clerical staff verifies each acceptance for eligibility, acceptability, and negotiability. The following lists some of the most common faults that *disqualify* an acceptance for purchase by the Federal Reserve even though the acceptance may meet the broad tests of eligibilty described in Table II.

(1) The face of the draft does not specify the details of the underlying transaction; this information is usually presented in a standard "eligibility" stamp.

(2) Incomplete description of underlying transaction. *Example:* "Merchandise—various; from —various countries to Japan." If a broad category must be used, it should be supported on the back of the draft or on an attachment giving the details of the commodities, the countries of origin and destination, and the amount of each such transaction.

(3) Draft drawn to finance only freight charges or service charges such as interest, customs, insurance.

(4) Changes in the terms of the draft or the tenor is incomplete or questionable.

(5) A draft drawn subject to a bill of lading date is not acceptable, i.e., the Federal Reserve will not purchase an acceptance on which the due date is described as a stated number of days from the date of the bill of lading issued in connection with the shipment of goods underlying the draft. At this writing, our interpretation is that there may be a legal infirmity to the practice of specifying the tenor of an acceptance in this way. The Federal Reserve prefers to see specific language such as "accepted to mature on . . . ."

(6) Authorized signatures missing, e.g., drawer, acceptor, endorser.

(7) Restrictive foreign endorsement or drafts drawn without recourse. *Example:* The endorsement "Pay any Bank, Banker, or Trust Co." does not under the Uniform Commercial Code impair negotiability among banks and special endorsees of banks, but this result may not follow under foreign laws.

(8) Words and figures on drafts do not agree, or any change casting doubt on the amount, such as "with collection charges" or "with interest".

(9) Drafts payable in a nonreserve city are not acceptable as a matter of policy.

Also, it should be noted that since July 11, 1974, when the dealer endorsement requirement was discontinued, the Federal Reserve buys two-name paper—i.e., the drawer and a nonaffiliated acceptor—for its own and its customer accounts.

MARKET PARTICIPANTS

The market for bankers' acceptances is an over-the-counter market made by perhaps ten to fifteen dealer firms, some with nationwide branches. Most of these firms deal in a variety of marketable obligations, with the acceptance trading constituting one part—in some cases a relatively modest part—of their overall activities. The major dealers in bankers' acceptances are located in New York City, a natural outgrowth of the close relationship between acceptance financing and foreign trade as well as between acceptances and the international departments of larger banks. Participants in the market, in addition to dealers, are the accepting banks both domestic and foreign, Edge Act corporations, other investors of all types ranging from individuals to foreign central banks, and the Federal Reserve System.

The acceptance market, until the latter part of 1969, differed from some other short-term markets in that it featured posted rates by dealers. The major dealers in acceptances quoted bid and asked rates for specified maturities and stood ready to buy or sell prime acceptances at their posted rates. Inasmuch as these acceptance rates changed rather infrequently prior to 1969, the relative stability provided the investor a certain measure of protection against market risks. As the market for bankers' acceptances became more volatile, the practice of posting rates was altered and, although some dealers continued to post bid and asked rates for informational purposes, it has become generally understood that trading is done on a negotiated basis.

Movements in acceptance rates are closely aligned with other short-term money market instruments and are also influenced by the size of dealers' portfolios. The difference in rate between what the dealer pays for acceptances and what he sells them for, as well as the spread on the cost of financing his position, largely determines his profit. The normal dealer spread between buying and selling rates is ⅛ to ¼ percent, but it can be 1 percent or higher in a sharply fluctuating market. Despite the relatively costly paper work involved with each acceptance transaction, i.e., the verification of each bill to assure negotiability and eligibility, some large volume dealers manage on somewhat smaller spreads, providing the cost of financing their holdings is favorable. Accepting banks utilize dealer quotations in establishing a discount basis for customer acceptance financing, usually adding an acceptance fee to the dealer bid rate.

DEALER TRADING RELATIONSHIP WITH THE FEDERAL RESERVE

A dealer firm trading in bankers' acceptances and desiring to establish a trading relationship with the Federal Reserve must meet certain financial, managerial, and operational criteria. Before the Federal Reserve trades with a dealer firm, the officers responsible for open market operations ask the following types of questions:

(1) Is the firm actively engaged on a daily basis in trading bankers' acceptances?
(2) Is the firm's trading activity of sufficient volume and diversification to satisfy the Federal Reserve's requirements that the dealer be a significant market participant?
(3) Does the firm maintain a portfolio of satisfactory size, particularly relative to the other firms with which the Desk transacts business?
(4) Is the firm reputable and financially sound?
(5) Will the Federal Reserve's open market operations benefit from recognition of the dealer, i.e., from the firm's ability to make markets and its ability to contribute to the development of a broader market?
(6) Is the management and staff competent?

If these questions can be answered affirmatively, with appropriate documentation, then the dealer firm can expect the Federal Reserve to establish a trading relationship with it.

ESTABLISHMENT OF BANK NAME AS PRIME

To qualify its acceptances for purchase by the Federal Reserve, a bank must establish its name in the market and its acceptances must be considered "prime". A bank may market its acceptances in any manner it chooses, but it is when sales are made to dealers reporting to the Acceptance Department on a daily basis that a bank's sales become known to the Federal Reserve. When a bank's acceptances move in the dealer market, the Federal Reserve can more easily reach a judgment regarding the marketability of the paper and whether it is considered prime by the dealers. The volume and frequency of market transactions is also a factor which the Federal Reserve considers before it decides to add a bank's name to the "acceptable" list that can be purchased in the open market. The financial condition and reputation of the bank is, of course, an important ingredient in whether a bank's acceptances are considered prime.

A bank seeking to have its acceptances qualify for purchase by the Federal Reserve Bank also has to meet certain other standard criteria in the form of documentation. The requirements are somewhat different for agencies or branches of foreign banks and for nonmember commercial banks than for Edge Act corporations and member banks of the Federal Reserve System.

Member banks of the Federal Reserve System and Edge Act corporations governed by Federal Reserve Regulation K have only to submit a list of authorized signatures, in addition to the requirement that the bank's acceptances trade as prime in the market. When a bank indicates to the Acceptance Department that it seeks to have its acceptances qualify for purchase by the Federal Reserve, a review of the bank's most recent examination by the Federal bank examiners is obtained from the Reserve District in which the bank is located.

The documents to be lodged by branches or agencies of foreign banks with the Federal Reserve Bank are:

(1) Certificate of resolution (in the form required by the Federal Reserve Bank of New York) of the board of directors of the foreign bank.

(2) Certification (in the form required by the Federal Reserve Bank of New York) by the principal officer or representatives of the agency or branch of the names, titles, and specimen signatures of persons authorized to sign acceptances.
(3) Certified copy of license to do business issued by the state in which the office is located.
(4) Copy of the letter to the State Banking Department requesting and authorizing the department to furnish the Federal Reserve Bank with copies of all reports of examinations of the foreign agency or branch.
(5) Opinion of the United States counsel to the foreign bank as to the authority of such bank to accept bills of exchange drawn upon it.
(6) Letter of transmittal from the foreign branch or agency addressed to the Federal Reserve Bank, accompanying the foregoing documents and containing a written undertaking by the agency or branch that it will inform the Federal Reserve Bank, at its request, of the details of any transactions underlying the acceptances.
(7) Whenever the principal officer or representative is to be succeeded, certification (in the form required by the Federal Reserve Bank of New York) by the principal officer or representative of the status and signature of his successor.
(8) Such financial statements as the Federal Reserve Bank may require.

It is recommended that the United States counsel to the foreign bank be consulted in connection with its preparation of the foregoing documents and that in the course of such preparation the counsel contact the Legal Department of the Federal Reserve Bank of New York.

A nonmember commercial bank seeking to qualify its acceptances for possible purchase by the Federal Reserve is required to supply similar information as follows:

(1) Opinion of counsel to the bank that (a) under its charter and the laws of the state in which it is located the bank is empowered to accept for payment at a future date bills of exchange drawn upon it and (b) the officers of the bank have been authorized by its directors to accept such bills.
(2) Certified copy of the most recent statement of condition of the bank.
(3) Most recent report of examination of the bank by the appropriate supervisory agency of the state.
(4) Copy of the letter from the bank to the State Banking Agency, authorizing and requesting the agency to furnish the Federal Reserve with copies of all examinations of the bank made by the agency.
(5) Letter of transmittal from the bank to the Federal Reserve Bank accompanying the foregoing and containing a written statement that the bank will inform the Federal Reserve, at its request, concerning the details of the transactions underlying its acceptances.

It should be emphasized that the policy of the Federal Reserve is to purchase in the open market only acceptances already established as prime acceptances; the lodging of the documents enumerated above with the Acceptance Department would not in and of itself mean that the acceptances of the Bank would be purchased immediately by the Federal Reserve. The documents merely put the Federal Reserve in a position to purchase the acceptances when such purchases are consistent with Federal Reserve policy objectives, or when Federal Reserve customer accounts request that such purchases be made.