# *83rd Annual Report 1996*

*Board of Governors of the Federal Reserve System*

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# *Letter of Transmittal*

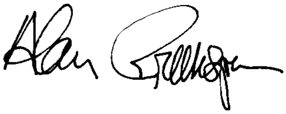
BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
Washington, D.C., May 28, 1997

THE SPEAKER OF
THE HOUSE OF REPRESENTATIVES

Pursuant to the requirements of section 10 of the Federal Reserve Act, I am pleased to submit the eighty-third annual report of the Board of Governors of the Federal Reserve System.

This report covers operations of the Board during calendar year 1996.

Sincerely,



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# *Part 1*

# *Monetary Policy and the U.S. Economy in 1996*

# *Overview*

The economy performed impressively in 1996. Solid advances in the real expenditures of households and businesses led to sizable gains in output. Employment rose briskly, and the unemployment rate edged down to its lowest level of the current expansion. Consumer price inflation increased because of the probably temporary effects of firmness in food and energy markets, but some broader price measures showed inflation holding steady or even declining. With the economy strengthening, intermediate- and long-term interest rates rose on net, but credit continued to be amply available to businesses and most households, and equity prices soared.

Several factors helped to restrain price increases in the face of high levels of resource utilization. Workers' concerns about job security helped limit, to some degree, the acceleration of wages, and further success in controlling health care costs helped to temper the rise in benefits. Moreover, significant declines in the prices of U.S. imports, resulting from low inflation abroad and appreciation of the dollar on foreign exchange markets, tended to hold down domestic prices. Damped inflation expectations probably contributed as well to the favorable price performance: A lengthening run of years during which inflation has been in a more moderate range, together with an understanding of the Federal Reserve's commitment to maintaining progress toward price stability, may have discouraged aggressive pricing behavior. Business firms continued to rely on cost control and gains in productivity, rather than on price increases, as the primary channels for achieving profit growth.

Still, the Federal Open Market Committee (FOMC) recognized the danger that pressures emanating from the tight labor market might trigger an acceleration of prices, which could eventually undermine the ongoing economic expansion. Consequently, although conditions were not deemed to warrant immediate policy action, the Committee's policy directives starting in mid-1996 reflected a perception that the most likely direction of any policy action would be toward greater restraint in the provision of reserves to the banking system. Forestalling a disruptive buildup of inflationary pressures in the near term and moving toward price stability over time remained central to the System's mission of promoting maximum sustainable growth of employment and production.

## The Evolution of Policy in 1996

The FOMC eased the stance of monetary policy twice around the beginning of the year—in December 1995 and in January—lowering the federal funds rate ½ percentage point in total, to 5¼ percent. These actions were taken to offset the effect on the level of the real federal funds rate of declines in inflation and inflation expectations in the second half of 1995 and thereby to help ensure the resumption of moderate economic

NOTE. The discussion here and in the next three chapters is adapted from *Monetary Policy Report to the Congress Pursuant to the Full Employment and Balanced Growth Act of 1978* (Board of Governors, February 1997). Data cited here and in the next four chapters are those available as of mid-March 1997.

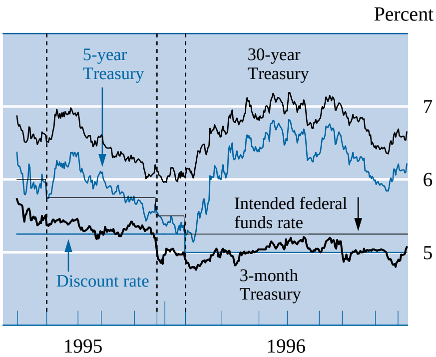
growth after the marked slowdown and inventory correction in late 1995.

By the spring, economic growth had become more vigorous than either the Committee or financial markets had foreseen. In response, intermediate- and longer-term interest rates as of mid-May were up around a full percentage point from the two-year lows reached early in the year. In combination with some softening of economic activity abroad and declines in interest rates in major foreign industrial countries, these developments contributed to a further appreciation of the dollar, building on the rise that had started in mid-1995. The Committee anticipated that the increase in the cost of credit, along with the higher exchange value of the dollar, would be sufficient to foster a downshift in economic expansion to a more sustainable pace and contain price pressures; thus, it left its policy stance unchanged at its spring meetings.

By early summer, however, the continued momentum in demand and pressures on labor resources that were being reflected in faster growth in wages were seen as posing a threat of increased inflation. Core inflation remained moderate, but in light of the heightened risk that it would turn upward, the Committee in its early July directive to the Manager of the Open Market Account indicated its view that near-term economic developments were more likely to lead to a tightening of policy than to an easing. Labor markets continued to be taut over the balance of the year, and this bias toward restraint was included in directives adopted at all of the Committee's remaining meetings in 1996.

After having peaked during midsummer, interest rates moved down on balance through the fall, as expansion of consumer spending and economic activity in general appeared to be moderating and markets saw less likelihood of a need for Federal Reserve firming action. Equity prices fell back for a time during the summer, reversing some of the substantial increase registered over the first half of the year, but by autumn they had reached new highs. Interest rates and dollar exchange rates turned back up late in the year when signs of rapid growth and more intense use of the economy's resources re-emerged.

Selected Interest Rates




NOTE. Small tick marks refer to dates in 1995 and 1996 on which the Federal Open Market Committee held scheduled meetings. Dashed lines indicate dates of meetings at which the Committee announced a monetary policy action: July 6, 1995; December 19, 1995; and January 31, 1996. The data are daily.

## Debt and the Monetary Aggregates

For the nonfinancial business sector, the effect of the higher intermediate- and long-term interest rates on the overall cost of funds in 1996 was offset to some degree by an easing of lending terms at banks and a narrowing of yield spreads on corporate bonds over Treasuries, as well as by declines in the cost of capital in the equity market. Encouraged, perhaps, by the prospects of sustained economic expansion and low inflation, banks, market lenders, and equity investors displayed a strong appetite for business obligations and seemed willing to require less compensation for the possible risks entailed. Some households, by contrast, faced a tightening of standards and terms with respect to credit card debt and some other types of consumer debt as banks reacted to a rising volume of delinquencies and charge-offs on these instruments. However, credit availability under home equity lines increased, particularly from finance companies but also from banks. Overall debt growth was slightly above the midpoint of its 3 percent to 7 percent monitoring range. The growth rates of M2 and M3 edged up and, as was anticipated in the monetary policy reports to the Congress in February and July, both aggregates ended 1996 near or above the upper end of their growth ranges. Again in 1996, the growth of M2 relative to nominal income and interest rates was generally in line with historical relationships, in contrast to its behavior during the early years of the decade. ■

# *The Performance of the Economy in 1996*

The economy turned in a remarkably favorable performance in 1996. Real GDP rose more than 3 percent, one of the larger gains of the past several years and appreciably more than the FOMC was expecting early in the year. Employment rose substantially, and the unemployment rate declined further. Tightness of the labor market led to a moderate pickup in wage increases in 1996. However, acceleration of prices was confined largely to the food and energy sectors; prices for other consumer products decelerated, as did prices paid by businesses for capital goods and materials.

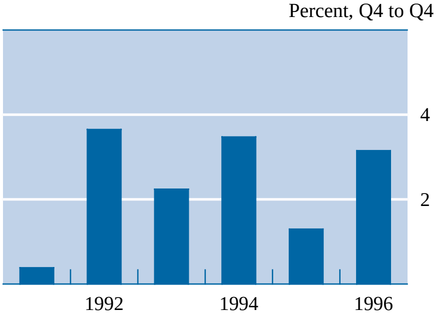
## The Labor Market

The number of jobs on nonfarm payrolls rose more than 2½ million from December 1995 to December 1996, an increase of about 2¼ percent. At year-end, the job count was up more than 12½ million from the lows of the early 1990s.

Employment in the private service-producing sector, in which nearly two-thirds of all nonfarm workers are employed, increased about 3 percent during 1996. Moderate employment gains were posted in retail trade, transportation, and finance, and sizable gains in hiring continued in some other service-producing industries, such as data processing, computer services, and engineering and management. Job growth at suppliers of personnel—a category that includes temporary help agencies—was more than 6 percent, a touch faster than in 1995 but much slower than it had been over 1992–94; with the tightening of labor markets in the past couple of years, longer-lasting commitments in hiring may have come back into greater favor among some employers.

Employment changes among producers of goods were mixed in 1996. In construction, employment climbed about 5½ percent, to a new high that was almost 4 percent above the peak of the last business expansion. In manufacturing, increases in factory jobs through the latter part of 1996 were not sufficient to reverse declines that had taken place earlier in the year. On net, the loss of factory jobs amounted to about ½ percent, a shade less than the average rate of decline since 1979, the year in which manufacturing employment peaked. Manufacturers of durable goods boosted employment slightly last year, but many producers of nondurables implemented further job cuts. As in many other recent years, reductions in factory employment were accompanied by strong gains in worker productivity. Consequently, increases in output were sizable—the rise in the Federal Reserve's index of manufacturing production cumulated to more than 4 percent over the year.

Change in Real GDP



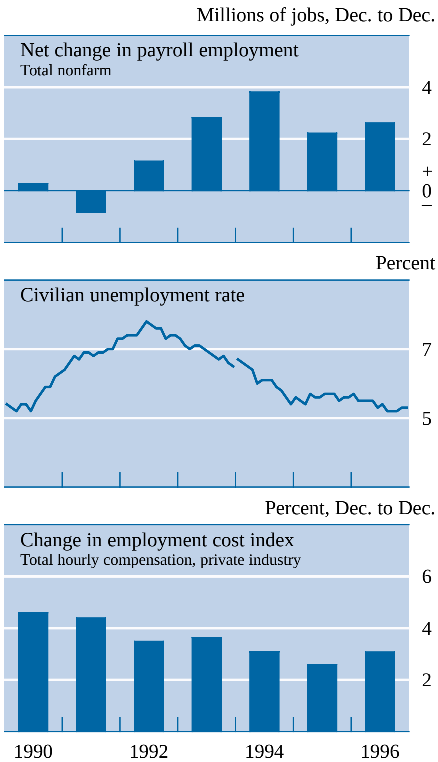

NOTE. The data are derived from chained (1992) dollars and come from the Department of Commerce.

Growth of output per hour in the nonfarm business sector as a whole picked up in 1996, rising about 1 percent over the year according to preliminary data. However, coming after a three-year period in which output per hour changed little, this rise left the average rate of productivity growth in the 1990s a bit below that of the 1980s and well below the average gains achieved in the first three decades after World War II. The sustained sluggishness in measured productivity growth this decade is difficult to explain, as it has occurred during a period when high levels of investment in new capital and extensive restructuring of business operations should have been boosting the efficiency of workers. Of course, measurement problems could be distorting the data. As a summary measure that relates aggregate output to aggregate input of labor, the nonfarm productivity index is affected by whatever deficiencies might be present either in adding up the nominal expenditures for goods and services in the economy or adjusting those expenditures for price change. A considerable amount of recent research suggests that growth of output and productivity is in fact understated, but whether the degree of understatement has been increasing over time is less clear.

In contrast to the experience of most other recent years, the 1996 rise in employment was accompanied by a sustained pickup in the labor force participation rate. The rise in participation boosted the labor supply and helped to relieve pressures on the labor market. Nonetheless, hiring during 1996 was sufficient to reduce the civilian unemployment rate from a December 1995 rate of 5.6 percent to a December 1996 rate of 5.3 percent.

Tightness of the labor market appears to have exerted some upward pressure on the cost of labor in 1996, even as some workers continued to express anxiety about job security. The employment cost index (ECI) for the private nonfarm sector of the economy showed compensation per hour moving up 3.1 percent over the year. The index had risen 2.6 percent in 1995. The step-up in hourly pay increases was to some extent the result of a hike in the minimum wage that took place at the start of October. More generally, however, businesses probably had to boost hourly compensation either to attract workers or to retain them at a time when alternative employment opportunities were perceived to be more widely available.

Labor Market Conditions




NOTE. The data are from the Department of Labor. The break in data for the unemployment rate at January 1994 marks the introduction of a redesigned survey; data from that point on are not directly comparable with those of earlier periods.

As in 1995, increases in hourly compensation in 1996 came more as wage and salary increases than as increases in fringe benefits. According to the ECI, the rise in wage rates for workers in the nonfarm sector amounted to nearly 3½ percent after a rise of 2¾ percent in 1995. By contrast, the ECI measure of the hourly cost of benefits rose only 2 percent, slightly less than it did in 1995 and much less than it rose on average over the past decade. Increases in the cost of benefits have been held down in recent years by reduced inflation for medical services and by the actions that many firms have taken to shift employees into managed care arrangements and to require them to assume a greater portion of the cost of health insurance and other medical benefits.

## Prices

The consumer price index rose more rapidly than in 1995, but the step-up was concentrated in the food and energy sectors—areas in which prices were affected by supply limitations that seemed likely to be of temporary duration. The CPI excluding food and energy—often called the "core" CPI—rose just a touch more than 2½ percent after having increased 3 percent during 1995. Both the total CPI and the core CPI have been affected in the past two years by technical improvements implemented by the Bureau of Labor Statistics that are aimed at obtaining more accurate readings of price change; the rise in the CPI in 1996 would have been somewhat greater if procedures used through 1994 had not been altered.

Other price indexes generally rose less rapidly than the CPI. Like the overall CPI, the chain-type price index for personal consumption expenditures (PCE) accelerated somewhat in 1996, but its rate of rise, shown in the accompanying table, was significantly lower than that of the CPI. The two measures of consumer prices differ to some degree in their weights and methods of aggregation. They also differ somewhat in their selection of price data, with the PCE measure relying on alternative data in some areas in which the accuracy of the CPI has been questioned. The chain-type price index for gross domestic purchases, which takes account of the prices paid by businesses and governments as well as those paid by consumers, moved up 2¼ percent during 1996, about the same as the percentage rise during 1995. By contrast, price measures associated with GDP decelerated in 1996 to thirty-year lows of around 2 percent or less. Conceptually, the GDP measures are indicative of price changes for goods and services that are produced domestically rather than price changes for goods and services purchased domestically—foreign trade accounting for the difference.

The 1996 outcomes for all these measures reflected an economy in which inflation pressures were muted. Sharp declines in non-oil import prices during the year lowered input costs for many domestic firms and likely caused other firms to restrain their product prices for

### Alternative Measures of Price Change

Percent

| Price measure | 1995 | 1996 |
|---|---|---|
| *Fixed-weight* | | |
| Consumer price index | 2.7 | 3.2 |
| Excluding food and energy | 3.0 | 2.6 |
| *Chain-type* | | |
| Personal consumption expenditures | 2.1 | 2.5 |
| Excluding food and energy | 2.3 | 2.0 |
| Gross domestic purchases | 2.3 | 2.2 |
| Gross domestic product | 2.5 | 2.1 |
| *Deflator* | | |
| Gross domestic product | 2.5 | 1.8 |

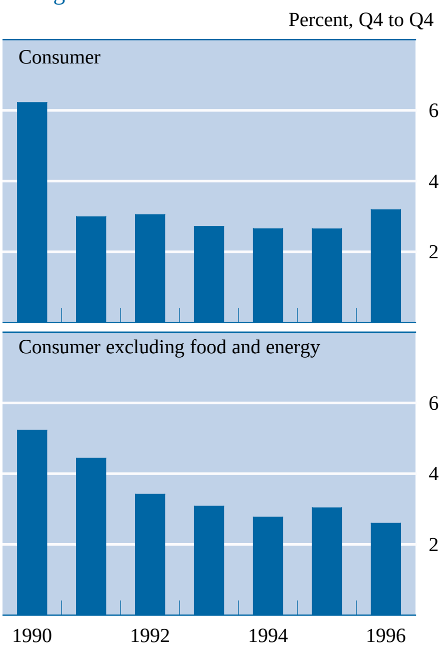
NOTE. Changes are based on quarterly averages and are measured to the fourth quarter of the year indicated from the fourth quarter of the previous year.

fear of losing market share to foreign competitors. Also important, in all likelihood, were the favorable imprints that several years of moderate and relatively stable rates of inflation have left on inflation expectations. Despite the uptick in hourly compensation and adverse developments in the food and energy sectors, survey data showed little change in consumers' expectations of inflation, and private forecasters' views of the prospects for prices held steady. Businesses commonly described the situation as one in which competitive pressures were intense and the "leverage" for raising prices simply was not present.

Food and energy prices were the exceptions. In the food sector, steep increases in grain prices in 1995 and the first few months of 1996 caused production adjustments among livestock farmers and substantial price increases for some livestock products. Later in the year, grain prices fell back, but livestock production could not recover in time to prevent significant price advances for some retail foods. Consumer prices for pork, poultry, and dairy products registered their largest increases in several years. Retail beef prices also rose but only moderately: Expansion of the cattle herd in previous years had laid the groundwork for a high flow of product to consumers, and herd reductions that occurred in 1996 augmented that flow. Elsewhere in the food sector, acceleration was reported in the price index for food away from home—a category that has a weight of almost 40 percent in the CPI for food; the rise in the minimum wage appears to have been an important factor in the acceleration. All told, the 1996 rise in CPI food prices amounted to 4¼ percent, the largest increase since 1990.

The energy sector was the other major part of the economy in which significant inflation pressures were evident in 1996. Crude oil prices, which had started firming in the latter part of 1995, continued on an upward course through much of 1996, rising more than 30 percent in total. Stocks of crude oil and petroleum products were tight during the year, even after allowing for an apparent downward trend in firms' desired inventories. Inventory building was forestalled by production disruptions at refineries, a string of weather problems here and abroad that boosted fuel requirements for heating or cooling, and a reluctance of firms to take on inventories that seemed likely to fall in value once renewed supplies from Iraq became available. Natural gas, too, was in tight supply at times, and its price surged. With retail prices of gasoline, fuel oil, and natural gas all moving up substantially, the CPI for energy rose

Change in Prices




NOTE. Consumer price index for all urban consumers. Based on data from the Department of Labor.

about 7½ percent over the four quarters of 1996, the largest increase since the Gulf War.

The CPI for goods other than food and energy rose 1 percent during 1996, one of the smallest increases of recent decades. As in 1995, price increases for new vehicles were moderate, and prices of used cars turned down after several years of sizable advances. Prices of apparel and house furnishings also fell; these prices, as well as the prices of vehicles, may have been heavily affected by the softness of import prices. Moderate increases were the rule among most other categories of goods in the CPI. In the producer price index, prices of capital equipment rose only ½ percent over 1996; computer prices continued to plunge, and the prices of other types of equipment rose moderately, on balance. Materials prices were weak: Prices of intermediate materials excluding food and energy declined about 1¼ percent from the fourth quarter of 1995 to the final quarter of 1996, and the producer price index for crude materials excluding food and energy dropped more than 6½ percent over that period. Productive capacity was adequate among domestic producers of materials, and supplies of many materials were readily available at competitive prices on the world market.

The CPI for non-energy services increased 3¼ percent in 1996. The rise was somewhat smaller than the increases of most other recent years. Prices of medical services decelerated for a sixth consecutive year, and increases in the cost of shelter were held down by another year of moderate advances in residential rent and owners' equivalent rent. Large increases were evident only in scattered categories: Airfares posted a large increase, and educational costs, maintaining a long-established trend, continued to rise quite rapidly relative to prices in general. ■

# *Domestic Spending and Finance in 1996*

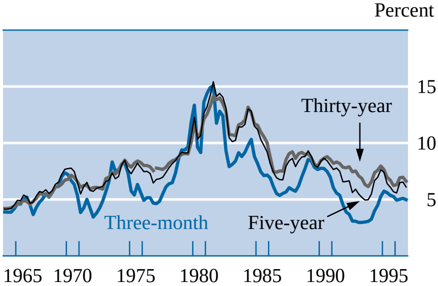
Aggregate spending of households, businesses, and governments recorded a sizable advance in 1996, rising a touch faster than real GDP. Household expenditures picked up, and business investment expenditures surged, the latter bolstered by increases in business profits and ready access to a variety of sources of finance on quite favorable terms. Government outlays for consumption and investment rose moderately in real terms.

## The Financial Backdrop: Interest Rates, Equity, and Debt

Declines in interest rates during the second half of 1996, elicited by evidence that economic growth had moderated, only partially reversed the increases over the first half. Longer-term Treasury rates rose on balance on the order of ½ percentage point over the year, and intermediate rates were up somewhat more. Spreads between most private rates and Treasuries narrowed markedly, reflecting the high quality of business balance sheets. Municipal rates moved up comparatively little over the first half of 1996, as earlier relative increases in these yields associated with discussions of fundamental tax reform were reversed when the likelihood of such changes to the tax code diminished. Movements in interest rates over the year appeared to be basically in their real component, as inflation expectations were little changed, according to surveys.

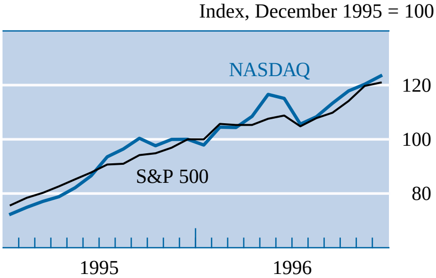
The substantial rise in equity prices in 1996 was only a bit below that registered in 1995. However, in contrast to 1995, when bond rates declined substantially, the equity gains came despite the net rise in bond rates. Corporate earnings were robust, but their advance fell short of share price increases, and price-earnings ratios rose to unusually high levels; dividend–price ratios were even more out of line with historical experience. Market participants appeared to be anticipating further robust earnings growth, and they also seemed to be requiring much less compensation for the extra risk of holding equities compared to, say, Treasury bonds. Such evaluations may have been based on a perceived environment of persisting low inflation and balanced economic growth

Selected Treasury Rates



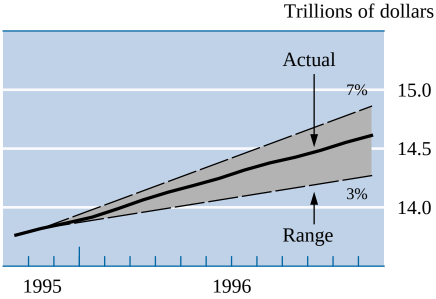

NOTE. The twenty-year Treasury bond rate is shown until the first issuance of the thirty-year Treasury bond, in February 1977.

Major Stock Price Indexes




NOTE. The data are monthly.

Total Domestic Nonfinancial Debt




NOTE. The range was adopted by the FOMC for the period from 1995:Q4 to 1996:Q4.

that would lower the odds of disruptions to economic activity.

Other asset prices were generally subdued. Commodity prices were flat to down. Commercial real estate prices, although no longer falling, rose at little more than the rate of inflation. Residential real estate prices increased moderately.

Growth of the debt of nonfinancial sectors in 1996, about 5½ percent, was similar to the rise in 1995. The growth of household sector debt dropped from 8¼ percent to 7¾ percent, a deceleration accounted for entirely by a sharp slowing of consumer credit. The expansion of business borrowing was held below its 1995 pace by an increase in internally generated funds, but at 4¾ percent it was faster than in any other year since 1989. Its strength reflected robust spending, extremely favorable credit conditions, and financing needs associated with a high level of mergers and acquisitions. Growth of federal debt slowed a bit further in 1996. State and local debt expanded slightly after two years of contraction.

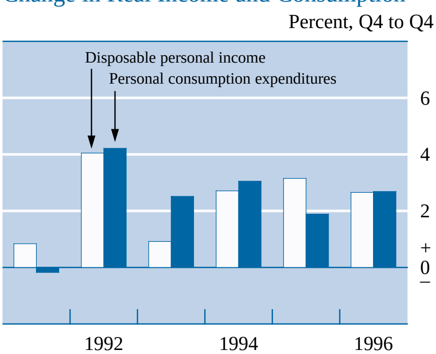
## The Household Sector

Household expenditures picked up in 1996—both consumer spending and residential investment. Although debt problems arose with greater frequency in the household sector in 1996 and may have restrained spending in some instances, households also benefited from healthy increases in real income and another year of sizable gains in wealth. Consumers were relatively optimistic about prospects for the economy at the start of 1996, and they became more so as the year progressed. Given this upbeat view, households were willing to take on additional mortgage debt at a brisk pace, but they did cut back on expansion of consumer credit after very large increases in 1994 and 1995.

### Spending, Income, and Saving

After having risen less than 2 percent in 1995, real personal consumption expenditures moved up 2¾ percent in 1996. Real outlays for consumer durables rose more than 5 percent after a gain of only 1¼ percent the previous year. As has been true for many years, real expenditures on computers and electronic equipment outpaced the growth of other household outlays by a wide margin in 1996. Sizable increases were also reported for most other types of consumer durables. However, real expenditures on vehicles changed little

Change in Real Income and Consumption




NOTE. The data are derived from chained (1992) dollars and come from the Department of Commerce.

on net over the year, as gains achieved during the first half were reversed after midyear. Late in 1996, sales of light vehicles may have been constrained to some degree by supply shortages that arose during strikes in the United States and Canada. Consumer purchases of nondurables rose 1¾ percent in 1996 after having increased 1 percent during 1995. Spending for services rose nearly 2¾ percent, slightly more than the average gain in previous years of the expansion.

After-tax personal income increased 5 percent in nominal terms over the four quarters of 1996. Wages and salaries rose briskly, and the income of farm proprietors surged. Other types of income generally exhibited moderate gains. Given the low level of price inflation, the rise in nominal income translated into another significant advance in real disposable income—about 2¾ percent over the year.

As in 1995, strong cross-currents continued to shape individual households' willingness—and ability—to spend from current income. Huge increases in stock market wealth provided some households the wherewithal to boost spending at a pace considerably faster than the growth of disposable income. But a number of households were likely held back by the need to divert income to the servicing of debt, and according to some survey evidence, households have become more concerned about saving for retirement. Responding to these influences, the annual average of the personal saving rate was up slightly from that of 1995; however, it remained relatively low compared with its longer-run average.

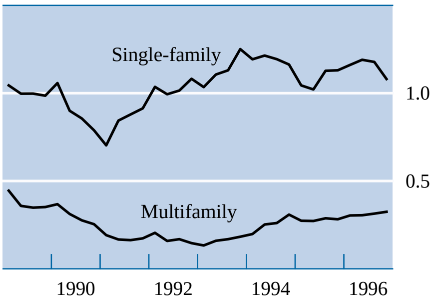
## Residential Investment

Outlays for residential investment expenditures posted a gain of about 4 percent in real terms over the four quarters of 1996, more than reversing a small decline in the previous year. Demand for single-family housing was especially strong. Although interest rates on longer-term fixed-rate mortgage loans moved up considerably in 1996, a substantial number of homebuyers side-stepped at least the initial costs by using adjustable-rate loans that were available at lower rates. The effects of the rate increases on the single-family market were cushioned by other influences as well, most notably the growth of employment and income. Even for fixed-rate loans, mortgage financing costs held at a level that, by historical standards, was low relative to household incomes. All told, sales of new homes surged to the highest annual total of the current expansion, and sales of existing homes established a historical high. New construction of single-family dwellings also rose but not so dramatically as sales, as builders apparently chose to work off some of their inventories of unsold units, which had climbed in 1995.

Construction of multifamily units maintained a path of recovery from the extreme lows of the early 1990s, moving up about 14 percent in terms of annual totals. The number of multifam-

Private Housing Starts

Millions of units, annual rate




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

ily units started—about 315,000—was double the number started in 1993, when construction of these units was at a low. However, compared with previous peaks, the 1996 total was less impressive—starts were twice as high in some years of the 1970s and 1980s. Although market conditions for multifamily properties varied considerably from city to city in 1996, the national average vacancy rate for multifamily rental units remained relatively high, and demographic influences were probably less supportive of multifamily housing than they were a decade or so ago. Also, manufactured houses have provided an increased number of families with an alternative to rental apartments in recent years.

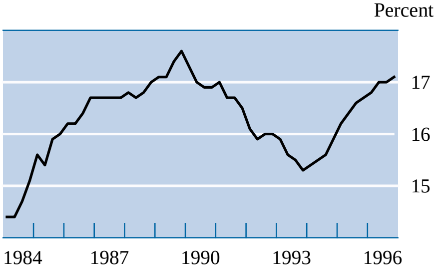
## Household Finance

Consumer credit grew 8¼ percent in 1996, just a bit over half the pace of the preceding two years. The sharp retrenchment likely reflected the burdens associated with a substantial accumulation of outstanding consumer debt over recent years as well as some tightening of lending terms and standards by commercial banks, particularly with respect to credit cards.

The slowing in consumer credit growth also was associated with a shift toward increased use of home equity loans. These loans were marketed vigorously, particularly by finance companies, in part as a vehicle for consolidating credit card and other outstanding consumer debt. Some of the growth in home equity loans reflected moves by finance companies and banks into the "subprime" market—lending either to higher-risk customers or on terms entailing unusually high loan-to-value ratios, or both. The push to expand home equity lending offset to some degree the effect of tighter lending standards and terms on credit cards and other forms of consumer credit.

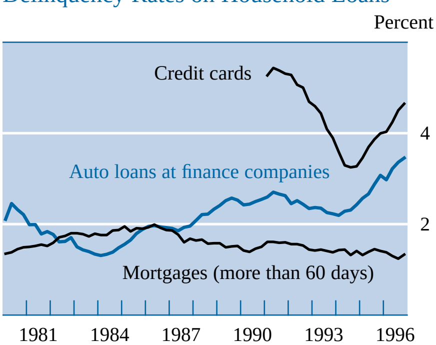
The shift toward home equity loans, along with a strong housing market, led to a pickup in mortgage debt growth in 1996 to a rate of 8¼ percent, the largest advance since 1990. Mortgage borrowing for home purchases was restrained surprisingly little by the increase in interest rates over the first half of the year. As noted previously, many borrowers were able to put off, at least for a time, much of the impact of the increase in rates by shifting to adjustable-rate mortgages, the rates on which rose much less than those on fixed-rate mortgages.

Household Debt-Service Burden




NOTE. As a percentage of disposable personal income. Debt is household mortgage and consumer debt, and debt service is the sum of required interest and principal payments on such debt. The data are quarterly.

Delinquency Rates on Household Loans




NOTE. The data for mortgages are from the Mortgage Bankers Association; for auto loans and credit cards, from the Federal Reserve. The data are quarterly.

Although the growth of household sector debt fell off a bit from the pace of recent years, it still exceeded that of disposable income. With loan rates up on average for mortgages and down only a little on consumer loans, debt-service burdens continued to rise, and some households experienced difficulties servicing certain kinds of debt. Delinquency rates on banks' consumer loans, particularly credit card loans, posted a second year of considerable increase, although they remained below levels in the early 1990s. At finance companies that are subsidiaries of automakers, auto loan delinquency rates rose to very high levels; but this rise apparently resulted in large part from a business strategy to compete in the vehicle market by easing lending standards. Auto loan delinquency rates at commercial banks also rose but remained well within historical ranges. Delinquency rates on residential mortgages turned up at some lenders but remained low overall.

Despite the rise in delinquencies on consumer debt, household balance sheets appeared healthy overall, as growth of household assets in 1995 and 1996 more than kept pace with the growth of debt. Household net worth, the sum of household financial claims and tangible assets less liabilities, rose approximately $5 trillion from the end of 1994 to the end of 1996, an amount that is equal to almost a full year's personal disposable income. Roughly two-thirds of that gain was accounted for by the surge in the prices of corporate shares, which lifted the value of a wide range of household investments, not only directly held stocks but also assets held in other forms such as pension plans. The ratio of household net worth to personal disposable income continued to climb in 1996, moving to its highest level in recent decades.

## The Business Sector

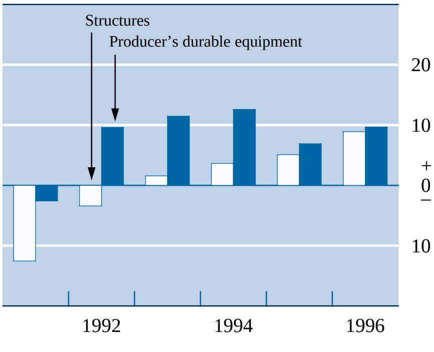
The performance of the business sector in 1996 was marked by continued rapid growth of fixed investment, a further increase in profits, and a conspicuous absence of serious imbalances. In these circumstances, businesses were able to obtain credit on exceptionally favorable terms. They also benefited from the rise in share values, which lowered the cost of obtaining finance through the equity markets.

### Investment Expenditures

Business fixed investment recorded a fifth consecutive year of strong expansion in 1996, moving up about 9½ percent. As in other recent years, investment was driven by rising profits, favorable trends in the cost of capital, and the ongoing efforts of businesses to boost efficiency. Although much of the investment spending was to replace depreciated equipment, the net addition to the aggregate capital stock appears to have been substantial. The rate of rise in the stock has picked up over the past two or three years after subpar growth through the latter half of the 1980s and first few years of the 1990s; the result-

Change in Real Business Fixed Investment

Percent, Q4 to Q4




NOTE. The data are derived from chained (1992) dollars and come from the Department of Commerce.

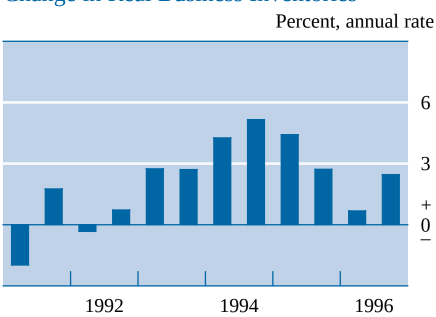
ing rise in the level of capital per worker should enhance labor productivity and potential output.

Equipment outlays moved up almost 9¾ percent in real terms in 1996. Business purchases of office and computing equipment once again rose much faster than the outlays for other types of equipment. Computer purchases were propelled by many of the same forces that have been at work in other recent years—most particularly, the expansion of networks and the availability of new models of computers embodying substantially improved computing power at highly attractive prices. Outlays for communications equipment also rose quite rapidly in 1996. Gains for other types of equipment were generally more modest.

Investment in nonresidential structures also rose substantially over the four quarters of 1996, posting the largest advance in several years. Business spending on structures went through an extended contraction in the latter part of the 1980s and early 1990s, and until recently the subsequent recovery has been relatively slow. That the 1996 gain in nonresidential investment would be so large was not evident until late in the year, when incoming data began to trace out sizable increases in new construction for many types of buildings. Investment in office buildings scored an especially large gain over the year, amid widespread reports of firming market conditions and reduced vacancy rates, and real outlays for other commercial structures moved up for a fifth consecutive year. Financing appeared to be in ample supply for commercial construction, and according to reports from the District Reserve Banks, speculative office building projects—that is, those without pre-committed tenants—were becoming more common.

Inventory investment was relatively subdued in 1996. The stock of nonfarm business inventories rose only 1½ percent over the four quarters of the year, the smallest increase since 1992. Businesses had been moving toward a reduced rate of stockpiling over much of 1995, and the rate of accumulation came almost to a halt in early 1996, when stocks of motor vehicles plummeted in conjunction with a strike at two plants that manufacture auto parts. Thereafter, inventory developments were relatively uneventful. Stocks of vehicles changed little on net over the final three quarters of the year, and accumulation of inventories by other nonfarm businesses was moderate on average. Stocks at year-end generally appeared to be at comfortable levels—or perhaps even a little tight—relative to trends in sales.

Change in Real Business Inventories




NOTE. Total nonfarm sector. The data are seasonally adjusted, derived from chained (1992) dollars, and come from the Department of Commerce.

## Corporate Profits and Business Finance

Business profits turned in another strong performance in 1996, building on the impressive gains of other recent years. Economic profits earned by foreign subsidiaries of U.S. corporations fluctuated from quarter to quarter but remained at high levels, and returns from domestic operations rose substantially for both financial and nonfinancial firms. Domestic profits of nonfinancial corporations, measured in proportion to the nominal value of these firms' output, reached the highest levels of the current expansion.

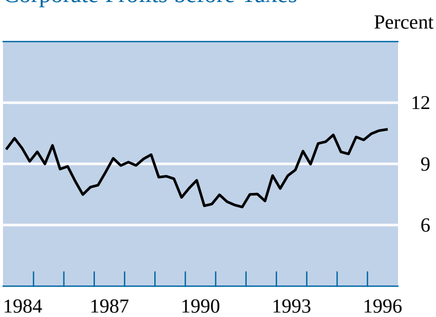
Although many interest rates rose in 1996, businesses continued to find credit readily available and at favorable terms. This accommodation likely resulted in part from the strong financial condition of firms, reflected in minimal delinquency rates on bank loans to businesses and very low default rates on corporate bonds, including those of low-rated issuers. With securitization of household debt instruments proceeding apace and with high levels of capital, banks appeared to have ample room on their balance sheets for business loans. This situation encouraged the development of a highly competitive lending environment in which banks further eased a variety of credit terms, such as covenants and markups over base rates. In capital markets, interest rate spreads of private debt instruments over Treasuries narrowed, particularly in the case of high-yield bonds. Surveys by the National Federation of Independent Business revealed a rising tendency of small businesses to borrow over 1996, with credit availability reported to be in a range more favorable than at any time in the current economic expansion.

On a gross basis, a pickup in bond issuance by nonfinancial firms in 1996 was accounted for mainly by speculative-grade offerings, likely in part a reaction to the improved pricing. In the fourth quarter, however, investment-grade issuance was substantial, responding to the decline in interest rates that began in late summer. Commercial paper declined in the final months of the year, primarily because of paydowns from bond proceeds, but bank lending to businesses was strong, in part because of robust merger activity. Despite a marked increase in gross stock issuance—with strong gains both for initial public offerings and for seasoned offerings—equity continued to be retired on net, as merger activity remained brisk and businesses used ample cash resources to repurchase their outstanding shares.

## The Government Sector

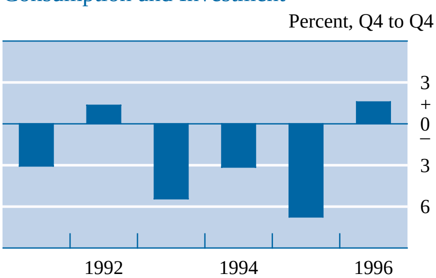
Real federal expenditures on consumption and gross investment—the part of federal spending that is included in GDP—rose about 1½ percent, on net, from the fourth quarter of 1995 to the fourth quarter of 1996, but the rise was

Corporate Profits before Taxes




NOTE. Profits of nonfinancial corporations from domestic operations, with adjustments for inventory valuation and capital consumption, as a percentage of GDP of nonfinancial corporate sector. Last observation is 1996:Q3.

Change in Real Federal Expenditures on Consumption and Investment

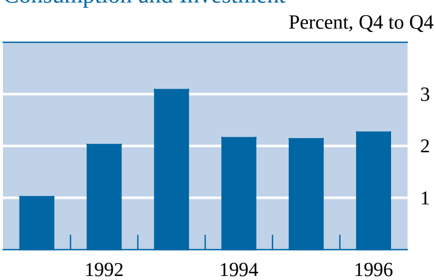



NOTE. The data are derived from chained (1992) dollars and come from the Department of Commerce.

mostly an artifact of late-1995 real purchases having been pushed to especially low levels by government shutdowns. The underlying trend of federal consumption and investment expenditures is probably better represented by the 2¾ percent annual rate of decline from the fourth quarter of 1994 to the final quarter of 1996. Reductions were apparent over this period both in real defense purchases and in real nondefense purchases.

Federal expenditures in the unified budget increased about 3 percent in nominal terms in fiscal 1996 after having increased 3¾ percent in fiscal 1995. Slower growth was recorded across many budgetary categories in fiscal 1996, and outright declines were reported in some. Combined expenditures on health, social insurance, and income security—items that account for more than half of all federal outlays—moved up 4½ percent, the smallest increase this decade. Defense spending was down about 2¼ percent in nominal terms, and net interest outlays rose much less rapidly than in fiscal 1995. Measured relative to the size of nominal GDP, total outlays in fiscal 1996 were the smallest since 1979. Legislative restraint has led to cuts in a number of discretionary programs in recent years, and the

Change in Real State and Local Expenditures on Consumption and Investment




NOTE. The data are derived from chained (1992) dollars and come from the Department of Commerce.

expanding economy has relieved pressure on those outlays that tend to vary inversely with the strength of activity.

Federal receipts increased about 7½ percent in fiscal 1996, the third year in which growth of receipts outpaced growth of nominal GDP by a significant margin. Receipts from individual income taxes climbed more than 11 percent in the most recent fiscal year, in conjunction with healthy increases in households' taxable earnings from capital and labor. Taxes on corporate profits also continued to rise rapidly, more or less in step with the growth of business earnings. The rapid growth of receipts, coupled with the restrained growth of expenditures, brought the unified budget deficit down to $107 billion in fiscal 1996 from almost $165 billion in fiscal 1995. The deficit as a share of nominal GDP was 1.4 percent, the smallest in more than twenty years.

Federal government debt grew 3¾ percent, the lowest rate in more than two decades. The growth of federal debt was held down in 1996 by legislative constraints on spending and by the boost to tax receipts from both the stronger economy and a booming stock market.

The aggregate consumption and investment expenditures of state and local governments rose slightly more than 2 percent in real terms over 1996. This gain was about the same as those of the two previous years. Outlays for services, which consist mainly of employee compensation and account for more than two-thirds of all state and local purchases, rose roughly 1½ percent in real terms. Investment expenditures, which make up the next biggest portion of state and local purchases, rose about 4½ percent, according to preliminary data. In the aggregate, the budget picture for state and local governments was relatively stable in 1996, as the surplus of nominal receipts over nominal current expenditures changed little from the positive readings of other recent years.

Two years of contraction of state and local government debt ended in 1996. The declines had occurred as issues that were pre-refunded earlier in the decade, when interest rates were unusually favorable, matured or became eligible to be called. Pre-refunded debt continued to be called in 1996, albeit at a reduced pace, but this decline was just offset by gross issuance, which picked up. ■

# Depository Credit and the Monetary Aggregates

The growth of credit supplied to the economy by depository institutions slowed in 1996, in part because of a shift to greater caution in making loans to consumers but also because of favorable conditions for selling loans in the securities markets. Shifts in the way that banks financed their credit growth in 1996 translated into an increased rate of expansion of M3. Growth of M2 also picked up, rising at a pace close to that of nominal GDP, but M1 contracted as sweep arrangements continued to expand.

## Depository Credit

The slower expansion of depository credit in 1996 entirely reflected a slower advance in bank credit. Growth at thrift institutions picked up, benefiting from strong demand for residential mortgages and improved capital positions. Growth of commercial bank loans moderated, as loans to businesses and, especially, consumers decelerated from elevated rates of growth in 1995. Bank portfolio expansion also appears to have been damped somewhat by a faster pace of asset securitization, likely spurred by receptive capital markets. For example, real estate loan growth at banks was a subdued 4 percent, despite a robust housing market and a pickup in commercial real estate. At the same time, outstanding securities backed by mortgage pools expanded nearly $200 billion in 1996, well above the pace of the preceding year. Commercial banks are a major source of securitized mortgages. The outstanding amount of consumer credit that had been securitized by banks also rose at a brisk pace in 1996, although not so rapidly as in 1995. As a result of the slowing of bank credit, the share of the 1996 advance in nonfederal debt that ended up on the books of depositories fell to about 38 percent, down from around 44 percent in the preceding two years.

Banks encountered an increased incidence of repayment problems on loans to consumers in 1996, and charge-off rates on these loans rose to around the peak levels of the last recession, in 1990–91. According to Federal Reserve surveys of senior loan officers, banks had anticipated some deterioration in the quality of their consumer loan portfolios, but they were surprised by its extent. These surveys also showed that banks considered the rate of charge-offs to be high relative to the level of delinquencies and that the credit-scoring models most banks use to evaluate consumer lending decisions have tended to be too optimistic. An important reason for the high level of charge-offs and the apparent shortcomings of the credit-scoring models was a 30 percent increase in personal bankruptcies. This surge stemmed in part from changes in the bankruptcy code that became effective at the beginning of 1996 against a backdrop of an apparently reduced stigma associated with this method of dealing with financial problems. Banks responded to the deterioration in their consumer loan portfolios by tightening standards and terms, especially on credit cards. In contrast, banks eased terms and conditions on home equity loans.

Despite the rise in repayment problems on consumer loans, the balance sheets and operating results of depositories remained strong in 1996. Bank profits were at historically high levels for the fourth consecutive year, a record reflecting the maintenance of relatively wide interest rate margins, further loan growth, and substantial fee income related to sales of mutual funds as well as to securitization and other off-balance-sheet activities. At year-end, almost 99 percent of commercial bank assets were held at banks classified as well capitalized. Underlying thrift profits were also stronger. However, profits at thrift institutions and at banks with deposits insured by the Savings Association Insurance Fund (SAIF) were held down temporarily by a special assessment on deposits to recapitalize SAIF. (Some bank deposits are SAIF-insured because of mergers with thrift institutions or acquisitions of them.)

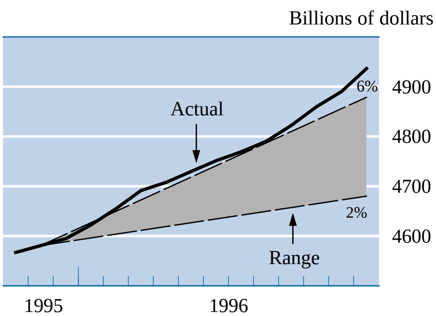
## The Monetary Aggregates

The slowing of depository credit notwithstanding, growth of the broader monetary aggregates strengthened in 1996: M3 expanded almost 7 percent, up from the pace of 1995 and above the upper end of its 2 percent to 6 percent annual range. M2 grew 4½ percent, up ½ percentage point from 1995 and in the upper portion of its 1 percent to 5 percent range. The ranges for monetary growth in 1996 had been chosen to be consistent with approximate price stability and a sustainable rate of real economic growth, rather than as indicators of the range of money growth rates likely to prevail under expected economic conditions.

The acceleration of M3 was caused partly by a shift in the way banks financed their credit—specifically, substituting issuance of large time deposits for borrowings from offices abroad. Both foreign and domestically chartered banks paid down net borrowing from foreign head offices and branches in 1996. For domestic banks, this paydown may have been related to the reduction to zero of insurance assessments on deposits, beginning with the last quarter of 1995. In addition, the greater growth of M3 relative to that of M2 reflected the need to fund particularly strong loan growth at U.S. branches and agencies of foreign banks, which do not offer the retail accounts that dominate deposits in M2.

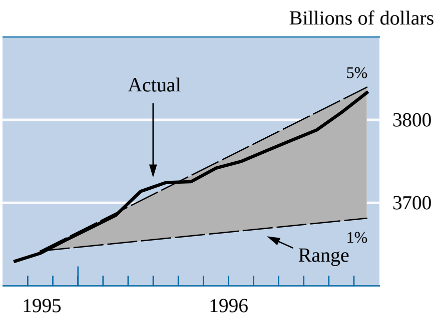
Growth of both M2 and M3 was supported again in 1996 by continuing robust advances in money market

Stock of M3




NOTE. The range was adopted by the FOMC for the period from 1995:Q4 to 1996:Q4.

Stock of M2



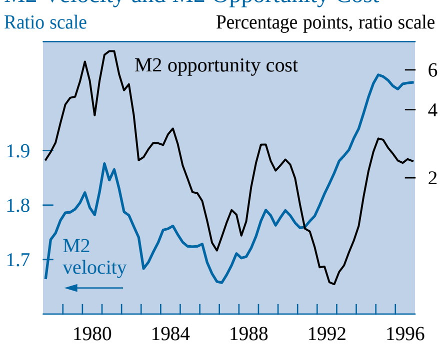

NOTE. The range was adopted by the FOMC for the period from 1995:Q4 to 1996:Q4.

mutual funds (MMMFs). Because the yields on these funds are based on the average return earned on their assets, they lag changes in yields on new market instruments; thus, the funds tend to attract additional inflows when market rates are falling. Accordingly, MMMFs advanced rapidly in the early part of the year, when the monetary easings of December and January pulled down short-term rates, and also later in the year, when short-term rates were again declining. However, these instruments expanded briskly even in the third quarter, when short-term rates were rising, suggesting that part of the attractiveness of MMMFs is the convenience they offer those investors engaged in moving funds in and out of stock and bond mutual funds, which expanded at a record pace last year. In addition, institution-only funds seemed to have considerable success in marketing cash management programs that capture excess cash of corporations and municipalities. Likely reflecting the attractiveness of money market and capital market mutual funds, deposits in M2 actually showed little growth in 1996. Retail deposit growth also may have been damped by a lack of aggressive pricing of deposits on the part of banks, as demand for their loans slipped and they apparently found it cheaper to finance a larger share of loan originations through securitizations and large time deposits.

The behavior of M2 relative to income, as summarized by its income velocity, again bore a fairly systematic relationship to M2's opportunity cost—the return on M2 assets relative to yields available on alternative instruments. The relationship of velocity to opportunity costs was reasonably stable historically, but it broke down in the early 1990s, a period characterized by extensive restructuring of balance sheets by households, businesses, and banks. In the process, M2 velocity rose substantially and, apparently, permanently. Since 1993, velocity no longer appears to be shifting higher, and M2 velocity and opportunity costs are moving together about as they did before 1990. However, the recent period of relative stability in this relationship has been too short for the Federal Reserve to place increased reliance on M2 as a guide to policy.

M1 contracted 4½ percent in 1996, as the pace at which new arrangements were established to sweep reservable retail transactions deposits to nonreservable nontransaction accounts accelerated. The initial amounts removed from transaction accounts by sweep arrangements established during the year amounted to $116 billion, compared with $45 billion in 1995. M1 continued to be supported by currency growth, as foreign demands, which were depressed earlier in the year partly in anticipation of the new $100 bill, picked up in the second half. Adjusted for the initial amounts removed from transaction accounts by sweep arrangements, M1 grew 5¼ percent in 1996. The sweeping of transaction deposits contributed to

M2 Velocity and M2 Opportunity Cost




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

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

Percent

| Item | 1993 | 1994 | 1995 | 1996 | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Year | Q1 | Q2 | Q3 | Q4 |
| Depository institution reserves[1] | | | | | | | | |
| Total | 12.2 | –1.2 | –4.9 | –11.4 | –7.9 | –6.4 | –16.4 | –16.9 |
| Nonborrowed plus extended credit | 12.2 | –1.5 | –4.9 | –11.4 | –6.5 | –7.6 | –17.6 | –16.0 |
| Required | 12.5 | –1.1 | –5.2 | –11.7 | –8.5 | –5.7 | –16.6 | –18.3 |
| Monetary base[2] | 10.4 | 8.4 | 4.1 | 3.8 | 1.5 | 3.0 | 5.4 | 5.1 |
| Concepts of money[3] | | | | | | | | |
| M1 | 10.6 | 2.5 | –1.6 | –4.6 | –3.5 | –1.4 | –6.5 | –7.3 |
| Currency | 10.2 | 10.2 | 5.4 | 5.7 | 2.7 | 4.4 | 7.6 | 7.7 |
| Demand deposits | 13.5 | .7 | 1.4 | 2.7 | 8.6 | 8.7 | –.9 | –5.5 |
| Other checkable deposits | 8.6 | –1.8 | –10.5 | –23.1 | –23.1 | –19.5 | –29.8 | –29.4 |
| M2 | 1.3 | .6 | 4.0 | 4.6 | 5.3 | 4.5 | 3.4 | 5.0 |
| Non-M1 components | –2.6 | –.3 | 6.7 | 8.8 | 9.3 | 7.0 | 7.7 | 10.2 |
| Savings (including MMDAs) | 2.9 | –4.3 | –3.2 | 11.7 | 13.9 | 10.4 | 8.4 | 12.1 |
| Small denomination time deposits | –10.6 | 2.4 | 15.4 | 1.3 | 1.2 | –1.8 | 2.2 | 3.8 |
| Retail money market mutual funds | –.8 | 7.6 | 18.7 | 17.1 | 14.6 | 16.3 | 16.3 | 17.2 |
| M3 | 1.1 | 1.7 | 6.2 | 6.9 | 6.6 | 6.4 | 5.4 | 8.4 |
| Non-M2 components | * | 6.6 | 15.3 | 15.5 | 11.7 | 13.9 | 12.7 | 20.4 |
| Large-denomination time deposits | –6.5 | 7.3 | 16.1 | 17.6 | 9.9 | 14.7 | 16.4 | 25.5 |
| Institution-only money market mutual funds | –2.4 | –4.9 | 24.0 | 19.8 | 21.4 | 12.1 | 20.6 | 19.8 |
| Repurchase agreements | 23.4 | 13.4 | 5.7 | 4.1 | 2.8 | 16.2 | –4.7 | 2.1 |
| Eurodollars | –1.6 | 23.4 | 12.2 | 17.4 | 11.8 | 11.0 | 8.7 | 34.7 |
| Domestic nonfinancial sector debt | 5.2 | 5.2 | 5.5 | 5.4 | 5.0 | 5.8 | 5.3 | 5.0 |
| Federal | 8.4 | 5.7 | 4.4 | 3.8 | 3.0 | 4.7 | 3.8 | 3.2 |
| Nonfederal | 4.0 | 5.1 | 5.9 | 6.0 | 5.7 | 6.2 | 5.8 | 5.6 |

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

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

2. The monetary base consists of total reserves; plus the currency component of the money stock; plus, for all quarterly reporters, and for all weekly reporters without required reserve balances, the excess of current vault cash over the amount applied to satisfy current reserve requirements. For further details, see the Federal Reserve's H.3 Statistical Release.

3. M1 consists of currency in circulation excluding vault cash; travelers checks of nonbank issuers; demand deposits at all commercial banks other than those due to depository institutions, the U.S. government, and foreign banks and official institutions, less cash items in the process of collection and Federal Reserve float; and other checkable deposits, which consist of negotiable orders of withdrawal and automatic transfer service accounts at depository institutions, credit union share draft accounts, and demand deposits at thrift institutions.

M2 is M1 plus savings deposits (including money market deposit accounts); small-denomination time deposits (including retail repurchase agreements), from which have been subtracted all individual retirement accounts (IRAs) and Keogh accounts at commercial banks and thrift institutions; and balances in taxable and tax-exempt retail money market mutual funds (money funds with minimum initial investments of less than $50,000), excluding IRAs and Keogh accounts.

M3 is M2 plus large-denomination time deposits at all depository institutions other than those due to money stock issuers; balances in institution-only money market mutual funds (money funds with minimum initial investments of $50,000 or more); wholesale RP liabilities (overnight and term) issued by all depository institutions, net of money fund holdings; and Eurodollars (overnight and term) held by U.S. residents at all banking offices in Canada and the United Kingdom and at foreign branches of U.S. banks worldwide, net of money fund holdings. For further details, see the Federal Reserve's H.6 Statistical Release.

* In absolute value, greater than zero and less than 0.05 percent.

a contraction of almost 12 percent in required reserves—twice the rate of decline of the previous year. The monetary base decelerated only a little, however, as growth of its major component, currency, was little changed between 1995 and 1996.

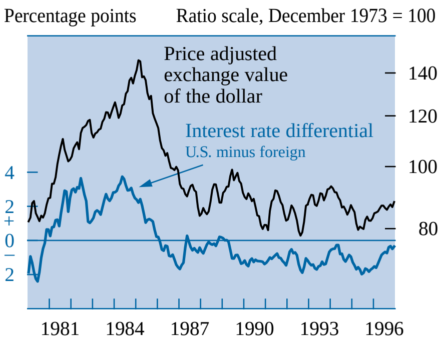
The Federal Reserve continued to monitor sweep activity closely, as persistent declines in the levels of required reserves have the potential to impinge on the Federal Reserve's ability to exert close day-to-day control over the federal funds rate—the overnight rate on reserves traded among depository institutions. Depositories hold balances at Reserve Banks to meet daily clearing needs in addition to satisfying statutory reserve requirements. At low enough levels, reserve balances may provide inadequate protection against adverse clearings, and banks' attempts to avoid overdrafts could generate highly variable daily demands for balances at the Federal Reserve and a volatile federal funds rate. Through 1996, however, no serious problems had emerged, in part because the substantial drop in depositories' required reserve balances attributable to sweeps was partially offset by increases in their holdings of required clearing balances—an arrangement whereby depositories pay for services provided by the Federal Reserve through the holding of specified amounts in reserve account balances. In addition, advances in banks' techniques of monitoring balances at the Federal Reserve and gauging their clearing needs have enabled them to operate efficiently and smoothly at relatively low levels of balances. Sweeps have had an effect on Federal Reserve earnings and the amounts it remits to the Treasury. The decline in reserve balances of about $12 billion attributable to sweeps must be matched by an accompanying lower level of Treasury securities on the books of the Reserve Banks. ■

# *International Developments*

Economic activity picked up in most major foreign industrial countries in 1996, but the pace of expansion, while brisk at times, was generally uneven over the course of the year. Output remained significantly below estimated potential in most countries, and unemployment remained high or even rose in much of Europe and in Canada. These conditions helped keep inflation in check; by the end of the year, the average inflation rate in the major foreign industrial countries was below 2 percent.

Growth in most of the major economies of Latin America rebounded in 1996 as the drag associated with the collapse of the Mexican peso in late 1994 and early 1995 dissipated. Asian countries generally continued to enjoy strong growth, although not as strong as in 1995. While output continued to decline in Russia and Ukraine, the pace of contraction slowed further; most of the other republics of the former Soviet Union showed signs of growth. The countries of Central and Eastern Europe recorded moderate growth in line with the recent average for these economies. In Africa, growth for the region as a whole reached 5 percent, significantly higher than in recent years. Economic activity picked up a bit in the Middle East after several years of relatively slow growth there.

Exchange Value of the Dollar
and Interest Rate Differential




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

The interest rate differential is the rate of long-term U.S. government bonds minus the weighted-average rate on comparable foreign securities, both adjusted for expected inflation; expected inflation is estimated by a thirty-six month moving average of consumer price inflation using staff forecasts of inflation where needed.

The data are monthly.

The U.S. trade deficit in goods and services widened to $114 billion in 1996 from $105 billion in 1995. Recent movements in the exchange value of the dollar had partly offsetting effects on net trade flows during the year. The appreciation of the dollar that began in 1995 and continued during 1996 began to boost imports and hold down exports of services as the year progressed. Meanwhile, lagged effects of the 1994–95 depreciation of the dollar continued to give a boost to merchandise exports. In addition, with U.S. income growth in 1996 close to the average for the country's major trading partners, U.S. imports increased more than exports, as is typical when increases in income among these countries are similar.

The current account deficit expanded to $165 billion from its 1995 level of $148 billion. As in 1995, a substantial portion of the balancing net capital inflows represented accumulations of foreign official assets in the United States. Recorded holdings of assets in the United States by private foreigners also increased rapidly in 1996, and recorded U.S. private holdings of foreign assets likewise rose substantially. The analysis of capital flows in 1996 is complicated, however, by the statistical discrepancy's wide swing from positive to negative.

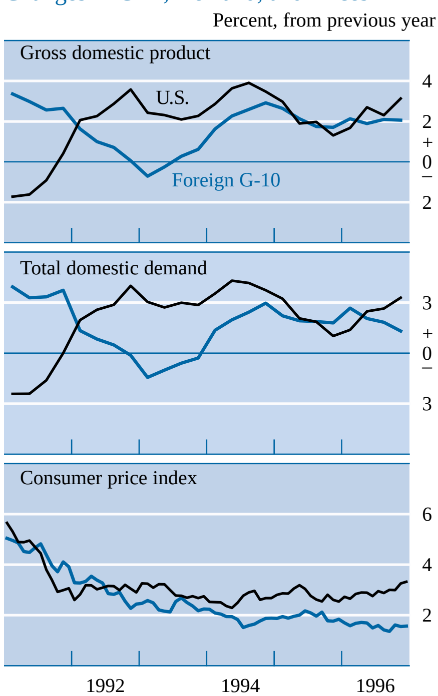
The foreign exchange value of the dollar rose about 4 percent on balance in 1996 in terms of a trade-weighted average of the other G-10 currencies.[1] The dollar's appreciation was consistent with the divergence in trends in economic activity in 1996 between the United States and most other major industrial countries. Relatively strong growth here combined with moderate and uneven growth abroad was also reflected in a widening differential between long-term interest rates in the United States and foreign countries. U.S. rates rose about ½ percentage point, while a weighted average of ten-year rates in foreign G-10 countries declined about ¾ percentage point on balance. Generally lower short-term interest rates plus fiscal consolidation, especially in Canada and some parts of Europe, also contributed to the fall in foreign long-term rates.

## Foreign Economies

In Germany, domestic demand remained fairly subdued during 1996, but net exports made a strong contribution to growth. Economic activity turned down early in the year because frigid winter weather restricted construction activity; the pace of activity rebounded temporarily in the spring but then slowed sharply at the end of the year. In the United Kingdom, France, and Italy, growth increased after midyear; but late in the year, activity slowed in France and declined in Italy. In Switzerland, economic activity again contracted over the course of the year. Growth remained sluggish in Canada over the first half of the year but increased substantially thereafter, partly in response to robust U.S. growth. In Japan, an exceptionally strong first quarter was followed by two quarters of stagnation, but in the fourth quarter, activity accelerated again. Stimulated by the easy stance of monetary and fiscal policies in recent years, private investment strengthened,

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

Changes in GDP, Demand, and Prices




NOTE. Data for the foreign G-10 countries are from national sources. The data are weighted by the countries' 1987–89 GDP as valued after adjusting for differences in the purchasing power of their currencies; GDP and domestic demand are in constant prices.

Data for the United States are from the Departments of Commerce and Labor. GDP and domestic demand are derived from chained (1992) dollars.

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

contributing to a rise in domestic demand over the year.

Weak growth in continental Europe contributed to increased slack in the labor market. The unemployment rate rose to post–World War II records in Germany, France, and Switzerland; unemployment also remained high in Italy and Belgium. By contrast, the rate of unemployment continued to decline steadily in the United Kingdom, where expansion has been under way for several years. In Canada, unemployment rose slightly after falling a bit in 1995; labor market conditions appeared to be improving near the end of the year. Japan's unemployment rate rose to a postwar high of 3.5 percent in the second quarter and fell only slightly over the rest of the year.

The deterioration of labor market conditions in several of the major foreign industrial countries reflected sustained or worsened shortfalls of actual output from estimated potential output. With growth at or slightly below its potential rate in Germany, Canada, and France, existing gaps were not narrowed; the discrepancy widened in Italy, where growth was significantly below its potential rate. Persistent output gaps continued to exert downward pressure on inflation rates. On average, consumer price inflation in the foreign G-10 countries continued to decline gradually, reaching about 1¾ percent by the last quarter of 1996. In Italy, the rate of consumer price inflation at the end of the year, 2½ percent, was less than half the year-earlier rate. An exception was the United Kingdom, where growth exceeded the rate estimated to be sustainable, and the underlying inflation rate rose slightly above 3 percent. In Japan, consumer prices were unchanged on balance over the year; the yen's depreciation raised import prices, offsetting ongoing domestic price deflation.

General government budget deficits narrowed further in Canada and the United Kingdom, partly as a result of rising economic activity but also because of fiscal policy changes aimed at reining in structural budget deficits. France also experienced some improvement in its deficit. Despite the Maastricht objective, budget deficits widened in Germany in 1996 to nearly 4 percent of GDP and in Italy to 6¾ percent, mainly as a result of slow growth.[2] In Japan, expansionary fiscal policy continued to widen the deficit significantly.

Long-term interest rates declined in all foreign G-10 countries except the United Kingdom. The drop was consistent with generally subdued economic growth and related downward pressure on inflation rates; fiscal consolidation also contributed where it occurred. Short-term interest rates fell as monetary policy eased in many countries in response to slowing economic activity and declining inflation. In Japan, the rate on three-month certificates of deposit remained at ½ percent to maintain support for economic recovery and to facilitate restructuring in the Japanese financial sector.

The current account surplus in Japan fell to a six-year low, in part because of lagged effects on exports from the yen's appreciation in 1995, but also because higher oil prices and the depreciation of the yen in 1996 raised the cost of imports denominated in dollars. Italy's current account surplus widened; weak domestic demand curbed imports, while exports received a boost from the restraints on labor costs that have improved Italy's international com-

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2. According to the Maastricht Treaty, only those countries that had a general government deficit of 3 percent of GDP or less in 1997 may participate in the European Monetary Union upon its scheduled commencement at the start of 1999.

petitiveness over the past few years. Canada's deficit was almost eliminated, in part because of strong exports to a healthy U.S. economy. The U.K. current account deficit also declined significantly, mostly on account of rising income from British investment abroad.

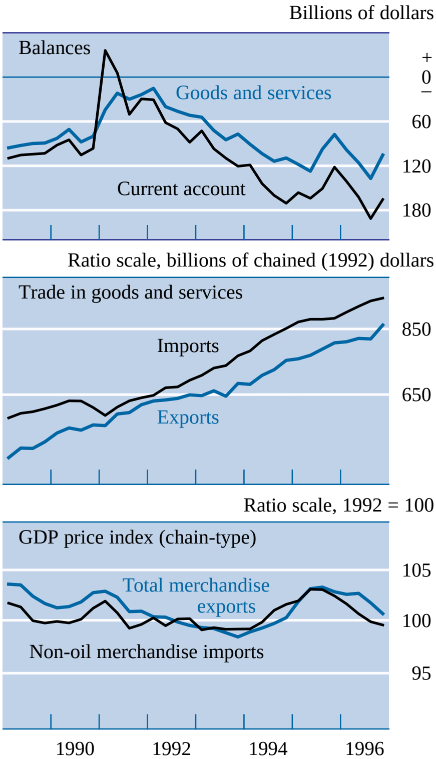
Mexico's economy bounced back from the sharp decline in output associated with the crisis that followed the December 1994 devaluation of the peso. By the end of the year, economic activity had regained the pace achieved before the crisis. With the currency stable and inflation much lower than in 1995—albeit at just under 30 percent—interest rates fell, helping investment and other elements of domestic demand take over from net exports as the driving force in the recovery. Mexico's trade balance remained in moderate surplus, declining somewhat in the second half of the year as imports accelerated and the expansion of non-oil exports slowed. The Argentine and Brazilian economies, which had been adversely affected in 1995 by spillovers from the Mexican crisis, grew at fairly rapid rates in 1996. Monetary tightening and a decline in copper prices slowed growth in Chile from the high rate recorded in 1995. Inflation in Venezuela exceeded 100 percent and, as noted, inflation remained high in Mexico; elsewhere in Latin America, it ranged from zero to 10 percent.

Economies in Asia slowed a bit on average in 1996 after booming in 1995. Earlier monetary tightening in some countries had its intended effect of moderating strong growth. In addition, exports were dampened in many economies by strong appreciation in their exchange rates in terms of the yen and by a generally weak global electronics market. Inflation remained low, ranging from 2 percent in Singapore to 7 percent in China.

## U.S. International Transactions

Real imports of goods and services in the United States rose rapidly over the four quarters of 1996, increasing slightly more than 8 percent after expanding about 4 percent in 1995. The pickup in U.S. economic activity boosted the demand for imports, and further impetus came from the dollar's appreciation, which put downward pressure on prices of imported goods other than oil in 1996. Most major categories of merchandise trade showed sizable increases in the volume of imports; oil and semiconductors were the notable exceptions. While rising faster than in

U.S. International Trade




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

1995, imports of services grew less in 1996 than imports of merchandise.

Real exports of U.S. goods and services expanded 7½ percent over the year, about the same pace as in 1995. Merchandise exports were stimulated by the pickup in growth in some important U.S. trading partners and by lingering effects of the dollar's depreciation in 1995. Exports to Mexico accounted for most of the expansion, but exports to Canada, South America, and Asia also increased. Exports to Western Europe were about the same in the fourth quarter of 1996 as they were a year earlier. Receipts from services exports grew more slowly in 1996. Much of the slowdown was in fees and royalties and in receipts from travelers to the United States, spending that was dampened in part by the appreciation of the dollar.

Foreign official assets in the United States increased $122 billion in 1996. A number of countries gained dollar reserves as they attempted to counter the domestic effects of large private capital inflows. In addition, exchange market intervention early in the year increased

## U.S. International Transactions

Billions of dollars, seasonally adjusted

| Transaction | Year | | Quarter | | | | |
|---|---|---|---|---|---|---|---|
| | | | 1995 | 1996 | | | |
| | 1995 | 1996 p | Q4 | Q1 | Q2 | Q3 | Q4 p |
| Goods and services, net | –105 | –114 | –19 | –25 | –29 | –34 | –26 |
| Exports | 787 | 836 | 204 | 205 | 209 | 206 | 216 |
| Merchandise | 576 | 612 | 149 | 150 | 153 | 150 | 158 |
| Services | 211 | 224 | 54 | 55 | 56 | 56 | 57 |
| Imports | 892 | 950 | 223 | 230 | 238 | 240 | 242 |
| Merchandise | 749 | 799 | 187 | 193 | 200 | 202 | 204 |
| Services | 142 | 150 | 36 | 37 | 37 | 38 | 38 |
| Investment income, net | –8 | –8 | –2 | * | –2 | –4 | –2 |
| Direct investment, net | 57 | 64 | 15 | 17 | 15 | 15 | 18 |
| Portfolio investment, net | –65 | –73 | –17 | –16 | –17 | –19 | –21 |
| Unilateral transfers, private and government, net | –35 | –42 | –9 | –11 | –9 | –9 | –13 |
| **Current account balance** | **–148** | **–165** | **–30** | **–35** | **–41** | **–48** | **–41** |
| Private capital flows, net | 17 | 89 | –10 | –21 | 37 | 38 | 36 |
| Bank-related capital, net (outflows, –) | –44 | –90 | 25 | –34 | 2 | –34 | –23 |
| U.S. net purchases (–) of foreign securities | –99 | –105 | –33 | –34 | –20 | –23 | –27 |
| Foreign net purchases (+) of U.S. securities | 195 | 285 | 29 | 48 | 60 | 78 | 99 |
| Treasury securities | 99 | 154 | 2 | 12 | 31 | 43 | 67 |
| Corporate and other non-Treasury bonds | 82 | 120 | 17 | 33 | 23 | 33 | 31 |
| Corporate stocks | 13 | 12 | 10 | 3 | 6 | 2 | 1 |
| Direct investment flows, net (outflows, –) | –35 | –4 | –29 | 5 | –9 | 12 | –13 |
| U.S. direct investment abroad | 96 | 88 | 44 | 23 | 26 | 9 | 30 |
| Foreign direct investment in United States | 60 | 84 | 15 | 29 | 17 | 21 | 17 |
| Other corporate capital flows, net | * | 3 | –3 | –6 | 4 | 5 | n.a. |
| Foreign official assets in United States (increase, +) | 110 | 122 | 11 | 52 | 14 | 24 | 33 |
| U.S. official reserve assets, net (increase, –) | –10 | 7 | * | * | –1 | 7 | * |
| U.S. government foreign credits and other claims, net | * | –1 | * | * | * | * | * |
| Total discrepancy | 32 | –53 | 29 | 5 | –9 | –22 | –27 |
| Seasonal adjustment discrepancy | 0 | 0 | 1 | 7 | * | –8 | 2 |
| Statistical discrepancy | 32 | –53 | 28 | –2 | –9 | –13 | –29 |

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

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

n.a. Not available. p Preliminary.

SOURCE. Department of Commerce, Bureau of Economic Analysis.

the holdings of certain industrial countries, and higher oil prices boosted the reserves of oil producers.

Recorded foreign private assets in the United States expanded even more rapidly than the record pace of 1995. Private entities abroad made net purchases of U.S. Treasury securities amounting to $154 billion, well in excess of purchases in any other year. Net purchases of U.S. government agency and corporate bonds also surpassed previous sums, reaching $120 billion, much of which represented U.S. borrowing in the Eurobond markets. In contrast, foreign net acquisitions of U.S. stocks were relatively restrained.

U.S. net purchases of foreign securities were also very strong in 1996, but stocks were favored over bonds. Net purchases of stocks in Japan were particularly large in the first half of the year. Equities of firms in Central and South America and in Asia also attracted U.S. investors in 1996, but net purchases in both these regions were still below the peak reached in 1993.

Net capital outflows occurred through banks and security dealers in 1996. With credit issued by banks in the United States slowing, lenders relied less on foreign sources of funds. Repurchase agreements with securities dealers in the United States were used by foreign investors to finance part of their very large net purchases of U.S. Treasury securities, contributing to the outflow.

Foreign direct investment in the United States, swelled by mergers and acquisitions, reached $84 billion in 1996, surpassing the previous record of $68 billion, reached in 1989. U.S. direct investment abroad was also strong although somewhat lower than in 1995. Investments in formerly state-owned enterprises in some foreign countries, along with mergers and acquisitions, contributed to the large outflows.

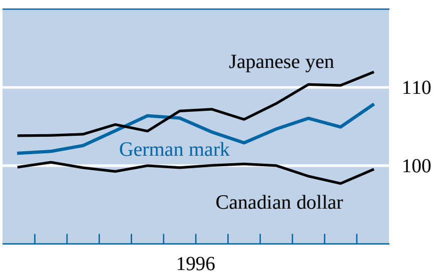
The large negative statistical discrepancy in 1996 contrasts sharply with the sizable positive figure of 1995. A negative discrepancy indicates net omissions or understatements of capital outflows and current account payments.

## Foreign Exchange Developments

The dollar appreciated about 7 percent in terms of the mark and the other currencies that were in the European exchange rate mechanism (ERM) throughout the year.[3] The rebound was consistent with growth in the United States exceeding that in continental Europe and with the associated widening of the differential between long-term interest rates in the two regions. Downward pressure on the mark may also have been related to uncertainties stemming from the scheduled introduction in 1999 of a single currency among the initial members of the European Monetary Union. Nonetheless, the prospects of a successful launch seemed to

3. The ERM linked the currencies of Austria, Belgium, Denmark, France, Germany, Ireland, the Netherlands, Portugal, and Spain throughout 1996. In October, the Finnish markka was added, and in November the Italian lira rejoined the ERM after an absence of about four years.

Exchange Value of the Dollar
versus Selected Currencies




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

improve in the eyes of market participants, judging by the narrowing of long-term interest rate differentials between Germany and other prospective EMU members.

By contrast, the dollar declined in value versus the pound and the Italian lira. Solid growth in the United Kingdom led to a tightening of monetary policy in late October, which in turn boosted sterling 9 percent. The lira strengthened 4 percent. Inflation in Italy fell to its lowest rate in more than twenty-five years, and prospects emerged for a substantial improvement in the country's fiscal deficit.

With weakness in economic activity persisting in Japan, the yen depreciated 12 percent versus the dollar. Switzerland's recession likewise depressed the Swiss franc, which fell 16 percent in terms of the dollar. The Canadian dollar moved only slightly compared to the U.S. currency over the year.

Adjusted for changes in consumer prices, the dollar declined about 1 percent on average measured against the currencies of eight newly industrializing countries in Latin America and Asia that are major U.S. trading partners.[4] The dollar appreciated 2½ percent in terms of the Mexican peso on a nominal basis, but adjusted for the inflation differential, the dollar depreciated 17 percent. This move was largely offset by the dollar's appreciation of 8 percent versus the Korean won in inflation-adjusted (and nominal) terms.

4. The countries are Chile, Hong Kong, Korea, Malaysia, Mexico, the Philippines, Singapore, and Taiwan.

## Foreign Exchange Operations

U.S. authorities did not intervene in foreign exchange markets in 1996. Reported net purchases of dollars by major foreign central banks were $46 billion in 1996, about $20 billion less than in the year before. In January the Bank of Mexico made a final payment of $650 million on its 1995 Federal Reserve swap drawing.

At the end of the year, the System held $19,264 million of marks and yen valued at current exchange rates. With the dollar's appreciation versus both currencies in 1996, the cumulative valuation gains on System foreign currency holdings declined $1,668 million. In the absence of transactions in foreign currency, the System realized no gains or losses. ■

# *Monetary Policy Reports to the Congress*

*Given below are reports submitted to the Congress on February 20 and July 18, 1996, pursuant to the Full Employment and Balanced Growth Act of 1978.*

## Report on February 20, 1996

### Monetary Policy and the Economic Outlook

The economy performed well in 1995. Moderate economic growth kept the unemployment rate at a relatively low level, and inflation, as measured by the change in the consumer price index, was in a range of 3 percent or less for the fifth straight year, the first such occurrence in thirty years. This desirable combination of low inflation and low unemployment provided further substantiation of a fundamental point that the Board has made in past reports—namely, that there is no trade-off in the long run between the monetary policy goals of maximum employment and stable prices set in the Federal Reserve Act. Indeed, it is by fostering price stability that a central bank can make its greatest contribution to the efficient operation and overall ability of the nation's economy to create jobs and advance living standards over time.

As economic prospects changed in 1995 and early 1996, the Federal Reserve found that promoting full employment and price stability required several adjustments in its policy settings. Last February, the economy still seemed to be pressing against its potential, and prices were tending to accelerate. To reduce the risk that inflation might mount, with the attendant threat to continued economic expansion, the Federal Open Market Committee raised the federal funds rate an additional ½ percentage point, to 6 percent. Inflation did, in fact, pick up in the first part of 1995, but data released during the spring indicated that price pressures were receding, and the Committee reduced the federal funds rate ¼ percentage point at its July meeting. Through the remainder of the year, inflation was even more favorable than had been anticipated in July, and inflation expectations decreased. In addition, an apparent slowing of economic activity late in the year further reduced the potential for inflationary pressures going forward. To forestall an undue increase in real interest rates as inflation slowed, and to guard against the possibility of unnecessary slack developing in the economy, the Committee eased reserve conditions in December and again at the end of January 1996, reducing the federal funds rate a total of ½ percentage point.

Monetary policy easings since mid-1995 contributed to declines in short-term market interest rates, which by mid-February were down 1 to 2 percentage points from the highs reached early last year. Intermediate- and long-term rates also moved sharply lower last year as the risks of rising inflation receded and as prospects for substantial progress in reducing the federal budget deficit seemed to improve. As of mid-February, these rates were 1¾ to 2¾ percentage points below their levels at the beginning of 1995. Helped by lower interest rates and favorable earnings, major equity price indexes rose 30 percent to 40 percent last year and have moved still higher in early 1996. These financial developments reduced the cost to businesses of financing investment and to households of buying homes and consumer durables; households were also aided by substantial additions to financial wealth from rising bond and equity prices.

The foreign exchange value of the U.S. dollar, measured in terms of the currencies of the other Group of Ten (G-10) countries, fell about 5 percent, on net, during 1995. The dollar appreciated substantially from the summer on and has advanced further on balance in 1996 but not enough to offset a sharp decline that took place in the first four months of 1995. Interest rates fell in most other foreign industrial countries, which also were experiencing slower economic growth, but by less than the decline in rates in the United States. Early in 1995, the dollar also was pulled down by the reactions to the crisis in Mexico, but the negative influence on the dollar from this source appeared to lessen as Mexican financial markets stabilized over the balance of the year. Inflation rates in major industrial countries held fairly steady in 1995 at levels somewhat lower than those prevailing in this country; thus, depreciation of the dollar in real terms against other G-10 currencies was less than the depreciation in nominal terms. Against the currencies of a broader group of U.S. trading partners, the dollar's real depreciation in 1995 was even smaller.

Borrowing and spending in the United States was facilitated not only by lower interest rates but also by favorable supply conditions in credit markets. Spreads between interest rates on securities issued by private firms and those issued by the Treasury generally remained narrow, and banks continued to ease terms and qualifying standards on loans to businesses and households through most of the year. Total debt of domestic nonfinancial sectors grew slightly more than 5 percent last year, just above the midpoint of the Committee's 3 percent to 7 percent monitoring range. Rapid growth of business spending on inventories and fixed capital early in the year boosted the credit demands of firms, despite strong corporate profits. Borrowing was also lifted by the financing of heavy net retirements of equity shares in connection with mergers and share repurchase programs. Growth of household debt slowed a bit but remained brisk; consumer credit continued to grow quite rapidly. Federal debt growth was relatively modest for a second year, influenced by a lower deficit and constraints on normal seasonal borrowing at year-end owing to the federal debt ceiling. Outstanding state and local government debt ran off more rapidly than in 1994.

Commercial banks and thrift institutions again financed a large portion of the borrowing last year; their share of total outstanding debt of nonfederal sectors edged up in 1994 and 1995 after having declined for more than fifteen years. The growth in depository credit was funded primarily with deposits, boosting the expansion of the broad monetary aggregates. M3 grew 6 percent, at the upper end of its 2 percent to 6 percent annual range established by the Committee at midyear. Depositories relied heavily on large-denomination time deposits for funding, but retail deposits also showed gains as declining market interest rates made these deposits more attractive to retail customers. M2 advanced 4¼ percent, putting it in the upper portion of its 1 percent to 5 percent annual range. The expansion of M2 was the largest in six years, and its velocity was unchanged after having increased during the previous three years. Nonetheless, growth of the aggregate was erratic through the year, and the stability of its relationship to nominal spending remains in doubt. M1 declined last year for the first time since the beginning of the official series in 1959. An increasing number of banks introduced retail sweep accounts, which shift money from interest-bearing checkable accounts to savings accounts to reduce banks' reserve requirements. Without these shifts, M1 would have risen in 1995, although slowly.

## Economic Projections for 1996

The relatively small amount of information that is available for 1996 indicates that the economy has started off slowly early this year, but fundamental conditions appear to be more encouraging than recent data might seem to suggest. Bad weather in a number of regions and the partial shutdown of the federal government have been disruptive to the economy this winter. These influences seem likely to leave only temporary imprints on spending and production, creating volatility in incoming data over the near term while having little effect on underlying trends.

The economy has also been slowed by production adjustments in some industries in which efforts are being made to bring stocks into better alignment with sales. Inventory accumulation apparently slowed in the fourth quarter, and with financial conditions remaining broadly conducive to growth of private final sales, inventory problems of a degree that might prompt a sustained period of widespread production adjustments do not seem likely. In the household sector, the accumulation of financial wealth brought on by the rise in the stock market has provided the wherewithal for increases in consumption greater than would otherwise have been expected—countering the potential negative influences of more burdensome levels of consumer debt. At the same time, reductions in mortgage interest rates have put the cost of financing a house within reach of a greater number of families and made it possible for a significant number of households to ease their debt-service burdens by refinancing their homes at lower rates. In the business sector, reductions in the cost of financing investment in new capital are providing some offset to the slowing tendencies that normally accompany a cyclical moderation in the growth of aggregate output. In addition, business

### Economic Projections for 1996

Percent

| Indicator | Federal Reserve governors and Reserve Bank presidents: Range | Federal Reserve governors and Reserve Bank presidents: Central tendency | Administration |
|---|---|---|---|
| *Change, fourth quarter to fourth quarter*[1] | | | |
| Nominal GDP | 4–5 | 4¼–4¾ | 5.1 |
| Real GDP[2] | 1½–2½ | 2–2¼ | 2.2 |
| Consumer price index[3] | 2½–3 | 2¾–3 | 3.1 |
| *Average level, fourth quarter* | | | |
| Unemployment rate[4] | 5½–6 | 5½–5¾ | 5.7 |

1. Change from average for fourth quarter of preceding year to average for fourth quarter of 1996.
2. Chain-weighted.
3. All urban consumers.
4. Civilian labor force. Figure for the Administration is an annual average.

investment in high-tech equipment likely will continue to be boosted not only by the ready availability of finance but also by technological upgrades and ongoing steep declines in the effective price of real computing power.

In the U.S. external sector, growth of exports strengthened after some sluggishness early in 1995. Expansion of income abroad seems likely to pick up this year, although the prospects still are subject to some downside risk. Imports, meanwhile, have slowed from the very rapid pace seen earlier in the expansion. On net, the underlying trends in exports and imports of goods and services appear to be essentially canceling out in terms of their combined contribution to growth of U.S. real gross domestic product.

Against the backdrop of these developments, members of the Board of Governors and the Reserve Bank Presidents, all of whom participate in the deliberations of the Federal Open Market Committee, anticipate that the U.S. economy will grow moderately, with little change in underlying inflation trends. The central tendency of the participants' forecasts of real GDP growth ranges from 2 percent to 2¼ percent, measured as the cumulative change in output from the final quarter of 1995 to the final quarter of 1996. The rise in activity is expected to be accompanied by further expansion of job opportunities and little change, on net, in the civilian unemployment rate over the four quarters of 1996. The central tendency of the unemployment rate forecasts for the fourth quarter of 1996 is a range of 5½ percent to 5¾ percent, compared with an average of 5.6 percent in the final quarter of 1995. The Committee's forecasts of economic growth and unemployment are quite similar to those of the Administration.

The central tendency of the Governors' and Reserve Bank presidents' forecasts of the rise in the consumer price index over the four quarters of 1996 is a range of 2¾ percent to 3 percent, a shade to the high side of the actual outcome of 1995. At this early point in 1996, with grain stocks exceptionally tight, there is some risk that food price increases at retail could be larger than those of recent years, especially if crop production should remain subpar again this year; and, even though recent upward pressures on energy prices should diminish with the return of normal weather, another year of declining prices cannot be taken as a given. Nonetheless, the experience with inflation at high levels of resource utilization was favorable in 1995, and with businesses still tightly focused on cost control and efficiency gain, broad tendencies toward increased rates of price increase are not anticipated. The Administration forecast of inflation is higher than the forecasts of the Federal Reserve officials, but the difference is not significant given the uncertainties of forecasting.

Price increases like those being forecast for the coming year would leave inflation no higher than it was in the first year or so of the current economic expansion, with the rate of increase holding appreciably below the average rate seen during the expansion of the 1980s. Although the Federal Reserve's long-run goal of restoring price stability has not yet been achieved, the capping of inflation and its diminution over recent business cycles is a clear indication of the substantial progress that has been made to date.

## Money and Debt Ranges for 1996

The Committee's intention to make further progress over time toward price stability formed the basis for the selection of the growth ranges for the monetary aggregates in 1996. In reaffirming the ranges that were adopted on a provisional basis in July, the Committee noted that it viewed them as benchmarks for what would be expected under conditions of reasonable price stability and historical velocity behavior. The Committee set the range for M2 at 1 percent to 5 percent and the range for M3 at 2 percent to 6 percent.

Given its expectations for inflation in 1996, the Committee anticipates that nominal GDP will grow somewhat faster this year than would be the case if the economy already were at price stability. If velocities of the aggregates were to exhibit roughly normal behavior this year and nominal income were to expand as anticipated by the Committee, M2 and M3 might grow near the upper ends of their ranges. In assessing the possible outcomes, the Committee noted that considerable uncertainty remains about the usefulness of the monetary aggregates in guiding the pursuit of its macroeconomic objectives. Although the monetary aggregates have been behaving more in line with historical patterns than was the case earlier in the decade, the effects of financial innovation and deregulation over the years have raised questions about the stability of the relationships between the aggregates and nominal GDP that have yet to be resolved.

The Committee also reaffirmed the 3 percent to 7 percent growth range for debt. Although there are indications that lenders may no longer be easing terms and conditions for granting credit to businesses and households, the Committee anticipated that credit supplies would remain ample and that debt would grow at about the same pace as nominal GDP. Such increases would be consistent with containing inflation and promoting sustainable growth.

Ranges for Growth of Monetary and Debt Aggregates

Percent

| Aggregate | 1994 | 1995 | 1996 |
|---|---|---|---|
| M2 | 1–5 | 1–5 | 1–5 |
| M3 | 0–4 | 2–6 [1] | 2–6 |
| Debt [2] | 4–8 | 3–7 | 3–7 |

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

1. Revised at July 1995 FOMC meeting.

2. Monitoring range for debt of domestic nonfinancial sectors.

## The Performance of the Economy

Measured in terms of the chain-type indexes that are now being emphasized by the Bureau of Economic Analysis, growth of real GDP averaged slightly less than 1½ percent at an annual rate over the first three quarters of 1995 after a gain of 3½ percent in 1994. The rise in aggregate output this past year was accompanied by an increase in payroll employment of 1¾ million, and the unemployment rate, after having fallen sharply in 1994, held fairly steady over the course of 1995, keeping to a range of about 5½ percent to 5¾ percent. Consumer prices, as measured by the CPI for all items, rose 2¾ percent over the four quarters of 1995, an increase that was virtually the same as those of the two previous years.

Growth of output during the past year was slowed in part by the actions of businesses to reduce the pace of inventory accumulation after a burst of stockpiling in 1994. Final sales—a measure of current output that does not end up in inventories—rose at an average rate of 2 percent over the first three quarters of 1995 after an increase of 3 percent over the four quarters of 1994. The slowing of final sales was largely a reflection of a downshifting in growth of the real outlays of households and businesses, from elevated rates of increase in 1994 to rates that were more sustainable. Real government outlays for consumption and investment edged down slightly, on net, during the first three quarters of 1995. Increases in real exports and real imports of goods and services were smaller than those of 1994; their combined contribution to GDP growth in the first three quarters was slightly negative.

## The Household Sector

Real personal consumption expenditures rose at an annual rate of about 2¼ percent over the first three quarters of 1995 after having risen slightly more than 3 percent over the four quarters of 1994. Available data suggest that growth of real outlays slowed further in the fourth quarter. The reduced rate of rise in consumption spending this past year came against the backdrop of moderate gains in employment and income. The financial wealth of households surged, but impetus to spending from this source evidently was countered by other influences, such as increases in debt burdens among some households and an apparent rise, according to survey data, in consumers' concerns about job security.

Real consumer expenditures for durable goods increased at an annual rate of 2¼ percent over the first three quarters of 1995, a slower rate of rise than in other recent years. Consumer expenditures for motor vehicles declined slightly, on net, over the first three quarters after having moved up nearly 20 percent over the three previous years; in the fourth quarter, unit sales of cars and light trucks, a key indicator of real outlays for vehicles, were down slightly from their third-quarter pace. Incentive programs that provided price concessions of one sort or another to buyers probably gave some lift to sales in 1995. However, "pent-up" demand, which had helped to boost sales earlier in the expansion, probably was no longer an important factor. Recent sales data do not seem to point to any big shifts in demand for vehicles around the turn of the year: The average rate of sales of cars and light trucks in December and January was a touch above the average for 1995 as a whole.

Real outlays for durable goods other than motor vehicles continued to rise at a brisk pace in 1995 but not so rapidly as in other recent years. Spending for furniture and household equipment hit a temporary lull in the first part of 1995 but picked up again over the next two quarters, lifted in part by a rebound in construction of new houses. Fourth-quarter data on retail sales seem to point to a further sizable increase in outlays for household durables; according to most anecdotal accounts, spending for home computers and other electronic gear, which has been surging in recent years, continued to move up rapidly through the latter part of 1995.

Consumer expenditures for nondurables increased at an annual rate of about 1½ percent, in real terms, over the first three quarters of 1995, a little less than the average of the previous ten years and considerably less than in 1994. The growth of real expenditures on apparel slowed sharply after three years of sizable advances. In the fourth quarter, real outlays for nondurables appear to have been lackluster.

Real expenditures for services—which account for more than half of total consumer outlays—increased at an annual rate of about 2¾ percent over the first three quarters of 1995, moderately faster than in either 1993 or 1994. After having declined in 1994, outlays for energy services increased sharply over the first three quarters of 1995: The unusually mild weather of late 1994 gave way, first, to more normal winter conditions in early 1995 and, later on, to hot summer weather that lifted fuel requirements for cooling. Spending gains for other categories of services proceeded at an annual rate of about 2¼ percent over the first three quarters of 1995, about the same rate of rise as in the two previous years.

Real disposable personal income rose at an average annual rate of about 2½ percent over the first three quarters of 1995, a gain that was about in line with the previous year's increase. Monthly data through November suggest that growth of real income may have picked up a little in the fourth quarter. Nominal personal income appears to have increased slightly faster in 1995 than it did in 1994, and growth of nominal disposable income, which excludes income taxes, apparently held close to its 1994 pace. Inflation continued to take only a moderate bite from increases in nominal receipts: The chain-type price index for personal consumption expenditures rose at an annual rate of 2½ percent over the first three quarters of 1995, matching, almost exactly, the increases in each of the two previous years.

After little change during 1994, the real value of household wealth surged in 1995. The value of assets was boosted substantially by huge increases in the prices of stocks and bonds. Liabilities continued to rise fairly rapidly but at a rate well below the rate of increase in household assets; rapid growth of consumer credit was again the most notable feature on the liability side. Behind these aggregate measures of household assets and liabilities was some wide variation in the circumstances of individual households. Appreciation of share prices and the rally in the bond market provided a substantial boost to the wealth of households holding large amounts of those assets. However, households holding few such assets benefited little from the rally in securities prices, and some of these households began to experience greater financial pressure in 1995. Debts taken on earlier proved to be difficult to repay in some instances, and a rising number of households saw their loans fall into delinquency. Overall, however, the incidence of financial stress among households appears to have been limited, as sustained increases in personal income helped to facilitate timely repayment of obligations.

Consumers maintained relatively upbeat perceptions of current and future economic conditions during 1995. The measure of consumer confidence that is prepared by the Conference Board held fairly steady at a high level. The index of consumer sentiment that is compiled by the University of Michigan Survey Research Center edged down a little, on net, from the end of 1994 to the end of 1995, but its level also remained relatively high. By contrast, some survey questions dealing specifically with perceptions of labor market conditions pointed to increased concerns about job prospects during the year; although employment continued to rise in the aggregate, announcements of job cuts by some major corporations may have rekindled consumers' anxieties about job security. In January of this year, consumer assessments of labor market conditions softened further, and the broader indexes of sentiment also declined. The January levels of the indexes were on the low side of their averages of the past couple of years but were well above levels that were reported through most of the first three years of the expansion.

Consumers tended to save a slightly higher proportion of their income in 1995 than they had in 1994. Large increases in financial wealth usually cause households to spend a greater share of their current income, thereby reducing the share of income that is saved. However, rising debt burdens and increased nervousness about job prospects would work in the opposite direction, and these influences may have offset the effect of increases in wealth. Some households also may have started focusing more intently on saving for retirement, especially in light of increased political debate about curbing the growth of entitlements provided under government programs. Nonetheless, the personal saving rate for all of 1995, while moving up a little, remained in a range that was relatively low by historical standards.

Residential investment fell in the first half of 1995 but turned up in the third quarter. Both the downswing in the first half and the subsequent rebound after midyear appear to have been shaped, at least in a rough way, by swings in mortgage interest rates. Although housing activity had been slow to respond to increases in mortgage interest rates through much of 1994, sizable declines in sales of new and existing homes started to show up toward the end of that year, and by early 1995, permits and starts also were dropping. However, the decline in activity proved to be relatively short and mild. By March, mortgage interest rates already were down appreciably from the peaks of late 1994, and midway through the second quarter, most indicators of housing activity were starting to rebound. Sales of new homes surged to especially high levels during the summer, and permits and starts of single-family units rose appreciably. In the autumn, sales retreated from their midyear peaks. Starts also slipped back somewhat during the autumn, but permits held firm.

The intrayear swings in the various housing indicators left the annual totals for these indicators at fairly elevated levels. The average pace of sales of existing homes over the first eleven months of 1995 was well above the average for the 1980s, even after having adjusted for increases in the stock of houses. Starts and sales of new single-family dwellings in 1995 were about one-tenth higher than their averages for the 1980s. So far in the 1990s, demographic influences have been less supportive of housing activity than in the 1980s, as the rate of household formation has lagged—in part because many young adults have delayed setting up their own domiciles. However, an offsetting impetus to demand has come from the improved affordability of housing, brought about in particular by declines in mortgage interest rates.

Construction of multifamily units, after having taken a notable step toward recovery in 1994, rose only moderately further in 1995. Over the first eleven months of 1995, starts of multifamily units amounted to 280,000 at an annual rate, compared with about 260,000 the previous year and a low of 162,000 in 1993. Financing for the construction of new multifamily projects appeared to be readily available this past year. However, the national vacancy rate for multifamily rental units, while down from the peaks of a few years ago, remained relatively high, and increases in rents were not of a magnitude to provide much incentive for the construction of new units.

## The Business Sector

Most indicators of business activity remained favorable in 1995, but strength was less widespread than it had been in 1994, and growth overall was less robust. The output of all nonfarm businesses rose at an annual rate of slightly less than 2 percent over the first three quarters of 1995, after a gain of 4 percent in 1994—a pace that could not have been sustained given already high operating levels. Inventory problems cropped up in some lines of manufacturing and trade in 1995 and prompted production adjustments. Scattered structural problems were apparent as well, especially in parts of retail trade in which intense competition for market share caused financial losses and eventual bankruptcy for some enterprises. More generally, however, business profits remained high in 1995, as firms continued to emphasize strategies that have served them well throughout the 1990s—most notably, tight control over costs and rapid adoption of new technologies, achieved by way of heavy investment in high-tech equipment.

In total, real business fixed investment increased at an annual rate of 8 percent over the first three quarters of 1995 after a gain of 10 percent in 1994. Growth in business spending for equipment continued to outpace the growth of investment in structures, even though the latter scored its largest gain of the past several years. On a quarterly basis, investment remained very strong through the first quarter of 1995. After having slowed sharply in the spring, it then picked up somewhat in the third quarter. Fragmentary data for the fourth quarter suggest that investment in plant and equipment recorded a gain of at least moderate size in that period.

Businesses continued to invest heavily in computers in 1995. In real terms, these expenditures rose at an annual rate of nearly 30 percent over the first three quarters of the year, an increase that was even more rapid than that of 1994. Excluding computers, real investment outlays increased less rapidly, on balance, than in 1994, and growth after the first quarter was modest, on net. In the equipment category, outlays for information-processing equipment other than computers moved up at an annual rate of about 13 percent in the first half of 1995 but fell back a little in the third quarter. Spending for industrial equipment followed a roughly similar pattern, with a small third-quarter decline coming on the heels of large gains in the first half of the year. Real outlays for transportation equipment declined in the second quarter but rebounded in the third. Real investment in nonresidential structures moved up in each of the first three quarters of 1995, at an annual rate of more than 6 percent, on average, after a gain of 3½ percent during 1994; the most recent year brought increased construction of most types of nonresidential buildings.

In the industrial sector, elevated levels of investment in equipment and structures in 1995 led to a gain of about 4 percent in industrial capacity. However, in a turnabout from the outcome of the previous year, output of the industrial sector rose considerably less rapidly than capacity: A gain of 1½ percent in total industrial production over the four quarters of 1995 was a sharp slowdown from a 1994 rise of more than 6½ percent. Production of consumer goods followed a choppy pattern during 1995 and rose less than ½ percent over the year as a whole, the smallest annual increase of the current expansion. The output of business equipment advanced in each quarter, but a cumulative gain of 4½ percent for this category was smaller than the increases of other recent years. Production of materials faltered temporarily in the second quarter, but production gains resumed thereafter, leading to a rise of about 2¼ percent over the four quarters of the year.

With capacity expanding rapidly and production growth slowing, the rate of capacity utilization in industry turned down sharply in 1995, backing away from the high operating rates of late 1994. As of this past December, the utilization rate in manufacturing was about ½ percentage point above its long-term average. In January of this year, utilization rates fell noticeably: Vehicle producers reduced assembly rates last month, and winter storms temporarily shut down manufacturing operations more generally.

After having risen rapidly during 1994, business inventories continued to build at a substantial pace in the early part of 1995. By the end of the first quarter, real inventories of nonfarm businesses were about 5½ percent above the level of a year earlier. Meanwhile, strength that had been evident in final sales during 1994 gave way to more subdued growth in the first quarter of 1995, and the ratio of inventories to sales rose. In the second and third quarters, growth of inventories was roughly in line with growth of business final sales; consequently, aggregate inventory–sales ratios held fairly steady during this period. Although data on inventory change in the year's final quarter are not yet complete, the available indicators suggest that significant imbalances probably were present in only a few industries at year-end. Potential for wider inventory problems appears to have been contained through a combination of production restraint late in 1995, caution in ordering merchandise from abroad, and discounting by some retailers during the holiday shopping season. Wholesalers reduced their inventories in the final two months of 1995, and manufacturers' stocks rose only slightly; aggregate inventory–sales ratios moved down in both sectors.

Business profits rose further over the first three quarters of 1995. Economic profits of all U.S. corporations increased at an annual rate of nearly 11 percent, a pace similar to that seen over the four quarters of 1994. The profits of corporations from their operations in the rest of the world moved up sharply, on net, and earnings from domestic operations also continued to advance. The strongest gains in domestic profits came at financial corporations and reflected, in part, an increased volume of lending by financial institutions, reduced premiums on deposit insurance at commercial banks, and rising profits of securities dealers. The economic profits earned by nonfinancial corporations from their domestic operations rose at an annual rate of about 3½ percent over the first three quarters of 1995 after three years in which the annual increases were 15 percent or more. A moderation of output growth at nonfinancial corporations and a flattening of the rise in profits per unit of output both worked to reduce the rate of growth in nominal earnings in 1995. Nonetheless, with unit costs also moving up at a moderate pace, the share of the value of nonfinancial corporate output that ended up as profits changed little, on net, in the first three quarters, holding in a range that was relatively high in comparison to the average profit share over the past couple of decades.

## The Government Sector

At the federal level, combined real outlays for investment and consumption fell at an annual rate of about 4¼ percent over the first three quarters of 1995, dropping to a level about 13 percent below its annual peak in 1990. Both investment and consumption were cut back over the first three quarters of 1995. Outlays for defense continued to contract, and nondefense expenditures turned down, reversing a moderate increase that took place over the four quarters of 1994.

Federal outlays in the unified budget, which covers items such as transfers and grants, as well as consumption and investment expenditures other than the consumption of fixed capital, rose 3¾ percent in nominal terms in fiscal 1995, matching almost exactly the percentage rise of the previous fiscal year. Nominal outlays for defense declined 3¼ percent in both fiscal 1995 and fiscal 1994. Outlays for social security increased about 5 percent in both years. Spending for Medicare and Medicaid continued to rise at rates appreciably faster than the growth of nominal GDP. Net interest payments jumped in fiscal 1995 after three years of relatively little change, but working in the other direction, net outlays for deposit insurance were more negative than in 1994 (that is, the margin between insurance premiums and the payout for losses increased). Proceeds from auctions of spectrum rights also helped to hold down expenditures; like the premiums for deposit insurance, these proceeds enter the budget as a negative outlay. In the first three months of fiscal 1996—that is, the three-month period ended in December—federal outlays were about 1 percent lower in nominal terms than in the comparable period of fiscal 1995. Nominal outlays for defense have continued to trend down this fiscal year, and the spending restraint embodied in recent continuing budget resolutions has translated into sharp cuts in nondefense outlays.

Federal receipts rose 7½ percent in fiscal 1995, after having increased 9 percent in fiscal 1994. In both years, categories of receipts that are most closely related to the state of the economy showed sizable increases. With receipts moving up more rapidly than spending in fiscal 1995, the federal budget deficit fell for a third consecutive year, to $164 billion. Progress in reducing the deficit in recent years has come from cyclical expansion of the economy, tax increases, nonrecurring factors such as the sale of spectrum rights, and adherence to the budgetary restraints embodied in the Budget Enforcement Act of 1990 and the Omnibus Budgetary Reconciliation Act of 1993.

The economic expansion also has helped to relieve budgetary pressures that many state and local governments were experiencing earlier in the 1990s. Excluding social insurance funds, surpluses in the combined current accounts of state and local governments were equal to about ½ percent of nominal GDP in the first three quarters of 1995; this figure was more than double the average for 1991 and 1992, when budgetary pressures were most severe.

Even so, state and local budgets remain at the center of strongly competing pressures, with the demand for many of the services that typically are provided by these governments continuing to rise at a time when the public also is expressing desire for tax relief. Although states and localities have responded to these pressures in different ways, the aggregate picture is one in which expenditures and revenues have continued to rise faster than nominal GDP—but by smaller margins than in the early part of the 1990s. In total, the current expenditures of state and local governments, made up mainly of transfers and consumption expenditures, were equal to about 12½ percent of nominal GDP in the first three quarters of 1995, up slightly from the percentages of the two previous years and about 1¾ percentage points higher than the comparable figure for 1989. Total receipts of state and local governments were equal to about 13¾ percent of nominal GDP in the first three quarters of 1995, up just a touch from the comparable percentages of the two previous years but about 1¼ percentage points higher than the percentage in 1989.

State and local outlays that are included in GDP have been rising less rapidly than the current expenditures of these jurisdictions because GDP excludes transfer payments, which have been growing faster than other outlays. In real terms, combined state and local outlays for consumption and investment increased at an annual rate of about 2½ percent over the first three quarters of 1995. Real investment expenditures, which consist mainly of outlays for construction, moved up at an annual rate of almost 7 percent. By contrast, consumption expenditures, which are about four times the size of investment outlays, rose only modestly in real terms—at an average annual rate of about 1½ percent.

## The External Sector

Growth of real GDP in the major foreign industrial countries other than Japan slowed sharply in 1995 from the robust rates of 1994. In Canada, where economic activity had been particularly vigorous through the end of 1994, the slowdown reflected weaker U.S. growth as well as macroeconomic policies intended to achieve improved fiscal balance and to prevent the reemergence of inflationary pressures. In Germany and the other European economies, appreciation of their currencies in terms of the dollar during the early months of the year and efforts to reduce public sector deficits contributed to the decline in the rate of real output growth. In contrast, Japan showed some tentative signs of recovery late in 1995 after almost no growth during the previous three years.

With the expansion of real GDP slowing in the foreign G-10 countries at a time when some slack remained, inflation stayed low. The average rate of consumer price inflation in these countries remained about 2 percent last year, essentially the same as in 1994 and somewhat less than in the United States.

Economic growth in the major developing countries slowed on average in 1995 from the strong pace recorded for 1994. The substantial contraction of economic activity in Mexico had important effects on U.S. trade, but real output also slowed in other developing countries, including Argentina. In response to the December 1994 collapse of the Mexican peso, the Mexican government adopted a set of policies intended to tighten monetary conditions, maintain wage restraint, and reduce government spending to mitigate the inflationary impact of the peso's devaluation and to achieve significant reduction in the current account deficit in 1995. Through the third quarter, the Mexican current account was approximately balanced; a deficit of about $20 billion had cumulated during the comparable three quarters of 1994. The merchandise trade balance improved to moderate surplus in 1995 from a substantial deficit in 1994. The improved trade performance in part reflected a severe contraction in aggregate demand. Mexican real output fell sharply early in the year but picked up toward the end of the year, for an annual decline of nearly 7 percent.

The newly industrializing economies in Asia—for example, Malaysia, Korea, and Taiwan—continued to grow rapidly during 1995, at about the same rate as in 1994. Although growth in most of these countries was driven by a strong expansion in internal demand, especially in investment, most countries also benefited from very fast export growth. The marked acceleration in exports was attributable at least in part to a real depreciation of their currencies against the yen and key European currencies during the early part of the year.

In the first eleven months of 1995 the nominal U.S. trade deficit in goods and services reached about $115 billion at a seasonally adjusted annual rate, a level slightly greater than the $106 billion recorded for 1994. U.S. income growth in 1995 was similar to the average for our trading partners, but as is typically the case, comparable increases in income seemed to bring forth an increase in U.S. demand for imports that was larger than the average increases in demand for our exports by the foreign countries with which we trade. Effects of the dollar's depreciation during 1994 and early 1995 worked in the opposite direction, tending to boost exports and hold down imports. Overall, the result of these offsetting tendencies was that the dollar value of exports grew somewhat faster than the dollar value of imports through November. Nonetheless, with the level of imports exceeding the level of exports at the start of the year, these growth rates translated into a slightly larger deficit. The current account deficit averaged about $160 billion at an annual rate during the first three quarters of 1995. Both the trade deficit and the deficit on net investment income widened somewhat, resulting in an increase from the $150 billion current account deficit experienced in 1994.

Real exports of goods and services grew at an annual rate of about 5 percent over the first three quarters of 1995. Agricultural exports remained at elevated levels, and the volume of computer exports continued to rise sharply. Other merchandise exports expanded in real terms at a marginally slower rate than did the total; within this broad category, machinery and industrial supplies accounted for the largest increases. Tabulation of the export data by country of destination showed divergent patterns: Exports to Mexico dropped in response to the economic crisis in that country, but shipments to developing countries in Asia rose sharply. Exports to Western Europe, Canada, and Japan increased as well.

Imports of goods and services increased at an annual rate of about 6 percent in real terms during the first three quarters, a slower rate of advance than during 1994. Imports of computers and semiconductors rose sharply, but imports of other machinery, consumer goods, and industrial supplies slowed. Import prices increased about 2½ percent in the twelve months ending in December 1995. An end to the very rapid rise in world non-oil commodity prices and low inflation abroad helped to restrain the rise in import prices.

In the first three quarters of 1995, recorded net capital inflows into the United States were substantial and nearly balanced the deficit in the U.S. current account. Sharp increases were reported in both foreign assets in the United States and U.S. assets abroad.

Foreign official asset holdings in the United States increased almost $100 billion through September. These increases reflected both intervention by certain industrial countries to support the foreign exchange value of the dollar and very substantial accumulation of reserves by several developing countries in Asia and Latin America. Private foreign assets in the United States also rose rapidly. Net purchases of U.S. Treasury securities by private foreigners totaled $97 billion, an amount far exceeding previous records. Net purchases of U.S. government agency bonds and corporate bonds were also very large.

Direct investment inflows reached almost $50 billion in the first three quarters of 1995; this total was about equal to the inflow during all of 1994 and almost matched the record pace of 1989. Mergers and acquisitions added substantially to the inflow of funds from foreign direct investors in the United States. U.S. direct investment abroad was even larger than foreign direct investment in the United States and also approached previous peak rates. U.S. net purchases of foreign stocks and bonds were up from 1994 but below the 1993 peak rate. The bulk of the net U.S. purchases of foreign securities were from the industrial countries; net purchases from emerging markets played a relatively small role.

## Labor Markets

The number of jobs on nonfarm payrolls increased 1¾ million over the twelve months ended in December 1995. After a sharp rise during 1994, gains in employment slowed in the first part of 1995, and the second quarter brought only a small increase. Thereafter, increases picked up somewhat. Nearly 450,000 jobs were added in the final three months of the year, a gain of about 1½ percent at an annual rate. In January of this year, with the weather keeping many workers at home during the reference week for the monthly survey of establishments, payroll employment fell sharply.

As in 1994, increases in payroll employment in 1995 came mainly in the private sector of the economy, but gains there were more mixed than those of 1994. In manufacturing, employment fell about 160,000 over the twelve months ended in December, reversing almost half of the previous year's gain. Losses were concentrated in industries that produce nondurables. A decline this past year in the number of jobs at apparel manufacturers was one of the largest ever in that industry. Sizable reductions in employment also were reported by manufacturers of textiles, tobacco, leather products, and petroleum and coal. In many of these industries, cyclical deceleration of the economy in 1995 compounded the effects of adjustments stemming from longer-run structural changes. In contrast to the widespread contraction in employment among producers of nondurables, employment at the manufacturers of durable goods increased slightly during 1995. Hiring continued to expand briskly at firms that produce business equipment. Metal fabricators also sustained growth in employment but at a slower pace than in 1994. The number of jobs in transportation equipment declined, on net.

In most other sectors of the economy, employment rose moderately last year. The number of jobs in construction increased 140,000 over the twelve months ended in December, a rise of more than 3 percent. In the private service-producing sector, which now accounts for about three-fourths of all jobs in the private sector, employment increased 1.7 million in 1995 after having advanced 2.6 million in 1994. Establishments that are involved in wholesale trade continued to boost payrolls at a relatively brisk pace in 1995. Retailers also added to employment but at a considerably slower rate than in 1994; within retail trade, employment at apparel outlets fell substantially last year, and payrolls at stores selling general merchandise dropped moderately after a large increase in 1994. Providers of health services added slightly more jobs than in other recent years. At firms that supply services to other businesses, employment growth was sizable again in 1995 but less rapid than in either of the two previous years; in this category, providers of computer services expanded their job counts at an accelerated pace in 1995, but suppliers of personnel—a category that includes temporary help agencies—added jobs at a much slower rate than in other recent years.

Results from the monthly survey of households showed the civilian unemployment rate holding in a narrow range throughout 1995, and the rate reported in December—5.6 percent of the labor force—was near the midpoint of that narrow range. In January of this year, the unemployment rate ticked up to 5.8 percent.

The proportion of working-age persons choosing to participate in the labor force edged down slightly, on net, over the course of 1995. It has changed little, on balance, since the start of the 1990s. By contrast, the two previous decades brought substantial net increases in labor force participation, although longer-term trends during the two decades were interrupted at times by spells of cyclical sluggishness in the economy. Two or three years ago, cyclical influences also seemed to be a plausible explanation for the sluggishness of labor force participation in the current business expansion. But, with the participation rate remaining sluggish as job opportunities have continued to expand, the evidence is pointing increasingly toward a slower rate of rise in the trend of participation. Slower growth of participation will tend to limit the growth of potential output unless an offsetting rise is forthcoming in the trend of productivity growth. So far in the current expansion, measured increases in productivity seem to have followed a fairly typical cyclical pattern, with larger increases early in the expansion and smaller gains, on average, in subsequent years. Overall, however, this pattern has not yielded evidence of a significant pickup in the longer-term trend of productivity growth.

The average unemployment rate for all of 1995 was about ½ percentage point below the average for 1994, and it was only a little above the levels to which the unemployment rate fell in the latter stages of the long business expansion of the 1980s. The low unemployment rates reached back then proved to be unsustainable, as they eventually were accompanied by a significant step-up in the rate of inflation, brought on in part by faster rates of rise in hourly compensation and unit labor costs. The current expansion, in contrast, has remained relatively free of increased inflation pressures working through the labor markets. The employment cost index for hourly compensation of workers in private nonfarm industries rose only 2.8 percent over the twelve months ended in December, the smallest annual increase on record in a series that goes back to the start of the 1980s. Hourly wages increased 2.8 percent during the past year, the same relatively low rate of increase as in 1994. The cost of fringe benefits, prorated to an hourly basis, rose only 2.7 percent last year, the smallest annual rise on record. With many firms still undergoing restructurings and reorganizations, many of which have involved permanent job losses, workers probably have been more reluctant to press for wage increases than they normally would have been during a period of tight labor markets. Also, firms have been making unprecedented efforts to gain better control over the rate of rise in the cost of benefits provided to employees, especially those related to health care. Although some of these efforts may have only a one-time effect on the level of benefit costs, groundwork also seems to have been laid for slower growth of benefits over time than would otherwise have prevailed.

## Prices

Early in 1995, inflation pressures that had started building in 1994 seemed to be gaining in intensity. Indexes of spot commodity prices continued to surge in the early part of last year, and in the producer price index, materials prices recorded some of the largest monthly increases of the past decade and a half. Consumer prices also began to exhibit some upward pressure, with the index for items other than food and energy moving up fairly rapidly over the first four months of the year.

The surge in inflation proved to be relatively short-lived, however. The spot prices of industrial commodities turned down in the spring of the year and fell further, on net, after midyear. Price increases for intermediate materials slowed in the second and third quarters of 1995, and by the final quarter of the year these prices also were declining. Monthly increases in the core CPI slowed in May; thereafter, increases generally were small over the remainder of the year. The slowing of the economy after the start of the year appears to have cut short the buildup of inflationary pressures before they could have much effect on the underlying processes of wage and price determination. In the end, the rise in the CPI excluding food and energy from the final quarter of 1994 to the final quarter of 1995 amounted to 3 percent, an increase that differed little from those of the two previous years. The increase in the total CPI in 1995 came in at 2¾ percent, the fifth consecutive year in which it has been in a range of 3 percent or less.

In the aggregate, rates of price increase held fairly steady for both goods and services this past year. The CPI for commodities other than food and energy rose 1¾ percent over the four quarters of 1995 after increases of 1½ percent in both 1993 and 1994. The last three-year period in which prices of these goods rose by such small amounts came in the middle part of the 1960s. Apparel prices continued to decline last year but not so rapidly as in the previous year. Price increases for vehicles moderated. The 1995 rise in the CPI for services other than energy was 3¾ percent; although this increase exceeded the 1994 rise by a slight amount, the results for both years were among the smallest increases for this category in the last three decades.

Trends in food prices and energy prices remained favorable to consumers in 1995. The rise in food prices from the final quarter of 1994 to the final quarter of 1995 was slightly more than 2½ percent, almost exactly the same as the increases of the two previous years. The last yearly increase in food prices in excess of 3 percent came five years ago, in 1990. In the intervening years, production adjustments by farmers and weather problems of one sort or another have caused temporary surges in the prices of some farm commodities, but these surges have not resulted in widespread pressures on food prices at the retail level. Moderate rates of increase in the costs of nonfarm inputs that contribute heavily to value added have been an important anchor in the setting of food prices at the consumer level. Also, if only by chance, years of poor crops—like that of 1995, when grain and oilseed production plummeted—have tended to be interspersed with years of good crops, a pattern that has prevented sustained upward pressures on farm and food prices. In the energy area, prices at the consumer level fell 1¾ percent, on net, over the four quarters of 1995, more than reversing a moderate 1994 increase. Gasoline prices dropped nearly 5 percent, on net, over the four quarters of the year, and consumer prices of natural gas also declined appreciably. However, some upward pressures developed in late 1995 and early this year, largely in response to unexpectedly cold temperatures that boosted fuel requirements for winter heating.

All told, the price developments of 1995 appear to have left a favorable imprint on expectations of future rates of inflation, if results from various surveys of consumers and forecasters are an accurate reflection of the views held by the broader public. Monthly responses to the surveys tend to bounce around somewhat, but over 1995 as a whole, average readings of anticipated price increases one year into the future were slightly lower than those of 1994, and survey responses about inflation prospects over the longer term came down more substantially. Although the responses regarding expected inflation still tended, on balance, to run to the high side of actual rates of price increase, the easing of inflation expectations this past year provided another encouraging sign that inflation processes that helped to undermine other recent business expansions are still in check in the current expansion.

## Financial, Credit, and Monetary Developments

In 1995 and early 1996, the Federal Reserve had to adjust its policy stance several times to promote credit market conditions supportive of sustained growth with low inflation. At the beginning of 1995, some risk remained that inflation might rise. To provide additional insurance against that development, the Federal Open Market Committee (FOMC) tightened reserve conditions, raising the intended federal funds rate ½ percentage point, to 6 percent, thereby extending the episode of policy firming that had begun one year earlier. As time passed, it became clear that these policy tightenings had been successful in containing inflationary pressures, and the System initiated ¼ point reductions in the federal funds rate in July and December 1995 and January 1996.

Most market interest rates had peaked before the policy tightening last February. During the spring, interest rates declined appreciably, as market participants increasingly came to believe that no additional policy restraint would be forthcoming, and, indeed, that easing might be in the cards. Mounting evidence that the growth of spending had downshifted and price pressures were muted, along with greater hopes that substantial progress would be made toward reducing the federal budget deficit, contributed to the change in attitudes and to the drop in interest rates, especially longer-term rates. On balance during 1995, interest rates dropped 1 to 2½ percentage points, with the largest declines registered on intermediate- and long-term securities. This year, short- and intermediate-term interest rates have fallen somewhat further, while long-term rates are unchanged to a little higher.

During the first part of last year, expectations of lower U.S. interest rates relative to other G-10 countries and other factors such as the crisis in Mexico contributed to a 10 percent depreciation of the trade-weighted exchange value of the dollar. By year-end, though, the dollar had retraced about half of these losses, and it has appreciated further on balance in 1996.

The course of interest rates during the year influenced overall credit flows and their composition. The expansion of the total debt of domestic nonfinancial sectors was relatively strong during the first half of the year but moderated later in 1995. For the year, debt grew 5¼ percent, a bit above the midpoint of its annual growth range. Initially, household and nonfinancial business credit demands were concentrated in floating-rate or short-term debt instruments. As the yield curve flattened, credit demands shifted to fixed-rate, long-term debt instruments.

Because depository institutions are important sources of short-term and floating-rate credit to households and businesses, depository assets grew rapidly early on and then backed off. The need to fund the increase in assets, along with declines in market interest rates relative to yields on retail deposits, led to the fastest growth in M2 and M3 since the late 1980s; M2 ended the year in the upper part of its annual range, and M3 was at the upper end of its range. In contrast, M1 declined for the first time since the beginning of the official series in 1959, as many banks introduced retail sweep accounts that shifted deposits from interest-bearing checking accounts to savings-type accounts in order to reduce reserve requirements.

## The Course of Policy and Interest Rates

The Federal Reserve entered 1995 having tightened policy appreciably during the previous year. Short-term interest rates had risen more than 2½ percentage points from the end of 1993, and long-term rates were up 2 percentage points. Policy tightening had been necessitated by the threat of rising inflation posed by unusually low real short-term interest rates earlier in the 1990s. Rates had been kept low to counter the effects of impediments to credit flows and economic growth. But as these impediments were reduced, the economy expanded at an unsustainable pace and margins of underutilized labor and capital began to erode. Ultimately, absent a firmer policy, excessive demands on productive resources and resulting higher inflation would have produced strains, threatening economic expansion.

In early February the policy actions taken in 1994 did not appear to be sufficient to head off inflationary pressures. The growth of economic activity had not shown convincing signs of slowing to a more sustainable pace, and available information, including a marked rise in materials prices during the last half of 1994, seemed indicative of emerging resource constraints and building inflationary pressures. In these circumstances, the FOMC agreed on a ½ percentage point increase in the federal funds rate, and the Board of Governors approved an equal increase in the discount rate.

During the remainder of the winter and through the spring, incoming data signaled that economic growth was finally moderating. At first, it was unclear if the slowdown was temporary or if it was a lasting shift toward a sustainable rate of economic expansion in the neighborhood of the economy's potential. Adding to the uncertainty was a pickup of consumer price inflation and a pronounced weakening in the foreign exchange value of the dollar. At the March meeting, the FOMC determined that it would be prudent to await further information before taking any additional policy actions, but it alerted the Manager of the System Open Market Account that, if intermeeting action were to be required, the step would more likely be to firm than to ease.

By the May meeting, substantial evidence had accumulated that the threat of rising inflation had lessened. Economic growth had slowed; although the adjustment to inventory imbalances that had developed earlier in the year was contributing to the slowdown, the underlying trajectory of final sales was still uncertain. The FOMC determined that the existing stance of policy was appropriate and expressed no presumption as to the direction of potential policy action over the intermeeting period, issuing a symmetric directive to the Account Manager.

Intermediate- and long-term interest rates had fallen throughout the winter and spring, as evidence accumulated that the expansion of economic activity was slowing and that inflationary pressures were ebbing. Furthermore, budget discussions in the Congress seemed to foreshadow significant fiscal restraint over the balance of the decade, putting additional downward pressure on these rates. Short-term rates had declined less, but in late spring, financial market participants had begun to anticipate an easing of monetary policy. By midyear, the three-month Treasury bill rate had declined about ¼ percentage point from its level at the beginning of the year, while rates on securities with maturities greater than one year had dropped as much as 2 percentage points.

Employment data released shortly after the May FOMC meeting were surprisingly weak, and by the July meeting it appeared that growth of aggregate output had sagged markedly during the second quarter as businesses sought to keep inventories from rising to undesirable levels. This deceleration of output growth was accompanied by a softening of industrial prices and a marked reduction in the pace at which materials prices were rising. With the economy growing more slowly than had been anticipated and potential inflationary pressures receding, the FOMC voted to ease reserve pressures slightly with a ¼ percentage point decline in the intended federal funds rate.

Although financial market participants had anticipated a decline in the federal funds rate at some point, bond and equity markets rallied strongly immediately after the change in policy was announced. However, a pickup in economic growth during the summer made further reductions in the funds rate appear less likely, and interest rates backed up for a time.

The Committee did keep rates unchanged at the August and September meetings. Although inflation had improved, the slowdown had been anticipated to a considerable extent. Moreover, uncertainties about federal budget policies and their effects on the economy remained substantial.

At the November meeting, the economic signals were mixed. Anecdotal information tended to suggest a softening in spending after the third quarter, but the extent of any slowing of spending and inflation was unclear. Although short-term rates remained above long-term averages on a real, inflation-adjusted basis, substantial rallies in bond and stock markets were thought likely to buoy spending. Against this backdrop, the FOMC voted to maintain the existing stance of monetary policy.

The generally positive news about inflation and hopes for a budget agreement had helped propel the bond market higher throughout the fall. By the December meeting, intermediate- and long-term interest rates were 1¾ to 2½ percentage points below their levels at the beginning of the year. The bond market rally, along with strong earnings reports, pushed equity prices higher during the year, and by mid-December, equity price indexes were up about 35 percent from levels at the beginning of the year. Since the last easing in July, inflation had been somewhat more favorable than anticipated, and the expansion of economic activity had moderated substantially after having posted a strong third quarter. With both inflation and inflation expectations more subdued than expected, and with the slowing in economic growth suggesting that price pressures would continue to be contained, the FOMC decided to reduce the intended federal funds rate an additional ¼ percentage point, bringing it to 5½ percent.

The data available at the time of the FOMC meeting in late January gave stronger evidence of slowing economic expansion. This development reduced potential inflationary pressures going forward and raised questions about whether monetary policy might unduly restrain the pace of expansion. The Committee believed that a further slight easing in monetary policy was consistent with keeping inflation contained and fostering sustainable growth, given that price and cost trends were already subdued. In these circumstances, the Committee lowered the intended federal funds rate ¼ percentage point, to 5¼ percent, and the Board approved an equivalent reduction in the discount rate, to 5 percent.

Partly as a consequence of the System actions in December and January, short- and intermediate-term interest rates have fallen ¼ to ½ percentage point since mid-December. However, on balance, longer-term rates are unchanged to a little higher. The absence of a firm agreement to reduce the federal budget deficit, and some tentative signs most recently that the economy might not be so sluggish as some market participants had feared, have held up longer-term rates.

## Credit and Money Flows

On balance in 1995, the debt of the domestic nonfinancial sectors grew at about the same pace as in the previous year, although within the year, debt growth was much stronger in the first half than in the second. Credit supplies remained plentiful: Banks continued to be willing lenders, and in securities markets most interest-rate spreads remained quite narrow. Debt burdens for households increased, but except for a few types of consumer credit obligations, delinquency rates remained at low levels. Rising equity prices bolstered the overall financial condition of households.

Federal debt rose 3¾ percent in 1995, slightly less than in 1994. The federal government's demands for credit fell largely because the budget deficit shrank about 20 percent for the calendar year. Federal debt growth also slowed toward year-end as the Treasury drew down its cash balance to keep borrowing within the $4.9 trillion debt ceiling.

### Growth of Money and Debt

Percent

| Measurement period | M1 | M2 | M3 | Domestic non-financial debt |
|---|---|---|---|---|
| *Year*[1] | | | | |
| 1980 | 7.5 | 8.7 | 9.6 | 9.5 |
| 1981 | 5.4 | 9.0 | 12.4 | 10.2 |
| | 2.5[2] | | | |
| 1982 | 8.8 | 8.8 | 9.7 | 9.8 |
| 1983 | 10.3 | 11.8 | 9.5 | 11.9 |
| 1984 | 5.4 | 8.1 | 10.8 | 14.6 |
| 1985 | 12.0 | 8.6 | 7.7 | 14.3 |
| 1986 | 15.5 | 9.2 | 9.0 | 13.3 |
| 1987 | 6.3 | 4.2 | 5.9 | 9.9 |
| 1988 | 4.3 | 5.7 | 6.3 | 9.0 |
| 1989 | .5 | 5.2 | 4.0 | 7.8 |
| 1990 | 4.2 | 4.1 | 1.8 | 6.8 |
| 1991 | 7.9 | 3.1 | 1.2 | 4.6 |
| 1992 | 14.3 | 1.8 | .6 | 4.7 |
| 1993 | 10.5 | 1.4 | 1.0 | 5.2 |
| 1994 | 2.4 | .6 | 1.6 | 5.2 |
| 1995 | –1.8 | 4.2 | 6.1 | 5.3 |
| *Quarter (annual rate)*[3] | | | | |
| 1995:Q1 | –.1 | 1.4 | 4.8 | 5.3 |
| Q2 | –.5 | 4.3 | 6.7 | 7.0 |
| Q3 | –1.5 | 7.0 | 8.0 | 4.6 |
| Q4 | –5.1 | 4.0 | 4.4 | 3.9 |

1. From average for fourth quarter of preceding year to average for fourth quarter of year indicated.
2. Adjusted for shift to NOW accounts in 1981.
3. From average for preceding quarter to average for quarter indicated.

State and local government debt fell 5½ percent—more than in 1994. A few years earlier, municipalities had taken advantage of low long-term rates to pre-refund a substantial volume of issues, many of which were eligible to be called in 1995. As those securities were called, and with gross issuance light, the stock of municipal securities contracted for a second consecutive year. Despite the overall reduction in debt outstanding, the ratios of tax-exempt to taxable yields jumped in the first half of the year and, for long-term debt, held at an elevated level during the remainder of the year. This increase was associated with concerns about the effect on demands for tax-free municipal debt of proposals for changes in federal taxation that would sharply reduce the tax advantages of holding municipal bonds.

Household borrowing remained robust in 1995, moderating only a bit from 1994, and the ratio of household debt to disposable personal income rose further. Even so, the financial condition of this sector remained good on balance, although there were signs of deterioration. The rally in the domestic equity markets supported household balance sheets by boosting net worth sharply. In addition, delinquency rates on home mortgages and closed-end consumer loans at banks, while rising, remained at low levels. Other indicators, however, provided evidence that some households were likely beginning to experience increased financial pressures. For instance, delinquency rates on credit card debt held by banks and on auto loans booked at captive finance companies rose sharply. Furthermore, the average household debt-service burden—calculated as the share of disposable income needed to meet required payments on mortgage and consumer debt—continued to rise last year. This measure of debt burden has now reversed about one-half of the decline it posted earlier in the decade.

The average debt-service burden of nonfinancial corporations—the ratio of net interest payments to cash flow—also rose last year, but it remained well beneath the most recent peak reached in 1990. The increase in debt burden was in part associated with the relatively strong growth of the debt of nonfinancial businesses. This sector's debt growth was especially robust early in the year, when business fixed investment picked up further and inventory accumulation was rapid. Debt issuance was also boosted by the rising wave of mergers, although a good number involved stock swaps. Financing needs fell back later on as investment growth slowed and profits increased. Funding patterns also shifted as bond yields fell, and firms relied more heavily on longer-term debt. Despite the increase in credit demands, interest rate spreads of investment-grade private securities over comparable Treasuries widened only slightly and remained narrow by historical standards, suggesting that lenders continued to view balance sheets of nonfinancial corporations as remaining healthy on the whole. Spreads on below-investment-grade debt rose more sharply but stayed well beneath levels reached early in the decade.

Commercial banks met a significant portion of the increase in business credit demands last year, which, in turn, contributed to the rapid expansion of bank

### Distribution of Bank Assets by Capital Status

Percentage of industry assets

| | 1990:Q4 | 1995:Q3 |
|---|---|---|
| Undercapitalized | 31.3 | .5 |
| Adequately capitalized | 38.6 | 2.9 |
| Well capitalized | 30.1 | 96.6 |

NOTE. Adjusted for examiner ratings.

balance sheets. Banks funded a portion of the loan increase by reducing their securities holdings, although higher market prices of securities and off-balance-sheet contracts left reported securities holdings slightly higher for the year. In fact, bank security holdings relative to the size of their balance sheets remained elevated and, together with banks' strong capital positions, indicated that late in the year banks were well positioned to continue accommodating the credit demands of households and businesses. Although qualitative information suggested that banks were no longer reducing the standards businesses needed to meet to qualify for loans, some easing of credit terms continued, with interest rate spreads on business loans narrowing further. Growth of real estate loans held by banks slowed over the year as the share of fixed rate mortgages in total originations rose with the decline in long-term rates. Banks tend to securitize fixed rate mortgages more than adjustable rate loans. Consumer loans on the books of banks began the year growing at very high rates; this growth decelerated throughout 1995 as the volume of securitization increased. In response to rising delinquency rates, some banks tightened terms and standards for consumer loans toward the end of 1995 and early 1996.

Total assets of thrift institutions are estimated to have risen slightly last year. Growth at healthy thrift institutions more than offset a substantial transfer of thrift assets to commercial banks through mergers. The revival of growth in thrift assets, along with the strong showing of bank credit, helped to nudge up depository credit as a share of domestic nonfinancial debt for the second straight year after fifteen years of declines. Banks and thrift institutions still account for more than one-third of all credit to nonfinancial sectors.

Banks and thrift institutions funded a large share of their asset growth with deposits, and M3 grew 6 percent. The non-M2 portion of M3 was especially strong, in part as depository institutions substituted large time deposits for non-deposit sources of funds. The sharp reduction in deposit insurance premiums, which made large time deposits a more attractive source of funds, probably contributed to this shift. Late in the year, branches and agencies of Japanese banks, facing some resistance in U.S. funding markets, ran off time deposits while continuing to increase their funding from overseas offices.

M2 rose as lower market interest rates and a flatter yield curve increased the relative attractiveness of retail deposits.[1] As is typical, deposit interest rates, and to a lesser extent returns on money market mutual funds, adjusted slowly to declines in market rates last year. Falling interest rates for comparable maturity market instruments were not the whole story for the growth of M2, however. As the yield curve flattened, the relative gains from holding longer-term assets with less certain price behavior

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1. In February 1996 M2 was redefined to exclude overnight repurchase agreements (RPs) and overnight Eurodollars; these instruments will remain in M3. These items were first included in M2 in 1980 because they were being substituted for demand deposits as businesses were in the process of managing their cash holdings more closely. Since then, other uses of overnight RPs and Eurodollars have come to dominate movements. Moreover, while RPs and Eurodollars are only 3 percent of M2, they contribute substantially to the short-run volatility of that aggregate. Removing these components from M2 should make the weekly levels of the aggregate less volatile and reduce the reporting burden on banks that have had to distinguish between overnight and term RPs and Eurodollars. On a monthly and quarterly basis, the relationships of the two measures of M2 to income and interest rates are almost indistinguishable. The historical M2 data presented in this report exclude overnight RPs and overnight Eurodollars.

fell, and this probably strengthened household demand for components of M2. Even so, M2 velocity was about unchanged after having increased for four years.

M1 fell almost 2 percent in 1995, the first annual decline since the beginning of the Board's official series in 1959. Sweeps of deposits from reservable checking accounts, a component of M1, to nonreservable money market deposit accounts were a major influence. Without these sweeps, M1 would have risen 1 percent. By the end of last year, sweeps had spread to thirty-two bank holding companies, and the initial amounts swept by these programs totaled $54 billion. The corresponding decline of more than $5 billion in required reserves largely showed through to reserve balances maintained at Federal Reserve Banks. As banks continue to introduce retail sweep programs in the future, the aggregate level of required reserve balances will tend to fall further. Although it has not happened yet, one possible consequence of the declining required reserve balances is greater instability in the aggregate demand for reserves and in overnight interest rates. In 1991, after the cut in reserve requirements at the end of 1990, unusually low levels of required reserve balances were associated with greater variability in the federal funds rate, as banks' volatile clearing needs began to dominate the demand for reserves, making daily reserve demand more difficult to estimate.

The run-off in reserve balances held down the growth of the monetary base to 4 percent in 1995. In addition, currency growth slowed, primarily owing to reduced shipments abroad. Foreign demand moderated with the stabilization of financial conditions in some countries where dollars circulate widely. Indeed, reduced demands from abroad contributed to a rare decline in the currency component of M1 this past summer, the first decrease since the early 1960s. The demand for existing Federal Reserve notes also slackened in anticipation of the introduction of a newly designed $100 bill that will be more difficult to counterfeit.

## Foreign Exchange Developments

The weighted-average foreign exchange value of the dollar in terms of the other G-10 currencies declined about 5 percent on balance last year. The dollar fell sharply through April and reached a low almost 10 percent below its value at the end of 1994. The downward pressure against the dollar was sparked by indications of some slowing of the pace of U.S. real output growth, which contributed to expectations that further increases in U.S. interest rates were unlikely, and by the acrimony surrounding the ongoing trade dispute between the United States and Japan. The crisis in Mexico also weighed on the dollar. On several occasions in March and early April the Trading Desk at the Federal Reserve Bank of New York, joined by some other central banks, intervened to buy dollars on behalf of the Department of the Treasury and the Federal Reserve System in an effort to counter the pressure for dollar depreciation.

The release by the G-7 officials of the communiqué from their meeting in late April supporting an orderly reversal of the dollar's decline and the signing of a trade agreement between the United States and Japan at the end of June helped to stabilize the dollar, which had fluctuated narrowly until early August. The dollar then rebounded somewhat and remained within a narrow range through the end of the year. The recovery of the dollar stemmed, in part, from perceptions that its earlier decline, particularly in terms of the yen, had been excessive in light of the underlying fundamentals. Moreover, weakness in the economies of some other major industrial countries began to emerge, reducing prospective returns available abroad. At times from May through August, the Trading Desk again entered the market in conjunction with other central banks to intervene in support of the dollar, reinforcing the view that U.S. authorities were committed to a strong dollar.

In all of the major foreign industrial countries, long-term interest rates declined during 1995, nearly reversing the increases that had occurred during the previous year. On average, rates on foreign government issues with maturities of ten years fell about 150 basis points in the twelve months to December, somewhat less than the decline that occurred in the comparable U.S. rate. In Canada, where economic activity slowed sharply, the drop in long-term rates nearly matched that in the United States, while in Italy, where political uncertainty remained a concern throughout the year, rates fell only 100 basis points. During the first few weeks of this year, long-term rates abroad generally moved down somewhat more but then most recently returned to their December average levels. An important exception is Japan, where rates have risen from their late-December levels, apparently reflecting market perceptions that the stage is set for a Japanese economic recovery. Short-term market rates in the major foreign industrial countries were mixed, but on average rates moved down.

On balance, the dollar depreciated about 8 percent in terms of the German mark during 1995 and by similar amounts in terms of most other currencies participating in the Exchange Rate Mechanism of the European Union. After substantial depreciation against the mark early in the year, the dollar stabilized and then partly recovered as economic indicators revealed significant softening in economic activity in Germany. Easing by the Bundesbank during the second half of the year reinforced the view that mark interest rates were not likely to rise and might fall further. The dollar depreciated slightly, on balance, in terms of the Canadian dollar, despite periods of selling pressure on the Canadian dollar during the year related to Canada's fiscal situation and possible secession by Quebec.

Although the dollar did fall to a record low, below 80 yen to the dollar in mid-April, by year-end the dollar had appreciated slightly in terms of the yen from its level at the end of 1994. So far this year, the dollar has appreciated somewhat further against the yen. Resolution of the trade dispute and repeated episodes of exchange market intervention by the Bank of Japan, sometimes in conjunction with U.S. and foreign monetary authorities, contributed to the appreciation of the dollar in terms of the yen during the second half of the year. However, the fundamental cause of the yen's decline during that period probably was the easing of monetary policy by the Bank of Japan that pushed short-term market interest rates to extremely low levels.

In terms of the Mexican peso, the dollar appreciated sharply from the onset of the crisis in late December 1994 to March. The dollar subsequently retraced some of those gains, and the peso–dollar rate fluctuated narrowly through the middle of the year. Uncertainty about the prospects for Mexican economic performance and macroeconomic policy sparked renewed appreciation of the dollar in terms of the peso in November. Since November, data indicating that the decline in Mexican real economic activity may have ended, some intervention by the Bank of Mexico in support of the peso, and a perception that the decline in the peso may have gone too far given the underlying fundamentals have contributed to some rebound of the peso. During the year, the Mexican authorities drew $3 billion on short-term swap lines with the Federal Reserve and the Exchange Stabilization Fund (ESF) of the U.S. Treasury and $10.5 billion on a medium-term swap facility provided by the ESF. By the end of January 1996, the short-term drawings had been entirely repaid.

Adjusted for relative consumer price inflation, the dollar was little changed, on balance, against a multilateral-trade-weighted average of the currencies of eight developing countries that are important U.S. trading partners. The dollar's 30 percent real appreciation against the Mexican peso was about offset by real depreciations against the other seven currencies.

# Report on July 18, 1996

## Monetary Policy and the Economic Outlook

The U.S. economy performed well in the first half of 1996. In early February, when the Federal Reserve prepared its last report on monetary policy, there was some concern about the strength and durability of the current economic expansion: The economy was operating at a relatively high level of resource utilization, but it was not exhibiting a great deal of forward momentum. As the year has unfolded, however, economic activity has proved quite robust. After rising only fractionally in the fourth quarter of 1995, real gross domestic product posted a solid gain over the first half of 1996, providing a considerable lift to job growth. Looking ahead, the members of the Federal Open Market Committee (FOMC) anticipate that economic activity will grow more moderately, on average, in coming quarters and that the unemployment rate will remain around the level it has averaged over the past year and a half.

Although overall consumer price inflation was boosted by higher energy prices during the first half of the year, the underlying trend of prices still appears to have been well contained. Over the past twelve months, the consumer price index excluding food and energy items has risen 2¾ percent—near the lower end of the narrow range that has prevailed since early 1994. Moreover, the deflator for personal consumption expenditures on items other than food and energy derived from data reported in the national income and product accounts (NIPA) has continued to show a slowing trend.

The combination of brisk growth and favorable underlying inflation so far this year has, of course, been welcome. Nonetheless, mounting pressures on resources are apparent in some segments of the economy—most notably in the labor market—and these pressures must be monitored closely. Allowing inflationary forces to intensify would ultimately disrupt the growth process. The Federal Reserve recognizes that its contribution to promoting the optimal performance of the economy involves containing the rate of inflation and, over time, moving toward price stability.

### Monetary Policy, Financial Markets, and the Economy over the First Half of 1996

Information available around the turn of the year suggested that the economy had downshifted after posting a strong gain in the third quarter of 1995. The growth of final demand appeared to have slowed, reflecting importantly a deceleration of consumer spending. In addition, hesitant growth abroad and a strengthening in the foreign exchange value of the dollar relative to the levels prevailing at mid-1995 were seen as limiting the prospects for further growth in exports. The slowdown in the growth of final demand had given rise to inventory buildups in some industries; in turn, the production cutbacks undertaken in response to those buildups were having a further damping effect on economic activity. Meanwhile, data on prices and wages suggested that inflation performance continued to be fairly satisfactory—indeed, better than many members of the FOMC had expected as of midyear 1995. To keep the stance of monetary policy from becoming effectively more restrictive owing to the slowdown in inflation in the second half of last year and to promote sustainable growth, the Committee eased the stance of policy in December 1995 and again at the end of January 1996, bringing the federal funds rate down a half percentage point in total, to 5¼ percent.

Most participants in financial markets were unsurprised by these policy adjustments, given the economic backdrop. Moreover, they anticipated that there would be scope for additional easing steps in the coming months. Thus, between mid-December and the end of January, interest rates on Treasury securities generally moved lower, especially at short and intermediate maturities, and stock price indexes edged higher on balance. The dollar strengthened slightly on net against the currencies of the other Group of Ten (G-10) countries, reflecting, in part, disappointing news about the pace of activity in Europe and consequently larger declines in interest rates there than in the United States.

The underlying trends in the economy early in the year were obscured to a degree by extraordinarily adverse weather that affected a significant part of the country. Through the course of the next few months, however, it became increasingly clear that the economy had regained vitality. Consumer spending perked up after a lackluster holiday season and was only temporarily depressed by the severe winter. Business demand for equipment proved quite strong, as did housing demand. The strengthening in sales facilitated businesses' efforts to control their inventories, and as that situation improved, industrial production rebounded smartly. Overall employment growth was brisk, and by June the unemployment rate reached its lowest level in six years.

Inflation during the first half of the year was generally well behaved. Energy prices surged, mainly in response to a run-up in the world price of oil, and bad news about grain crops raised the prospect of higher food prices down the road. However, price inflation for consumer items other than food and energy held steady or moved a bit lower. Labor costs presented a mixed picture. The increase in total hourly compensation over the first three months of the year, as measured by the employment cost index (ECI), was in line with its recent moderate trend. However, within total compensation, the wage and salary component of the ECI surged in the first quarter, and further signals of wage acceleration came from a more rapid increase in average hourly earnings in the second quarter.

Against the backdrop of stronger activity but subdued inflation trends, the Federal Reserve made no adjustments to its policy stance after January. With economic activity more clearly on the upswing, however, and prospects for a breakthrough on the federal budget seeming to fade, intermediate- and long-term interest rates reversed course in February and trended up over subsequent months. Since the end of December, the yield on the thirty-year Treasury bond has increased about 1 percentage point, on net, while the yield on the five-year note has risen about 1¼ percentage points over the same period. The rate on three-month bills has edged up only slightly. Despite the backup in bond yields, major stock-price indexes rose considerably further through the first half of the year; most of those gains were erased in late June and the first half of July, however, as company reports raised questions about the pace of earnings growth. The rise in bond yields has boosted the dollar in foreign exchange markets; since mid-April, the dollar has generally traded against an average of the currencies of the other major industrial countries about 4 percent above its level at the end of December.

During the first half of the year, credit remained easily available to most household and business applicants. Interest rate spreads on private debt over Treasury securities remained narrow. In response to the recent increase in delinquencies on credit card accounts, many banks have tightened their standards for approval of new accounts, but this appears to have only partially reversed a marked relaxation of such standards earlier this decade, and banks overall remain aggressive in the pursuit of new borrowers, especially business clients. The debt of all domestic nonfinancial sectors combined expanded at about a 4¾ percent annual pace, placing this aggregate near the middle of its monitoring range. M2 and M3 are currently near the 5 percent and 6 percent upper boundaries of their respective growth ranges, in line with the FOMC's expectation as of last February. In contrast to the experience of the early 1990s, growth in the monetary aggregates relative to nominal gross domestic product has been broadly in line with historical relationships, given the structure of interest rates.

## Economic Projections for 1996 and 1997

As noted previously, the members of the Board of Governors and the Reserve Bank presidents, all of whom participate in the deliberations of the Federal Open Market Committee, generally think it likely that economic activity will return to a moderate growth path in the second half of 1996 and in 1997 after the larger gains in the first half of this year. The resulting increase in real GDP over 1996 as a whole would be in the range of 2½ percent to 2¾ percent, somewhat above the forecasts in the February report on monetary policy. For 1997, the central tendency of the forecasts spans a range of 1¾ percent to 2¼ percent. The civilian unemployment rate, which averaged around 5½ percent in the second quarter of 1996, is expected to stay near this level through the end of this year and perhaps to edge higher during 1997.

Economic activity clearly retains considerable momentum. The trend in final demand is positive, and inventories appear to be well aligned with the current pace of sales—perhaps even a bit lean. Accordingly, the members of the FOMC recognize the possibility that growth could remain elevated a while, with the potential for putting greater pressure on resources. Nonetheless, most members think that some slowing from the rapid growth pace recorded, on average, in the first half is the most likely outcome. Housing construction and other interest-sensitive activity should be restrained to some degree by the rise in long-term interest rates over the past several months. And although some of the lagging economies abroad are expected to perform better this year, there are still concerns about the solidity of that acceleration and the associated lift to U.S. exports. In addition, growth in real business fixed investment appears to be tapering off, although spending will likely remain buoyant because of the rapid rate of product innovation and dramatic price declines in the computer area. Consumer spending is also expected to grow less rapidly in coming quarters. Household wealth has been boosted substantially by the run-up in stock prices over the past year and a half, but for many households, debt burdens have risen significantly in recent years and may represent a constraint on purchases of big-ticket items.

Most members of the FOMC expect the rise in the consumer price index over the four quarters of 1996 to be in the range of 3 percent to 3¼ percent, about ¼ percentage point higher than they predicted last winter. The projected increase in the consumer price index is also somewhat larger than that recorded in 1995. However, that step-up would mainly reflect developments in the food and energy sectors, which are likely to add to overall inflation in 1996 after having damped it in 1995. Apart from these volatile sectors, inflation has remained in check so far this year despite high levels of resource utilization and reports that tightness in some parts of the labor market is placing upward pressure on wages. Assuming no further adverse shocks to food and energy prices, and in the context of the Federal Reserve's intent to keep trend inflation well contained, the Committee believes that overall CPI inflation should recede. Accordingly, the central tendency of the FOMC's forecasts shows CPI inflation dropping back to the range of 2¾ percent to 3 percent in 1997.

### Economic Projections for 1996 and 1997

Percent

| Measure | Federal Reserve governors and Reserve Bank presidents: Range | Federal Reserve governors and Reserve Bank presidents: Central tendency | Administration |
|---|---|---|---|
| | | 1996 | |
| *Change, fourth quarter to fourth quarter*[1] | | | |
| Nominal GDP | 4¾–5¾ | 5–5½ | 5.0 |
| Real GDP | 2½–3 | 2½–2¾ | 2.6 |
| Consumer price index[2] | 3–3¼ | 3–3¼ | 3.2 |
| *Average level, fourth quarter* | | | |
| Unemployment rate[3] | 5¼–5¾ | About 5½ | 5.6 |
| | | 1997 | |
| *Change, fourth quarter to fourth quarter*[1] | | | |
| Nominal GDP | 4–5½ | 4¼–5 | 5.1 |
| Real GDP | 1½–2½ | 1¾–2¼ | 2.3 |
| Consumer price index[2] | 2½–3¼ | 2¾–3 | 2.8 |
| *Average level, fourth quarter* | | | |
| Unemployment rate[3] | 5½–6 | 5½–5¾ | 5.7 |

1. Change from average for fourth quarter of preceding year to average for fourth quarter of year indicated.
2. All urban consumers.
3. Civilian labor force. Figure for the Administration is an annual average.

The Committee's inflation projections incorporate the technical improvements the Bureau of Labor Statistics is making to the CPI in 1996 and 1997; they are expected to shave a little from inflation in both years. The Committee also recognizes that the remaining biases in the CPI are not negligible and may not be stable over time. Thus, it will continue to monitor a variety of alternative measures of price change as it attempts to gauge progress toward the long-run goal of price stability.

The Administration has just released its midyear update to its economic and budgetary projections. Its forecasts for real growth and inflation in 1996 and 1997 are broadly in line with the central tendencies of the forecasts of Federal Reserve policymakers.

## Money and Debt Ranges for 1996 and 1997

At its meeting earlier this month, the Committee reaffirmed the ranges for 1996 growth of money and debt that it had established in February: 1 percent to 5 percent for M2, 2 percent to 6 percent for M3, and 3 percent to 7 percent for the debt of the domestic nonfinancial sectors. In addition, the Committee set provisional growth ranges for 1997 at the same levels.

### Ranges for Growth of Monetary and Debt Aggregates

Percent

| Aggregate | 1995 | 1996 | Provisional for 1997 |
|---|---|---|---|
| M2 | 1–5 | 1–5 | 1–5 |
| M3 | 2–6 | 2–6 | 2–6 |
| Debt | 3–7 | 3–7 | 3–7 |

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

In setting the ranges for M2 and M3, the Committee intended to communicate its expectation as to the growth of these monetary aggregates that would result under conditions of approximate price stability, assuming that the aggregates exhibit the same trends relative to nominal spending that prevailed for many years until the early 1990s and that seem to have reemerged after an intervening period of marked deviation. Based on that reemergence and on Committee members' expectations for the growth of nominal GDP in 1996 and 1997, the Committee anticipates that both M2 and M3 will probably finish near the upper boundaries of their respective ranges each year. The Committee expects that the debt of the domestic nonfinancial sectors will remain near the middle of its monitoring range in 1996 and 1997. In light of the rapid pace of technological change and innovation still occurring in the financial sector—and the attendant uncertainty about the future behavior of the aggregates—the Committee will continue to rely on a wide range of other information in determining its policy stance.

## Economic and Financial Developments in 1996

Economic activity has increased substantially thus far this year. Real gross domestic product grew at an annual rate of about 2¼ percent in the first quarter of 1996, and the available data point to a much larger increase in the second quarter. The increases in activity have been facilitated by generally supportive financial conditions: Although long-term interest rates have risen considerably on net since early 1996, intermediaries have continued to supply credit to most borrowers on favorable terms, and interest rate spreads on corporate securities over Treasury securities have remained narrow. In the foreign exchange markets, the dollar has appreciated, on average, against the currencies of the other major industrial countries.

## Economic Developments

### *The Household Sector*

After a sluggish performance in late 1995, spending by households has picked up noticeably this year. Consumer expenditures increased about 3½ percent at an annual rate in real terms in the first quarter and appear to have posted another sizable gain in the second quarter. In addition, according to indexes such as those compiled by the Survey Research Center at the University of Michigan and the Conference Board, consumer sentiment has generally been relatively upbeat. In the real estate market, sales of new single-family dwellings have posted an average level well above that of last year, thus encouraging builders to boost housing starts.

Outlays for durable goods have continued to be the strongest component of spending, extending the long-standing uptrend in the share of durables in total real consumption. Declining relative prices and the availability of innovative products have continued to lift demand for home electronic equipment and software products. In addition, sales of light motor vehicles, bolstered by relatively generous incentives and perhaps by the cash freed up by the surge in mortgage refinancings last winter, averaged a healthy 15 million unit annual rate in the first half of 1996.

After a lackluster performance in 1995, real outlays for nondurable goods have also risen this year; the average level of these expenditures in April and May was nearly 3 percent at an annual rate above that recorded in the fourth quarter. Meanwhile, spending on services has remained on a moderate uptrend, with short-run variations reflecting the effects of weather on household energy use.

Consumer spending has been supported by brisk gains in wage and salary income associated with the better pace of hiring this year. However, other components of before-tax income, taken together, have risen less rapidly than they did in 1995, and gains in after-tax income were restrained by larger-than-usual tax bills (final payments less refunds) this spring. Accordingly, the level of the personal saving rate in May was somewhat below that recorded in late 1995, although fragmentary data suggest that saving rose sharply in June. In any event, taking a longer perspective, spending and income have grown at roughly similar rates over the past few years, and the saving rate has generally fluctuated in a fairly narrow band between 4 percent and 5 percent since 1993—a low level historically.

The recent developments in financial markets may have had an important influence on the spending decisions of individual households. In particular, households holding large stock portfolios have enjoyed sizable increases in wealth over the past year and a half, which may be inducing them to consume greater fractions of their incomes than they would otherwise. At the same time, a growing number of households are apparently finding it difficult to meet their debt-service obligations, judging from the appreciable rise in delinquency rates on consumer loans in recent years. In addition, it is possible that job insecurity and longer-run concerns about retirement income have caused many households to raise their targets for asset accumulation. However, the relative stability of the saving rate over the past few years suggests that the net effect of these factors on overall consumption—at least to date—has been limited.

Residential construction has, on the whole, been robust this year. Private housing starts averaged nearly 1.5 million units at an annual rate through June, a pace appreciably above that in 1995. In addition, the volume of shipments of mobile homes (“manufactured housing”), which has doubled over the past five years, now stands around 350,000 units at an annual rate, the highest level since 1974.

In the single-family sector, starts and sales of new homes were surprisingly firm in the face of severe weather in early 1996, and they moved still higher in the second quarter. Moreover, the regular survey of the National Association of Homebuilders continued to indicate solid demand through early July, and the Mortgage Bankers Association reported that loan applications for home purchases remained brisk through midyear.

Relative to the lows reached in early 1996, the rate on thirty-year conventional fixed-rate home mortgages has risen nearly 1½ percentage points and has been fluctuating around 8¼ percent in recent weeks. However, a number of factors seem to have cushioned the effects of these higher mortgage rates. In particular, rates on adjustable-rate mortgages have risen only about half as much as have those on thirty-year fixed-rate loans. Also, house prices have firmed somewhat, which may have raised confidence in the investment value of residential real estate and thus contributed to the recent rise in the homeownership rate, which is now at its highest level since the early 1980s. Probably more important in this regard, however, is the trend in the affordability of housing. One simple measure of affordability is the monthly mortgage payment on a new home having a given set of attributes, divided by average monthly household income. Despite the increase in mortgage rates this year, this measure suggests that the cash-flow burden of homeownership is still only modestly above the lows of the past thirty years.

Construction of multifamily housing averaged about 300,000 units at an annual rate in the first half of 1996, a rate somewhat above that in 1995 but a fairly low one historically. Market conditions vary geographically, but the rental vacancy rate for the nation as a whole seems to have tilted back up, after generally trending down between mid-1993 and mid-1995. Also, the absorption rate, which measures the percentage of apartments that are rented within three months of their completion, edged back down in 1995 after several years of increases.

### *The Business Sector*

Developments in the business sector were quite favorable in the first half of 1996. After decelerating in 1995, real business fixed investment rose at a 12½ percent annual rate in the first quarter of 1996, with sizable advances for both equipment and structures. And, although real investment appears to have decelerated again in the second quarter, it probably posted an appreciable gain. Over the past four years, real investment has grown around 8 percent per year, on average, and now stands at a level that implies quite substantial growth in the capital stock. The updating of capital and the increase in capital per worker are key to lifting productivity growth and living standards.

Outlays for producers’ durable equipment rose at an annual rate of about 14 percent in real terms in the first quarter, after a 7½ percent rise over the course of 1995. As has been true throughout the expansion, much of the first-quarter growth was in real outlays for computers and other information-processing equipment; such investment received particular impetus from extensive price cutting in virtually all segments of the computer market and from a push to acquire the state-of-the-art equipment needed to take full advantage of popular new software and opportunities for information transfer. However, incoming orders data and recent anecdotal reports suggest that the growth in real outlays for computers may be slowing. Meanwhile, demand for other types of capital equipment, which had softened in 1995, firmed somewhat in the first quarter.

In the nonresidential construction area, real investment continued to expand in the first quarter. However, the monthly data suggest that outlays softened in the second quarter, an occurrence that is consistent with the downturn in contracts—a forward-looking indicator of construction outlays—since late 1995.

Trends within the construction sector have been divergent. In the office sector, the modest recovery that seemed to be under way appears to have waned even though vacancy rates have continued to fall and transactions prices have continued to rise. Outlays dropped noticeably in the fourth quarter of 1995 and the first quarter of 1996, and preliminary data suggest that they remained at a fairly low level in the second quarter. In contrast, spending for commercial structures other than office buildings, which has been rising briskly since 1992, continued to advance through the first quarter—although further gains may be limited by an emerging excess of retail space in some parts of the country and the recent leveling out of transactions prices. Elsewhere, outlays for industrial construction, which had moved up over 1994 and the first half of 1995, have been nearly flat over the past few quarters, while construction of hotels and motels, which account for less than 10 percent of structures outlays, has boomed.

Investment in nonfarm business inventories slowed dramatically in the fourth quarter of 1995 after running at a fairly rapid pace over much of last year, and it nearly ceased in the first quarter of 1996 as motor vehicle stocks plummeted. Automotive stocks had risen appreciably over the second half of 1995, and some reduction was in train even before a March strike at General Motors curbed production; with the strike, dealer stocks were drawn down sharply. In addition, although firms outside motor vehicles apparently made considerable progress in rectifying inventory imbalances in late 1995, many continued to restrain production in response to continued weak orders in early 1996; producers of household durables and textiles are notable examples.

Inventory investment evidently rebounded in the second quarter, mainly because motor vehicle stocks stabilized as sales and production returned to rough balance. Outside of motor vehicles, stocks accumulated moderately, on balance, in April and May. As of May, inventory–sales ratios for all major sectors were noticeably below their levels in late 1995; the decline in the ratio for retailers was especially steep.

Economic profits of all U.S. corporations continued to surge in the first quarter, extending the steep climb that began in the early 1990s. The strength in profits in recent quarters has been attributable in large part to robust earnings growth at domestic financial institutions and a rebound in profits at foreign subsidiaries of U.S. corporations. In the domestic nonfinancial corporate sector, the profit share—pretax profits divided by the sector's GDP—has been hovering around 10 percent since mid-1994, after having risen appreciably over the preceding few years; its current level is similar to the levels attained in the mid-1980s but well below the highs of the 1960s and 1970s. About half of the increase in the sector's profit share since the early 1990s has reflected a reduction in net interest expenses.

*The Government Sector*

Although the nation continues to grapple with the prospect of growing federal budget deficits in the years ahead, the incoming news on the budget for fiscal 1996 has been extremely favorable. The deficit in the unified budget over the first eight months of the fiscal year—the period from October to May—was only $109 billion, $27 billion less than during the comparable period of fiscal 1995. The improvement in the deficit primarily reflected exceptionally rapid growth in receipts; outlays continued to rise at about the same pace as had been recorded, on average, over the preceding four years. If present trends continue, the fiscal 1996 deficit, when measured as a percentage of nominal GDP, will be the smallest since 1979.

Federal receipts in the first eight months of fiscal 1996 were 8 percent higher than in the same period a year earlier; the rise was considerably greater than that of nominal GDP. Boosted by the upswing in business profits, corporate taxes have been increasing at double-digit rates since fiscal 1993, and that path has extended into fiscal 1996. Individual income taxes have also risen sharply this year; little information is available on the factors behind the surge in individual payments, but it may have resulted, at least in part, from capital gains realizations associated with the strong performance in financial markets last year.

In total, federal outlays in the first eight months of fiscal 1996 were 4 percent higher than during the corresponding period of fiscal 1995. Outlay growth was damped by the reductions in discretionary domestic spending implied by this year's appropriations legislation. However, expenditures for "mandatory" programs continued to rise rapidly, and net outlays for deposit insurance were less negative than in 1995 (that is, insurance premiums and the proceeds from net sales of thrift assets declined). In addition, net interest payments increased moderately, reflecting the growth in the stock of outstanding federal debt.

Federal expenditures on consumption and investment—the part of federal spending included directly in GDP—increased at an annual rate of about 6 percent in real terms in the first quarter of 1996 after declining about 13 percent in the fourth quarter of 1995. In part, real spending rose in the first quarter because the government shutdowns that occurred during the budget crisis depressed real spending less in the first quarter than in the fourth. Even so, given the enacted appropriations, the first-quarter increase was almost surely a transitory spike.

The fiscal position of states and localities has been relatively stable in the aggregate over the past few years. As measured in the NIPA, the surplus (net of social insurance funds) in the sector's operating accounts has fluctuated in the range of $30 billion to $40 billion (annual rate) since the beginning of 1994; it stood around the middle of that range in the first quarter. On the whole, these governments are in considerably better shape than they were in the early 1990s. Even so, the sector remains under pressure to balance rising demand for services—especially in education, corrections, and health care—against the public desire for tax relief.

Real expenditures on consumption and gross investment—the part of state and local spending included directly in GDP—declined somewhat in the first quarter of 1996. However, the decrease reflected primarily the effects of the unusually adverse winter weather, and spending appears to have rebounded in the second quarter. State and local employment posted a respectable gain, on net, over the first six months of the year. In addition, outlays for construction rose about 3½ percent in real terms over the year ending in the first quarter, reflecting higher spending on highways and schools; monthly construction data through May suggest that spending rose substantially in the second quarter.

Receipts of state and local governments rose about 4 percent in nominal terms over the year ending in the first quarter, about matching the rise in nominal GDP. The sector's own-source general receipts, which comprise income, corporate, and indirect business taxes, rose about 1 percentage point faster, with solid gains in all major components. Federal grants have changed little, on net, over the past four quarters.

### *The External Sector*

The nominal trade deficit in goods and services widened from its low fourth-quarter level of $78 billion at an annual rate to $97 billion in the first quarter of 1996, slightly less than the deficit of $105 billion for 1995 as a whole. The current account deficit stood at $142 billion (annual rate) in the first quarter, about the same as the figure for 1995 as a whole. In April, the trade deficit increased from the average level for the first quarter.

After expanding very slowly during the second half of 1995, the quantity of U.S. imports of goods and services rose about 10 percent at an annual rate in the first quarter, and preliminary data for April show another sizable increase. The rebound in imports largely reflected the strengthening of U.S. economic activity. In addition, non-oil import prices have declined somewhat since last fall, after having risen sharply in late 1994 and early 1995. A turnaround in imported automotive vehicles, consumer goods, and non-oil industrial supplies, following more than six months of declines, accounted for most of the increase in imports during the first four months of 1996.

The quantity of U.S. exports of goods and services expanded at a 2 percent annual rate during the first quarter; it also appears to have expanded at about this pace in April. The somewhat subdued pace of export growth so far this year reflects, in part, a bunching of shipments, particularly of machinery, that resulted in an unusually strong increase in exports in the fourth quarter of last year.

Trends in economic activity have varied across the major foreign industrial countries so far in 1996. In Japan, economic recovery appears to have taken hold, although the underlying pace of real GDP growth is clearly less than the nearly 13 percent annual rate reported for the first quarter; the first-quarter growth rate was boosted, in part, by a temporary surge in government spending and measurement practices associated with the leap year.[2] In Canada, growth remained subdued in the

2. Although the statistical agencies in many countries take the number of working days in the quarter into account when seasonally adjusting data, the statistical agencies in Japan, France, and Italy among the G-10 countries do not make working-day adjustments.

first quarter as real GDP rose only 1¼ percent at an annual rate despite much stronger growth in domestic demand; indicators for the second quarter suggest some strengthening.

Economic performance so far this year in Europe has been mixed. In Germany, real GDP declined another 1½ percent at an annual rate in the first quarter, largely because severe weather caused a substantial contraction in construction spending; preliminary data suggest that construction activity rebounded in the second quarter with the return to more normal weather. In contrast, French real GDP expanded nearly 5 percent at an annual rate in the first quarter, supported by a very sizable rebound in consumption as well as leap-year effects; strikes during the fourth quarter of last year depressed economic activity and contributed to a decline in private consumption spending. Indicators for the second quarter suggest that output growth moderated from its first-quarter pace. In the United Kingdom, real GDP grew at an annual rate of 1½ percent during the first quarter, somewhat more slowly than during the second half of 1995. On the policy front, most European countries are seeking to rein in their fiscal deficits during 1996 and 1997, in part to comply with the criterion in the Maastricht Treaty that countries participating in the third stage of the European Monetary Union, now scheduled to begin on January 1, 1999, not have excessive fiscal deficits. As a reference value, the treaty specifies that deficits greater than 3 percent of a country's GDP are excessive, but it also provides scope for accepting deficits above that level in some circumstances.

In Mexico, robust growth of real GDP in the first quarter extended the recovery in economic activity that began in the second half of 1995. Through June, the Mexican trade balance remained roughly stable at the level reached toward the end of last year after having improved markedly over the course of 1995. Argentina also appears to be emerging from the steep declines in output experienced during the first half of 1995, while Chile continues to enjoy steady growth. Activity in Brazil has begun to expand again in recent months, following a sharp contraction in mid-1995.

Economic growth in our major Asian trading partners (other than Japan) appears to have picked up again this year after slowing noticeably during the second half of 1995 from the extremely rapid rates recorded in 1994 and the first half of 1995. The recent pickup in activity was associated with an easing of monetary policy in some of these countries in the second half of last year and the early part of this year. In China, output appears to have expanded during the first quarter at around the 10 percent annual rate recorded in 1995, with a pickup in consumption spending compensating for weaker growth in the external sector.

Consumer price inflation generally stayed low in the major foreign industrial countries and declined or remained moderate elsewhere. In Japan, prices in the second quarter, on average, were slightly above their year-earlier levels because of the effects of yen depreciation on import prices; this upturn followed a year of deflation. In western Germany, inflation slowed through June to only about 1¼ percent. Inflation in Italy remained higher than in the other major foreign industrial countries but slowed to below 4 percent through June. In Canada, inflation also moved down further this year, to about 1½ percent in May.

Inflation trends in Latin America have been mixed. In Mexico, the twelve-month change in consumer prices diminished to about 32 percent in June, compared with a reading of 52 percent for the twelve months ending in December 1995. Consumer price inflation has also declined further in Brazil and remained low in Argentina. In contrast, prices have picked up in Venezuela in response to the depreciation of its currency associated with the adoption of a program of macroeconomic stabilization. In Asia, inflation has decreased so far in 1996 in China and remained moderate to low elsewhere.

*Labor Market Developments.*

Labor demand was strong over the first half of 1996. Growth in nonfarm payroll employment exhibited considerable month-to-month variability but averaged a hefty 235,000 per month. In addition, the civilian unemployment rate remained low, holding in the narrow range around 5½ percent that has prevailed since late 1994.

Employment gains were fairly broadly based over the first half of the year. The services sector, which now accounts for nearly 30 percent of nonfarm employment, continued to be a mainstay of job growth, showing increases of nearly 120,000 per month, on average, over the first half. Within services, growth in employment in business services remained rapid, with large gains at computer and data processing firms as well as at temporary help agencies, and employment in health services trended up further. In addition, construction payrolls rose a brisk 30,000 per month, on average—an annual rate of about 7 percent. Elsewhere, payrolls at wholesale and retail trade establishments continued to increase at about the same pace as that in 1995, and employment in the finance, insurance, and real estate category picked up after having been nearly flat over 1994 and 1995.

Developments in manufacturing were uneven but showed some improvement in the second quarter. As 1996 started, firms were still adjusting employment to the slower path of output that had been evident since early 1995, and payrolls—especially at firms producing nondurable goods—were reduced further. In the past three months, manufacturing employment has held fairly steady, buoyed by the pickup in industrial activity, and the average factory workweek, which had contracted appreciably in 1995, trended up through June.

For the nonfarm business sector as a whole, productivity rose at an annual rate of about 2 percent in the first quarter of 1996, echoing the acceleration in output. However, productivity had posted an outright decline in the fourth quarter of 1995; all told, productivity rose about 1 percent over the year ending in the first quarter of 1996, in line with the average pace this decade. In the manufacturing sector, productivity rose 4¼ percent over the past year, although the reported increase was probably overstated because firms in this sector have been relying increasingly on workers supplied by temporary help firms, who are counted as service industry employees rather than as manufacturing employees in the establishment survey of the Bureau of Labor Statistics.

Labor force participation has remained sluggish this year. The participation rate, which measures the percentage of the working-age population that is either employed or looking for work, did retrace the dip that occurred in late 1995. But taking a longer perspective, the overall participation rate (adjusted for the redesign of the household survey in 1994) has changed little, on net, since 1989 after rising fairly steadily from the mid-1960s to the late 1980s. The flattening reflects mainly a marked deceleration in women's participation, owing both to a leveling off in the percentage of women who are in the labor force for at least part of a given year and slower growth in the average number of weeks they spend in the labor force that year. Moreover, with the average number of weeks these women spend in the labor force having risen to a level only slightly below the average for men, a significant rebound in participation does not seem very likely over the near term. The sluggishness in participation tends to restrain the growth of potential output unless it is offset by a better productivity performance or by faster growth in the working-age population—neither of which has yet been in evidence.

Despite the tightness in labor markets in recent quarters, the broad trends in hourly compensation appear to have held fairly steady. The employment cost index for private industry—a measure that includes wages and benefits—rose at an annual rate of about 3 percent over both the first three months of 1996 and over the twelve months ending in March; the ECI had also increased about 3 percent over the twelve months ending in March 1995. Compensation growth has continued to be damped by a marked deceleration in employer-paid benefits—especially payments for medical insurance, which have been restrained by the slowing in medical care costs, the switch in insurance arrangements from traditional indemnity plans to health maintenance organizations and other managed care plans, and changes in the provisions of health plans (including greater sharing of health care costs by employees). On the whole, wages also seem to have been held in check, although the most recent data may be hinting at some acceleration. Notably, the wage and salary component of the ECI rose sharply in the first quarter; although the data are volatile and the first-quarter figure likely overstates current wage trends, the twelve-month change in the series moved up to 3¼ percent, nearly ½ percentage point larger than the increases in the preceding two years. Separate data on average hourly earnings of production or nonsupervisory workers also show a recent acceleration in wages; the twelve-month change in this series moved up to about 3½ percent in June.

*Price Developments*

The underlying trend of prices has remained favorable this year—notably, the CPI excluding food and energy rose at an annual rate of 2¾ percent over the first six months of the year, near the lower end of the narrow range than has been evident since early 1994. Developments in food and energy markets boosted overall inflation, however, and the total CPI rose at an annual rate of 3½ percent over the first half; this pattern was the reverse of that seen in 1995, when a small drop in energy prices, combined with only a modest increase in food prices, held the rise in the total CPI to just 2½ percent. Meanwhile, the producer price index for finished goods rose about 2¾ percent over the twelve months ending in June; excluding food and energy, the PPI rose 1½ percent, a bit less than over the preceding year.

Consumer energy prices picked up around the turn of the year and rose at an annual rate of about 12 percent, on net, over the first six months of 1996. With crude oil stocks drained by strong worldwide demand for heating oil and weather-related supply disruptions in the North Sea and elsewhere, the spot price of West Texas intermediate (WTI) soared from around $18 per barrel, on average, in the second half of 1995 to a high of around $25 per barrel in mid-April; the WTI price has since retraced much of that run-up. Reflecting the surge in crude oil prices, retail prices of refined petroleum products rose sharply through May, on balance. However, they fell markedly in June, and private surveys of gasoline prices imply a further decrease in early July.

Retail food prices rose at an annual rate of about 4 percent over the first six months of 1996, somewhat above the pace of the preceding few years. At the farm level, prices of grains and other commodities rose to exceptionally high levels as adverse crop conditions in some parts of the country exacerbated an already tight stock situation. For some foods—notably, dairy products, cereals and bakery products, poultry, and pork—the pass-through tends to occur relatively rapidly, and retail prices of such items have already risen appreciably. Beef prices fell through May as producers sold off herds in response to higher feed costs and poor range conditions; they turned around in June and will likely rise further over the next several quarters as the selloff of breeding stock will eventually lead to tighter supplies.

Price increases for consumer goods other than food and energy slowed to 1 percent at an annual rate over the first half of 1996, after averaging about 1½ percent per year over the preceding three years. Increases in goods prices have been restrained, in part, by the uptrend in the dollar since mid-1995, which has helped to damp import prices. In addition, with the operating rate in the manufacturing sector having fallen to about its long-term average, pressure from the materials side has been limited. Indeed, the PPI for intermediate materials (excluding food and energy) actually fell a bit over the past twelve months, after having risen 7½ percent over the preceding year. Looking ahead, however, the latest report from the National Association of Purchasing Managers suggests that vendor performance deteriorated markedly in June, a development that could portend some firming of prices of materials and supplies over the near term.

Prices of non-energy services rose 3¾ percent at an annual rate over the first half, about the same as the rise over 1995 as a whole. Airfares accelerated significantly in the first half. However, shelter costs increased less rapidly than they had in 1995, and prices of medical care continued to decelerate; over the six months ending in June, the CPI for medical care services rose at an annual rate of only about 3¼ percent, roughly 1 percentage point below the 1995 pace. Moreover, there is some evidence that the CPI may be understating the recent slowing in medical care inflation, in part because it does not fully capture the discounts negotiated between medical providers and insurers, including managed care plans. The price measure used to deflate consumer expenditures on medical care in the NIPA better reflects such factors; it rose less than 2 percent over the year ending in the first quarter of 1996 after having risen 4½ percent over the preceding year.

Judging from the various surveys of consumers and forecasters, expectations of near-term CPI inflation deteriorated slightly in the first half of 1996. Notably, although both the University of Michigan and the Conference Board had reported a noticeable drop in their one-year-ahead measures in the second half of 1995, that improvement was not sustained in 1996; the recent monthly readings have bounced around, but the June results from both surveys were similar to those recorded, on average, in the first half of 1995. In contrast, longer-run inflation expectations, which have presumably been less affected by the recent news in food and energy markets, have held fairly steady. Smoothing through the monthly data, the University of Michigan's measure of expected CPI inflation over the next five to ten years has not changed much since late 1994, and the survey of professional forecasters conducted by the Federal Reserve Bank of Philadelphia during the second quarter of 1996 produced the same expectation for the succeeding ten years as that in the survey taken in the fourth quarter of 1995.

## Financial Developments

### *Credit*

Financial conditions in the first half of 1996 supported the pickup in the growth of spending. For the most part, lenders continued to pursue credit applicants aggressively as reflected, for example, in narrow spreads of interest rates on corporate securities over those on Treasury securities. The debt of domestic nonfinancial sectors increased about 4¾ percent at an annual rate from the fourth quarter of 1995 through May of this year, a pace that was a bit slower than last year but still sufficient to place the level of this aggregate in the middle of its monitoring range for 1996.

### *The Government Sector*

Federal debt outstanding increased about 4 percent at an annual rate over the first half of 1996, a shade below the average rate of increase last year. The impasse over the debt ceiling disrupted the timing and size of some Treasury auctions but did not alter the longer-term trajectory of federal debt.

The pattern of net borrowing by state and local governments in the past several years has been heavily influenced by their efforts to retire debt issued at relatively high interest rates in the mid-1980s. They have pursued these efforts through a strategy of advance refunding: In the early 1990s, when bond yields were seen as especially favorable, state and local governments issued new debt, even before call provisions on the older bonds could be exercised, and placed the proceeds in escrow accounts. As it became possible to do so, the issuing governments began calling the older debt, using the contents of the escrow accounts to complete the transactions. Reflecting these retirements, the amount of state and local government debt outstanding declined about 4 percent per year in 1994 and 1995. This process is still in train but evidently on a smaller scale; available information suggests that state and local government debt outstanding declined only marginally during the first half of this year.

### *The Household Sector*

The pace of borrowing by households appears to have moderated somewhat from the elevated rates of 1994 and 1995, but it remains substantial. In particular, consumer credit expanded at a 9½ percent annual rate from the fourth quarter of 1995 through May of this year, a rate that was down from 14½ percent over the four quarters of 1995. Mortgage debt actually expanded somewhat more rapidly during the first quarter than in 1995 (7¾ percent at an annual rate versus 6½ percent), and available indicators suggest that growth during the second quarter dropped back only to about last year's pace. The recent backup in mortgage rates, which only began in February, has had little effect on borrowing thus far and might even have increased it temporarily by accelerating transactions.

The rapid growth in household debt during the past few years has resulted in a sizable increase in the estimated ratio of scheduled payments of principal and interest to disposable personal income. This measure of debt-servicing burden has trended up over the past two years, and as of the first quarter of 1996, was approaching—but still short of—the levels attained toward the end of the last business cycle expansion.

Several other recent indicators suggest that some households are experiencing financial strains. For example, the Consolidated Report of Condition and Income shows that the delinquency rate on credit-card receivables at commercial banks has increased significantly in recent quarters, retracing about one-third of the improvement that took place during the first few years of the current economic expansion. The delinquency rate on auto loans at the finance companies affiliated with the major manufacturers moved up sharply beginning about two years ago and since late last year has hovered around historically high levels. Anecdotal evidence suggests that the rise in both credit card and auto-loan delinquency rates reflects a strategy to liberalize lending standards as part of an overall marketing effort. The auto loan delinquency rate has also been boosted a bit by the increased prevalence of leasing. Lease customers tend to be better credit risks than the average conventional borrower, and the shift toward leasing has had the effect of skimming the more financially secure car buyers and thus degrading somewhat the remaining pool of people financing their purchases through conventional loan contracts.

The personal bankruptcy rate also surged to a new high this year. The extent to which this development reflects mounting financial difficulties of households is clouded, however, by changes in federal law (effective at the start of 1995) that may have increased the attractiveness of bankruptcy by increasing the value of assets that can be protected from liquidation in bankruptcy proceedings. The "cost" of bankruptcy to households has also been effectively lowered by the greater willingness of lenders to extend credit to riskier borrowers—even those with a previous bankruptcy on their records.

Other indicators are less suggestive of a deterioration in the financial condition of households. For example, the delinquency rate for mortgage loans sixty days or more past due at all lenders is near its lowest level in two decades, while the rate on closed-end consumer loans—despite having moved up over the past eighteen months—remains low by historical standards. Moreover, the aggregate balance sheet of the household sector clearly is in very good shape; owing in large part to the surge in equity prices over the past year and a half, the ratio of household net worth to disposable personal income moved up into record territory recently.

Apparently in response to the recent run-up in delinquency and charge-off rates on consumer loans, banks have selectively tightened their standards for consumer lending. These actions reversed steps taken earlier in the decade, when many card issuers increased the growth of their credit card receivables by offering accounts to customers who previously would have been denied credit. The belief was that more sophisticated credit-scoring techniques would control risks adequately, but it appears that some "adverse selection" occurred and that the uptick in delinquencies has been larger than at least some banks had planned. About 20 percent of the respondents in the Federal Reserve's most recent survey of senior loan officers reported having tightened standards for approving applications for credit cards, and 10 percent reported tightening standards for other consumer loans. Notwithstanding the recent tightening of standards, supply conditions for loans from banks to consumers still appear accommodative.

*The Business Sector*

The debt of nonfinancial businesses also appears to have expanded somewhat less rapidly during the first half of 1996 than it did last year. In part, the moderation in borrowing can be traced to the behavior of the financing gap for incorporated nonfinancial enterprises—the excess of their capital expenditures (including inventory investment) over their internally generated funds. During 1995, this gap narrowed quite substantially, reflecting strong profits and a marked reduction in inventory investment. Available indications are that the gap has remained small this year.

External funding for business spending has been in plentiful supply thus far this year. One piece of evidence on this point is that interest rate spreads on investment-grade bonds have edged down slightly since the beginning of the year. Additionally, spreads on high-yield bonds have declined markedly and are as low as they have been in at least a decade. Also, supply conditions for loans from banks to businesses continue to look quite favorable. According to the Federal Reserve's most recent survey of bank lending officers, standards for approval of commercial and industrial loans were about unchanged from January to May of this year, and terms on such loans were eased on net. Surveys by the National Federation of Independent Business indicate that small businesses have not faced difficulty getting credit, and stories abound of new small-business lending programs of banks.

Gross offerings of long-term bonds by nonfinancial corporations have been running about in line with last year's pace. However, the mix of issuers has shifted somewhat, reflecting the changing structure of rates. Late last year and early this year, investment-grade corporations were issuing a hefty volume of bonds to pay down commercial paper and to refinance existing long-term debt. As the rates on investment-grade bonds increased this year, issuance of such debt dropped off. Rates on high-yield bonds moved up less, however, and issuers of those bonds continued to offer new debt at a rapid pace.

Gross issuance of equity shares by nonfinancial corporations has been exceedingly strong this year. Indeed, total offerings in each of the three months of the second quarter set successive monthly records. This activity has been fueled by initial public offerings and other equity issuance by relatively young companies. Share retirements by nonfinancial corporations have also been very heavy. Announced stock buybacks by such firms in both the first and second quarters ran at $28 billion per quarter—the fastest pace since the late 1980s. On net, available information suggests that nonfinancial corporations retired even more equity during the first half of 1996 than they had in 1995.

Share retirements and merger activity have generated much less issuance of debt recently than they did in the 1980s. Recent share repurchases have been undertaken mostly by companies seeking to return the excess cash on their balance sheets to stockholders. And recent mergers and acquisitions have mainly been accomplished through stock swaps between companies in similar lines of business, rather than the leveraged transactions commonplace in the 1980s. In line with the limited extent of debt financing, the mergers executed thus far in 1996 have resulted in little net change in bond ratings—again in marked contrast to the experience of the 1980s.

*Depository Intermediation*

The growth of credit provided by depository institutions slowed sharply in the fourth quarter of last year and first quarter of this year, and commercial bank credit—a component of total depository credit for which more recent data are available—slowed further in the second quarter. The share of thrift institutions in total depository credit has continued to decline in recent quarters. This long-standing trend may have been given additional impetus last summer by the opening up of a differential between the premium rates paid by banks and thrifts for their deposit insurance; this differential has reduced the cost of funds for banks relative to the cost of funds for thrift institutions.

The reduction and subsequent elimination of the deposit insurance premium for financially sound banks probably played a role in shifting bank funding toward deposits. During the first half of 1996, banks increased their deposit liabilities more rapidly than their nondeposit liabilities—a contrast from the preceding few years when banks relied disproportionately for their funding on nondeposit sources, including borrowing from their foreign offices.

## The Monetary Aggregates

The increased reliance on deposit sources of funding by banks has helped support the growth of the broad money aggregates of late. Between the fourth quarter of last year and June of this year, M3 expanded at an annual rate of about 6 percent, putting it at the upper boundary of its annual growth cone. As in 1995, the growth in M3 this year was led by those components not included in M2. In the aggregate, these components increased about 11 percent at an annual rate between the fourth quarter of last year and June of this year, only moderately below the 1995 average pace of 14½ percent. Institution-only money-market mutual funds increased about 18 percent at an annual rate over this period. This component of the money stock increased especially rapidly during the first three months of the year. Often, the yields on these funds lag changes in short-term market interest rates, making them particularly attractive investments when short-term market rates are declining, as they were

### Growth of Money and Debt

Percent

| Measurement period | M1 | M2 | M3 | Domestic non-financial debt |
|---|---|---|---|---|
| *Year* [1] | | | | |
| 1980 | 7.5 | 8.7 | 9.6 | 9.5 |
| 1981 | 5.4<br>2.5 [2] | 9.0 | 12.4 | 10.2 |
| 1982 | 8.8 | 8.8 | 9.7 | 9.8 |
| 1983 | 10.3 | 11.8 | 9.5 | 11.9 |
| 1984 | 5.4 | 8.1 | 10.8 | 14.6 |
| 1985 | 12.0 | 8.6 | 7.7 | 14.4 |
| 1986 | 15.5 | 9.2 | 9.0 | 13.3 |
| 1987 | 6.3 | 4.2 | 5.9 | 10.0 |
| 1988 | 4.3 | 5.7 | 6.3 | 8.8 |
| 1989 | .6 | 5.2 | 4.0 | 7.9 |
| 1990 | 4.1 | 4.1 | 1.8 | 6.8 |
| 1991 | 7.9 | 3.1 | 1.2 | 4.6 |
| 1992 | 14.3 | 1.8 | .6 | 4.7 |
| 1993 | 10.5 | 1.4 | 1.0 | 5.2 |
| 1994 | 2.4 | .6 | 1.6 | 5.2 |
| 1995 | −1.8 | 4.0 | 5.9 | 5.6 |
| *Quarter (annual rate)* [3] | | | | |
| 1995:Q1 | −.1 | 1.0 | 4.5 | 5.4 |
| Q2 | −.5 | 3.3 | 6.3 | 7.1 |
| Q3 | −1.5 | 6.9 | 7.9 | 4.9 |
| Q4 | −5.1 | 4.1 | 4.5 | 4.7 |
| 1996:Q1 | −2.7 | 5.9 | 7.2 | 4.7 |
| Q2 | −.5 | 4.1 | 5.3 | n.a. |

1. From average for fourth quarter of preceding year to average for fourth quarter of year indicated.
2. Adjusted for shift to NOW accounts in 1981.
3. From average for preceding quarter to average for quarter indicated.

around the turn of the year when the Federal Reserve eased policy.

M2 increased 4¾ percent at an annual rate between the fourth quarter of 1995 and June of this year, leaving it near the upper boundary of its growth range. For many years before the early 1990s, the velocity of M2 (defined as the ratio of nominal GDP to M2) moved roughly in tandem with the opportunity cost of holding M2—that is, the interest earnings forgone by holding M2 assets rather than market instruments such as Treasury bills. This relationship implied that M2 tended to move in proportion to nominal GDP, except as it was influenced by changes in the opportunity cost of holding it. When the opportunity cost rose, owners of M2 tended to economize on their holdings, driving up the velocity of M2.

Beginning around the early 1990s, however, this historical relationship began to break down. Indeed, in 1991 and 1992, the velocity of M2 rose sharply even as the opportunity cost of holding M2 declined. A number of reasons for this development have been adduced, including the unusually steeply sloped yield curve and very low level of short-term interest rates, which helped to attract the public out of liquid balances and into more readily available long-term mutual funds; the credit crunch at banks and the resolution of troubled thrift institutions, which reduced the aggressiveness with which these institutions sought retail deposits; and household balance-sheet restructuring, which entailed in part repayment of loans out of liquid money balances. The divergent movement of the velocity of M2 and its opportunity cost continued until the end of 1992. More recently, the variables have once again been moving essentially in parallel. In light of the rapid ongoing pace of innovation and technological change in financial services, however, it is impossible to know whether the new parallel movement of velocity and the opportunity cost will persist.

M1 declined about 1¾ percent at an annual rate during the first half of 1996, just as it had done over the four quarters of 1995. The recent sluggish behavior of M1 reflects the ongoing spread of so-called sweep programs, under which idle reservable deposits are "swept" into money-market-deposit accounts (MMDAs). (The appendix provides additional information on sweep accounts.) Estimates based on initial amounts swept suggest that M1 would have expanded at about a 7 percent annual rate during the first half of 1996 in the absence of these programs. Another factor contributing to the recent weakness in M1 has been the growth of currency, which has been sluggish by the standards of the early 1990s. Foreign demand for currency apparently has tailed off somewhat. In large part, the slackening in net foreign demand owes to substantial reflows from Argentina and Mexico, where earlier worst-case fears about the stability of the financial system have not been realized. Reflows from Western Europe and Asia have also been significant, but net shipments to the former Soviet Union remain sizable. On the whole, demand for the new $100 bill has been substantial, but this has not had any detectable effect on the stock of currency outstanding.

The sluggish growth of currency has held down expansion of the monetary base to only about 2 percent at an annual rate thus far this year. The other restraint on the growth of the base has been the turnaround in the behavior of required reserves. After surging at double-digit rates in 1992 and 1993, required reserves have been on a downward trend, and at an increasing rate. Thus far this year, required reserves have contracted about 7½ percent at an annual rate. The emergence of this trend is perhaps the most direct consequence of the spread of sweep programs. Absent such programs, required reserves probably would have increased about 10 percent over the same period, owing to strong growth in demand deposits. Continued spread of sweep programs could affect the federal funds market, perhaps leading to greater volatility like that experienced in early 1991 following the elimination of reserve requirements on nontransactions deposits. Thus far, such instabilities have not been realized, but the Federal Reserve is monitoring the situation carefully.

## Interest Rates, Equity Prices, and Exchange Rates

### *Interest Rates*

Interest rates on Treasury securities rose over the first half of 1996, with the most pronounced increases occurring for intermediate-term securities. Between the end of December 1995 and the middle of July, the rate on three-month bills increased somewhat less than ¼ percentage point, the rate on five-year notes rose about 1¼ percentage points, and the rate on thirty-year bonds rose about 1 percentage point. Despite these increases, nominal Treasury rates overall continued to be relatively low by the standards of the past twenty years.

The spread between interest rates on investment-grade private bonds and those on comparable-maturity Treasury securities remained narrow during the first half of the year. In particular, the average spread on Baa-rated industrial bonds over thirty-year Treasury bonds continued to fluctuate near where it has been for the past several years and well below the levels typical of the 1980s. The spread on investment-grade utility bonds continued to drift upward, but this appeared to reflect the market's increasing perception that some firms in that industry might become riskier as a result of deregulation and new competitive pressures. The rate spread on high-yield bonds over the comparable Treasury notes narrowed sharply, reversing the upward drift of 1995, and returning this measure to the low end of its range over the past decade. The continuing low level of spreads on most investment-grade securities, as well as the marked decline of the spread on high-yield securities, appeared to reflect in part market participants' increasing confidence in the durability of the economic expansion and consequent optimism about the creditworthiness of corporate borrowers.

### *Equity Prices*

Share prices have fallen in recent weeks, most notably those of "high-tech" companies whose ability to maintain steep earnings trajectories has come into question. On net, though, broad indexes of equity prices have held steady or moved up slightly since the end of 1995. As of July 16, the S&P 500 composite index of stock prices had increased 2 percent thus far this year, while the NASDAQ index had returned to its beginning-of-year level. Even this performance has been impressive, given that it occurred in the face of appreciable upward movement in long-term interest rates.

### *Exchange Rates*

Since mid-April, the weighted-average value of the dollar in terms of the other G-10 currencies has generally been about 4 percent above its level at the end of December, although the dollar has moved down somewhat in mid-July.

When compared with an index of currencies from a somewhat broader group of U.S. trading partners, the dollar has appreciated 3 percent since December after adjustment for changes in relative consumer prices. The dollar has risen on balance about 4 percent in terms of the German mark and about 6 percent in terms of the Japanese yen.

The dollar has been supported by perceptions of a disparity in the performance of the U.S. economy relative to that of many of our major trading partners and the resulting expectations for the course of relative interest rates. Specifically, while data suggesting robust growth in the United States caused interest rates to rise, questions remained about the strength of expansions in a number of other industrial countries, particularly in Europe. Average long-term (ten-year) interest rates in the other G-10 countries have risen only slightly, about 20 basis points, since the end of December. With U.S. rates rising substantially more than that, the appreciation of the dollar over this period is consistent with the shift in the long-term interest differential in favor of the dollar. In addition, the dollar was lifted to an extent against the yen by data early in the year showing that the Japanese external surpluses were narrowing.

Despite a weak output performance, long-term interest rates in Germany have risen about 50 basis points, with much of that increase coming during the first quarter. Long-term interest rates have actually fallen since the end of last year in some European countries, such as France and Italy, where political and economic policy uncertainties have been reduced. In Japan, long-term interest rates have risen about 30 basis points, on balance. Short-term market interest rates abroad are generally lower than they were at the end of last year. German short-term market rates are down nearly 50 basis points, while rates in France are down more than 100 basis points and those in the United Kingdom are down 70 basis points. Official lending rates have been reduced by the central banks in Germany, France, the United Kingdom, and several other European countries in 1996. In Japan, short-term market interest rates remain near the historically low levels reached during the second half of 1995 as the Bank of Japan's official rates have been unchanged. Stock markets in the foreign G-10 countries have risen 3 percent to 15 percent since the end of December, except in the United Kingdom, where stock prices, on balance, are about unchanged.

The Mexican peso traded during the first half of 1996 in a range somewhat stronger than that which prevailed at the end of 1995. Mexican twenty-eight-day treasury bill (cetes) rates have declined from nearly 50 percent in December to around 30 percent as the rate of inflation has fallen. The economic positions of Mexican households and firms have improved since early 1995, but problems in the financial system remain, as evidenced by increasing amounts of nonperforming loans at banks. Stock prices have risen, on balance, about 5 percent in peso terms since December, buoyed by the interest rate declines and evidence of recovery in the Mexican economy.

The pace at which private foreigners acquired U.S. assets increased markedly in the first quarter. Although private net purchases of U.S. Treasury securities were small, there were large increases in the private holdings of U.S. government agency bonds and U.S. corporate bonds, as U.S. corporations issued heavily in the Eurobond market. In addition, direct investment capital inflows surged to almost $30 billion in the first quarter, reflecting a pickup in foreign acquisitions of U.S. firms. Together, these gross inflows totaled nearly $80 billion, roughly twice the U.S. current account deficit for the quarter. U.S. net purchases of foreign stocks and bonds were also sizable in the first quarter, with net purchases of foreign stocks from Japan particularly large. U.S. direct investment abroad slowed somewhat between the fourth quarter of 1995 and the first quarter of 1996 but remained near the record pace for all of last year. In April and May, private foreign interest in U.S. securities continued to be strong while U.S. investor interest in foreign stocks cooled somewhat from the strong first-quarter pace.

Foreign official holdings in the United States increased about $52 billion in the first quarter of 1996 after a record $110 billion rise in 1995. These increases reflected both intervention to support the foreign exchange value of the dollar by certain industrial countries and substantial reserve accumulation by several developing countries. Data for April and May indicated continued increases in official holdings in the United States but on a much more modest scale.

## Appendix: Sweeps of Retail Transaction Deposits

In January 1994, depository institutions began implementing sweep programs for retail customers.[3] In such programs, balances in household transaction accounts (typically NOW accounts, but also some demand deposits, both of which are included in M1) are swept into savings deposits, which are part of the non-M1 portion of M2. Such sweeps shift deposits from reservable (transactions) accounts to nonreservable (savings) accounts without impairing depositors' ability to access the funds for transactions purposes. Depositories have an incentive to establish these programs because reserves held at the Federal Reserve earn no interest. Retail sweep programs reduce reported reserves, the monetary base, and M1.

3. Sweep accounts for business customers of banks became widespread in the mid-1970s. They involve sweeps of demand deposits into repurchase agreements or other money market instruments whose minimum sizes are too large to accommodate households.

### Sweeps of Transaction Deposits into Savings Accounts

Percentage of industry assets

| Period | Monthly averages of initial amounts | Cumulative total |
|---|---|---|
| *1994* | | |
| January | 5.3 | 5.3 |
| February | 2.2 | 7.5 |
| March | .0 | 7.5 |
| April | .0 | 7.5 |
| May | .0 | 7.5 |
| June | .0 | 7.5 |
| July | .0 | 7.5 |
| August | .0 | 7.5 |
| September | 1.5 | 9.0 |
| October | .6 | 9.6 |
| November | .3 | 9.9 |
| December | .0 | 9.9 |
| *1995* | | |
| January | .0 | 9.9 |
| February | .0 | 9.9 |
| March | .0 | 9.9 |
| April | .0 | 9.9 |
| May | 5.0 | 14.9 |
| June | 7.3 | 22.2 |
| July | .6 | 22.8 |
| August | 4.6 | 27.4 |
| September | 5.9 | 33.3 |
| October | 7.7 | 41.0 |
| November | 4.3 | 45.3 |
| December | 9.2 | 54.5 |
| *1996* | | |
| January | 13.7 | 68.2 |
| February | 7.0 | 75.2 |
| March | 6.4 | 81.6 |
| April | 7.8 | 89.4 |
| May | 8.4 | 97.8 |

NOTE. Figures are the estimated total of transaction account balances initially swept into savings accounts owing to the introduction of new sweep programs. Monthly totals are averages of daily data.

Regular monthly updates of initital amounts swept may be obtained by email by sending an email address along with a phone number to *sweeps–frb@frb.gov*. Those without access to email may request data by calling (202) 872-7577.

They have no effect on M2, because both transactions and savings accounts are in M2.

Retail sweep programs have been established either as daily sweeps or as weekend sweeps. Under a daily sweep, a depositor's transaction balances above a target level are shifted each night into a special savings account created for the purpose. If debits threaten to reduce the remaining transaction account balances below zero, enough funds are transferred back from the savings account to reestablish the target level of transaction balances. Because only six transfers are allowed out of a savings account within a statement month, on the sixth transfer, the entire savings balance is returned to the transaction account. Alternatively, in a weekend sweep program, all affected transaction account balances are swept into the special purpose savings account over the weekend and then returned on Monday. Some "weekend sweep" programs undertake sweeps on certain holidays as well.

No information is available on the current amounts of transaction balances that are being swept into savings accounts. The Federal Reserve has obtained data from depositories only on the initial amounts swept on the date each program was established. The table, which is updated and made available to the public on an ongoing basis, shows that the initial amounts swept under programs implemented through May 1996 have cumulated to $98 billion. With a marginal reserve requirement of 10 percent on most of these balances, the cumulative reduction of required reserves attributable to the initial amounts swept has been nearly $10 billion. ■

# *Part 2*

# *Records, Operations, and Organization*

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

## Regulation D
### Reserve Requirements of Depository Institutions

### November 20, 1996—Amendments

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

Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley, Lindsey, and Meyer, and Mses. Phillips and Yellen.

Under the Monetary Control Act of 1980, depository institutions, Edge Act corporations, Agreement corporations, and U.S. agencies and branches of foreign banks are subject to reserve requirements set by the Board. The act directs the Board to annually adjust the amount subject to the lower reserve requirement to reflect changes in transaction balances nationwide. Recent decreases in transaction balances warranted a decrease to $49.3 million, and the Board amended Regulation D accordingly.

The Garn–St Germain Depository Institutions Act of 1982 establishes a zero percent reserve requirement on the first $2 million of an institution's reservable liabilities. The act also provides for annual adjustments to that exemption amount based on deposit growth nationwide. Recent growth in deposits warranted an increase to $4.4 million, and the Board amended Regulation D accordingly.

The amendments are effective with the reserve computation period beginning December 31, 1996, for institutions reporting weekly and December 17, 1996, for institutions reporting quarterly.

To reduce reporting burden for small institutions, depository institutions with total deposits below specified levels are required to report their deposits and reservable liabilities quarterly or less frequently, while larger institutions must report weekly. To reflect increases in the growth rate of total deposits at all depository institutions, the Board increased the deposit cutoff levels used in determining the frequency and detail of deposit reporting, to $59.3 million for nonexempt depository institutions and to $48.2 million for exempt depository institutions, beginning in September 1997.

### December 23, 1996—Amendments

The Board amended Regulation D to simplify and update the regulation and reduce regulatory burden, effective April 1, 1997.

Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley, Lindsey, and Meyer, and Mses. Phillips and Yellen.

After a review in accordance with its policy of regular review of regulations and the requirements of the Riegle Community Development and Regulatory Improvement Act of 1994, the Board adopted a revision of Regulation D to simplify and clarify the regulation and remove certain obsolete material from it.

## Regulation E
### Electronic Fund Transfers

March 20, 1996—Amendments

The Board amended Regulation E to clarify, simplify, and update the regulation, effective May 1, 1996, with compliance mandatory by January 1, 1997.

Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Mses. Phillips and Yellen.[1]

The amendments change the exemptions for securities or commodities transfers and for preauthorized transfers to or from accounts at small institutions, simplify the language and format of the regulation, and delete obsolete provisions.

## Regulation G
### Securities Credit by Persons Other Than Banks, Brokers, or Dealers

## Regulation T
### Credit by Brokers and Dealers

## Regulation U
### Credit by Banks for the Purpose of Purchasing or Carrying Margin Stocks

November 20, 1996—Interpretation

The Board approved an interpretation of Regulations G, T, and U to implement requirements of the National Securities Markets Improvement Act of 1996, effective November 19, 1996.

Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley, Lindsey, and Meyer, and Mses. Phillips and Yellen.

The National Securities Markets Improvement Act of 1996 removes the Board's authority to regulate certain loans by registered broker–dealers unless the Board finds that such rules are in the public interest or necessary for the protection of investors. The Board issued an interpretation to clarify that it had not made such a finding and that provisions of its margin regulations for which it no longer had general authority were not in effect. The interpretation also identified regulatory provisions the Board had adopted to implement section 8(a) of the Securities Exchange Act of 1934, which had been repealed by the 1996 act, and concluded that those provisions were no longer in effect. In connection with this action, the Board sought public comment on proposed amendments to its margin regulations to implement the requirements of the act.

## Regulation H
### Membership of State Banking Institutions in the Federal Reserve System

August 5, 1996—Amendments

The Board amended Regulation H to improve compliance with certain flood insurance requirements, effective October 1, 1996.

Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley and Meyer, and Mses. Phillips and Yellen. Absent and not voting: Mr. Lindsey.

The Board and five other federal agencies adopted rules to implement the National Flood Insurance Reform Act of 1994. The rules did not change the basic flood insurance requirements but were designed to improve compliance with requirements concerning mandatory purchase of flood insurance and notice of flood hazards.

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

### December 23, 1996—Interim Amendment

The Board approved an interim amendment to Regulation H to revise the guidelines for determining the frequency of examinations for banks, effective January 30, 1997.

Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley, Lindsey, and Meyer, and Mses. Phillips and Yellen.

The Board, along with the other federal banking agencies, revised the criteria for determining the frequency of examinations to implement provisions of the Riegle Community Development and Regulatory Improvement Act of 1994 and the Economic Growth and Regulatory Paperwork Reduction Act of 1996. Under the new criteria, well-managed banks with a composite rating of 2 and with assets of $250 million or less are eligible to be examined once every eighteen months instead of once every twelve months. In connection with this action, the Board sought public comment on the revised guidelines.

## Regulation H
## Membership of State Banking Institutions in the Federal Reserve System

## Regulation K
## International Banking Operations

## Regulation Y
## Bank Holding Companies and Change in Bank Control

### January 29, 1996—Amendment

The Board amended Regulations H, K, and Y to simplify the process for reporting suspected crimes and suspicious activities by banking organizations supervised by the Federal Reserve, effective April 1, 1996.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, and Lindsey and Mses. Phillips and Yellen.[2]

The new rule, which was developed by the Federal Reserve, the other federal banking agencies, and the Financial Crimes Enforcement Network of the Department of the Treasury, significantly reduces burdens while enhancing the ability of law enforcement authorities to investigate and prosecute criminal offenses involving U.S. financial institutions.

## Regulation H
## Membership of State Banking Institutions in the Federal Reserve System

## Regulation Y
## Bank Holding Companies and Change in Bank Control

### August 7, 1996—Amendments

The Board amended Regulations H and Y to incorporate a measure of market risk in its risk-based capital guidelines for state member banks and bank holding companies, effective January 1, 1997, with compliance mandatory by January 1, 1998.

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

The Board, along with the other federal banking agencies, revised the risk-based capital standards to set forth a supervisory framework for measuring

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

market risk of debt and equity positions in institutions' trading accounts and all foreign exchange and commodity positions, wherever located. The amendments require banks and bank holding companies with significant exposure to market risk to measure that risk using their own internal value-at-risk models, as specified in the rule, and hold commensurate amounts of capital.

## Regulation K
## International Banking Operations

### January 19, 1996—Amendment

The Board approved an amendment to Regulation K to permit certain foreign banks to establish representative offices in the United States through advance notice, effective January 24, 1996.

> Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Mses. Phillips and Yellen.[1]

The amendments permit foreign banks that meet certain requirements to establish representative offices without filing a formal application. The amendments clarify that only those foreign banking organizations subject to the International Banking Act and the Bank Holding Company Act may take advantage of general consent procedures to establish a representative office to engage in limited administrative functions in connection with their existing U.S. banking operations. The Board also decided to review on a case-by-case basis inquiries by special-purpose government banks seeking exemptions from regulation under the Foreign Bank Supervision Enhancement Act on the basis that they do not fall within the definition of a foreign bank under Regulation K.

### February 7, 1996—Amendment

The Board approved an amendment to Regulation K to establish criteria for evaluating the operations of certain foreign banks, effective March 25, 1996.

> Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Mses. Phillips and Yellen.[1]

The amendment sets out the criteria under which the Board will assess the U.S. operations of foreign banks that are not subject to comprehensive, consolidated supervision or regulation by their home country supervisors. The Board will take the criteria into account in deciding whether and under what terms such banks can continue to operate in the United States.

### May 9, 1996—Amendments

The Board amended Regulation K to set a date by which certain foreign banks must select a home state and to update the regulation, effective May 9, 1996.

> Votes for this action: Messrs. Greenspan and Kelley and Mses. Phillips and Yellen. Absent and not voting: Mr. Lindsey.[1]

The Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994 removed geographic restrictions on interstate banking by foreign banks and required certain foreign banks without U.S. deposit-taking offices to select a home state. The Board amended Regulation K to require those banks to select a home state by June 30, 1996; remove outdated restrictions on certain mergers by U.S. bank subsidiaries of foreign banks outside their home states; and delete obsolete and superseded provisions concerning selection of a home state.

### July 17, 1996—Amendment

The Board approved an amendment to Regulation K to establish rules governing the management of offshore banking offices by U.S agencies and branches of foreign banks, effective August 28, 1996.

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

The amendment prohibits foreign banks from using their U.S. branches or agencies to manage types of activities through offshore offices that could not be managed by a U.S. bank at its foreign branches or subsidiaries. The amendment implements a provision of the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994.

## Regulation L
## Management Official Interlocks

### July 10, 1996—Amendments

The Board amended Regulation L to conform rules on management interlocks to recent statutory changes and to update the regulation, effective October 1, 1996.

Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Ms. Yellen. Absent and not voting: Ms. Phillips.[1]

The Board revised its rules on management interlocks to implement certain requirements of the Riegle Community Development and Regulatory Improvement Act of 1994. The revisions also clarify the rules and reduce unnecessary regulatory burden.

## Regulation M
## Consumer Leasing

### September 18, 1996—Revision

The Board revised Regulation M to simplify and clarify required disclosures for car leasing and other types of consumer lease transactions, effective October 1, 1997.

Votes for this action: Messrs. Greenspan, Kelley, Lindsey, and Meyer and Mses. Phillips and Yellen. Absent and not voting: Ms. Rivlin.

The revision included additional requirements for early disclosure of termination charges; requirements for disclosure of the gross cost of a lease, the residual value of the leased property, and the estimated lease charge; a requirement that certain leasing disclosures be segregated from other information; and new provisions concerning advertising on radio and television.

## Regulation O
## Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks; Loans to Holding Companies and Affiliates

### November 1, 1996—Amendments

The Board amended Regulation O to permit insiders of a bank and its affiliates to obtain loans under benefit plans available to all company employees and to simplify a procedure, effective November 1, 1996.

Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley and Meyer, and Mses. Phillips and Yellen. Absent and not voting: Mr. Lindsey.

The amendment implements a requirement in the Economic Growth and Regulatory Paperwork Reduction Act of 1996. The Board also simplified the procedure under which a bank's board of directors can exclude executive officers from the policymaking functions of the bank and, therefore, from the restrictions of the regulation.

## Regulation R
## Relations with Dealers in Securities Under Section 32, Banking Act of 1933

### October 30, 1996—Rescission of Regulation and Related Interpretation

The Board approved rescission of Regulation R and a related interpretation, effective December 6, 1996.

> Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley, Lindsey, and Meyer, and Mses. Phillips and Yellen.

Regulation R implemented section 32 of the Glass–Steagall Act, which prohibits interlocks between member banks and firms primarily engaged in underwriting and dealing in securities. A related interpretation clarified the applicability of the prohibitions of section 32 to bank holding companies. After a review of the regulation and interpretation as required by the Riegle Community Development and Regulatory Improvement Act of 1994, the Board determined that the regulation, which restated the statutory language of section 32, and the interpretation that applied the prohibitions to bank holding companies were no longer necessary. In addition, certain other interpretations of section 32 were moved to Miscellaneous Interpretations.

## Regulation S
## Reimbursement for Providing Financial Records; Recordkeeping Requirements for Certain Financial Records

### March 26, 1996—Amendments

The Board amended Regulation S to conform certain definitions in the regulation to the Uniform Commercial Code, effective May 28, 1996, and deferred certain other effective dates until that date.

> Votes for this action: Messrs. Greenspan and Lindsey and Mses. Phillips and Yellen. Absent and not voting: Mr. Kelley.[1]

The Board and the Department of the Treasury jointly adopted amendments to their rules under the Bank Secrecy Act that require enhanced recordkeeping related to certain funds transfers by financial institutions. The amendments revise definitions and conform the definitions of certain terms to their meanings under article 4A of the Uniform Commercial Code. The two agencies deferred the effective date of the recordkeeping rules until May 28, 1996, and the Board also deferred the effective date of subpart B of Regulation S until that date.

### June 5, 1996—Amendments

The Board amended subpart A of Regulation S to establish rates and conditions under which payment would be made to financial institutions for assembling or providing certain financial records, effective July 12, 1996.

> Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Mses. Phillips and Yellen.[1]

The Right to Financial Privacy Act requires that the Board establish the rates and conditions for reimbursement of financial institutions for costs incurred in responding to requests for records by government agencies. The Board's amendments streamlined subpart A and updated the fees it specifies.

### November 14, 1996—Amendment

The Board amended subpart B of Regulation S to clarify its applicability, effective December 20, 1996.

Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley, Lindsey, and Meyer, and Mses. Phillips and Yellen.

Subpart B of Regulation S refers to the substantive provision of a joint rule adopted by the Board and the Department of the Treasury relating to recordkeeping requirements for funds transfers and transmittals of funds under the Bank Secrecy Act. The Board amended subpart B to clarify that the regulation does not apply to any person or transaction or class of persons or transactions that the Department of the Treasury has exempted from the joint rule.

## Regulation T
## Credit by Brokers and Dealers

### April 24, 1996—Amendments

The Board updated Regulation T to take into account developing trends in the securities markets. The updates became effective July 1, 1996, except for certain provisions relating to options transactions, which become effective June 1, 1997.

Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Mses. Phillips and Yellen.[1]

The final rule eliminates restrictions on the ability of broker–dealers to arrange for credit, increases the type and number of domestic and foreign securities that can be bought on margin and increases the loan value of some other securities; removes Board rules on options transactions and relies on the margin rules of self-regulatory organizations; and reduces restrictions on transactions involving foreign persons, foreign securities, and foreign currency. The new rule also includes certain technical changes.

## Regulation V
## Loan Guarantees for Defense Production

### October 1, 1996—Repeal

The Board repealed Regulation V, effective October 9, 1996.

Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley, Lindsey, and Meyer, and Mses. Phillips and Yellen.

After a review required by section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994, the Board found Regulation V to be obsolete. The Board's action did not represent a change in any policy.

## Regulation Y
## Bank Holding Companies and Change in Bank Control

### August 23, 1996—Amendment

The Board amended an interpretive rule in Regulation Y to permit bank holding companies under certain conditions to purchase, as a fiduciary, securities of investment companies they advise, effective September 30, 1996.

Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley, Lindsey, and

Meyer, and Ms. Phillips. Absent and not voting: Ms. Yellen.

The condition on such purchases is that they must be specifically authorized by the terms of the instrument creating the fiduciary relationship, by court order, or by the law of the jurisdiction under which the trust is administered. The revision conforms the rule to those of other federal banking agencies and the standard in section 23B of the Federal Reserve Act.

### October 23, 1996—Interim Rule

The Board approved an interim amendment to Regulation Y to provide a definition of a well capitalized bank holding company, effective October 23, 1996.

Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley and Meyer, and Mses. Phillips and Yellen. Absent and not voting: Mr. Lindsey.

The Board adopted the interim rule in connection with easing provisions of Regulation Y to eliminate the requirement that bank holding companies seek the Board's approval before engaging de novo in permissible nonbanking activities. The easing would apply to holding companies that are well capitalized and meet other criteria specified in the Economic Growth and Regulatory Paperwork Act of 1996. The interim rule also implements provisions of the act to establish expedited procedures for qualified well capitalized bank holding companies to be approved to acquire smaller companies that engage in any permissible nonbanking activities listed in Regulation Y as well as to engage in nonbanking activities that the Board has approved only by order.

For purposes of determining the capital levels at which a bank holding company is considered well capitalized under the act and Regulation Y, the Board adopted, as an interim rule, two criteria: (1) risk-based capital thresholds that are the same as those for determining that a state member bank is well capitalized and (2) a modified leverage ratio. The Board sought public comment on the definition and how it should be applied to foreign banking organizations.

## **Regulation Z**
## Truth in Lending

### January 24, 1996—Amendment

The Board amended Regulation Z to adjust the threshold amount of mortgage points and fees that entails certain additional disclosures, effective January 1, 1996.

Votes for this action: Messrs. Greenspan, Blinder, Kelley, and Lindsey and Mses. Phillips and Yellen.[2]

The Home Ownership and Equity Protection Act of 1994 requires that creditors make additional disclosures on mortgages for which total points and fees payable by the consumer exceed the larger of $400 or 8 percent of the total loan amount and requires that the Board annually adjust the absolute dollar value of the threshold amount for the forthcoming calendar year according to the annual percentage change in the consumer price index as of June 1 of the preceding year. On the basis of the CPI on June 1, 1995, the Board increased the threshold amount to $412 for 1996.

### September 11, 1996—Amendments

The Board amended Regulation Z to limit lender liability for disclosure errors and to establish new rules for debt cancellation agreements, effective October 21, 1996.

Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley, Lindsey, and Meyer, and Mses. Phillips and Yellen.

The Truth in Lending Act Amendments of 1995 established new rules for creditor liability for closed-end loans secured by real property or dwellings and consummated on or after September 30, 1995. The 1995 amendments created several tolerances for accuracy in disclosing the amount of the finance charge; within those tolerances, creditors have no civil or administrative liability. The 1995 amendments also clarified requirements for disclosure of certain fees connected with mortgage loans. The Board revised Regulation Z to implement the 1995 amendments and established new disclosure rules for debt cancellation agreements.

### December 3, 1996—Amendment

The Board amended Regulation Z to adjust the threshold amount of mortgage points and fees that entails certain additional disclosures, effective January 1, 1997.

> Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley, Lindsey, and Meyer, and Mses. Phillips and Yellen.

Acting under the requirements of the Home Ownership and Equity Protection Act of 1994, the Board increased the level of points and fees beyond which mortgage creditors must disclose additional information (see Regulation Z amendment of January 24, 1996, above). On the basis of the CPI on June 1, 1996, the Board increased the threshold amount to $424 for 1997.

## Regulation EE
Netting Eligibility for Financial Institutions

### January 3, 1996—Amendment

The Board amended Regulation EE with regard to the definition of a financial institution, effective February 20, 1996.

> Votes for this action: Messrs. Greenspan, Blinder, and Kelley and Mses. Phillips and Yellen.[1]

The amendment clarifies that, for purposes of qualifying as a financial institution under Regulation EE, an entity may declare itself, either orally or in writing, to be a financial market intermediary.

## Miscellaneous Interpretations

### April 15, 1996—Definition

The Board defined unimpaired capital stock and surplus for purposes of section 23A of the Federal Reserve Act, effective July 1, 1996.

> Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Mses. Phillips and Yellen.[1]

The new rule adopts the definition of unimpaired capital and unimpaired surplus used to calculate the limits in Regulation O (Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks) for insider lending and used by the Office of the Comptroller of the Currency to calculate the limit on loans by a national bank to a single borrower.

## Rules Regarding Availability of Information

### November 20, 1996—Interim Amendment

The Board approved an interim amendment to its Rules Regarding Availability of Information to increase certain fees associated with requests under the Freedom of Information Act, effective January 1, 1977.

> Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley, Lindsey, and Meyer, and Mses. Phillips and Yellen.

The amended fee schedule reflects increases in the cost of conducting searches and reviewing and copying documents. The Board also requested comment on the new fee schedule.

## Policy Statements and Other Actions

### March 19, 1996—Uniform Rules of Practice and Procedure for Administrative Hearings

The Board amended its Uniform Rules of Practice and Procedure for Administrative Hearings, effective June 5, 1996.

> Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Mses. Phillips and Yellen.[1]

The Board, along with the other federal banking agencies, clarified certain provisions of the rules and made other changes that are expected to increase the efficiency and fairness of administrative hearings.

### October 22, 1996—Amendment

As required by the Debt Collection Improvements Act of 1996, the Board amended its Rules of Practice for Hearings to increase the maximum amount of each civil money penalty under its jurisdiction to account for inflation, effective October 24, 1996.

> Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley and Meyer, and Mses. Phillips and Yellen. Absent and not voting: Mr. Lindsey.

### January 24, 1996—Fedwire Policy Statement

The Board set rules for access to Fedwire by a service provider located outside the United States, effective February 1, 1996.

> Votes for this action: Messrs. Greenspan, Blinder, and Lindsey and Mses. Phillips and Yellen. Absent and not voting: Mr. Kelley.[2]

The revisions make the arrangements for a foreign service provider subject to the conditions applicable to the arrangements for a domestic service provider and to several additional conditions related to access to examination information and other data.

### May 7, 1996—Standards for Safety and Soundness

The Board approved guidelines prescribing safety and soundness standards for the asset quality and earnings of depository institutions, effective October 1, 1996.

> Votes for this action: Messrs. Greenspan and Kelley and Mses. Phillips and Yellen. Absent and not voting: Mr. Lindsey.[1]

As required by section 132 of the Federal Deposit Insurance Corporation Improvement Act of 1991, the Board, along with the other federal banking agencies, prescribed safety and soundness standards for the asset quality and earnings of depository institutions. The guidelines require that institutions (1) establish and maintain systems to identify problem assets and prevent their deterioration and (2) evaluate and monitor earnings to ensure that they are sufficient to maintain adequate capital and reserves.

### May 23, 1996—Interest Rate Risk Policy Statement

The Board provided guidance on sound practices for managing interest rate risk, effective June 26, 1996.

> Votes for this action: Messrs. Greenspan and Kelley and Mses. Phillips and Yellen. Absent and not voting: Mr. Lindsey.[1]

The policy statement, which was issued in conjunction with the other federal banking agencies, identifies the key elements of interest rate risk management and describes prudent principles and practices for each element. It emphasizes the importance both of a comprehensive risk-management process and of adequate oversight by the boards of directors and the senior management of banks. The statement also describes the critical factors affecting the agencies' evaluation of interest rate risk when making determinations of capital adequacy.

### April 24, 1996—Uniform Cash Access Policy

The Board approved a new cash access policy for the Federal Reserve Banks that provides for greater consistency in cash service levels at Reserve Banks, effective May 1, 1998.

Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Mses. Phillips and Yellen.[1]

The revised policy provides for a base level of free-of-charge access to currency for all depository institutions but restricts the number of offices served and the frequency of access. Depository institutions that meet volume thresholds will be able to obtain more frequent free access. Access beyond the free service level will be priced.

### October 22, 1996—Policy Statement on Payments System Risk

The Board modified its procedures for measuring daylight overdrafts to take into account posting times for Treasury investments resulting from electronic tax payments, effective November 18, 1996.

Votes for this action: Mr. Greenspan, Ms. Rivlin, Messrs. Kelley, Lindsey, and Meyer, and Mses. Phillips and Yellen.

### October 30, 1996—Announcement of Date of Expansion of Fedwire Operation Hours and Establishment of Daylight Overdraft Posting Time

The Board set December 8, 1997, as the effective date of its previously announced expansion of operating hours for the Fedwire on-line funds transfer service and established a posting time for certain nonwire transactions.

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

The Board announced that beginning December 8, 1997, the Fedwire on-line funds transfer service will operate from 12:30 a.m. to 6:30 p.m., eastern time, Monday through Friday. The Board also established 8:30 a.m. eastern time as the daylight overdraft posting time for certain nonwire transactions that had been based on the 8:30 a.m. opening time of the Fedwire funds transfer service.

## 1996 Discount Rates

The Board approved one change in the basic discount rate during 1996, a decrease from 5¼ percent to 5 percent in late January. In addition, the Board approved numerous changes, including both increases and decreases, in the rates charged by the Federal Reserve Banks for seasonal and for extended credit; rates for both types of credit are set on the basis of market-related formulas and those rates exceeded the basic discount rate by varying amounts during the year.

## Basic Discount Rate

The Board's decisions on the basic rate are made against the background of the policy actions of the Federal Open Market Committee (FOMC) and the related economic and financial developments that are covered more fully in part 1 of this REPORT and in the minutes of the 1996 meetings of the FOMC that also appear in this REPORT.

The Board's approval of a ¼ percentage point reduction in the basic discount rate, to 5 percent, on January 31, 1996, followed the FOMC's decision on the same day to ease reserve conditions slightly, an action that was expected to foster a decrease of about ¼ percentage point in the federal funds rate. The complementary policy actions were taken against the backdrop of a potential reduction in inflationary pressures associated with the moderation in economic growth in previous months. In an environment of already subdued price and wage trends, a slight easing of monetary policy was deemed to be consistent with containing inflation and encouraging further economic expansion at a sustainable pace.

Over the remainder of 1996 the Board considered further requests to change the basic rate but took no action on them. All those requests called for increases of ¼ or ½ percentage point. The initial requests to increase the rate were submitted by two Federal Reserve Banks during the first half of May, and the number of outstanding requests rose gradually to a maximum of eight during September and again from mid-October to early November. All but one had been withdrawn by year-end. In reaching its decisions not to approve the requests, the Board took account of the favorable performance of inflation, including the persistence of subdued increases in labor compensation and overall prices despite high levels of resource use as reflected especially in low unemployment. In these circumstances, the Board concluded that there was no clear case for raising the discount rate.

## Structure of Discount Rates

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

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

A different flexible rate is charged on extended-credit loans, which are made to depository institutions that are under sustained liquidity pressure and are not able to obtain funds from other sources. The rate for extended credit is 50 basis points higher than the seasonal rate and is at least 50 basis points above the basic rate. In appropriate circumstances, borrowings of extended credit could be at the basic rate for up to thirty days, but any further borrowings would be charged the flexible rate.

Exceptionally large adjustment-credit loans that arise from computer breakdowns or other operating problems that are not clearly beyond the reasonable control of the borrowing institution are assessed the highest rate applicable to any credit extended to depository institutions; under the current structure, that rate is the flexible rate on extended credit.

At the end of 1996 the structure of discount rates was as follows: a basic rate of 5 percent for short-term adjustment credit, a rate of 5.35 percent for seasonal credit, and a rate of 5.85 percent for extended credit. During 1996 the flexible rate on seasonal credit ranged from a low of 5.15 percent to a high of 5.50 percent, and the flexible rate on extended credit ranged from a low of 5.65 percent to a high of 6 percent.

## Board Votes

Under the provisions of the Federal Reserve Act, the boards of directors of the Federal Reserve Banks are required to establish rates on loans to depository institutions at least every fourteen days and to submit such rates to the Board of Governors for review and determination. Federal Reserve Bank proposals on the discount rate include requests to renew the formulas for calculating the flexible rates on seasonal and extended credit. Votes relating to the reestablishment of existing rates or for the updating of market-related rates under the seasonal and extended credit programs are not shown in this summary. All votes on discount rates taken by the Board of Governors during 1996 were unanimous.

### *Vote on the Basic Discount Rate*

*January 31, 1996.* Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of New York, Philadelphia, Cleveland, Atlanta, Minneapolis, Dallas, and San Francisco to reduce the basic discount rate ¼ percentage point, to 5 percent.

Votes for this action: Messrs. Greenspan, Kelley, and Lindsey and Mses. Phillips and Yellen. Votes against this action: None. Absent and not voting: Vice Chairman Blinder.[2]

The Board subsequently approved similar actions taken by the directors of the Federal Reserve Banks of Boston, Richmond, Chicago, and Kansas City, effective February 1, 1996, and by the directors of the Federal Reserve Bank of St. Louis, effective February 5, 1996. ▪

# Minutes of Federal Open Market Committee Meetings

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

The minutes of the meetings contain the votes on the policy decisions made at those meetings as well as a résumé of the discussions that led to the decisions. The summary descriptions of economic and financial conditions are based on the information that was available to the Committee at the time of the meetings rather than on data as they may have been revised later.

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

Policy directives of the Federal Open Market Committee are issued to the Federal Reserve Bank of New York as the Bank selected by the Committee to execute transactions for the System Open Market Account. In the area of domestic open market activities, the Federal Reserve Bank of New York operates under two sets of instructions from the Federal Open Market Committee: an Authorization for Domestic Open Market Operations and a Domestic Policy Directive. (A new Domestic Policy Directive is adopted at each regularly scheduled meeting.) In the foreign currency area, the Committee operates under an Authorization for Foreign Currency Operations, a Foreign Currency Directive, and Procedural Instructions with Respect to Foreign Currency Operations. These policy instruments are shown below in the form in which they were in effect at the beginning of 1996. Changes in the instruments during the year are reported in the records for the individual meetings.

## Authorization for Domestic Open Market Operations

### In Effect January 1, 1996

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

(a) To buy or sell U.S. Government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal

Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U.S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; provided that the aggregate amount of U.S. Government and Federal agency securities held in such Account (including forward commitments) at the close of business on the day of a meeting of the Committee at which action is taken with respect to a domestic policy directive shall not be increased or decreased by more than $8.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting;

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

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

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

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

## Domestic Policy Directive

### In Effect January 1, 1996[1]

The information reviewed at this meeting suggests a substantial slowing in the expansion of economic activity after a strong gain in the third quarter. Nonfarm payroll employment increased further in November, but the civilian unemployment rate edged up to 5.6 percent. Industrial production was little changed on average over October and November after a moderate rise in the third quarter. Total nominal retail sales rose somewhat on balance over October and November. Housing starts were down in October after a large increase in the third quarter. However, orders for nondefense capital goods point to substantial expansion of spending on business equipment in the near term, and nonresidential construction has risen appreciably further. Wage trends have been stable and consumer prices have risen relatively slowly on average in recent months.

Most market interest rates have declined slightly since the Committee meeting on November 15. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has risen slightly on balance over the intermeeting period.

The substantial moderation in the growth of M2 and M3 since midsummer continued in November; however, for the year through November, M2 expanded at a rate in the upper half of its range for 1995 and M3 grew at a rate at the upper end of its range. Growth in total domestic nonfinancial debt has slowed somewhat in recent months but for the year to date remains around the midpoint of its monitoring range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the range it had established on January 31–February 1 for growth of M2 of 1 to 5 percent, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee also retained the monitoring range of 3 to 7 percent for the year that it had set for growth of total domestic nonfinancial debt. The Committee raised the 1995 range for M3 to 2 to 6 percent as a technical adjustment to take account of changing intermediation patterns. For 1996, the Committee established on a tentative basis the same ranges as in 1995 for growth of the monetary aggregates and debt, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to decrease slightly the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

1. Adopted by the Committee at its meeting on December 19, 1995.

## Authorization for Foreign Currency Operations

### In Effect January 1, 1996

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

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

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

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

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

D. To maintain an overall open position in all foreign currencies not exceeding $25.0 billion. For this purpose, the overall open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies. The net position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

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

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

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

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

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

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

6. All operations undertaken pursuant to the preceding paragraphs shall be reported promptly to the Foreign Currency Subcommittee and the Committee. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in the absence of members of the Board serving on the Subcommittee, other Board Members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, his alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of the Manager, System Open Market Account (“Manager”), for the purposes of reviewing recent or contemplated operations and of consulting with the Manager on other matters relating to his responsibilities. At the request of any member of the Subcommittee, questions arising from such reviews and consultations shall be referred for determination to the Federal Open Market Committee.

7. The Chairman is authorized:

A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Treasury;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on policy matters relating to foreign currency operations;

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G(1) of the Board of Governors’ Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

## Foreign Currency Directive

### In Effect January 1, 1996

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

2. To achieve this end the System shall:

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

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

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

3. Transactions may also be undertaken:

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

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

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

4. System foreign currency operations shall be conducted:

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

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

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

## Procedural Instructions with Respect to Foreign Currency Operations

### In Effect January 1, 1996

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

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

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

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

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

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

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

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

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

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

## Meeting Held on January 30–31, 1996

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., starting on Tuesday, January 30, 1996, at 2:30 p.m. and continuing on Wednesday, January 31, 1996, at 9:00 a.m.

*Present:*

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Ms. Phillips

Mr. Stern
Ms. Yellen

Messrs. Broaddus, Guynn, Moskow, and Parry, Alternate Members of the Federal Open Market Committee

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

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

Messrs. Lang, Lindsey, Mishkin, Promisel, Rolnick, Rosenblum, Siegman, Simpson, Sniderman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors
Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors
Mr. Slifman, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Rosine,[2] Senior Economist, Division of Research and Statistics, Board of Governors
Mr. Reid,[2] Economist, Division of Monetary Affairs, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

2. Attended portions of meeting relating to the Committee's review of the economic outlook and establishment of its monetary and debt ranges for 1996.

Mr. Beebe, Ms. Browne, Messrs. Davis, Dewald, Goodfriend, and Hunter, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Boston, Kansas City, St. Louis, Richmond, and Chicago respectively
Mses. Krieger and Rosenbaum, Vice Presidents, Federal Reserve Banks of New York and Atlanta respectively

In the agenda for this meeting, it was reported that advices of the election of the following members and alternate members of the Federal Open Market Committee for the period commencing January 1, 1996, and ending December 31, 1996, had been received and that the named individuals had executed their oaths of office.

The elected members and alternate members were as follows:

William J. McDonough, President of the Federal Reserve Bank of New York, with Ernest T. Patrikis, First Vice President of the Federal Reserve Bank of New York, as alternate;
Edward G. Boehne, President of the Federal Reserve Bank of Philadelphia, with J. Alfred Broaddus, Jr., President of the Federal Reserve Bank of Richmond, as alternate;
Jerry L. Jordan, President of the Federal Reserve Bank of Cleveland, with Michael H. Moskow, President of the Federal Reserve Bank of Chicago, as alternate;
Robert D. McTeer, President of the Federal Reserve Bank of Dallas, with Jack Guynn, President of the Federal Reserve Bank of Atlanta, as alternate;
Gary H. Stern, President of the Federal Reserve Bank of Minneapolis, with Robert T. Parry, President of the Federal Reserve Bank of San Francisco, as alternate.

By unanimous vote, the following officers of the Federal Open Market Committee were elected to serve until the election of their successors at the first meeting of the Committee after December 31, 1996, with the understanding that in the event of the discontinuance of their official connection with the Board of Governors or with a Federal Reserve Bank, they would cease to have any official connection with the Federal Open Market Committee:

| | |
|---|---|
| Alan Greenspan | Chairman |
| William J. McDonough | Vice Chairman |
| Donald L. Kohn | Secretary and Economist |
| Normand R.V. Bernard | Deputy Secretary |
| Joseph R. Coyne | Assistant Secretary |
| Gary P. Gillum | Assistant Secretary |
| J. Virgil Mattingly, Jr. | General Counsel |
| Thomas C. Baxter, Jr. | Deputy General Counsel |
| Michael J. Prell | Economist |
| Edwin M. Truman | Economist |

Richard W. Lang, David E. Lindsey, Frederic S. Mishkin, Larry J. Promisel, Arthur J. Rolnick, Harvey Rosenblum, Charles J. Siegman, Thomas D. Simpson, Mark S. Sniderman, and David J. Stockton, Associate Economists

By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account until the adjournment of the first meeting of the Committee after December 31, 1996.

By unanimous vote, Peter R. Fisher was selected to serve at the pleasure of the Committee as Manager, System Open Market Account, on the understanding that his selection was subject to being satisfactory to the Federal Reserve Bank of New York.

*Secretary's note:* Advice subsequently was received that the selection of Mr. Fisher as Manager was satisfactory to the board of directors of the Federal Reserve Bank of New York.

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

## Authorization for Domestic Open Market Operations

*Reaffirmed January 30, 1996*

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

(a) To buy or sell U.S. Government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U.S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; provided that the aggregate amount of U.S. Government and Federal agency securities held in such Account (including forward commitments) at the close of business on the day of a meeting of the Committee at which action is taken with respect to a domestic policy directive shall not be increased or decreased by more than $8.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting;

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

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

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

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

By unanimous vote, the Authorization for Foreign Currency Operations shown below was reaffirmed.

## Authorization for Foreign Currency Operations

*Reaffirmed January 30, 1996*

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

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

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

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

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

D. To maintain an overall open position in all foreign currencies not exceeding $25.0 billion. For this purpose, the overall open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies. The net position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

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

| Foreign bank | Amount (millions of dollars equivalent) | Foreign bank | Amount (millions of dollar equivalent) |
|---|---|---|---|
| Austrian National Bank | 250 | Bank of Mexico | 3,000 [1] |
| National Bank of Belgium | 1,000 | Netherlands Bank | 500 |
| Bank of Canada | 2,000 | Bank of Norway | 250 |
| National Bank of Denmark | 250 | Bank of Sweden | 300 |
| Bank of England | 3,000 | Swiss National Bank | 4,000 |
| Bank of France | 2,000 | Bank for International Settlements: | |
| German Federal Bank | 6,00 | Dollars against Swiss francs | 600 |
| Bank of Italy | 3,000 | Dollars against authorized European currencies other than Swiss francs | 1,250 |
| Bank of Japan | 5,000 | | |

1. The additional temporary $3 billion swap arrangement with the Bank of Mexico, approved by the Committee on February 1, 1995, was allowed to lapse on January 31, 1996, in line with its original terms. See minutes of the FOMC meeting of December 19, 1995.

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

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

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

5. Foreign currency holdings shall be invested insofar as practicable, considering needs for minimum working balances. Such investments shall be in liquid form, and generally have no more than 12 months remaining to maturity. When appropriate in connection with arrangements to provide

investment facilities for foreign currency holdings, U.S. Government securities may be purchased from foreign central banks under agreements for repurchase of such securities within 30 calendar days. 6. All operations undertaken pursuant to the preceding paragraphs shall be reported promptly to the Foreign Currency Subcommittee and the Committee. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in the absence of members of the Board serving on the Subcommittee, other Board members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, his alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of the Manager, System Open Market Account (''Manager''), for the purposes of reviewing recent or contemplated operations and of consulting with the Manager on other matters relating to his responsibilities. At the request of any member of the Subcommittee, questions arising from such reviews and consultations shall be referred for determination to the Federal Open Market Committee.

7. The Chairman is authorized:

A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Treasury;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on policy matters relating to foreign currency operations;

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G(1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

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

## Foreign Currency Directive

*Reaffirmed January 30, 1996*

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

2. To achieve this end the System shall:

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

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

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

3. Transactions may also be undertaken:

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

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

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

4. System foreign currency operations shall be conducted:

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

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

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

By unanimous vote, the Procedural Instructions with Respect to Foreign Currency Operations shown below were reaffirmed.

## Procedural Instructions with Respect to Foreign Currency Operations

*Reaffirmed January 30, 1996*

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

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

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

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

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

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

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

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

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

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

## Agreement to “Warehouse” Foreign Currencies

At its meeting on January 31–February 1, 1995, the Committee had approved an increase from $5 billion to $20 billion in the amount of eligible foreign currencies that the System was prepared to “warehouse” for the Treasury and the Exchange Stabilization Fund (ESF). The purpose of the warehousing facility, which has been in place for many years, is to supplement the U.S. dollar resources of the Treasury and the ESF for financing purchases of foreign currencies and related international operations. The enlargement of the warehousing agreement was intended to facilitate U.S. participation in the Multilateral Program to Restore Financial Stability in Mexico, announced by President Clinton on January 31, 1995, by warehousing up to $20 billion in German marks and Japanese yen held by the Treasury through the ESF. The Committee had agreed that it would review each year the need to maintain this level of warehousing authority in light of the progress and requirements of the program.

The Treasury and the Exchange Stabilization Fund had made no use of the warehousing facility over the past year. Nevertheless, consistent with Federal Reserve support for the program of assistance to Mexico, the members agreed that it was appropriate to postpone consideration of an adjustment in the overall size of the facility at least until the end of the disbursement phase of the Mexican program currently scheduled for August 1996. Accordingly, the Committee reaffirmed the warehousing authority by unanimous vote.

By unanimous vote, the Program for Security of FOMC Information was amended to conform it to the treatment of transcripts of FOMC meetings and the procedures that the Committee had been following for some time in regard to redactions of confidential information in transcripts and other documents that are released to the public after five years. In addition, the Committee agreed to amend the program so that the automatic extension of Federal Reserve staff access to confidential material after six months could be suspended for certain particularly sensitive documents.

On January 23, 1996, the continuing rules, resolutions, and other instruments of the Committee had been distributed with the advice that, in accordance with procedures approved by the Committee, they were being called to the Committee's attention before the January 30–31 organization meeting to give members an opportunity to raise any questions they might have concerning them. Members were asked to indicate if they wished to have any of the instruments in question placed on the agenda for consideration at this meeting, and no requests for such consideration were received.

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on December 19, 1995, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. He indicated that the swap line drawing by the Bank of Mexico had been repaid in full on January 29, 1996. The Committee ratified that transaction by unanimous vote.

The Manager also reported on recent developments in domestic financial markets and on System open market transactions in U.S. government securities and federal agency obligations during the period December 19, 1995, through January 30, 1996. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook, the ranges for the growth of money and debt in 1996, and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

Only a limited amount of new information was available for this meeting because of delays in government releases; that which was available, along with anecdotal commentary, suggested that the economy had been growing relatively slowly in recent months. Consumer spending had expanded modestly on balance, growth in business investment in capital goods appeared to have slackened somewhat recently, and housing demand seemed to have leveled out. Slower growth in final sales was leading to inventory buildups in a few industries, and these buildups, together with the disruptions from government shutdowns and severe weather, were having a restraining effect on economic activity. The demand for labor was still growing at a moderate pace, though, and the unemployment rate remained relatively low. The recent data on prices and wages had been mixed, but there was no firm evidence of a change in underlying inflation trends.

Nonfarm payroll employment continued to expand moderately in December; the gain was in line with the average monthly increase for 1995. Employment in manufacturing, boosted by the settlement of a strike at a major aircraft manufacturer, reversed the declines of October and November. Construction payrolls rose further in December, despite unfavorable weather in some parts of the country. Job growth remained solid in much of the services industry, although employment at personnel supply firms was little changed. The civilian unemployment rate remained at 5.6 percent in December.

Industrial production edged up in December and for the fourth quarter as a whole advanced only slightly; industrial activity remained sluggish in January according to the limited statistical information that was available. In December, manufacturing output rose a bit in association with an increase in motor vehicle assemblies and aircraft production. Elsewhere in manufacturing, the growth of output of office and computing equipment slowed somewhat from the rapid pace of previous months, and the production of defense and space equipment and of nondurable consumer goods registered sizable declines. The output of utilities was boosted somewhat in December by the effect of colder-than-average temperatures on the demand for heating services. Utilization of total industrial capacity fell slightly but remained at a moderately elevated level.

Retail sales continued to grow at a relatively modest rate in December, and the fourth-quarter increase was considerably smaller than those of the previous two quarters. In the fourth quarter, lower spending at general merchandisers offset much of the sales gains registered at automotive dealerships, furniture and appliance stores, and building and supply outlets. Consumer surveys indicated some deterioration in consumer confidence in January. Recent indicators of housing demand and activity were mixed. Sales of new homes edged still lower in November (latest data available), and sales of existing homes declined by a larger amount in December than in November. However, housing starts rebounded in November from a sizable October decline, and conditions in mortgage markets remained quite favorable, led by a further decline in rates.

The sparse statistical data available on business fixed investment, along with anecdotal information, suggested a moderation recently in the expansion of business spending on capital goods, including some slowing of investment in computers. Investment in transportation equipment, however, apparently had held up well in the fourth quarter. Incoming data on construction contracts pointed to some slowing in the growth of nonresidential building activity from a relatively brisk pace during most of 1995.

The information available on business inventories suggested that inventory imbalances might have emerged in a few sectors in association with weaker-than-expected sales. Motor vehicle inventories were at elevated levels compared with sales in late 1995, and manufacturers responded by offering incentive packages on new cars and trucks and by adjusting downward their January production schedules. Data on manufacturing and retail trade inventories for November had been delayed, but published information on inventories held by wholesale distributors indicated a decline in that month, reversing part of October's sizable run-up. Much of the decline occurred in nondurable goods, although machinery distributors also reported a sizable liquidation. The inventory–sales ratio for the wholesale trade sector edged down in November but remained near the high end of its range in recent years.

The nominal deficit on U.S. trade in goods and services narrowed in October from its average rate in the third quarter. The value of imports declined more than the value of exports. Much of the contraction in imports reflected reductions in oil and automotive products that more than offset another strong rise in computer goods. For exports, an advance in machinery exports to record levels was outweighed by a reduction in shipments of agricultural and automotive products. Available data on economic activity in the major foreign industrial countries suggested that the pace of expansion in Europe had slowed further on average while growth in Japan had picked up a little.

Recent data suggested little change in underlying inflation trends. Consumer prices increased slightly in December after having been unchanged in November; food prices were quiescent over the two-month period while energy prices rose on balance, with a December rebound more than offsetting a sizable November drop. Excluding food and energy items, consumer prices were up modestly over the November–December period and for all of 1995 advanced slightly more than in 1994. Producer prices of finished goods were up considerably in November and December after having risen slowly in earlier months; in large part, the price increases late in the year reflected sharp upward movements in both finished foods and finished energy prices. For 1995, producer prices of finished goods other than food and energy rose at a subdued pace, though somewhat more than in 1994. Commodity prices had been mixed recently after having trended down earlier. Average hourly earnings of production and nonsupervisory workers increased somewhat in December after having been unchanged in November. Increases in average hourly earnings had been trending up over the past several years.

At its meeting on December 19, 1995, the Committee adopted a directive that called for some slight easing in the degree of pressure on reserve positions, which was expected to result in a decline in the federal funds rate from around 5¾ percent to around 5½ percent. The directive did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. Accordingly, the directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and M3 over coming months.

After the meeting, open market operations were directed initially toward implementing the slight easing in the degree of reserve pressure that had been adopted by the Committee and thereafter toward maintaining this new reserve posture. Operations were complicated by large swings in reserve demands associated with year-end pressures and the adverse effects of unusually severe winter weather on check clearings. Although the federal funds rate exhibited somewhat greater volatility than normal over the period, it nonetheless averaged close to the expected level of 5½ percent. The occasional periods of firmness in reserve market conditions contributed to higher adjustment plus seasonal borrowing, on average, over the period.

Most market interest rates had declined somewhat further over the period after the December 19 meeting. Rates moved lower immediately after the policy easing action, and most fell still more on balance over the remainder of the intermeeting interval in response to incoming information about the economy and the prospects for fiscal policy, at least in the near term. Both were seen as suggesting slower economic expansion for a time and an increased likelihood of additional easing of monetary policy in coming months. With bond yields down on balance, and occasionally approaching two-year lows, major indexes of equity prices advanced sharply further.

The trade-weighted value of the dollar in terms of the other G-10 currencies continued to rise over the intermeeting period despite the decline in U.S. interest rates. The dollar's upward movement against the German mark and other European currencies was associated with increasing indications of further weakening of economic expansion in key European countries and greater declines in interest rates in those countries than in the United States. The dollar's appreciation relative to the Japanese yen appeared to be related in part to a narrowing of Japan's trade and current account surpluses. The dollar was unchanged on balance against the Canadian dollar, while the Mexican peso rose considerably in relation to the dollar.

Growth of M2 and M3 strengthened in December and January. The pickup in M2 growth partly reflected the effect of recent declines in short-term interest rates; those declines had made money market instruments less attractive relative to household savings accounts in M2, whose offering rates tend to be adjusted downward with a considerable lag. In addition, the flattening of the term structure of interest rates had lessened the comparative attractiveness of bond mutual funds, which had continued to experience only light inflows. Faster growth of M3 in December and January was associated with both the pickup in M2 expansion and the issuance of additional large time deposits to help finance a noticeable step-up in bank loan demand in January. The expansion of M2 from the fourth quarter of 1994 to the fourth quarter of 1995 was in the upper half of the Committee's annual range, and M3 grew at the upper end of its range. Growth of total domestic nonfinancial debt had been moderate in recent months, and for the year was near the midpoint of this aggregate's monitoring range.

The staff forecast prepared for this meeting suggested that economic activity would expand at a relatively slow pace over the near term. This forecast was not materially different from that prepared for the December meeting, except for a slightly weaker outlook for the current quarter that was related in part to an inventory correction and the effects of unusually severe winter weather on spending and output. Over the remainder of the two-year forecast horizon, the economy was expected to grow generally along its estimated potential. Consumer spending was anticipated to keep pace with the growth of disposable income; concerns about job security remained and consumer debt burdens had risen further, but the still-ample availability of credit and the substantial rise in the value of household equity holdings would support additional increases in consumption. The further decline in mortgage rates recently from already-favorable levels would help to sustain homebuilding activity at a relatively high level. With sales and profits projected to grow more slowly, and with utilization of existing capacity having eased considerably, business investment in new equipment and structures was expected to expand at a more moderate rate. In light of the recent strengthening of the dollar, the external sector was expected to exert a small restraining influence on real activity over the projection period as a whole. Much uncertainty still surrounded the fiscal outlook, but the recent impasse in the budget negotiations between the Administration and the Congress suggested a lower degree of fiscal restraint over coming years than had been assumed in the previous forecast. Given the projected outlook, rates of utilization of labor and capital resources and of inflation were not expected to change materially.

In the Committee's discussion of current and prospective economic activity, members noted a number of temporary factors that were retarding the expansion. The weakness in business activity this winter was to some extent the result of the partial shutdown of the federal government and the severe storms in a number of regions; both clearly were transitory influences on the economy. Growth of economic activity also was being constrained by production cutbacks stemming from efforts to bring stocks into better alignment with disappointing sales in a number of industries. Even so, in the absence of major overhangs in inventories of business equipment and consumer durables, and given favorable conditions in financial markets, members believed that a resumption of moderate, sustainable growth after a relatively brief period of weakness was the most likely outlook for the economy. At the same time, many observed that the risks to such an outcome did not seem balanced. A number of concerns, including the extent of the damping effects of high debt loads and employment uncertainty on consumption and questions about the sources of further export growth, suggested the possibility of sluggish expansion, while possible developments on the upside were more difficult to identify. With resource use unlikely to vary appreciably, the members generally expected no significant change in the underlying inflation picture over the year ahead. The recent performance of inflation had some encouraging aspects, and the odds on greater price pressures seemed relatively small at this time.

In keeping with the practice at meetings when the Committee establishes its long-run ranges for growth of the money and debt aggregates, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members had prepared individual projections of economic activity, the rate of unemployment, and inflation for the year 1996. Measured on the basis of chain-weighted indexes, the forecasts of the growth in real GDP had a central tendency of 2 to 2¼ percent and a full range of 1½ to 2½ percent for the period from the fourth quarter of 1995 to the fourth quarter of 1996. The members and nonmember presidents generally anticipated that economic expansion in line with their forecasts would be associated with employment growth close to that of the labor force. Accordingly, their forecasts of the civilian rate of unemployment in the fourth quarter of 1996 were near the current level, with a central tendency of 5½ to 5¾ percent and a full range of 5½ to 6 percent. Projections of the rate of inflation, as reflected in the consumer price index, had a central tendency of 2¾ to 3 percent; that central tendency was on the high side of the outcome for 1995— when the rise in the index was held down by damped increases in food prices and declines in energy prices—but a few of the forecasts anticipated a slightly lower rate of inflation.

In their review of developments across the nation, the Federal Reserve Bank presidents reported modest growth in most major areas of the country. Many referred, however, to an admixture of strengths and weaknesses in their local economies, and a majority observed that on balance growth in regional business activity appeared to have slowed in the last few months. In keeping with the data available for the nation as a whole, the slowing seemed to be concentrated in manufacturing and especially at firms producing motor vehicles and parts. Some presidents referred to relatively negative, or at least cautious, sentiment among many of their business contacts.

Much of the recent softening in economic activity appeared to arise from production cutbacks in various sectors of the economy in which involuntary accumulation of inventories seemed to have occurred as a result of weaker sales trends in the past few months. The members expected this inventory adjustment process to have a relatively pronounced effect on production and overall business activity in the current quarter and perhaps to some extent in the second. While a greater-than-expected inventory adjustment with spreading effects through the economy could not be ruled out, the underlying strength of demand was likely to be sufficient to restore and sustain moderate growth in overall economic activity as the current inventory and production adjustments subsided.

With regard to consumer spending, members referred to overall indications of lackluster retail sales during the holiday season and into January. The anecdotal commentary on retail sales attributed some of the recent weakness in a number of areas to the clearly temporary effects of unusually severe winter weather and the partial shutdown of the federal government. The members anticipated that moderate growth in retail sales would resume, though some felt that the consumer sector might remain vulnerable on the downside. The consumer spending outlook was complicated by a number of crosscurrents. Negative factors cited by the members included ongoing concerns about job security that were being sustained by a continuing stream of workforce reduction announcements by major business concerns, increased consumer debt burdens that were showing up in rising delinquency rates on some types of loans, and the apparent satisfaction of much of the earlier pent-up demand for consumer durables. On the positive side, reduced interest rates, still readily available credit, and the accumulation of financial wealth from the sharp rise in stock and bond prices were seen as likely to support continuing gains in consumer spending.

Further increases in business fixed investment were viewed as a likely prospect for the year ahead, though the growth of such investment probably would be well below the strong pace experienced earlier in the current cyclical expansion. Anecdotal reports indicated continuing strength in nonresidential construction in some parts of the country, but declining rates of capacity utilization augured reduced growth going forward. The expansion of investment in producers' durable equipment also was expected to slow, but from a pace that had seemed unsustainable. While appreciable further growth could be expected in expenditures for high-tech equipment as business firms continued to focus on improving the efficiency of their operations in a highly competitive environment, spending for other types of equipment was likely to be sluggish. Members noted in particular the prospects for weaker business spending for motor vehicles, especially for heavy trucks. However, the fundamental determinants of investment in business equipment, including the reduced cost of financing such investment, remained positive and this sector of the economy should continue to provide considerable impetus to the expansion.

The members also viewed the considerable decline that had occurred in mortgage interest rates and the ample availability of housing finance as key factors in their forecasts of sustained residential construction at relatively high levels. Adverse weather conditions appeared to have retarded homebuilding activity in a number of areas in recent weeks, but several members commented that underlying trends in housing demand were favorable and that residential construction had remained relatively strong in several parts of the country.

The outlook for fiscal policy was uncertain, especially with regard to whether longer-term spending and taxation measures would be enacted to implement the goal of a balanced federal budget by the year 2002. For the year immediately ahead, however, the members continued to anticipate considerable restraint in federal spending, partly as a byproduct of the current budget debate between the Congress and the Administration. With regard to the external sector of the economy, prospects for economic growth in major trading partners—led by developments in Europe—appeared to have weakened, and the recent appreciation of the dollar in the foreign exchange markets also might tend to damp net exports. Consequently, several members saw downside risks in the foreign trade sector over the year ahead.

The members anticipated that inflation would remain contained in 1996, but they did not expect significant progress toward more stable prices. They referred to crosscurrents bearing on the outlook for wages and prices in the year ahead. Factors pointing to potentially higher inflation included increased pressures on food prices stemming from disappointing harvests in some areas and relatively low grain supplies. More generally, resource utilization was expected to remain high and greater pressures could emerge in labor and product markets. Members noted that one broad measure of wages had picked up and that there was a small rise in the number of anecdotal reports indicating that labor shortages were contributing to higher wages in some parts of the country. In addition, unusually muted increases in the costs of worker benefits had been holding down overall compensation costs, and this pattern might not persist. On the other hand, high levels of resource utilization had been associated for some time with lower rates of growth in costs than would have been anticipated on the basis of historical experience. In particular, a general sense of job insecurity in a period of major business restructurings was holding down increases in labor compensation. In an environment of strong competition, which was preventing many businesses from passing on rising costs through higher prices, firms continued to focus on efforts to control costs by improving the efficiency of their operations, and this was helping to hold down inflation. An apparent decline in inflationary expectations also would provide a moderating influence on inflation trends in the period ahead. While most of the members saw little reason to anticipate appreciably lower inflation over the year ahead, they also viewed the odds on a pickup in inflation as fairly low; they could see possible reasons for optimism on the long-run trend in inflation; and they generally remained confident that further progress toward price stability would be made over the longer term.

In keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey–Hawkins Act), the Committee reviewed the ranges for growth of the monetary and debt aggregates in 1996 that it had established on a tentative basis at its meeting in July 1995. The tentative ranges included expansion of 1 to 5 percent for M2 and 2 to 6 percent for M3, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was provisionally set at 3 to 7 percent for 1996. The tentative ranges for 1996 were unchanged from the actual ranges for 1995. In July, the range for M3 had been raised 2 percentage points to reflect developments that seemed to be fostering a return to the historical pattern of somewhat faster growth in M3 than in M2.

In their discussion, the members took note of a staff analysis which indicated that monetary expansion consistent with the moderate growth of nominal GDP that the members were projecting for 1996 most likely would be around the upper ends of the tentative ranges adopted last July. M2 and M3 velocity over the past couple of years had conformed more closely on balance with historical patterns, and the projections assumed that this behavior would continue in 1996. In light of the experience of earlier years, however, when the velocities of these aggregates had exhibited pronounced atypical behavior, substantial uncertainty still surrounded any projections of monetary expansion and the linkage between particular rates of money growth and the basic objectives of monetary policy.

Most members endorsed a proposal to adopt the relatively low ranges for growth of M2 and M3 in 1996 that the Committee had set on a tentative basis in July 1995. These members favored retention of the tentative ranges because they could be viewed as benchmarks for money growth that would be associated with price stability, assuming behavior of velocity in line with historical experience, and a reaffirmation of those ranges would underscore the Committee's commitment to a policy of achieving price stability over the longer term. Some members also noted that any adjustment of these ranges to align them more fully with projections of money growth consistent with the Committee's expectations for expansion of the economy and prices in 1996 could be misinterpreted. Such an action might be seen as suggesting that the Committee had a greater degree of confidence in the relationship between money growth and broad measures of economic performance than was warranted by its current understanding of that relationship or that the Committee was now placing greater emphasis on the broad monetary aggregates as a gauge of the thrust of monetary policy.

Two members favored somewhat higher growth ranges for M2 and M3 in 1996. They noted that the expansion of these broad aggregates was anticipated to be around the upper ends of their tentative ranges, and perhaps even higher, given the Committee's expectations for the performance of the economy and prices. In their view, the higher ranges would be more consistent with what they saw as the Committee's obligations under the Federal Reserve Act to set ranges consistent with expected or desired economic outcomes for the year, and the reasons for establishing those ranges could easily be set forth and understood as an appropriate technical adjustment that would not imply any lessened commitment to the Committee's price stability goal.

The Committee unanimously preferred to retain the 3 to 7 percent range for total domestic nonfinancial debt in 1996. This position took account of a staff projection indicating that the debt aggregate was likely to continue to grow at a rate generally in line with the expansion of nominal GDP, although some moderation in private credit demands was anticipated and there were indications that lenders were no longer easing their terms and conditions for granting credit to consumers and businesses.

At the conclusion of its discussion, the Committee voted to approve without change the tentative ranges for 1996 that it had established in July of last year. In keeping with its usual procedures under the Humphrey–Hawkins Act, the Committee would review its ranges at midyear, or sooner if interim conditions warranted, in light of the growth and velocity behavior of the aggregates and ongoing economic and financial developments. Accordingly, the following longer-run policy statement for 1995 was approved for inclusion in the domestic policy directive:

> The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was set at 3 to 7 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

> Votes for this action: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, McTeer, Ms. Phillips, and Mr. Stern. Votes against this action: Mr. Lindsey and Ms. Yellen.

Mr. Lindsey and Ms. Yellen dissented because they preferred somewhat higher ranges for M2 and M3. They recognized that the relationships between the ranges for the monetary aggregates and broad measures of economic performance were subject to substantial uncertainty, but ranges higher than those adopted on a tentative basis in July 1995 were more likely to encompass monetary expansion consistent with the central tendency of members' current forecasts of nominal GDP growth for 1996. Raising the ranges for M2 and M3 would in their view conform those ranges more closely with the provisions in the Federal Reserve Act that require the System to communicate to the Congress its objectives and plans for the growth of the aggregates for the calendar year. They believed the Committee could readily explain that such an adjustment to the ranges did not represent a lessened commitment to its price stability goal or an increased emphasis on the monetary aggregates in policy formulation.

The Committee also discussed alternatives to the monetary aggregates for communicating its intentions with regard to the course of inflation over the longer run. Some members thought that explicit numerical goals or forecasts for inflation over a period of years would have several important benefits, including enhanced credibility that could reduce the costs of achieving price stability and greater flexibility to respond to the emergence of economic weakness by easing policy for a limited period of time without arousing inflation concerns. Other members, while endorsing fully the long-term goal of price stability, had a number of reservations about implementing such proposals, especially at this time. Based on experience in the United States and elsewhere, many were skeptical about the payoff in terms of greater credibility or flexibility in policy implementation. Moreover, they believed that substantially more study and deliberation were required to explore fully the alternatives and the consequences of changes in the way the Committee formulated and communicated its objectives. They also thought that any such assessment would need to take account of the prospects for, or disposition of, closely related legislation that was now being considered in the Congress. The Committee did not take any action on this issue at this meeting, but it recognized that the matter would need to be revisited from time to time.

In the Committee's discussion of policy for the intermeeting period ahead, the members supported a proposal calling for some slight easing in reserve conditions. Although a pickup to an acceptable rate of expansion was seen as the most likely course for the economy in coming quarters, the risks of a shortfall in growth were believed to be significant. At the same time, while most members were forecasting high levels of resource use and little change in the rate of inflation this year, they saw only a very limited risk that a slight easing move might foster higher inflation under prevailing circumstances, and some felt that there were favorable prospects for a slightly improved inflation performance. Under the circumstances, a slight decrease was warranted in the real federal funds rate from a level that a number of members considered still a bit to the firm side—a stance that seemed less appropriate in light of the reduced threat over the last year of a pickup in inflation. One member pointed out that such a decrease would tend to counter the effects on aggregate demand of the recent rise in the foreign exchange value of the dollar, which might continue to move higher if interest rate declines expected by the markets were not forthcoming. It was noted that postponing a decision in this uncertain economic climate could be defended on the ground that more evidence was needed to ascertain whether the weakness in the economy was quite temporary or more lasting; if it was the former, inflationary pressures could re-emerge at lower interest rates. On the other hand, a few members commented that the currently sluggish performance of the economy could be read as calling for a more pronounced easing move, but they preferred a cautious approach to policy in light of current inflation trends and the uncertainties that surrounded their forecasts of some strengthening in the economy.

The Chairman informed the Committee that he had asked the members of the Board of Governors to convene immediately after this meeting to consider a reduction of ¼ percentage point in the discount rate. Such a reduction had been proposed by a total of six Federal Reserve Banks at this point. Given the easing in reserve markets favored by the Committee and the possibility of a lower discount rate, the members did not believe that a further policy move was likely to be needed during the intermeeting period. Accordingly, they favored an unbiased directive that did not incorporate a presumption about the likely direction of any adjustments to policy during the next several weeks. In keeping with its usual practice, the Committee did not rule out the possibility of an intermeeting policy change on the basis of unanticipated economic or financial developments.

At the conclusion of the Committee's discussion, all the members supported a directive that called for a slight reduction in the degree of pressure on reserve positions and that did not include a bias about the likely direction of an adjustment to policy during the intermeeting period, should unanticipated developments warrant a change in policy. Accordingly, the Committee decided that in the context of its long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth in M2 and M3 over coming months.

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

The information reviewed at this meeting suggests that the economy has been growing rather slowly in recent months. Nonfarm payroll employment continued to expand moderately in December, and the civilian unemployment rate remained at 5.6 percent. Industrial production increased only slightly further in the fourth quarter. Growth of consumer spending was modest, on balance, over the past several months. Housing starts rebounded in November from a sizable October decline. Orders for nondefense capital goods point to a moderation in the expansion of spending on business equipment, and nonresidential construction has risen appreciably further. The nominal deficit on U.S. trade in goods and services narrowed in October from its average rate in the third quarter. There has been no clear change in underlying inflation trends.

Most market interest rates have declined somewhat since the Committee meeting on December 19. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has risen further over the intermeeting period.

Growth of M2 and M3 strengthened in December and January. From the fourth quarter of 1994 to the fourth quarter of 1995, M2 expanded in the upper half of its range and M3 grew at the upper end of its range. Growth in total domestic nonfinancial debt has been moderate in recent months, placing this aggregate near the midpoint of its monitoring range for the year.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was set at 3 to 7 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to decrease slightly the existing degree of pressure on reserve positions, taking account of a possible reduction in the discount rate. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for short-run policy: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Ms. Phillips, Mr. Stern, and Ms. Yellen. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, March 26, 1996.

The meeting adjourned at 12:00 p.m.

Donald L. Kohn
Secretary

## Meeting Held on March 26, 1996

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, March 26, 1996, at 8:00 a.m.

*Present:*

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Ms. Phillips
Mr. Stern
Ms. Yellen

Messrs. Broaddus, Guynn, Moskow, and Parry, Alternate Members of the Federal Open Market Committee

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

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

Messrs. Lang, Mishkin, Promisel, Rolnick, Rosenblum, Siegman, Simpson, Sniderman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Reinhart, Assistant Director, Division of Monetary Affairs, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Stone, First Vice President, Federal Reserve Bank of Philadelphia
Messrs. Davis, Dewald, Goodfriend, and Hunter, Senior Vice Presidents, Federal Reserve Banks of Kansas City, St. Louis, Richmond, and Chicago respectively
Mr. Judd, Ms. Rosenbaum, and Mr. Rosengren, Vice Presidents, Federal Reserve Banks of San Francisco, Atlanta, and Boston respectively
Mr. Bentley, Assistant Vice President, Federal Reserve Bank of New York

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on January 30–31, 1996, were approved.

The Manager of the System Open Market Account reported on developments in foreign exchange markets during the period January 31, 1996, through March 25, 1996. There were no open market transactions in foreign currencies for System account during this period, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period January 31, 1996, through March 25, 1996. By unanimous vote, the Committee ratified these transactions.

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

Much of the information reviewed at this meeting had been influenced to an uncertain degree by unusually severe winter weather, industrial strikes, and U.S. government shutdowns. On balance, however, growth of economic activity appeared to have picked up after having slowed appreciably in late 1995. Growth in consumer spending seemed to have resumed at a moderate rate in the wake of January's storms; business spending on durable equipment was recording further healthy gains; and housing demand was showing some signs of strengthening. With businesses making considerable progress in getting their inventories under control, industrial production and employment had rebounded briskly. The recent data on prices gave little indication of any change in underlying inflation trends.

A surge in nonfarm payroll employment in February considerably more than offset a large weather-related drop in January. Very large job gains were recorded in February in the construction, retail trade, and services industries; however, some of these increases reflected the reversal of the depressing effects of January's severe winter storms and the efforts of some firms to make up for associated production losses. A small rise in manufacturing employment in February only partially offset a further loss of factory jobs in January. The civilian unemployment rate fell to 5.5 percent in February.

Industrial production rose sharply in February, more than offsetting a sizable decline in January. Part of the net increase in output over the January–February period reflected an upturn in aircraft production after the settlement of a strike at a major aircraft manufacturer. In addition, output of office and computing machines continued to rise at a rapid pace, and the production of other types of business equipment picked up. Output of consumer goods changed little on balance over the two-month period. Manufacturing production expanded about in line with capacity over the first two months of the year, leaving the overall rate of utilization of manufacturing capacity little changed.

Nominal retail sales increased briskly in February after having registered little change in January. The February spurt was paced by strong motor vehicle purchases, but spending at general merchandise stores and apparel outlets also was up considerably after a weak performance in previous months. Sales at durable goods stores were less robust, rising only slightly in February. Recent indicators of housing demand and activity were generally favorable. Starts of both single-family and multifamily units moved higher on balance over January and February, and sales of new homes increased appreciably in January (latest data available). By contrast, sales of existing homes declined in January for a fourth consecutive month.

Business demand for durable equipment apparently remained fairly robust in early 1996. Incoming orders for computing equipment were particularly strong in January, and shipments of such equipment posted further healthy gains. With airline profits high and new models of airplanes being introduced, orders for aircraft had climbed rapidly over recent months. Orders for other types of equipment also had picked up on balance over the last several months, although shipments of such equipment dropped in January after a sizable rise in the fourth quarter. Nonresidential construction activity appeared to be growing more slowly: Non-office commercial construction continued its upward trend but office, institutional, and industrial building activity had slowed noticeably in recent months, and contracts for those categories also had softened.

Business inventories rebounded sharply in January from a large drop in December. Much of the January buildup in stocks occurred in manufacturing, where part of the backup may have been associated with delays in shipments as a result of winter storms. The inventory–sales ratio for the sector edged up in January but was little changed on balance in recent months. Inventories at the wholesale level also rose considerably in January; the inventory–sales ratio increased slightly but was still well below the high levels of last fall. Retail stocks recorded a modest rise in January after a sharp decline in December. The January increase was in line with the advance in sales, and the inventory–sales ratio for the sector as a whole was unchanged from December and remained well below levels seen over most of 1995.

The nominal deficit on U.S. trade in goods and services in December (latest data available) was little changed from its November level. On a quarterly-average basis, however, the deficit in the fourth quarter was substantially smaller than it had been in the third quarter. The value of exports of goods and services rose appreciably in the fourth quarter, with the largest increases occurring in machinery exports and foreign tourist services. The value of imports declined slightly, largely as a result of decreases in imports of automotive products, consumer goods, and oil. The data available on economic conditions in the major foreign industrial countries in early 1996 suggested that a moderate recovery was under way in Japan, and there were some signs of a pickup in activity in much of Western Europe, although the German economy remained weak.

Inflation trends had remained stable in recent months. At the consumer level, food prices continued to edge up in February and energy prices again were under appreciable upward pressure. Excluding the often-volatile food and energy items, consumer prices advanced in February at a slightly slower rate than in January; and for the twelve months ended in February, consumer prices rose a little less than in the comparable year-earlier period. At the producer level, prices of finished goods other than food and energy were unchanged on balance over January and February; the rise in this measure of prices over the twelve months ended in February was somewhat larger than in the comparable year-earlier interval. Average hourly earnings of production and nonsupervisory workers edged down in February after a considerable increase in January. However, for the twelve-month period ended in February, average hourly earnings rose more than in the year-earlier period.

At its meeting on January 30–31, 1996, the Committee adopted a directive that called for a slight reduction in the degree of pressure on reserve positions, taking account of a possible reduction of ¼ percentage point in the discount rate. The directive approved by the Committee did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period, should unanticipated developments warrant a policy change. Accordingly, the directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and M3 over coming months.

On January 31, the Board of Governors approved a reduction of ¼ percentage point in the discount rate, to a level of 5 percent. The decrease was made effective immediately and was passed through to interest rates in reserve markets. Open market operations during the intermeeting period were directed toward maintaining this new policy stance, and the federal funds rate averaged around 5¼ percent, the level expected to be associated with that stance.

Because the easing move had been largely anticipated in financial markets, the initial response was a small decline in short-term rates and little change in long-term rates. Over the remainder of the period, however, most interest rates moved higher in response to incoming economic data that were seen as suggesting improved prospects for economic growth and, accordingly, a reduced likelihood of further easings in monetary policy. In addition, the absence of much progress in federal budget negotiations was viewed by the markets as indicating that the chances a major multiyear deficit-reduction plan would be adopted this year were becoming more remote. Despite the increase in bond yields, major indexes of equity prices recorded sizable gains.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined slightly over the intermeeting period. The dollar fell appreciably during the initial portion of the period—before evidence of a more robust U.S. economy emerged—while data on the German money supply and the Japanese economy were suggesting upward revisions to expected interest rates abroad. In late February, emerging signs that the U.S. economy was generally stronger than expected and that economic conditions abroad were comparatively weaker than they had seemed earlier fostered a rebound in the value of the dollar.

Growth of the broader monetary aggregates strengthened considerably in February and early March following the decline in short-term interest rates in late 1995 and early 1996. The acceleration of M2 reflected a surge in demand deposits as well as larger inflows to retail money market mutual funds, whose yields tend to adjust with a lag to changes in short-term market interest rates. Larger inflows to institution-only money market funds contributed to M3's stronger performance. Growth of total domestic nonfinancial debt slowed somewhat in December and January, reflecting reduced federal government borrowing, but remained moderate on balance.

The staff forecast prepared for this meeting suggested that the pace of economic expansion would pick up over coming months after a sluggish fourth quarter. Other than a better performance over the first half of 1996 associated with a somewhat faster increase in final sales, this forecast differed little from that prepared for the previous meeting and indicated that the economy was expected to expand generally along its estimated potential. Consumer spending was projected to grow slightly more than disposable income; the favorable effect of higher equity prices on household wealth and the still-ample availability of credit were expected to outweigh persisting consumer concerns about job security and the effects of already high household debt burdens. Homebuilding activity was projected to decline a little in response to the recent backup in residential mortgage rates but to remain at a relatively high level. A less rapid pace of business investment in equipment and structures was expected in light of the decline over the past year in the rate of utilization of production capacity and the moderate growth projected for sales and profits. The external sector was expected to exert a small restraining influence on economic activity over the projection period. The persisting impasse in the federal budget negotiations suggested little further fiscal contraction in coming quarters. Given the outlook for economic activity, rates of utilization of labor and capital were not expected to change materially and inflation was projected to increase modestly.

In the Committee's discussion of current and prospective economic developments, members commented on the resiliency of the economy, which appeared to have strengthened appreciably after a period of subpar growth. The latter had been induced to a large extent by inventory adjustments whose effects were exacerbated temporarily by government shutdowns, unusually severe winter weather, and industrial strikes. The adjustment in inventory investment seemed to be nearing its completion, and some members observed that the settlement of the recent strike in the motor vehicle industry might well impart added impetus to the expansion over the nearer term. Considerable volatility could be expected in the short-run performance of the economy, but the members continued to view trend growth at a pace near the economy's potential as the most probable outcome. Many also commented that the risks to such a forecast appeared to have shifted from being predominantly on the downside earlier in the year to better balanced currently. Still, substantial uncertainties attended the economic outlook, and a number of members observed that an economic performance that differed considerably in either direction from their current forecasts might well materialize over the projection period. Regarding the outlook for inflation, members' assessments tended to center on expectations of little change in average consumer price inflation over the projection horizon.

The review of regional economic developments by the Federal Reserve Bank presidents pointed to moderate expansion in economic activity across much of the nation, though growth was described as modest in a few regions and relatively robust in some others. Business conditions appeared to have improved in a number of areas since early in the year, but as had been true previously, activity in various sectors of the economy remained uneven. Manufacturing of most durable goods other than motor vehicles and some defense industry products displayed considerable strength, while the production of many nondurable goods tended to lag. In agriculture, high feed costs and low market prices were depressing the cattle industry, while elevated grain prices were boosting the incomes of farmers not subject to the effects of locally adverse weather conditions.

The economy had displayed considerable resilience in the face of adjustments to production associated with efforts by many business firms to reduce inventories and a number of additional, albeit temporary, developments that had tended to retard the expansion in the latter part of 1995 and at the start of this year. Apparently, relatively low long-term interest rates and the related substantial appreciation in the value of stock and bond market holdings had been important factors helping to sustain spending in this period. In the context of continued underlying momentum in final demand and some decline in excess stocks of unsold motor vehicles stemming from the recently ended strike at a major domestic producer, inventories now seemed to be in better balance with sales and the economy to be better positioned to accommodate sustained expansion. Some members observed, however, that the recent increase in intermediate- and long-term interest rates would tend to blunt demand in interest-sensitive sectors of the economy. Moreover, stock market prices had risen to comparatively high levels in relation to earnings and interest rates and might be vulnerable to further weakness in the debt markets or to any tendency for business profit margins to erode.

In the course of their comments about developments in key sectors of the economy, members referred to recent indications, including anecdotal reports, of appreciable strengthening in retail sales that tended to support forecasts of sustained growth in consumer spending in coming quarters. In addition, surveys of consumer sentiment, which had been more favorable recently, and sharply increased household net worth were seen as positive factors in the outlook for consumer expenditures. On the negative side, some members observed that the rise in consumer indebtedness and the recent increase in interest rates would tend to damp consumer spending. Given these financial crosscurrents, it was suggested that growth in consumer spending might approximate that of disposable income over the forecast horizon.

The prospects for business capital spending remained a supportive element in the outlook for further economic expansion, but growth in such spending was expected to slow considerably from its rapid pace over the past few years. The ready availability and fairly low cost of business finance in equity and debt markets and the continuing commitment of business firms to modernizing their facilities to hold down costs in highly competitive markets would tend to support growth in business fixed investment. Profits and cash flows were expected to remain reasonably strong, though there were tentative signs of some softening in profit margins. On the other hand, the longevity of the current expansion had resulted in the addition of a good deal of production capacity in recent years. This development in conjunction with some decline in capacity utilization over the past several quarters pointed to less need for expansion in plant and equipment. The rise in outlays for computers and related products was likely to remain fairly robust in light of the continuing advances in technology and the marked downtrend in computer prices, but the growth of computer expenditures was projected to be well below the extraordinary pace of the past few years. The slowdown would reflect factors that were expected to damp the growth of overall business investment spending and a greater saturation of potential computer markets that might lead to more emphasis on replacement demand rather than the further expansion of capacity.

Housing activity generally was expected to be well maintained in coming quarters, though likely to moderate to some extent from current levels in lagged response to the rise that had occurred in mortgage interest rates. The response of housing expenditures to rate increases was uncertain, and a few members commented that the prospective slowing in housing construction could be fairly pronounced. For the nearer term, however, recent data were indicative of considerable underlying strength in housing markets, especially in light of the adverse effects of notably unfavorable weather conditions in many parts of the country this winter. Those data tended to be supported by anecdotal reports of significant improvement in housing markets in several regions over the course of recent months. Contributing to that performance, however, might be a temporary acceleration of purchases by homebuyers who anticipated further increases in mortgage interest rates. The latter were viewed, nonetheless, as still low in comparison with their average level over the past several years.

The outlook for fiscal policy remained uncertain, especially for future years. It was suggested that the stalemate between the Congress and the Administration on major spending and tax issues might not be resolved in coming months or indeed during the current session of the Congress. However, already legislated appropriations and current continuing resolutions still pointed to considerable restraint in federal spending this year. With regard to the external sector of the economy, projections of appreciable growth in exports tended to be supported by anecdotal comments of strong export demand for goods produced in various parts of the country, including some improvement in exports to Mexico. At the same time, imports might well expand somewhat more rapidly than exports if the domestic economy strengthened as projected this year from its reduced rate of growth in 1995.

The members did not differ greatly in their assessments of the most probable course of inflation. Their expectations ranged from essentially unchanged to slightly higher inflation in comparison with 1995. At the same time, members expressed somewhat differing views about possible deviations of inflation from their expectations. Those who emphasized the risks of higher-than-projected inflation tended to cite the potential for increasing wage and price pressures in an economy that already was operating at or close to its estimated capacity. Increases in labor costs had been unusually subdued in light of the relatively low unemployment nationwide and widespread anecdotal reports of labor shortages. In this view the rise in labor costs could well accelerate at some point, though not necessarily in the near term, with some feedthrough to prices. Other developments that generated some concern about the outlook for inflation included the rise in the costs of medical benefits in the fourth quarter, price pressures in the energy and food sectors of the economy, and the possibility that the recent rise in intermediate- and long-term interest rates might to some extent reflect worsening inflationary expectations. Other members saw only a limited risk of higher inflation, and a few indicated that they did not rule out some reduction in consumer price inflation from that experienced in 1995. In this view there was sufficient capacity in the economy to allow room for moderate growth of economic activity in line with their forecasts without fostering added inflation. Moreover, there was only scattered evidence of accelerating increases in worker compensation associated with labor shortages and little indication that possibly diminishing worries about job security would induce rising labor militancy. Some members also stressed the persistence of strong competition in numerous markets that tended to preclude or restrain raising prices.

In the Committee's discussion of policy for the intermeeting period ahead, all the members endorsed a proposal to maintain an unchanged degree of pressure in reserve markets. This policy preference was based on expectations of growth in business activity at a pace averaging in the vicinity of the economy's potential, a perception among the members that the risks to such an outlook were more balanced than earlier, and anticipations that under these circumstances inflation would remain constrained. The economy seemed to have adequate forward momentum and did not appear to require any further stimulus, whose implementation might contribute to inflationary pressures in the economy. Several members observed that robust growth in broad money for some months suggested that monetary policy had been supportive of sustained economic expansion. At the same time, information on the economy and prices did not seem to indicate developing inflation pressures that needed to be contained by tightening policy at this juncture. Indeed, some members commented that, judged from one perspective, financial conditions had tightened somewhat as a consequence of the recent rise in intermediate- and long-term interest rates, though it was difficult to disentangle the real and the inflation components of the rate increases. Nonetheless, a number of members noted that inflation was not expected to moderate further over the projection horizon and that it could move higher and the Committee would need to be particularly vigilant in guarding against such an outcome. Against this background, the members favored an unbiased instruction in the directive that did not prejudice possible intermeeting adjustments to policy in either direction.

At the conclusion of the Committee's discussion, all the members indicated a preference for a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that slightly greater or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth in M2 and M3 over coming months.

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

Many of the data for recent months reviewed at this meeting were influenced to an uncertain degree by unusually severe winter weather, industrial strikes, and U.S. government shutdowns. On balance, the expansion in economic activity appears to have picked up after slowing appreciably in late 1995. Nonfarm payroll employment surged in February, considerably more than offsetting a large drop in January, and the civilian unemployment rate fell to 5.5 percent. Manufacturing production increased sharply in February after a sizable decline in January. Growth of consumer spending, which had been sluggish earlier in the winter, spurted in February, paced by strong motor vehicle purchases. Housing starts rose in January and February. Orders and contracts point to continuing expansion of spending on business equipment and nonresidential structures. The nominal deficit on U.S. trade in goods and services narrowed substantially in the fourth quarter from its average rate in the third quarter. There has been no clear change in underlying inflation trends.

Changes in short-term market interest rates have been mixed while long-term rates have risen appreciably since the Committee meeting on January 30–31. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has declined slightly over the intermeeting period.

Growth of M2 and M3 has strengthened considerably in recent months, while expansion in total domestic nonfinancial debt has remained moderate on balance.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in January established ranges for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was set at 3 to 7 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Ms. Phillips, Mr. Stern, and Ms. Yellen. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, May 21, 1996.

The meeting adjourned at 10:35 a.m.

Donald L. Kohn
Secretary

## Meeting Held on May 21, 1996

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, May 21, 1996, at 9:00 a.m.

*Present:*

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Ms. Phillips
Mr. Stern
Ms. Yellen

Messrs. Broaddus, Guynn, Moskow, and Parry, Alternate Members of the Federal Open Market Committee

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

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

Messrs. Lang, Lindsey, Mishkin, Promisel, Rolnick, Rosenblum, Siegman, Simpson, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Slifman, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Associate Director, Division of Monetary Affairs
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Rives, First Vice President, Federal Reserve Bank of St. Louis

Mr. Beebe, Ms. Browne, Messrs. Davis, Dewald, Eisenbeis, Goodfriend, and Hunter, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Boston, Kansas City, St. Louis, Atlanta, Richmond, and Chicago respectively

Mr. Altig, Mses. Chen and Rosenbaum, Vice Presidents, Federal Reserve Banks of Cleveland, New York, and Atlanta respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on March 26, 1996, were approved.

The Manager of the System Open Market Account reported on developments in foreign exchange markets during the period March 26 through May 20, 1996. There were no open market transactions in foreign currencies for System account during this period, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period March 26 through May 20, 1996. By unanimous vote, the Committee ratified these transactions.

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

The information reviewed at this meeting suggested that economic activity had expanded moderately on balance in recent months. Final demand, which had been quite robust early in the year, was showing some signs of slowing in recent data. Consumer spending appeared to be growing at a moderate pace; business expenditures on durable equipment had registered further large gains, though new orders had flattened out; and housing demand seemed to be holding up well despite the increase in mortgage interest rates this year. Business inventories, most notably in the automotive industry, had been brought into better alignment with sales, and industrial production and employment had risen appreciably. Upward pressures on food and energy prices accounted for somewhat larger increases in consumer prices.

Nonfarm payroll employment was essentially unchanged in April after rising substantially in the first quarter; part of the slowdown resulted from an unwinding of special factors that had boosted job growth in the first quarter. Payrolls continued to expand in April in retail trade; finance, insurance, and real estate; and the services industries. In contrast, employment in construction fell sharply, reversing much of the large first-quarter gain. In manufacturing, employment declined further in April despite the settlement of a major strike in the automotive sector and the return of affected workers to their jobs. The civilian unemployment rate fell to 5.4 percent.

Industrial production rebounded in April from an appreciable decline in March. The changes in industrial output over the two-month period largely reflected fluctuations in motor vehicle assemblies associated with a strike and its subsequent settlement. Manufacturing of products other than motor vehicles rose moderately in April on the strength of further large advances in the output of office and computing equipment and of construction supplies. Utilization of total industrial capacity, which had varied in recent months in concert with movements in production, climbed in April to a rate slightly above that of the fourth quarter of 1995.

Retail sales declined somewhat in April after posting a strong gain in the first quarter. Sales of durable goods, which had increased substantially in the first quarter, retraced part of that advance in April; the drop more than offset a further rise in sales of nondurable goods. Housing activity was well sustained in April, with the run-up in mortgage rates that began in February having had little perceptible effect to date. Single-family housing starts were up considerably in April, and sales of new and existing homes remained brisk in March (latest data available).

Business fixed investment accelerated sharply in the first quarter of 1996 following three quarters of relatively moderate expansion; however, recent data on orders and contracts pointed, on balance, to some deceleration in business spending on both durable equipment and nonresidential structures. Much of the first-quarter pickup reflected stronger spending for durable equipment; purchases of computing equipment remained robust and spending on other durable equipment increased. Nonresidential construction activity also advanced further in the first quarter; however, construction of office buildings continued to lag, and construction of other commercial buildings slowed after recording strong gains for several years.

Business inventories declined in March after rising appreciably on average over January and February; inventory accumulation over the quarter as a whole was of modest proportions, as firms sought to bring stocks into better balance with sales. In manufacturing, inventories changed little in March and the ratio of stocks to sales was not far above historical lows. In the wholesale sector, inventories declined a little further in March, reflecting a reduction in stocks of motor vehicles, and the inventory–sales ratio remained near the middle of its range in recent years. Retail inventories also declined in March, with cuts in stocks of motor vehicles more than accounting for the drop. The inventory–sales ratio for the retail sector was near the low end of its range in recent years.

The nominal deficit on U.S. trade in goods and services in the first quarter was substantially larger than in the fourth quarter of last year. The value of imports increased sharply in the first quarter after declining in the two previous quarters. Moreover, growth in the value of exports slowed considerably in the first quarter from the pace of other recent quarters. Available data indicated that the performance of the economies of the major foreign industrial countries was mixed in the first quarter. The recovery in Japan was still under way while economic activity in continental Europe remained generally weak, with the German economy apparently having contracted further and the French economy exhibiting signs of only a modest upturn after a fourth-quarter decline. Moderate further expansion in economic activity evidently was occurring in Canada and the United Kingdom.

Rising crude oil and, to a lesser extent, food prices led to somewhat larger increases in consumer and producer price indexes in March and April. For nonfood, non-energy items, however, consumer prices rose only slightly in April after three months of somewhat faster advances; over the twelve months ended in April, this measure of consumer inflation increased a little less than the rise over the comparable year-earlier period. At the producer level, prices of finished goods other than food and energy items recorded a third straight small increase in April. Over the twelve months ended in April, this measure of producer prices rose slightly less than over the comparable year-earlier period. Hourly compensation of private industry workers expanded in the first quarter at the average rate for all of 1995; the growth was associated with a decline in benefit costs and a sharp rise in wages and salaries.

At its meeting on March 26, 1996, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth in M2 and M3 over coming months.

Open market operations were directed toward maintaining the existing degree of pressure on reserve positions throughout the intermeeting period, and the federal funds rate averaged near 5¼ percent, the level expected to be associated with that unchanged policy stance. Other short-term market interest rates changed little over the period, and because the Committee's decision had been largely anticipated in financial markets, longer-term rates also were little changed initially. Over the remainder of the period, however, intermediate- and long-term rates came under upward pressure when incoming economic data were seen by market participants as pointing to stronger growth in output and employment and therefore to a somewhat tighter monetary policy stance than previously had been expected. Despite the increase in bond yields, most indexes of stock prices rose on balance over the intermeeting period, apparently reflecting generally favorable first-quarter earnings reports and the improved economic outlook.

In foreign exchange markets, the rise of U.S. interest rates contributed to a considerable appreciation of the trade-weighted value of the dollar in terms of the other G-10 currencies. The dollar was particularly strong against the German mark, reflecting incoming data that suggested continued weakness in economic activity in Germany and, accordingly, a greater likelihood of further monetary policy easing by the Bundesbank. The dollar rose less against the yen, partly owing to information indicating a strengthening of the economic recovery in Japan and heightened market expectations of a near-term tightening of monetary policy by the Bank of Japan.

Growth of M2 and M3 slowed substantially in April after having recorded sizable increases earlier in the year. Weakness in demand deposits after unusually rapid first-quarter expansion and sluggishness in currency demand were factors in the slowdown. In addition, the rise in market interest rates in recent months, which had increased the opportunity costs of holding retail deposits, likely had a restraining effect on these deposits. For the year through April, both aggregates grew at rates somewhat above the upper bounds of their respective ranges for the year. Expansion in total domestic nonfinancial debt remained moderate on balance over recent months, and this aggregate stayed near the middle of its monitoring range for the year.

The staff forecast prepared for this meeting suggested that the economy would remain generally around its estimated potential. Consumer spending was expected to grow in line with disposable income; the favorable effect of higher equity prices on household wealth and the still-ample availability of credit were expected to outweigh persisting consumer concerns about job security and the influence of already-high household debt burdens. Homebuilding was projected to decline a little in response to the recent backup in residential mortgage rates but to remain at a relatively high level because of generally supportive employment and income conditions and the still- favorable cash flow affordability of homeownership. Business spending on equipment and structures was expected to grow less rapidly in light of the projected moderate growth of sales and profits and the lower rate of utilization of production capacity now prevailing. The external sector was projected to exert a small restraining influence on economic activity over the projection period, even though an anticipated firming of economic activity abroad would bolster demand for U.S. exports. Little additional fiscal contraction was anticipated over the projection period. Inflation recently had been lifted by adverse developments in the energy market and was projected to remain above the levels of recent years, given the high level of resource utilization and the effects of tight grain supplies on food prices. Further risks of inflationary pressure were associated with a possible elevation of the federal minimum wage.

In their discussion of current and prospective economic conditions, members commented that the economy had been stronger this year than they had anticipated and appeared to be growing at a quite robust pace. However, they generally expected the expansion to slow, keeping the economy close to its potential. Views differed to some extent with regard to the risks surrounding such an outlook. Some saw those risks as fairly evenly balanced, given prospective restraint from the rise in bond yields and the foreign exchange value of the dollar since early this year. Others expressed concern that economic growth might continue at a pace that could increase pressures on resources, with adverse implications for inflation in an economy already operating in the neighborhood of its estimated long-term potential. Moreover, faster increases in energy and food prices could contribute to higher overall inflation, both directly and by boosting inflationary expectations, and the proposed increase in the minimum wage would add to cost pressures if it were enacted into law. Nonetheless, while the chances of a pickup in inflation later had risen to some extent, a number of members emphasized that no firm evidence had surfaced thus far to signal that labor compensation was increasing at a faster rate or that core inflation was worsening, and even the early signs of increased pressures on costs and prices were mixed. The past few years had witnessed significantly lower cost pressures and more subdued inflation than typically would have been experienced in earlier years with similar rates of resource utilization, but whether this favorable outcome would persist was an open question.

Members observed that the stronger-than-expected performance of the economy thus far this year reflected relatively rapid growth in final demand. Favorable financial conditions, notably the relatively low interest rates of the latter part of 1995 and early 1996 and increases in wealth stemming from sizable advances in stock market prices, evidently were undergirding the expansion. Indications of improving or continuing high levels of economic activity were widespread across the nation according to recent anecdotal reports and regional data, though agricultural conditions in many areas were cited as a significant exception. While the economy appeared to have solid and balanced momentum that pointed to sustained growth, a number of factors were seen as likely to foster more moderate expansion beginning in the second half of the year. These included the effects of higher intermediate- and long-term interest rates on interest-sensitive sectors of the economy such as housing, consumer durables, and business fixed investment. The appreciation of the dollar over the past year and near-term moderation in federal government spending also were expected to exert some restraint on economic activity over the forecast horizon. Some members also questioned the sustainability of the performance of the stock market; a correction in this market would help to restrain aggregate demand. Nonetheless, the continued strength in economic activity raised questions about whether these developments would damp demand sufficiently to keep resource utilization at sustainable levels.

In their review of recent developments and the outlook for key sectors of the economy, members noted that consumer spending had strengthened considerably this year after a period of sluggish growth in late 1995. The recent data on consumer spending were reinforced by anecdotal reports from various parts of the country. The wealth effects from the further gains that had occurred in stock market prices, along with sustained increases in employment and a ready availability of consumer financing, were seen as playing a positive role in boosting consumer expenditures. Barring changes in these underlying factors, continued growth in consumer spending seemed likely, although members referred to developments that could begin to slow such growth over the months ahead. The latter included the satisfaction of much of the earlier pent-up demand for consumer durables and fairly elevated levels of consumer debt. On balance, moderate expansion in consumer expenditures, perhaps in line with the growth in incomes, seemed likely over the projection period.

Business fixed investment was believed likely to remain a source of considerable strength in the expansion, though growth in this sector of the economy also was expected to moderate from the elevated pace thus far this year. The desire of many business firms and other users of capital equipment to take advantage of new, more effective, and less expensive computer and other technologies and more generally to add further to capital in an effort to reduce costs in highly competitive markets would continue to underpin investment spending. In addition, equity and other financing remained available on relatively attractive terms. On the other hand, the rise in business investment in recent years had brought capital stocks into more acceptable alignment with expected sales, damping the need for further sizable additions.

Business firms appeared to have completed, or nearly completed, their efforts to bring inventories into better balance with sales, including the rebuilding of motor vehicle stocks after the strike at a major manufacturer was settled in March. On the basis of recent experience, subdued growth in inventories could be anticipated in the context of the projected expansion of overall economic activity at a pace near the economy’s long-run potential. It was suggested, however, that such an expectation implied relatively restrained inventory investment in comparison with past cyclical patterns. Accordingly, much stronger growth in such investment could occur, with concomitant effects on incomes and the growth of overall spending.

With regard to the outlook for housing, the rise in mortgage rates in the past few months could be expected to retard residential construction activity to some extent. Thus far, however, increased interest costs did not appear to have had any perceptible effects on housing sales or construction. Indeed, the housing sector was continuing to display a good deal of strength in many parts of the country. Some members observed that the appreciable momentum in housing activity reflected strength in the underlying fundamentals, including continued affordability, that seemed likely to sustain a high level of housing construction for a considerable period of time despite somewhat higher mortgage rates.

In the area of fiscal policy, legislative agreement had not yet been reached on how to implement the objective of a balanced federal budget over time, but decisions covering the nearer term implied continued budget restraint. On the foreign trade side of the economy, an anticipated firming of economic conditions abroad would provide impetus to real net exports. At the same time, however, imports were expected to rise appreciably in response to the expansion of domestic economic activity and the appreciation of the dollar, and on balance the external sector probably would not be boosting real GDP.

The outlook for inflation was of key importance to the formulation of monetary policy at this time, but it was clouded by substantial uncertainty. One source of uncertainty was the behavior of food and energy prices. Increases in these prices largely accounted for the more rapid rise in consumer prices thus far this year, and they likely would continue to add to inflation in the months ahead. Retail energy prices had risen appreciably, but at least some of that increase was expected to be reversed over the near term. Retail food prices did not yet display any significant effects from the sizable rise in grain prices in recent months, and while some effects on retail prices were likely, their extent and duration were difficult to gauge at this point. Moreover, it was difficult to anticipate how much the higher food and energy prices might affect inflation expectations and wage demands and thereby potentially become embedded more generally in the price structure.

Also of concern to the members were the possible effects on inflation of continued pressures on resources, especially if the current pace of the expansion should fail to moderate as much as projected. In recent years, the relationship between resource use and inflation had not followed earlier patterns. In particular, increases in labor compensation had been comparatively subdued over an extended period of what seemed to be relatively full employment highlighted by anecdotal reports of scarcities of various types of labor in numerous parts of the country. In part, worker willingness to accept comparatively limited increases in compensation could be attributed to the apparent rise in insecurity about the permanence of jobs or the availability of alternative jobs, but the reasons were not fully understood. From the standpoint of the inflation outlook, it therefore was uncertain how long the period of relatively restrained increases in labor compensation would last. Against this background, a number of members indicated that they perceived an appreciable risk of rising labor costs and related inflation, even though there was little evidence to date of such developments; others noted that they could not rule out the possibility that the favorable experience would be extended.

In the Committee's discussion of policy for the intermeeting period ahead, all the members supported a proposal to maintain an unchanged degree of pressure in reserve markets. The members agreed that the balance of risks on inflation had shifted substantially since early in the year. At that time, the economy had seemed sluggish and inflation was seen as possibly easing, but more recent developments indicated that the economy was stronger and rising inflation down the road could not be ruled out. Nonetheless, while policy might need to be firmed at some point to head off emerging inflation pressures, financial conditions were not so obviously stimulative as to counsel a need for any immediate tightening of policy. The real federal funds rate probably was not greatly out of line with its appropriate level, and the rise in longer-term interest rates and the exchange rate meant that financial conditions were now exerting more restraint than earlier this year. More information might provide a better sense of how the higher interest rates were affecting aggregate demand and perhaps also help—to a small degree—to shed light on the considerable uncertainties surrounding the relationship of output to inflation. In any event, actual inflation data—apart from food and energy prices—and many of the usual early warning signs of mounting price pressures did not yet indicate a pickup in the underlying trend of prices. Accordingly, the members viewed policy as appropriately positioned under current circumstances, though ongoing developments would need to be reassessed at the upcoming meeting in early July. Some members noted that the Committee would need to anticipate, and act to preclude, a rise in the core rate of inflation that, if it were to materialize, would be difficult and costly to reverse. In this regard, the view was expressed that a firming in policy sooner rather than later was likely to end up promoting stability in output and prices.

In the Committee's discussion of possible intermeeting adjustments to policy, all the members indicated at least some preference for retaining a symmetric directive. Members commented that the probability of developments during this period that would warrant a change in policy before the next meeting was quite low. Moreover, symmetry did not rule out an intermeeting adjustment, and the Chairman could call for a Committee consultation should the incoming information raise questions about the stance of monetary policy. Some members felt that it was especially appropriate that a policy action that represented a reversal of the previous move be made with a full discussion at a regular meeting. Some members also commented that an asymmetric directive toward restraint would imply a predisposition on the part of the Committee to tighten policy at some point, possibly at the next meeting. While they would be prepared to take such a step if the evidence warranted, their preference was to come into the July meeting without such a presumption.

At the conclusion of the Committee's discussion, all the members indicated a preference for a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that slightly greater or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth in M2 and M3 over coming months.

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

The information reviewed at this meeting suggests that, on balance, economic activity has grown moderately in recent months. Nonfarm payroll employment changed little in April after rising substantially in the first quarter; the civilian unemployment rate fell to 5.4 percent. Industrial production increased sharply in April, largely reflecting a rebound in motor vehicle assemblies after a strike in March. Retail sales declined somewhat in April after posting a strong gain in the first quarter. Single-family housing starts rose considerably in April. Orders and contracts point to some deceleration in spending on business equipment and nonresidential structures after a very rapid expansion in the first quarter. The nominal deficit on U.S. trade in goods and services widened significantly in the first quarter from its rate in the fourth quarter of last year. Upward pressures on food and energy prices have led to somewhat larger increases in the consumer price index over recent months.

Short-term market interest rates have changed little while long-term rates have risen somewhat further since the Committee meeting on March 26. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has appreciated considerably over the intermeeting period.

Growth of M2 and M3 slowed substantially in April after recording sizable increases earlier in the year. For the year through April, both aggregates grew at rates somewhat above the upper bounds of their respective ranges for the year. Expansion in total domestic nonfinancial debt remained moderate on balance over recent months.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in January established ranges for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was set at 3 to 7 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Ms. Phillips, Mr. Stern, and Ms. Yellen. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, July 2–3, 1996.

The meeting adjourned at 1:15 p.m.

Donald L. Kohn
Secretary

## Meeting Held on July 2–3, 1996

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, July 2, 1996, at 1:00 p.m. and continued on Wednesday, July 3, 1996, at 9:00 a.m.

*Present:*

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Mr. Meyer
Ms. Phillips
Ms. Rivlin
Mr. Stern
Ms. Yellen

Messrs. Broaddus, Guynn, Moskow, and Parry, Alternate Members of the Federal Open Market Committee

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

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

Messrs. D. Lindsey, Mishkin, Promisel, Rolnick, Rosenblum, Siegman, Simpson, Sniderman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Winn,[3] Assistant to the Board, Office of Board Members, Board of Governors
Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Messrs. Madigan and Slifman, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors
Mr. Brayton,[4] Ms. Johnson,[4] Messrs. Reinhart and Smith,[5] Assistant Directors, Divisions of Research and Statistics, International Finance, Monetary Affairs, and International Finance respectively, Board of Governors
Ms. Kusko[4] and Mr. Wilcox,[4] Senior Economists, Divisions of Research and Statistics and Monetary Affairs respectively, Board of Governors
Ms. Garrett, Economist, Division of Monetary Affairs, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Ms. Holcomb, First Vice President, Federal Reserve Bank of Dallas
Mr. Beebe, Ms. Browne, Messrs. Davis, Dewald, Eisenbeis, Goodfriend, and Hunter, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Boston, Kansas City, St. Louis, Atlanta, Richmond, and Chicago respectively
Messrs. Kos and Meyer, Vice Presidents, Federal Reserve Banks of New York and Philadelphia respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 21, 1996, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market trans-

3. Attended portion of meeting concerning issues relating to the long-run price objective for monetary policy.

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

5. Attended portion of the meeting relating to the Committee's review of its swap line agreements.

actions in foreign currencies for System account during the period since the meeting on May 21, 1996, and thus no vote was required of the Committee.

The Manager also reported on recent developments in domestic financial markets and on System open market transactions in U.S. government securities and federal agency obligations during the period May 21, 1996, through July 2, 1996. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook, the ranges for the growth of money and debt in 1996 and 1997, and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting suggested that economic activity advanced considerably further in the second quarter, although growth in aggregate final demand showed some signs of slowing. Consumer spending continued to post sizable gains, but business investment in equipment and structures apparently was rising less vigorously, and higher mortgage rates evidently were starting to exert some restraint on housing construction activity. Business inventories had been brought into better balance with sales, and production and employment had risen appreciably. Upward pressures on food and energy prices had led to somewhat larger increases in the consumer price index over recent months.

Nonfarm payroll employment continued to expand briskly over April and May. Job gains were concentrated in the service-producing and construction industries, while employment in manufacturing was stable on balance over the April–May period after having declined somewhat in 1995 and the first quarter of 1996. The civilian unemployment rate rose in May to 5.6 percent, which was the average rate for the year to date.

Industrial production increased appreciably further in May. In contrast to April's advance, much of which had resulted from the resumption of operations at a major motor vehicle manufacturer after the settlement of a strike, the May rise largely reflected gains in a wide range of non-auto-related manufacturing industries as well as a weather-related jump in electricity generation. The surge in overall output lifted total utilization of industrial capacity somewhat above the average rate recorded during the previous two quarters.

Total nominal retail sales surged in May after having changed little in April; the increase in sales, coupled with available information on prices, suggested that real consumer spending on goods had risen substantially on balance since the first quarter. Recent data (available through April) indicated that spending on services had increased moderately on balance in recent months. Single-family housing starts fell considerably in May from the relatively high April level. The decline suggested that the rise in mortgage rates in recent months had begun to damp construction activity, but indicators of housing demand, such as sales of new and existing homes, remained relatively robust.

Growth in business expenditures on durable equipment and nonresidential structures appeared to be slowing following a surge in outlays in the first quarter. In May, shipments of nondefense capital goods rebounded from the substantial decline in April; however, excluding movements in the volatile aircraft category, shipments were down on balance over the two months. Among the major components, shipments of both computing and communications equipment fell sharply in April and retraced only part of that decline in May. Recent data on new orders pointed to more modest increases in spending on business equipment over the months ahead. Nonresidential building activity increased considerably further in April (latest data available), but incoming information on contracts suggested that growth in nonresidential construction would weaken somewhat in coming months.

Businesses had made considerable progress in recent months in bringing their inventories into better alignment with sales. In manufacturing, stocks rose moderately in April after a decline in March. The stock-to-shipments ratio dropped further in April and was at a low level. At the wholesale trade level, inventory accumulation was appreciable in April after several months of modest growth. The inventory-to-sales ratio for this sector edged up in April but remained well below the elevated levels of last fall. Retail inventories increased slightly in April after a large decline in March associated with a substantial liquidation of motor vehicle stocks. The aggregate ratio of inventories to sales for retail establishments was around the lower end of its range in recent years.

The nominal deficit on U.S. trade in goods and services widened in April from its rate in the first quarter, reflecting a slightly larger increase in the value of imports than in that of exports. The expansion in imports was concentrated in oil as U.S. refiners sought to meet growing domestic demand and rebuild their inventories. The rise in exports was broadly based, although exports of computers, semiconductors, and automotive products edged off. Economic activity in the major foreign industrial countries appeared to have expanded moderately on balance since the beginning of the year. In the first quarter, economic performance ranged from unexpectedly robust in Japan to further weakness in Germany; the limited data available for the second quarter suggested a slowdown in Japan, a bounceback in Germany, and moderate growth in other major trading partners.

Although upward pressures on energy prices continued to boost overall consumer prices in April and May, price increases for nonfood, non-energy items remained small. Over the twelve months ended in May, the increase in core consumer prices was appreciably smaller than in the previous twelve-month period; much of the deceleration reflected swings in automobile finance charges. At the producer level, higher prices for finished energy goods over April and May were partially offset by slightly lower prices for finished foods; prices for nonfood, non-energy finished goods were little changed over the two-month period and rose less over the twelve months ended in May than in the comparable year-earlier period. Data on average hourly earnings of production and nonsupervisory workers indicated that this measure of labor costs had increased by a somewhat larger amount in the year ended in May than in the comparable year-earlier period.

At its meeting on May 21, 1996, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth in M2 and M3 over coming months.

Open market operations were directed toward maintaining the existing degree of pressure on reserve positions throughout the intermeeting period. The federal funds rate averaged near 5¼ percent, the level expected to be associated with the unchanged policy stance. Because the Committee's decision had been largely anticipated in financial markets, other market interest rates also were little changed during the early part of the period. However, market rates increased appreciably following the release of a strong employment report in early June, though most of that rise was later retraced as expectations of near-term tightening of monetary policy diminished. On balance, most market rates were up a little over the intermeeting period. Major indexes of stock prices were down on balance over the period.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies depreciated slightly over the intermeeting period. The dollar declined against the German mark and other European currencies as growing indications of a recent pickup in economic activity in Germany damped market expectations of any further easing of monetary policy by the Bundesbank. By contrast, the dollar rose against the yen in apparent response to a series of statements by Japanese officials suggesting that there would be no near-term firming of Japanese monetary policy.

The broad monetary aggregates were weak in May: M2 declined, and M3 expanded relatively sluggishly. The weakness in M2 and M3 was associated in part with the adverse effects of the earlier rise in market interest rates on the opportunity costs of holding deposits. Deposit balances also may have been drawn down to meet unusually large individual tax liabilities on the April 15 tax date. Partial data for June pointed to a rebound in both aggregates. For the year through June, these aggregates were estimated to have grown at rates around the upper bounds of their respective annual ranges. Expansion of total domestic nonfinancial debt had slowed somewhat in recent months, but the debt aggregate had remained in the middle portion of its annual range.

The staff forecast prepared for this meeting suggested that, after a sizable advance in economic activity in the second quarter, growth would moderate and the economy would expand around or perhaps a little above its estimated potential. Consumer spending was projected to expand at a more moderate pace, in line with disposable income; the favorable effect of higher equity prices on household wealth and the still-ample availability of credit were expected to balance persisting consumer concerns about job and retirement security and the restraining effect of high household debt burdens. Homebuilding was forecast to slow somewhat in response to the back-up in residential mortgage rates but was expected to remain at a relatively high level in the context of sustained income growth and the still-favorable cash flow affordability of home ownership. Business spending on equipment and structures was projected to grow less rapidly in light of the anticipated moderate growth of sales and profits and the reduced rate of utilization of production capacity now prevailing. The external sector was expected to exert a small restraining influence on economic activity over the projection period, even though an anticipated firming of economic activity abroad would bolster demand for U.S. exports. Little further fiscal contraction was forecast over the projection period. Inflation recently had been lifted by adverse developments in energy markets and was projected to remain above the levels of recent years, given the still-high level of resource utilization and the effects of tight grain supplies on food prices.

In the Committee's discussion of current and prospective economic developments, members commented on the stronger-than-expected expansion in overall economic activity in recent months, but for a variety of reasons they anticipated that growth would slow appreciably over the second half of the year to a pace more in line with the growth in the economy's potential. Key factors bearing on this outlook included the prospective effects of the rise in interest rates and the dollar that had occurred since earlier in the year and the waning influence of transitory factors that had stimulated economic activity in the second quarter. The members generally agreed, however, that, apart from evidence of some moderation in the growth of business investment expenditures from a very rapid pace, there were few hard indications of a slowing in the expansion and the risks were clearly to the upside of their current forecasts. Against that background, they were concerned that inflation could begin to rise. Cost and price pressures had been surprisingly well contained at high levels of resource utilization, but this unusually favorable performance might not be sustained, and in any event even greater resource utilization, as would occur if growth did not moderate appreciably, carried substantial inflation risk. There were some scattered indications in statistical and anecdotal reports that tended to suggest that wage inflation might be trending higher, although key measures of price inflation, excluding their food and energy components, continued to display a flat or even a declining trend.

In keeping with the practice at meetings when the Committee sets its long-run ranges for the money and debt aggregates, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members provided individual projections of the growth in real and nominal GDP, the rate of unemployment, and the rate of inflation for the years 1996 and 1997. (The ranges in this paragraph take into account minor revisions made by a few members subsequent to the meeting.) The forecasts of the rate of expansion in real GDP for 1996 as a whole had a central tendency of 2½ to 2¾ percent, reflecting expectations of considerable moderation in the rate of economic growth over the second half of the year; for 1997, the projections centered on continued moderate growth of GDP in a range of 1¾ to 2¼ percent. With regard to the expansion of nominal GDP, the forecasts were concentrated in growth ranges of 5 to 5½ percent for 1996 and 4¼ to 5 percent for 1997. The civilian rate of unemployment associated with these forecasts was expected by most members to remain around 5½ percent this year and to be in a range of 5½ to 5¾ percent in 1997. This level of resource utilization was expected to be associated with a slightly higher rate of inflation in 1996, as measured by the consumer price index, than that recorded in 1995 owing to developments in the food and energy sectors, but a decline was anticipated in 1997. Specifically, the projections converged on rates of 3 to 3¼ percent in 1996 and 2¾ to 3 percent in 1997. The projections for both 1996 and 1997 were based on individual views concerning what would be an appropriate monetary policy over the projection horizon.

In their assessment of factors bearing on the outlook for final demand, members commented that growth in consumer spending was likely to moderate in coming quarters from its pace thus far this year. This moderation would reflect the projected slowing in income growth. While overall employment conditions, the buildup of household net worth, and access to financing would bolster consumer expenditures, members also cited a number of limiting factors. The latter included the increase in consumer indebtedness, satisfaction of earlier pent-up demand for consumer durable goods, and continuing concern about job security. Higher interest rates also were expected to exert an inhibiting effect on purchases of consumer durables, including those related to housing. Some members observed that while slower growth in consumer spending was the most probable forecast, they saw an upside risk from the wealth effects of the large rise that had occurred in the value of stock market holdings.

Business expenditures for plant and equipment were expected to grow at a slower though still appreciable pace. Indeed, such spending already appeared to be moderating. Contract data suggested that nonresidential construction activity was on a slowing growth trajectory and expansion of outlays for producers' durable equipment also appeared to have softened. Given the outlook for slower growth in final demand, many businesses would not have to add significantly to capacity. However, spending for computing equipment, while perhaps moderating from the exceptional pace of recent quarters, was thought likely to remain buoyant as continuing innovations and declining prices stimulated further solid gains in this segment of business spending.

Housing was seen as another important sector of the economy that was likely to exert a retarding effect on the expansion as the rise that had occurred in mortgage interest rates was felt increasingly in housing markets. The anecdotal information from around the nation and the available statistics suggested, however, that those markets generally had remained surprisingly ebullient thus far, and there were only limited indications of some softening in home construction activity.

Business inventory investment was viewed as a key upside risk in the economic outlook for coming quarters. An inventory overhang at the end of last year had been corrected in the first quarter, and inventory investment was indicated to have turned positive again in the second quarter. However, current inventory-to-sales ratios appeared to be relatively lean, and final sales that exceeded current expectations might well induce a sharp upward adjustment in inventory accumulation, especially if lead times were to lengthen and producers perceived shortfalls in their safety stocks.

Members viewed the outlook for inflation as a source of substantial uncertainty in their forecasts, though many saw reasonable prospects that a rate of economic expansion in line with their forecasts and associated levels of capacity utilization would prove to be consistent with little change in the core rate of inflation. Some important measures of price inflation, after adjustment to exclude their volatile food and energy components, had shown a flat or even a declining trend in recent quarters. The outlook for overall price increases would remain contingent in part on food and energy price developments, but more importantly on underlying cost pressures in the economy.

Several members commented that the levels of utilization of capital and labor resources that had prevailed over the past couple of years would have been expected, on the basis of historical patterns, to foster rising cost pressures and greater inflation. However, labor compensation gains had been subdued in relation to earlier cyclical experience, likely as a consequence of increased worker concerns about job security and job opportunities. Despite the continued low rate of unemployment and widespread anecdotal reports of tight labor markets across the country, there were only limited indications in national data that wage inflation might be increasing. Whether greater labor cost pressures would emerge in the context of the members' consensus forecast for economic activity was a critical issue in the outlook for prices, though it was noted that at least some of the rising costs were likely to be absorbed in shrinking profit margins. Even if greater price inflation were averted under that scenario, the members saw a substantial risk that if economic growth did not slow in line with their current forecasts, the resulting added pressures on resources would at some point translate into higher price inflation. Accordingly, the factors bearing on the outlook for resource use and inflation needed to be monitored with special care in this period.

With regard to inflation over the long run, the members agreed that it was essential for the Committee to continue to focus on reducing inflation over time because the achievement of an even less inflationary economic environment would foster a more productive economy and maximum sustainable economic expansion. The members acknowledged that as inflation diminished to very low levels, questions about the measurement of the overall price level presented difficult problems for assessing progress toward price stability. Some also observed that the precise level of average price inflation that might be compatible with the optimal functioning of the economy was an unsettled issue owing, for example, to potential rigidities in labor markets. Thus far, such rigidities had not impeded the economy from functioning at a very high level as inflation came down, and continued adaptation to even lower inflation rates was very likely. However, the Committee would need to pay careful attention to these potential problems as inflation fell further. For now, the members agreed that some additional progress in reducing inflation was very likely to improve the ultimate performance of the economy, and that it was particularly important at this juncture to resist firmly any tendency for inflation to worsen.

In keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey–Hawkins Act), the Committee at this meeting reviewed the ranges for growth of the monetary and debt aggregates that it had established in January for 1996, and it decided on tentative ranges for those aggregates for 1997. The current ranges set in January for the period from the fourth quarter of 1995 to the fourth quarter of 1996 were unchanged from the ranges for 1995 and included expansion of 1 to 5 percent for M2 and 2 to 6 percent for M3. An unchanged monitoring range of 3 to 7 percent was set in January for growth of total domestic nonfinancial debt in 1996.

A majority of the members favored retaining the current ranges for this year and extending them on a provisional basis to 1997. They anticipated that growth of M2 and M3 probably would continue at rates close to the upper limit of their respective ranges in both years, given the Committee's expectations for the performance of the economy and prices. However, despite a degree of concern about setting ranges that did not more comfortably encompass expected growth, these members preferred not to change the ranges for a variety of reasons. The current ranges for the broad monetary aggregates could be viewed as anchors or benchmarks for money growth that would be associated with approximate price stability and sustained economic growth, assuming behavior of velocity in line with historical experience. Accordingly, a reaffirmation of those ranges would underscore the Committee's commitment to a policy of achieving price stability over time; and in the view of some members, higher ranges could raise questions in this regard. Moreover, a change in the ranges might be misinterpreted as a signal of greater reliance on the broad monetary aggregates in the formulation and conduct of monetary policy. In this connection, the members noted that the behavior of M2 in relation to nominal GDP and interest rates had displayed a pattern over the past two years or so that was in line with historical norms before the 1990s. However, in light of difficulties in the early 1990s and changes in financial markets, the prospective growth of M2 and its velocity remained subject to considerable uncertainty and the members felt that it would be premature for the Committee to place increased reliance on M2 at this point.

A few members preferred somewhat higher growth ranges for M2 and M3 because such ranges would more comfortably surround the Committee's expectations for monetary growth. The higher ranges would be more informative for the Congress and the public as to the money growth likely to be associated with the Committee's expected economic outcomes for the period covered by the ranges. They believed that the reasons for establishing the higher ranges could readily be explained and understood as appropriate technical adjustments that did not imply any lessened commitment to the Committee's price stability goal. For example, such an explanation appeared to have been accepted with little or no comment by the public when the range for M3 was increased in July 1995.

The Committee members were unanimously in favor of retaining the current monitoring range of 3 to 7 percent for growth of total domestic nonfinancial debt in 1996 and extending that range on a provisional basis to 1997. They took account of a staff projection indicating that growth of the debt aggregate was likely to slow somewhat from its pace earlier this year in line with some moderation in the expansion of nominal income. According to the staff projection, growth in the debt measure would be near the midpoint of the existing range over the period through 1997.

At the conclusion of this discussion, the Committee voted to reaffirm the ranges for growth of M2 and M3 and the monitoring range for expansion of total domestic nonfinancial debt that it had established in January for 1996. For the year 1997, the Committee approved provisional ranges for M2 and M3 and a provisional monitoring range for total domestic nonfinancial debt that were unchanged from the 1996 ranges. In keeping with its usual procedure under the Humphrey–Hawkins Act, the Committee would review its preliminary ranges for 1997 early next year, or sooner if interim conditions warranted, in light of their growth and velocity behavior and ongoing economic and financial developments. Accordingly, the Committee voted to incorporate the following statement regarding the 1996 and 1997 ranges in its domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at this meeting the ranges it had established in January for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1997 the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1996 to the fourth quarter of 1997, of 1 to 5 percent for M2 and 2 to 6 percent for M3. The Committee provisionally set the associated monitoring range for growth of total domestic nonfinancial debt at 3 to 7 percent for 1997. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, McTeer, Meyer, Mses. Phillips and Rivlin, and Mr. Stern. Votes against this action: Mr. Lindsey and Ms. Yellen.

Mr. Lindsey and Ms. Yellen dissented because they preferred somewhat higher ranges for M2 and M3 growth in 1996 and 1997. The central tendencies of the members' forecasts of nominal GDP for the two years were likely to be associated with growth of the broad monetary aggregates at rates around the top of the current ranges. Somewhat higher ranges would more comfortably encompass the anticipated growth of the monetary aggregates and in their view would conform more closely with the provisions and intent of the Federal Reserve Act that require the System to communicate its objectives and plans for monetary growth to the Congress. They believed the reasons for raising the ranges could easily be explained and understood as a technical adjustment that did not represent a reduced commitment to the goal of price stability or an increased emphasis on the monetary aggregates in policy formulation.

In the Committee's discussion of policy for the intermeeting period ahead, all but one of the members supported a proposal to maintain an unchanged policy stance. These members also indicated that they preferred or could accept an asymmetric directive that was biased toward restraint. In their view, the most likely outcome was a slowing of the expansion to a more sustainable pace and a continuation of subdued inflation. Nevertheless, they were concerned that the risks to that outcome were tilted toward higher inflation. While a strong economy generally was a welcome development, at current levels of resource use a continuation of rapid growth was not likely to be sustainable because it would have the potential for adding significantly to inflation pressures. However, inflation had remained relatively damped thus far, and the rise in interest rates among other factors was expected to curb demand. Moreover, any tendency for price pressures to mount was likely to emerge only gradually and be reversible through a relatively limited policy adjustment. The current stance of monetary policy could not be described in this view as clearly accommodative. While the federal funds rate had been reduced appreciably in nominal terms over the past year, its current level on an inflation-adjusted basis seemed to be only marginally below its peak prior to mid-1995. In the circumstances, the Committee could afford to wait for more evidence to see whether additional inflation pressures were likely to develop. A number of key economic data would become available over the next several weeks that would provide a much better basis for assessing the economy's momentum over the second half of the year and the outlook for inflation.

A differing view gave more emphasis to prospects for rising inflation and the need for immediate action to forestall a buildup of cost and price pressures before they undermined the expansion. There was little firm evidence that economic growth was slowing and reports of appreciable wage pressures were increasing. Inflation expectations persisted in financial markets, and probably in product and labor markets as well; if they were allowed to worsen, the Committee's long-run goal of price stability would become much more difficult to achieve. Delaying action risked the need for a greater adjustment in policy at a later date with possible disruption to the economy.

Members observed that an asymmetric directive would represent a shift from the symmetric directives that had been adopted over the past year but would be in keeping with their assessments of the risks of higher inflation. Several commented that an asymmetric directive did not imply a commitment to tighten monetary policy at some point, whether during the intermeeting period or at a future meeting, but it did imply the need for special vigilance. Some noted that a policy tightening action could tend to have a more pronounced effect than usual because it would indicate a shift in the direction of policy and might generate expectations of further tightening. Under the circumstances, the Committee would consult in some way before any policy tightening was undertaken.

At the conclusion of the Committee's discussion, all but one member indicated that they supported a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward the possible firming of reserve conditions during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth of M2 and M3 over coming months.

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

The information reviewed at this meeting suggests that economic activity advanced considerably further in the second quarter, but increases in final demand showed some signs of moderation. Nonfarm payroll employment was up substantially in April and May; the civilian unemployment rate rose to 5.6 percent in May. Industrial production increased appreciably further in May, reflecting gains across a wide range of industries. Real consumer spending rose substantially on balance over April and May. Single-family housing starts fell considerably in May from a relatively high level in April. Orders and contracts point to some deceleration in spending on business equipment and nonresidential structures after a very rapid expansion earlier in the year. The nominal deficit on U.S. trade in goods and services widened in April from its rate in the first quarter. Upward pressures on food and energy prices have led to somewhat larger increases in the consumer price index over recent months.

Most market interest rates have edged higher since the Committee meeting on May 21. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has depreciated slightly over the intermeeting period.

M2 declined in May, though partial data for June pointed to a rebound. Growth of M3 was relatively sluggish in May but also appears to have turned up in June. For the year through June, both aggregates are estimated to have grown at rates around the upper bounds of their respective ranges for the year. Expansion in total domestic nonfinancial debt has been moderate on balance over recent months and has remained in the middle portion of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at this meeting the ranges it had established in January for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1997 the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1996 to the fourth quarter of 1997, of 1 to 5 percent for M2 and 2 to 6 percent for M3. The Committee provisionally set the associated monitoring range for growth of total domestic nonfinancial debt at 3 to 7 percent for 1997. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for short-run policy: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Meyer, Mses. Phillips, Rivlin, and Yellen. Vote against this action: Mr. Stern.

Mr. Stern dissented because he was convinced that a modestly more restrictive policy was warranted. In his view, the momentum of the economy and strains on capacity in labor and some other markets raised the possibility of an acceleration of inflation that would jeopardize the economic expansion. This concern aside, Mr. Stern also believed that current circumstances were favorable for policy action to reduce inflation further and thereby help to sustain the ongoing improvement in the economy.

As a prelude to its formal review later in the year, the Committee at this meeting considered its existing network of swap arrangements with a number of foreign central banks and the Bank for International Settlements. From time to time in recent years the Committee had discussed a variety of issues relating to its foreign exchange activities and its financial arrangements with other central banks. In this discusssion, the Committee considered in particular whether the swap arrangements, all of which had been put in place in the 1960s, remained an appropriate approach to international financial cooperation among central banks in light of the evolution of the international financial system in recent decades, and whether other approaches should be considered. The Committee made no decisions relating to these matters, though it was understood that these issues would be explored further.

It was agreed that the next meeting of the Committee would be held on Tuesday, August 20, 1996.

The meeting adjourned at 12:50 p.m.

Donald L. Kohn
Secretary

## Meeting Held on August 20, 1996

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, August 20, 1996, at 9:00 a.m.

*Present:*

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Mr. Meyer
Ms. Phillips
Ms. Rivlin
Mr. Stern
Ms. Yellen

Messrs. Broaddus, Guynn, Moskow, and Parry, Alternate Members of the Federal Open Market Committee

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

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

Messrs. Lang, Lindsey, Mishkin, Promisel, Rolnick, Rosenblum, Siegman, Simpson, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

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

Messrs. Madigan and Slifman, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors
Ms. Johnson, Assistant Director, Division of International Finance, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Connolly, First Vice President, Federal Reserve Bank of Boston
Mr. Beebe, Ms. Browne, Messrs. Davis, Dewald, Eisenbeis, and Goodfriend, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Boston, Kansas City, St. Louis, Atlanta, and Richmond respectively
Ms. Krieger, Vice President, Federal Reserve Bank of New York
Mr. Sullivan, Assistant Vice President, Federal Reserve Bank of Chicago
Mr. Bryan, Consultant, Federal Reserve Bank of Cleveland

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on July 2–3, 1996, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market transactions in foreign currencies for System account during the period since the meeting on July 2–3, 1996, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in U.S. government securities and federal agency obligations during the period July 3, 1996, through August 20, 1996. By unanimous vote, the Committee ratified these transactions.

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

The information reviewed at this meeting suggested that the economic expansion had moderated somewhat recently. Growth in consumer spending appeared to be slowing, business purchases of equipment and structures were rising less vigorously, and higher mortgage rates were beginning to exert a restraining effect on housing construction. Business inventory accumulation had been quite modest, and production and employment were expanding less rapidly. Increases in labor compensation had been somewhat larger this year, but consumer price inflation, adjusted for food and energy prices, had remained on a fairly steady trend.

Private nonfarm payroll employment increased relatively rapidly in July, though at a considerably slower pace than in the second quarter. Job growth in the services industry slowed sharply, and manufacturing employment declined appreciably after having risen somewhat in the second quarter. In contrast, the expansion in employment in wholesale and retail trade picked up slightly in July, and the number of jobs in construction continued to increase at about the second-quarter pace. The average workweek for private production or nonsupervisory workers fell considerably in July, to a level a little below its average for the second quarter, and the civilian unemployment rate edged up to 5.4 percent.

Industrial production rose slightly further in July after three consecutive months of strong gains; manufacturing production expanded less rapidly, and electricity generation dropped sharply as a result of unseasonably cool weather. A substantial increase in the production of motor vehicles and parts accounted for most of the advance in manufacturing output. Elsewhere, the manufacture of office and computing equipment continued on its strong upward trend in July while the production of other business equipment slipped. The output of consumer goods edged lower after having risen slightly in May and June. The rate of utilization of total industrial capacity declined a little in July but remained at a relatively high level.

Retail sales weakened somewhat over June and July following several months of robust growth. Sales of motor vehicles were down in both months, and spending on other goods rose sluggishly on balance. Housing starts fell somewhat further in July, reflecting a sizable decline in single-family starts that more than offset a bounceback in multifamily starts. The drop in housing starts, coupled with lower sales of new and existing homes in June (latest data available), suggested that the rise in mortgage rates was exerting a damping effect on housing demand and homebuilding activity.

Growth in business spending on durable equipment and nonresidential structures had slowed after a very rapid expansion earlier in the year. Shipments of nondefense capital goods were little changed in June after a sizable increase in May. Weakness in outlays for aircraft more than offset persisting strength in spending on office and computing equipment, and purchases of other types of equipment, notably communications and industrial equipment, continued to advance briskly. Nonresidential construction activity rebounded in June from an appreciable decrease in May. The pace of office building picked up, and construction of other commercial and industrial structures posted healthy gains after May declines.

Business inventories increased by a modest amount in June after having contracted in May. In manufacturing, inventories continued to run off in June, reducing the sector's stock–sales ratio to near its historical low. Wholesale trade stocks also fell in June, and the inventory–sales ratio was in the lower portion of its range over recent years. Retail inventories rose in June; larger stocks at automotive dealers more than accounted for the increase. The inventory–sales ratio for the sector as a whole edged higher but remained at a relatively low level.

The nominal deficit on U.S. trade in goods and services narrowed in June, but on a quarterly average basis the deficit widened in the second quarter from its rate in the first quarter. In June, the value of exports declined slightly, but the value of imports dropped by a considerably larger amount from a relatively high rate in May. Available information suggested that economic activity in the major foreign industrial countries continued to advance, but at an uneven pace; in Germany, activity rebounded from the contraction in the first quarter, while in Japan a considerable slowing of growth had occurred in the second quarter after very rapid expansion in the first quarter.

Price inflation remained moderate on balance in June and July, with declines in energy prices essentially offsetting increases in food prices. Over a somewhat longer horizon, consumer prices for nonfood, non-energy items rose slightly less in the twelve months ended in July than in the previous twelve-month period. Producer prices of finished goods other than food and energy also increased more slowly in the twelve months ended in July. In contrast, growth in labor costs had picked up. The employment cost index for private industry workers advanced at a somewhat faster rate in the second quarter than in the first quarter or in the second half of 1995. Measured over the year ended in June, the index rose by a slightly larger amount than in the previous year.

At its meeting on July 2–3, 1996, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions but that included a bias toward the possible firming of reserve conditions during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and M3 over coming months.

With economic growth moderating and inflation quiescent, open market operations were directed toward maintaining the existing degree of pressure on reserve positions throughout the intermeeting period. The federal funds rate averaged a little higher than the level expected with an unchanged policy stance, in part because of unexpectedly high demand for reserves in late July and early August. On balance, most other short-term market interest rates declined slightly, and intermediate- and long-term rates fell somewhat more, over the intermeeting period. In the days immediately following the meeting, rates rose sharply in response to incoming data, notably the employment report for June that market participants viewed as indicating increasing pressures on economic resources and labor costs. Subsequently, however, that rise was more than reversed when further data releases were interpreted as suggesting that the economic expansion might be slowing and that the upturn in labor compensation was mild. Equity prices also exhibited considerable volatility over the period since the Committee meeting on July 2–3, with major indexes of stock prices falling steeply through late July before recouping part to most of their losses in association with the bond market rally and favorable earnings reports.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined slightly over the intermeeting period. The flow of information suggesting a slowing in U.S. economic growth and reduced prospects for a near-term tightening of Federal Reserve policy weighed against the dollar. On the other hand, the yen was bolstered by incoming data suggesting that the Japanese current account surplus was again widening, and the German mark benefited from the Bundesbank's inaction at a time when market participants were expecting a policy easing.

Growth of M2 and M3 moderated in July. Much of the slowdown in the expansion of M2 was associated with an unexpected decline in demand deposits, which had grown rapidly earlier in the year. With bank credit expanding sluggishly, the funding needs of banks were modest, and the slower growth of M2 showed through to M3. For the year through July, both aggregates were estimated to have increased at rates somewhat below the upper bounds of their respective ranges for the year. Expansion in total domestic nonfinancial debt had been moderate on balance over recent months and had remained in the middle portion of its range.

The staff forecast prepared for this meeting suggested that the expansion would slow to a rate around, or perhaps a little above, the economy's estimated growth potential. Consumer spending was projected to expand at a more moderate pace that would be in line with the projected increase in disposable income; the favorable effect of the earlier run-up in equity prices on household wealth and the generally ample availability of credit were expected to balance continuing consumer concerns about the adequacy of their savings and the restraining effect of high household debt burdens. Homebuilding was forecast to slow somewhat in response to the backup in residential mortgage rates but to remain at a relatively high level in the context of sustained income growth and the still-favorable cash flow affordability of home ownership. Business spending on equipment and structures was projected to grow less rapidly in light of the anticipated moderate growth of sales and profits. On balance, the external sector was expected to exert a small restraining influence on economic activity over the projection period. Only modest fiscal restraint was anticipated over the forecast horizon. Inflation recently had been lifted by adverse developments in energy markets and was projected to remain above the levels of recent years, given the high level of resource utilization, the effects of tight grain supplies on food prices, and a noticeable step-up in labor compensation reinforced by the legislated rise in the federal minimum wage.

In the Committee's discussion of current and prospective economic developments, members commented that on balance the information received since the July meeting, including anecdotal reports from around the nation, pointed to some slowing in the growth of economic activity from a very rapid pace during the spring. The extent of the slowing remained uncertain, and it was unclear at this juncture whether the expansion would slow sufficiently to contain pressures on labor and other producer resources. Nonetheless, broad measures of price inflation, adjusted to exclude their volatile food and energy components, did not exhibit any uptrend despite robust growth in economic activity this year and high levels of resource use. Indeed, some price measures suggested that inflation had trended lower through the second quarter. Moreover, there were no early signs of pressures or imbalances in the industrial sector. In labor markets, however, there were increasing indications of tightness that might at some point feed through to greater inflation. Upward wage adjustments were becoming more evident and increases in overall compensation had edged up, suggesting the possibility of further increases in labor costs at current or higher levels of labor utilization even before taking account of the effects of the rise in the minimum wage. Although increases in compensation might be moderated by greater productivity or absorbed for a time by lower profit margins, the risks seemed tilted toward increases in inflation at some point, especially if the growth of the economy continued to outstrip its potential and added to pressures on resources.

In the course of the Committee's discussion, members cited a variety of indications that economic growth was slowing from a very rapid pace, and they pointed to a number of factors that in their view should promote continued, though more moderate, expansion in economic activity. These included generally supportive financial conditions, relatively high levels of consumer confidence, and the absence of major imbalances in the economy. It was noted that much of the stimulus for the strong expansion in the first half of the year had been provided by large increases in spending for consumer durables, housing, and business equipment; however, growth in such spending could be expected to slow in the context of increasingly satisfied pent-up demands and the lagged effects of earlier increases in intermediate- and long-term interest rates on these interest-sensitive sectors of the economy. A key uncertainty in the outlook was the prospective behavior of inventories. Should the expansion in final demand fail to moderate to a sustainable pace, business firms would be likely to intensify their efforts to build their inventories, which currently were widely viewed as satisfactory or even relatively lean in relation to sales. While some buildup in inventories appeared to be occurring in the current quarter, developments that might lead to a sharp increase in inventory investment, such as shortages of various goods and materials and lengthening delays in securing deliveries, were not in evidence at this time. Accordingly, aggressive inventory accumulation remained an upside risk to the projected expansion but not one that was likely to materialize unless final demand were to exceed current forecasts by a significant margin.

In their discussion of the outlook for inflation, members observed that increases in prices had remained remarkably subdued for an extended period in relation to measures of resource utilization, notably the rate of unemployment. Such behavior differed markedly from the historical experience under similar circumstances. One factor tending to hold down prices has been highly competitive markets—throughout the nation and internationally as well—that have made it very difficult for business firms to raise prices. Another key factor, though one whose importance might now be starting to diminish, was the persistence of comparatively small increases in labor compensation, which remained appreciably below earlier norms in relation to levels of unemployment. This development appeared to reflect worker concerns about job security in a period of major business restructuring and downsizing activities as well as substantially reduced increases in benefit costs, notably those relating to health care.

In assessing whether a relatively favorable inflation performance was likely to continue, the members focused on a variety of issues. One was whether the expansion would moderate sufficiently to keep pressures on labor and other resources from intensifying. Another was whether a rate of unemployment in the vicinity of its current level would foster added wage pressures. Uncertainty also surrounded the extent to which further increases in labor compensation costs, should they materialize, would be passed through to higher prices. Improvements in productivity were likely to offset part of such increases, but how much remained an open question. In addition, profit margins were high, but the extent to which they might narrow to absorb increasing labor costs was difficult to predict. With regard to the outlook for wages, members observed that, though it was too early to reach a firm judgment, the acceleration of wage increases this year might well augur faster advances that were more in line with historical experience under essentially full employment conditions. Moreover, the tendency toward reduced increases in the costs of benefits might tend to dissipate, though some members commented that further economies in the provision of medical services might well be achievable for some period. On balance, the inflation risks in the outlook clearly seemed to be to the upside, with the potential for more inflation stemming from rising labor compensation costs augmented by a rise in the minimum wage and the prospect of higher food prices and perhaps energy prices over the next several quarters.

In the Committee's discussion of policy for the intermeeting period ahead, members focused on indications that the economy already was slowing, perhaps by enough to limit pressures on resources, and they noted that broad statistical measures of prices and the anecdotal evidence did not suggest that a pickup in inflation was already under way. Consequently, all but one of the members supported a proposal to maintain an unchanged policy stance. A number also commented that real interest rates were not unusually low, suggesting that any pickup in inflationary pressures, should that occur, would be modest and readily contained. One concern was that policy tightening at this point might generate an excessive reaction in financial markets, both because it was not generally expected and because it would represent a change in policy direction that might well lead to expectations of further policy tightening. Such a development could have serious adverse consequences for economic activity if the expansion was in fact already slowing to a more sustainable and less inflationary pace. These members therefore concluded that the prudent course at this point was to await further developments that would permit them to assess the possible need for some tightening with a higher degree of confidence. At the same time, it was emphasized that the Committee remained committed to a policy that would resist a rise in inflation; such a policy would entail moving in anticipation of greater price pressures and before they showed through to actual inflation. Accordingly, they also agreed on the desirability of a directive that remained biased toward possible tightening in the intermeeting period ahead. Such a directive would imply that any tightening should be implemented promptly if developments were perceived as pointing to rising inflation. For now, the Committee should remain particularly vigilant to incoming information bearing on the outlook for inflation.

A differing view gave more weight to the risks of rising inflation. In this view, while there were uncertainties, the weight of the evidence suggested that a prompt policy action was needed to contain inflation and set the stage for further progress toward price stability. The possibility of an overreaction in financial markets to a tightening move could not be ruled out, but such a reaction was likely to be short-lived. More importantly, a prompt action would reduce the risk that inflation would worsen and pose difficult problems for monetary policy later.

At the conclusion of the Committee's discussion, all but one member indicated that they supported a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward the possible firming of reserve conditions during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth of M2 and M3 over coming months.

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

The information reviewed at this meeting suggests that growth in economic activity recently has moderated somewhat. Private nonfarm payroll employment grew less rapidly in July, the average workweek fell sharply, and the civilian unemployment rate edged up to 5.4 percent. Industrial production increased slightly in July after three months of strong gains. Real consumer spending weakened somewhat on balance over June and July following several months of robust growth. Housing starts fell somewhat further in July. Growth in spending on business equipment and nonresidential structures has slowed after a very rapid expansion earlier in the year. The nominal deficit on U.S. trade in goods and services widened in the second quarter from its rate in the first quarter. Increases in labor compensation have been somewhat larger this year, but consumer price inflation, adjusted for food and energy prices, has remained on a fairly steady trend.

Most short-term market interest rates have declined slightly while intermediate- and long-term rates have fallen somewhat more since the Committee meeting on July 2–3, 1996. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has depreciated slightly over the intermeeting period.

Growth of M2 and M3 moderated in July. For the year through July, both aggregates are estimated to have grown at rates somewhat below the upper bounds of their respective ranges for the year. Expansion in total domestic nonfinancial debt has been moderate on balance over recent months and has remained in the middle portion of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in January for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1997 the Committee agreed on a tentative basis to set the same ranges as in 1996 for growth of the monetary aggregages and debt, measured from the fourth quarter of 1996 to the fourth quarter of 1997. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Meyer, Mses. Phillips, Rivlin, and Yellen. Vote against this action: Mr. Stern.

Mr. Stern dissented because he believed that policy should become modestly more restrictive. He was concerned that, in the absence of a substantial and sustained improvement in productivity, the prevailing pattern of demand might engender an increase in inflationary pressures, and that such pressures would ultimately threaten the ongoing economic expansion. In Mr. Stern's judgment, it was prudent at this point to resist such a development in order to lay a foundation for the long-term health of the economy.

It was agreed that the next meeting of the Committee would be held on Tuesday, September 24, 1996.

The meeting adjourned at 12:45 p.m.

Donald L. Kohn
Secretary

## Meeting held on September 24, 1996

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, September 24, 1996, at 9:00 a.m.

*Present:*

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Mr. Meyer
Ms. Phillips
Ms. Rivlin
Mr. Stern
Ms. Yellen

Messrs. Broaddus, Guynn, Moskow, and Parry, Alternate Members of the Federal Open Market Committee

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

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

Messrs. Lang, Lindsey, Mishkin, Promisel, Rosenblum, Siegman, Simpson, Sniderman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

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

Messrs. Madigan and Slifman, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Mr. Smith,[6] Assistant Director, Division of International Finance, Board of Governors

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

Ms. Pianalto, First Vice President, Federal Reserve Bank of Cleveland

Messrs. Beebe, Davis, Dewald, Eisenbeis, and Hunter, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Kansas City, St. Louis, Atlanta, and Chicago respectively

Messrs. Bentley, Hetzel, Ms. Krieger, and Mr. Rosengren, Vice Presidents, Federal Reserve Banks of New York, Richmond, New York, and Boston respectively

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on August 24, 1996, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market transactions in foreign currencies for System account during the period since the meeting on August 20, 1996, and thus no vote was required of the Committee.

6. Attended portion of meeting relating to proposal to amend the Authorization for Foreign Currency Operations.

The Manager also reported on recent developments in domestic financial markets and on System open market transactions in U.S. government securities and federal agency obligations during the period August 20, 1996, through September 23, 1996. By unanimous vote, the Committee ratified these transactions.

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

The information reviewed at this meeting suggested that the expansion of economic activity had moderated appreciably from an elevated second-quarter pace. Growth in consumer spending had slowed noticeably, and higher mortgage rates seemed to be exerting some modest restraint on housing demand. While business demand for durable equipment remained strong, spending on nonresidential structures had weakened a little. Business inventory accumulation appeared to have picked up, although the level of inventories remained modest in relation to sales. Employment and production had continued to post sizable gains in recent months, but the increases were somewhat below those recorded earlier in the year. Consumer price inflation, excluding its food and energy components, had edged lower this year despite somewhat larger increases in labor compensation.

Private nonfarm payroll employment grew less rapidly over July and August than it had in the second quarter; aggregate hours worked by private production workers also expanded at a slower pace over the two-month period. Job growth in the services industries was somewhat lower over the two months compared with that of the second quarter. Manufacturing employment changed little on balance over the July–August period, and construction hiring was down considerably in August after a July increase that was a little above the pace of the second quarter. The civilian unemployment rate declined to 5.1 percent in August.

Industrial production also advanced somewhat less rapidly on average in July and August after having recorded strong gains in the previous few months; slower growth was evident in mining and utilities as well as in manufacturing. Smaller increases in the output of motor vehicles and parts accounted for part of the slowdown in the expansion of the manufacturing sector in August; in addition, the output of consumer goods other than motor vehicles remained sluggish, and the production of construction supplies declined significantly after having surged in the second quarter. Elsewhere in manufacturing, business equipment, notably its office and computing component, continued its robust expansion over July and August, and defense and space equipment extended the upturn that had begun in the second quarter. The rate of utilization of total industrial capacity was unchanged on balance from June to August and remained at a relatively high level.

Total retail sales rose slightly over July and August after having declined substantially in June. Decreased outlays at food stores, gas stations, and furniture and appliance stores in August were a little more than offset by a sharp pickup in sales at general merchandisers, apparel stores, and outlets for durable goods other than furniture and appliances. Housing starts rebounded in August from a July drop and for the two months were about unchanged on average from their second-quarter level; however, permits for single-family housing were unchanged in August and had fallen from their second-quarter level. Sales of existing homes weakened in June and July.

Demand for business equipment had remained strong in recent months. Shipments of nondefense capital goods declined in July, retracing part of a substantial second-quarter advance, but recent data on new orders pointed to further increases in business spending for durable equipment, notably office and computing equipment, in coming months. Nonresidential construction activity fell somewhat in July after having decreased a little in the second quarter.

Business inventory investment picked up sharply in July; most of the increase occurred at retail establishments. Manufacturing inventories rose somewhat, with the gain concentrated at manufacturers of producers' durable equipment. The stock–sales ratio for the sector was around its historical low. In the wholesale sector, inventories edged higher in July despite a substantial drop in stocks of farm products, and the inventory–sales ratio for the sector fell to the low end of its range over recent years. Retail stocks expanded considerably at both automotive dealers and non-auto establishments in July. Inventory–sales ratios edged higher in most retail categories, but they remained at relatively low levels.

The nominal deficit on U.S. trade in goods and services widened substantially in July from its June level and also from its average rate for the second quarter. Despite one-time service payments related to the Olympics and larger inflows of imported oil, imports edged down in July from the sharply increased rate recorded for the second quarter; the latter largely reflected the strength of the U.S. economy during the first half of the year. Exports fell considerably more in July than did imports; in addition to decreased exports in such categories as consumer goods, aircraft and parts, automotive products, and other industrial supplies, part of the measured decline may have reflected residual seasonality in the data. Available information suggested that, on balance, the economies of the major foreign industrial countries had strengthened in recent months. In Japan, a mild second-quarter pause after very rapid first-quarter growth had been followed by renewed expansion. Economic activity in Germany had rebounded sharply in the second quarter from a first- quarter contraction, and further expansion appeared to be in train. Although economic growth had been sluggish in Canada and the United Kingdom in the second quarter, recent indicators suggested a pickup in activity in those countries as well. By contrast, France and Italy had experienced little, if any, growth since early in the year.

Consumer price inflation remained moderate on balance over July and August; declines in energy prices offset higher food prices. Excluding food and energy, consumer prices recorded a somewhat smaller advance over the twelve months ended in August than over the previous twelve months. Producer prices of finished goods other than food and energy were unchanged on net over July and August, and this index rose at a significantly slower pace over the twelve months ended in August than over the preceding twelve months. Average hourly earnings of production or nonsupervisory workers rebounded in August, more than offsetting a small July decline. Over the year ended in August, this measure of labor costs increased considerably more than it had over the previous year.

At its meeting on August 20, 1996, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions but that included a bias toward the possible firming of reserve conditions during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and M3 over coming months.

With incoming information generally confirming that economic growth was moderating and that price inflation remained subdued, open market operations were directed toward maintaining the existing degree of pressure on reserve positions throughout the intermeeting period. The federal funds rate generally remained close to the level expected with an unchanged policy stance, but most other market interest rates exhibited considerable volatility and rose somewhat on balance over the intermeeting interval. Despite the rise in many market interest rates, equity prices rebounded over the period, and most major market indexes reached record highs.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies appreciated slightly over the intermeeting period. The dollar's rise reflected in part the increase in U.S. long-term interest rates over the period. Declines in market rates abroad, both short- and long-term, also contributed to the dollar's strengthening. In Japan, newly released data led market participants to lower their assessments of the strength of that country's economic expansion and of the prospects of any near-term increase in official interest rates. In Germany, a reduction by the Bundesbank in its repo rate in late August and subsequent statements by Bank officials regarding possible additional declines in official rates appeared to foster market expectations that monetary policy might be eased further.

Growth of M2 and M3 picked up in August from sluggish rates in July but remained below the average increases over the first half of the year. A continuing, rapid runoff in the liquid deposit components of these aggregates was offset in part by solid gains in retail money market funds and small time deposits, whose yields had not declined in step with decreases in market interest rates in early August. For the year through August, both aggregates grew at rates in the upper portions of their respective annual ranges. Expansion in total domestic nonfinancial debt had been moderate on balance over recent months and had remained in the middle portion of its range.

The staff forecast prepared for this meeting, which differed little from that for the previous meeting, suggested that the expansion would slow to a rate around, or perhaps a little above, the economy's estimated growth potential. Expansion of consumer spending was forecast to rebound from the sluggish third-quarter rate in light of strong income trends, the favorable effect of the rise in the stock market this year on household wealth, and the generally ample availability of credit. Homebuilding was anticipated to slow somewhat in response to this year's increase in residential mortgage rates but to remain at a relatively high level in the context of sustained income growth and the still-favorable cash flow affordability of home ownership. The expansion of business investment in equipment and structures was projected to slow gradually in response to an easing of pressures on capacity, a prospective slackening in the growth of corporate cash flows, and the rise in long-term interest rates that had occurred this year. Only modest fiscal restraint was anticipated over the forecast period. Inflation, which had been boosted thus far in 1996 by adverse developments in food and energy markets, was projected to remain somewhat above that of recent years, given high levels of resource utilization and a noticeable step-up in labor compensation that would be reinforced by the legislated rise in the federal minimum wage.

In the Committee's discussion of current and prospective economic developments, members commented that the incoming information had been mixed since the August meeting but that on the whole it continued to suggest appreciable slowing in the economic expansion from a rapid and unsustainable pace in the second quarter. Data for many components of final demand, notably in the consumer sector, indicated that economic growth had moderated considerably in recent months. At the same time, supply-side data including employment and industrial production had remained relatively robust, contributing to uncertainty about underlying growth and suggesting that inventory accumulation had picked up during the summer. While the extent of the slowing in the overall expansion remained unclear, there were no indications of serious imbalances in the economy, and the members generally viewed further growth at a pace near that of the economy's potential as a likely prospect. They continued to be concerned, however, about the outlook for inflation, given the high level of production. In that regard, some commented that labor markets appeared to have tightened further in recent months and that wages were rising at a somewhat faster pace. Even so, the rate of price inflation had not picked up and the prospects were good that inflation would remain contained for some time. Whether the factors that had contributed to such a price performance would persist remained a key uncertainty in the economic outlook, and the members generally agreed that the risks continued to be tilted to some extent in the direction of rising price inflation over the forecast horizon.

In their discussion of the outlook for spending in key sectors of the economy, members commented that consumer expenditures were likely to pick up after their summer lull, though probably to a pace appreciably below that in the first half of this year. Favorable factors in the outlook for consumer spending included strong gains in employment and income, the wealth effect stemming from the rise that had occurred in the value of financial assets, and generally buoyant consumer sentiment. The improvement in the consumer sector would tend to be restrained, however, by the increase in consumer debt burdens and the probable satisfaction of much of the pent-up demands for consumer durables during the current expansion. Business fixed investment likewise was expected to provide considerable further stimulus to the economy. Expenditures for business equipment, notably for office and computing equipment, were expected to expand substantially further, and recent weakness in nonresidential construction might well prove to be temporary, judging in part from anecdotal reports of considerable strength in commercial real estate markets in many areas. On the whole, however, the completion of numerous capital spending programs in conjunction with slower projected growth in overall demand could be expected to temper the expansion of business investment over coming quarters. In the housing sector, recent developments were somewhat mixed, but they suggested on balance that housing activity had held up better than expected in the light of increased mortgage interest rates. It was suggested in this regard that the retarding effects of higher rates on fixed-rate mortgage contracts were being blunted to some extent by shifts toward adjustable rate mortgages. Even so, and consistent with the softening already observed in a number of areas, residential construction was thought likely to drift lower over time.

The outlook for inventory investment, as is typically the case, was very difficult to assess. The moderation in the expansion of final demand in recent months, together with still relatively robust growth in employment and production, suggested that inventory investment had picked up since the second quarter. The strength in inventories in July tended to confirm that assessment. However, assuming moderate economic growth in line with current forecasts, there was no reason to anticipate substantial further strengthening in inventory investment over coming quarters. Indeed, the recent rebuilding of inventories after little or no growth earlier in the year made rapid expansion less likely going forward. The members acknowledged, nonetheless, that inventory developments needed to be monitored with care, including such indirect signs as rising pressures on the prices of intermediate goods and tightening delivery schedules that might provide incentives for a rapid buildup. With capacity utilization already at high levels, relatively rapid growth in inventory investment, if it were superimposed on stronger-than-projected expansion in final demand, could portend serious pressures on resources and inflationary consequences for the economy.

In their comments about the outlook for inflation, members observed that the recent behavior of price inflation was a welcome though highly unusual development, given current pressures on resources. The statistical and anecdotal information provided evidence of increasingly tight labor markets that under similar conditions historically had been associated with considerable upward pressure on nominal labor compensation and, in turn, on prices. While wages, and probably total labor compensation, were rising more rapidly this year, the acceleration in the latter still appeared to be held down by worker insecurity and relatively subdued increases in the cost of benefits. Moreover, for a variety of reasons rising labor costs were not currently being passed through to prices, which by several key measures adjusted for their volatile food and energy components exhibited a steady or even a declining trend. Explanations tended to concentrate on the intense competition in many markets, which prevented firms from raising prices to absorb cost increases.

Competitive pressures also were compelling firms to curb cost increases through improvements in their productivity performance. Widespread reports suggested major gains in productivity in numerous industries, induced in recent years by business restructuring and related activities and by large capital investments that had introduced increasingly productive equipment. Although currently available measures of productivity for the economy as a whole showed only weak gains, sectoral disaggregation of the data gave reasons to question the productivity measurements. Productivity had increased fairly sharply in manufacturing, and the slowdown in overall productivity since 1973 had been concentrated in the service areas of the economy. Indeed, measured productivity in noncorporate businesses—largely services—had displayed a negative trend for many years. This result was implausible and suggested considerable error in estimating output and prices for many services. Consequently, it was likely that actual productivity growth was higher than the current measures indicated. By the same token, the rate of price inflation was lower than had been reported, consistent with the findings of a number of studies of distortions in published price data.

The implications for the inflation outlook were not clear-cut. The key question was how long the favorable price behavior would persist. Advances in productivity had boosted profit margins, and high margins were helpful in that they could absorb some portion of any cost increases for a time. However, many business contacts indicated that they would resist squeezes in profit margins, and continued acceleration in costs would eventually feed through to greater price inflation whatever the rate of productivity growth. The behavior of costs and the ability of businesses to pass along any greater increases over time would depend on the extent to which the expansion would slow and how much associated pressure there would be in labor and product markets. In this connection, some members observed that even if the expansion were to slow to a sustained pace around the rate of increase of the economy's potential, price inflation could well trend at least modestly higher at current levels of resource utilization. Others did not disagree that the odds might be tilted marginally in that direction, but they continued to believe that a great deal of uncertainty surrounded the outlook for resource use and, in turn, the relationship between a given degree of pressure on resources and overall price changes. In sum, assuming economic growth generally in line with their forecasts, the critical question for some was when and how much inflation would rise; many others were not persuaded of the inevitability of such an outcome.

In the Committee's discussion of policy for the intermeeting period ahead, nearly all the members indicated that they could support an unchanged policy stance and the retention of a bias toward restraint in the directive. The members generally agreed that while the risks were greater that price inflation would rise than that it would fall, higher inflation was not a foregone conclusion and most believed that the uncertainties in the outlook made it prudent to hold monetary policy on a steady course and await further developments. The expansion appeared to be slowing substantially and broad measures of prices, adjusted for fluctuations in their food and energy components, still indicated a steady or even slightly declining inflation trend. In these circumstances, the Committee could wait for more information on the momentum of the expansion and the degree of pressure on resources and its implications for inflation. A delay in adjusting monetary policy was facilitated by its current positioning, which did not appear to be far from a desirable longer-term stance because any pickup in inflation was likely to be relatively small and gradual, and was further supported by the possibility of an excessive reaction in financial markets to a change in the direction of policy. A few members indicated that they could vote for some slight tightening in policy, although they did not feel any urgency about such a move. They observed that the decision was a close one for them, and in light of the uncertainties that were involved, they were willing to join the majority and wait for further evidence bearing on the outlook for inflation. With regard to possible intermeeting adjustments to policy, the members agreed that retaining an asymmetric directive that was biased toward restraint would be consistent with their assessments of the inflation risks in the economy. Accordingly, information suggesting that the odds on higher inflation had risen should be met with a prompt policy firming.

A differing view focused on the desirability of a prompt move toward restraint to curb what were seen as growing inflationary pressures in the economy. Tight labor markets were likely to exert continuing upward pressure on labor costs, barring unexpected weakness in the economy, and at some point those costs would begin to be passed through to prices. In the circumstances, it was important for policy to be forward-looking and to move promptly to head off intensifying inflationary pressures. Potentially, waiting could require more disruptive policy tightening actions later and could risk the credibility of the System's anti-inflation policy.

At the conclusion of the Committee's discussion, all but one of the members indicated that they could accept a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward the possible firming of reserve conditions during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth of M2 and M3 over coming months.

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

The information reviewed at this meeting suggests that growth in economic activity has moderated appreciably from an elevated second-quarter pace. Private nonfarm payroll employment grew less rapidly over July and August than in the second quarter, while the civilian unemployment rate declined to 5.1 percent in August. Industrial production increased somewhat less rapidly on average in July and August than in the prior few months. Total retail sales rose slightly over July and August after having declined substantially in June. Housing starts in July and August were unchanged on average from their second-quarter level. Demand for business equipment has remained strong, while spending on nonresidential structures has changed little on balance in recent months. The nominal deficit on U.S. trade in goods and services widened substantially in July from its average in the second quarter. Increases in labor compensation have been somewhat larger this year, but consumer price inflation, excluding its food and energy components, has edged lower.

Most market interest rates have risen somewhat on balance since the Committee meeting on August 20, 1996. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has appreciated slightly over the intermeeting period.

Growth of M2 and M3 picked up in August, but they continued to expand at rates below those in the first half of the year. For the year through August, both aggregates are estimated to have grown at rates in the upper portions of their respective ranges for the year. Expansion in total domestic nonfinancial debt has been moderate on balance over recent months and has remained in the middle portion of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in January for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1997 the Committee agreed on a tentative basis to set the same ranges as in 1996 for growth of the monetary aggregages and debt, measured from the fourth quarter of 1996 to the fourth quarter of 1997. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Meyer, Mses. Phillips, Rivlin, and Yellen. Vote against this action: Mr. Stern.

Mr. Stern dissented because he believed that a modestly more restrictive policy was appropriate. In his view, historical precedents suggested that prolonged periods of taut labor markets were eventually associated with rising inflation. Given prevailing pressures on resources, especially labor, Mr. Stern was concerned about the distinct risk of an acceleration of inflation. Should this acceleration occur, he believed it would prove disruptive to the favorable performance of the economy, and he preferred to begin to address this risk promptly.

### Amendment to Authorization for Foreign Currency Operations

At this meeting the Committee considered a proposal to replace the existing twelve-month maturity limit on the investment of foreign currency balances with an eighteen-month average duration limit. The proposal was designed to allow the Manager a wider choice of maturities and hence somewhat greater operational flexibility in the implementation of the System's primary portfolio objectives of liquidity with respect to investments in foreign government securities and limits on overall interest rate and credit risks. At the conclusion of their review, the Committee members voted unanimously to amend section 5 of the Authorization for Foreign Currency Operations to read as follows:

> 5. Foreign currency holdings shall be invested to ensure that adequate liquidity is maintained to meet anticipated needs and so that each currency portfolio shall generally have an average duration of no more than 18 months (calculated as Macaulay duration). When appropriate in connection with arrangements to provide investment facilities for foreign currency holdings, U.S. Government securities may be purchased from foreign central banks under agreements for repurchase of such securities within 30 calendar days.

### Liquidity Management and the Maturity Structure of the SOMA Portfolio

The Committee also reviewed, on a preliminary basis, its current practices with regard to the maturity structure of the System Open Market Account (SOMA) portfolio of Treasury obligations. In its last such review, at its meeting on March 31, 1992, the Committee decided that the enhanced liquidity of the SOMA portfolio that had been achieved should be maintained but that net additions to System holdings should continue to be spread across all maturity areas. In the course of their discussion at this meeting, the members agreed that the primary objective in the management of the SOMA portfolio was to ensure a high degree of liquidity so that prompt and effective adjustments could be made without unduly affecting the market for Treasury securities.

It was agreed that the next meeting of the Committee would be held on Wednesday, November 13, 1996.

The meeting adjourned at 1:40 p.m.

Donald L. Kohn
Secretary

## Meeting Held on November 13, 1996

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Wednesday, November 13, 1996, at 9:00 a.m.

*Present:*

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Mr. Meyer
Ms. Phillips
Ms. Rivlin
Mr. Stern
Ms. Yellen

Messrs. Broaddus, Guynn, Moskow, and Parry, Alternate Members of the Federal Open Market Committee

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

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

Messrs. Lang, Lindsey, Mishkin, Promisel, Rolnick, Siegman, Simpson, Sniderman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Messrs. Madigan and Slifman, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors
Mr. Reinhart, Assistant Director, Division of Monetary Affairs, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors
Mr. Moore, First Vice President, Federal Reserve Bank of San Francisco
Ms. Browne, Messrs. Davis, Dewald, Eisenbeis, Goodfriend, and Hunter, Senior Vice Presidents, Federal Reserve Banks of Boston, Kansas City, St. Louis, Atlanta, Richmond, and Chicago respectively
Messrs. Cox and Judd, Vice Presidents, Federal Reserve Banks of Dallas and San Francisco respectively
Ms. Perelmuter, Assistant Vice President, Federal Reserve Bank of New York

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on September 24, 1996, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market transactions in foreign currencies for System account during the period since the meeting on September 24, 1996, and thus no vote was required by the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period September 24, 1996, through November 12, 1996. By unanimous vote, the Committee ratified these transactions.

By unanimous vote, the Committee authorized the renewal for an additional one-year period of the System's reciprocal currency (''swap'') arrangements with foreign central banks and the Bank for International Settlements. The amounts and maturity dates of the arrangements approved for renewal are shown in the table below.

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

The information reviewed at this meeting suggested that the growth of economic activity slowed substantially in the third quarter, and the limited information available for the period since then indicated continued moderate expansion. A marked softening in the growth of consumer expenditures accounted for much of the slowing in the third quarter, but slight weakening

| Foreign bank | Amount of arrangement (millions of dollars equivalent) | Term (months) | Maturity date |
|---|---|---|---|
| Austrian National Bank | 250 | 12 | 12/04/96 |
| Bank of England | 3,000 | | 12/04/96 |
| Bank of Japan | 5,000 | | 12/04/96 |
| Bank of Norway | 250 | | 12/04/96 |
| Bank of Sweden | 300 | | 12/04/96 |
| Swiss National Bank | 4,000 | | 12/04/96 |
| Bank for International Settlements: | | | |
| Swiss francs | 600 | | 12/04/96 |
| Other authorized European currencies | 1,250 | | 12/04/96 |
| Bank of Mexico | 3,000 | | 12/13/96 |
| Bank of Canada | 2,000 | | 12/15/96 |
| National Bank of Belgium | 1,000 | | 12/18/96 |
| National Bank of Denmark | 250 | | 12/28/96 |
| Bank of France | 2,000 | | 12/28/96 |
| German Federal Bank | 6,000 | | 12/28/96 |
| Bank of Italy | 3,000 | | 12/28/96 |
| Netherlands Bank | 500 | | 12/28/96 |

in housing demand, net exports, and federal purchases of goods and services also exerted retarding effects. On the other hand, a sizable increase in inventory investment, greater strength in business demand for durable equipment, and an upturn in spending on nonresidential construction helped foster moderate further economic growth in the third quarter. Employment posted sizable increases over the third quarter and rose substantially further in October, but on balance the gains were somewhat below those recorded earlier in the year. Industrial production had weakened somewhat recently. Consumer price inflation had picked up this year because of larger increases in food and energy prices. Increases in labor compensation, though moderating in the third quarter, also had been somewhat larger this year.

Private nonfarm payroll employment increased considerably in October after a small rise in September; private payroll growth had moderated on balance since midyear but nevertheless had remained substantial. In October, job gains were large in service industries; construction employment registered another moderate gain; and manufacturing payrolls edged up after a sizable September loss. The civilian unemployment rate in October was unchanged at 5.2 percent.

Industrial production appeared to have declined appreciably in October after having grown briskly on balance over earlier months of the year. Much of the slackening in October resulted from work stoppages in the motor vehicles industry, but the output of other industries also apparently decreased slightly on balance. The drop in production was accompanied by a slight decline in capacity utilization in manufacturing.

Total retail sales rose appreciably in September after having changed little on net over July and August; for the third quarter as a whole, total retail sales edged higher after having expanded briskly in the first half of the year. September sales totals were boosted by strong spending at automotive dealers, food stores, and nondurable goods outlets. However, expenditures for furniture, appliances, and other non-auto durable goods fell, and apparel sales weakened a little further. Housing starts declined in September from the unusually high level recorded in August, and permits moved lower for a second straight month. Home sales were mixed, with sales of new homes well sustained in September while those of existing homes continued on a downtrend.

Growth of business fixed investment surged in the third quarter. Outlays for durable equipment picked up sharply, and new orders for business equipment remained on an upward trend. Sales of computers and communications equipment increased rapidly, but demand for other capital goods was up only slightly during the quarter. In the transportation sector, expenditures on motor vehicles and aircraft strengthened while sales of heavy trucks continued to drift lower. Spending on nonresidential structures more than reversed a second-quarter decline; however, incoming data on contracts pointed to a continuation of the pattern of somewhat slower growth recorded thus far in 1996.

The pace of inventory investment picked up markedly after midyear, but inventory–sales ratios nonetheless remained relatively low. In manufacturing, inventories rose moderately in the third quarter, more than offsetting a small rundown in stocks in the previous quarter; stock–shipments ratios for most industries remained near the low end of their recent ranges. In the wholesale sector, inventories declined sharply in September after having edged down in the previous two months, and the aggregate inventory–sales ratio for the sector fell to the low end of its range over recent years. At the retail level, substantial inventory accumulation occurred over the July–August period (latest data). Although stock–sales ratios rose slightly, inventories remained relatively well aligned with sales.

The nominal deficit on U.S. trade in goods and services narrowed somewhat in August from a high rate in July; however, for the two months combined, the deficit was considerably wider than its average rate for the second quarter. Exports declined appreciably over the July–August period, with most of the decrease occurring in nonmonetary gold and aircraft. Imports rose only marginally on balance over the two months. The limited available information suggested that, on average, economic activity in the major foreign industrial countries expanded moderately in the third quarter.

Consumer price inflation had picked up on balance this year as a result of sizable increases in food and energy prices. Over August and September, however, increases in food prices were offset by a net decline in energy prices, and overall consumer prices rose more moderately. For the twelve months ended in September, the advance in consumer prices of items other than food and energy was a little smaller than it had been over the previous twelve months. At the producer level, price inflation also was moderate over August and September despite appreciable increases in the prices of food and energy items; producer prices of items other than food and energy rose considerably less over the twelve months ended in September than they had over the previous twelve months. Growth in the employment cost index for private industry workers slowed considerably in the third quarter after having trended up over the first two quarters of the year; however, this measure of labor compensation was up slightly over the twelve months ended in September compared with the previous twelve months. Average hourly earnings of production and nonsupervisory workers were unchanged in October, but the twelve-month rise in this index through October was a bit larger than the increase over the previous twelve months.

At its meeting on September 24, 1996, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions but that included a bias toward the possible firming of reserve conditions during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and M3 over coming months.

With incoming information continuing to suggest moderate economic growth and subdued price inflation, open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions, and the federal funds rate generally remained close to the level expected with an unchanged policy stance. Market participants had anticipated some tightening of monetary policy at the September 24 meeting, and the announcement of an unchanged policy led to an immediate decline in interest rates, with the larger decreases occurring at the shorter end of the yield curve. Interest rates, especially those at intermediate and longer maturities, dropped further over the remainder of the period in response to information indicating that price and labor cost pressures were lower than market participants had expected. Equity markets responded to the declines in interest rates as well as to favorable earnings reports, and most major indexes reached record highs.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies depreciated slightly on balance over the intermeeting period. Interest rates in the foreign industrial countries fell somewhat less on average than did U.S. interest rates. The dollar changed little against the German mark and most other major continental European currencies, but it rose against the yen as prospects for a significant supplemental budget package in Japan waned in the aftermath of the recent elections in that country. The dollar declined against the pound sterling in response to the release of favorable data on the U.K. economy as well as an unexpected increase in the Bank of England's minimum lending rate.

M2 grew at a slower pace in September and October than it had over earlier months of the year; the weaker expansion resulted from a continuing rapid runoff in its liquid deposit components. Nonetheless, M2 was estimated to have grown for the year through October at a rate in the upper half of the Committee's annual range. By contrast, M3 expanded at a substantially faster rate in September and October than it had earlier in the year, reflecting a surge in its large time deposit and other managed liability components to meet business demand for bank loans. For the year through October, M3 was estimated to have grown at a rate around the top of its annual range. Total domestic nonfinancial debt had expanded moderately on balance over recent months and had remained in the middle portion of its range.

The staff forecast prepared for this meeting suggested that the expansion would continue at a rate close to, or perhaps a little above, the economy's estimated growth potential. Consumer spending was projected to rebound in the current quarter and subsequently to expand at a moderate pace in line with the projected increase in disposable income; the favorable effect on household wealth of the rise that had occurred in stock prices and the ample availability of credit for most borrowers were expected to balance continuing consumer concerns about the adequacy of their savings and the restraining effect of high household debt burdens. Homebuilding was forecast to decline slightly further in response to the previous backup in residential mortgage rates but to stabilize at a relatively high level in the context of continued income growth and a generally favorable cash flow affordability of home ownership. Business spending on equipment and structures was projected to grow less rapidly in light of the anticipated moderate growth of sales and profits. On balance, the external sector was expected to exert a small restraining influence on economic activity over the projection period. A slight degree of fiscal restraint was anticipated over the forecast horizon. Continued pressure on resources, especially in labor markets, pointed to a likely underlying tendency toward higher inflation over the projection period; however, it was expected that improved supply conditions in food and energy markets, as well as planned technical changes, would damp increases in the consumer price index relative to the elevated 1996 rate.

In the Committee's discussion, members commented that most recent developments bearing on the outlook for economic growth and inflation had been favorable. The information on economic activity since the September meeting had confirmed earlier indications of appreciable slowing in the expansion to a sustainable pace close to the economy's potential. The outlook remained subject, as usual, to considerable uncertainty, but many of the members observed that underlying trends in key sectors of the economy along with generally supportive financial conditions seemed consistent with further moderate economic expansion. In this regard, several focused on what they saw as the promising prospects for a rebound in the growth of consumer expenditures following weak expansion in the third quarter; the pickup would help sustain moderate economic growth over the nearer term despite some anticipated retrenchment in inventory accumulation. With respect to the outlook for inflation, members emphasized that despite widespread indications of tight labor markets, the increase in wages had been muted and somewhat less than anticipated, and there was no broad evidence of rising price inflation. Indeed, many major measures of inflation had exhibited a slight downtrend since 1993. Looking ahead, views differed to some extent regarding the most likely course for inflation. Several members indicated that, while recent developments were encouraging, they continued to see the risks as tilted toward some rise, even assuming that the expansion settled into a pattern of growth near the economy's potential as they anticipated and resource utilization remained near current levels; other members felt that the risks surrounding the forecasts for both economic growth and price inflation had become more evenly balanced, but more evidence was needed before a firm judgment could be reached.

In their review of developments in key sectors of the economy, members said that they anticipated a pickup in consumer spending from its much reduced rate of growth in the third quarter. While the factors relating to the prospects for consumer expenditures did not all point toward greater strength, members tended to focus on those favoring an upturn. These included persisting growth in employment and incomes and clearly upbeat consumer sentiment as evidenced by recent surveys and anecdotal reports. Financial factors also seemed likely on balance to accommodate continuing growth in consumer spending, in particular the marked increases that had occurred in the value of stock holdings and a still-ample availability of credit to most households. Supporting evidence included anecdotal reports from retailers in a number of areas who were experiencing sizable gains in sales and seemed optimistic about the outlook for the upcoming holiday season. Among the developments that would tend to limit growth in consumer spending, members emphasized that the level of consumer indebtedness had strained the liquidity of many households. The growth of consumer credit was now exhibiting a moderating trend, possibly pointing to restrained spending by many households because of already heavy debt service burdens and generally tightening credit standards for consumer loans. Other negative factors cited in the outlook for consumer expenditures were the possibility of a correction in the stock market and the probable satisfaction of much of the earlier pent-up demand for consumer durables. In balancing these conflicting influences, the members generally concluded that a pickup in the growth of consumer spending to a moderate pace was a likely prospect for this critical sector of the economy.

Business fixed investment was expected to provide further but diminished impetus to the expansion. This view took account of the continued availability of debt and equity financing on favorable terms but also of expectations of a more moderate growth trend in sales and the substantial buildup that had already occurred in stocks of equipment and structures. With regard to the latter, some overbuilding of commercial and other structures characterized conditions in a number of areas. Nonetheless, members reported considerable nonresidential building activity in several parts of the country, and nationwide such activity was expected to help sustain modest growth in overall nonresidential construction in coming quarters.

Recent data, supported by anecdotal reports from several though not all parts of the country, suggested that residential building activity was slowing somewhat, apparently in lagged response to earlier increases in mortgage interest rates. However, in the context of the partial reversal recently of the previous increases in mortgage rates and sustained growth in employment and incomes, the housing sector was viewed as likely to exert only a minor constraint on overall economic activity over the forecast horizon. Another somewhat negative factor in the outlook for economic activity was the prospect of some widening in the nation's trade deficit over the projection period.

Fiscal policy currently remained on a mildly restrictive course, but the range of potential developments was especially wide, injecting an element of considerable uncertainty in the economic outlook. Legislation affecting the federal budget could have marked beneficial or adverse effects not only directly on spending and incomes but also on business and consumer confidence and financial markets.

The growth of nonfarm business inventories in the third quarter had exceeded earlier expectations, but members commented that the sizable rise appeared to have been largely voluntary and the overall level of inventories was still historically low in relation to sales. Against this background, inventory accumulation was likely to continue but at a slower pace in the current quarter. Beyond the near term, inventory investment was expected to become a more neutral factor in the performance of the economy, given the absence of incentives to build stocks relative to sales in a period of moderate growth in projected demand. The members recognized, however, that the prospective behavior of inventories remained subject to substantial uncertainties.

In their discussion of the outlook for inflation, members again focused on developments in labor markets and the extent to which rising cost pressures in those markets might be passed through to higher prices. The statistical and anecdotal information generally continued to point to tight labor markets and to a somewhat faster rise in labor compensation costs this year. Even so, the increases in such costs were still falling short of those that would have been anticipated on the basis of historical experience under similar labor market conditions. Moreover, the advance in the overall employment cost index in the third quarter, while perhaps understated to some extent, was appreciably below expectations. At the same time, business firms generally were not raising their prices sufficiently to compensate for faster increases in their labor costs, to the extent that the latter were occurring, evidently because of the persistence of intense competition in most markets. Indeed, with the notable exception of the overall consumer price index, the rate of inflation as measured by various broad price indexes had tended to ease marginally or at worst to stabilize over the past two years. Prices of farm commodities and industrial materials had declined considerably recently.

Despite the recent encouraging reports on labor compensation and prices, the members agreed that the risks of rising inflation could not be dismissed, and several continued to view slightly higher inflation as a likely if not inevitable prospect. Much would depend, of course, on the strength of the economic expansion and the associated degree of pressure on resources, notably in labor markets which appeared to have comparatively little slack in relation to other producer resources. It was suggested in this regard that restrained increases in labor compensation in comparison with historical experience probably were a transitory phenomenon, though one could not predict when a more normal relationship would re-emerge. A related concern was whether the tightness in labor markets would ease sufficiently and quickly enough to prevent inflation pressures from escalating significantly. Some members mentioned a number of favorable factors in the outlook for inflation that tended to attenuate such concerns, such as reduced pressures on food prices as a result of better-than-expected harvests and improved supply conditions in markets for energy. Relatively restrained monetary growth in recent months also was cited as a development consistent with subdued inflationary pressures. Moreover, the view was advanced that recent developments in bond markets could be read as suggesting some decrease in inflationary expectations. On balance, while the members expressed varying degrees of concern that tight labor markets and attendant increases in wages might at some point lead to rising price inflation, they agreed that there was little or no evidence of such a development at this point and the outlook was far from certain.

In the Committee's discussion of policy for the intermeeting period ahead, all the members indicated that they could support an unchanged policy stance and the retention of a bias toward restraint in the directive. The slowing of the expansion to a sustainable pace near the economy's growth potential and the recent surprisingly favorable inflationary developments suggested lower risks of strengthening price pressures and provided the Committee with a desirable opportunity to pause and observe further developments bearing on the course of economic activity and inflation. Indeed, to the extent that inflation expectations had declined recently, short-term interest rates, which had changed little in nominal terms, had edged higher in real terms, implying slightly greater monetary restraint and reducing the odds that inflation would pick up.

With regard to possible adjustments to policy during the intermeeting period, all the members indicated that they could support a proposal to retain the current bias toward restraint. Several viewed such a bias as desirable because they continued to believe that the risks remained tilted, at least to some extent, toward rising inflation over time. In the circumstances, an asymmetric directive would best reflect their views even if, as seemed likely, intermeeting developments did not prompt a policy tightening adjustment. Other members commented that a shift to a symmetric directive might be viewed as more consistent with the apparently diminished inflationary pressures. They agreed, however, that such a shift would be premature in the currently uncertain environment and might signal, inaccurately, that the Federal Reserve was less concerned about the possibility of a a modest upward trajectory in price inflation.

At the conclusion of the Committee's discussion, all the members indicated that they supported a directive that called for maintaining the existing degree of pressure on reserve positions and retaining a bias toward the possible firming of reserve conditions during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth of M2 and relatively strong expansion in M3 over coming months.

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

The information reviewed at this meeting suggests that growth in economic activity slowed substantially in the third quarter, and the limited available information indicates continued moderate expansion more recently. Private nonfarm payroll employment increased appreciably on balance over September and October. The civilian unemployment rate remained at 5.2 percent in October. Industrial production, which continued to rise in the third quarter, appears to have declined in October owing in important measure to work stoppages in the motor vehicles industry. Total retail sales turned up in September after slumping earlier in the summer. Housing starts fell in September from the exceptionally high level registered in August. Outlays for business equipment were strong in the third quarter and new orders continued to trend upward; business spending on nonresidential structures posted a moderate advance. Inventory investment was substantial in the third quarter, but inventory–sales ratios remained relatively low. The nominal deficit on U.S. trade in goods and services widened considerably in July–August from its average rate in the second quarter. Increases in labor compensation, though moderating in the third quarter, have trended up this year; consumer price inflation also has picked up this year, owing to larger increases in food and energy prices.

Market interest rates have moved lower since the Committee meeting on September 24, 1996, with the largest declines occurring in intermediate- and long-term maturities. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has depreciated slightly over the intermeeting period.

Growth of M2 in September and October remained below its pace in the first half of the year, while expansion of M3 was substantially higher over those two months. For the year through October, M2 is estimated to have grown at a rate in the upper half of the Committee's annual range, and M3 at a rate around the top of its range. Expansion in total domestic nonfinancial debt has been moderate on balance over recent months and has remained in the middle portion of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in January for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1997 the Committee agreed on a tentative basis to set the same ranges as in 1996 for growth of the monetary aggregages and debt, measured from the fourth quarter of 1996 to the fourth quarter of 1997. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and relatively strong expansion in M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Meyer, Mses. Phillips, Rivlin, Mr. Stern, and Ms. Yellen. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, December 17, 1996.

The meeting adjourned at 12:25 p.m.

Donald L. Kohn
Secretary

## Meeting Held on December 17, 1996

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, December 17, 1996, at 9:00 a.m.

*Present:*

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Mr. Meyer
Ms. Phillips
Ms. Rivlin
Mr. Stern
Ms. Yellen
Messrs. Broaddus, Guynn, Moskow, and Parry, Alternate Members of the Federal Open Market Committee

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

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

Messrs. Lang, Lindsey, Mishkin, Promisel, Rolnick, Rosenblum, Siegman, Simpson, Sniderman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

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

Mr. Slifman, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Reinhart, Assistant Director, Division of Monetary Affairs, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors
Mr. Barron, First Vice President, Federal Reserve Bank of Atlanta
Messrs. Beebe, Davis, Eisenbeis, and Goodfriend, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Kansas City, Atlanta, and Richmond respectively
Messrs. Gavin, Kos, and Rosengren, Vice Presidents, Federal Reserve Banks of St. Louis, New York, and Boston respectively
Mr. Evans, Assistant Vice President, Federal Reserve Bank of Chicago

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on November 13, 1996, were approved.

The Manager of the System Open Market Account reported on developments in foreign exchange markets since the meeting on November 13, 1996. There were no transactions in foreign currencies for System account during this period, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period from November 13, 1996, through December 16, 1996. By unanimous vote, the Committee ratified these transactions.

The Committee members discussed certain changes in the procedures for conducting domestic open market operations that the Manager of the System Open Market Account had proposed for implementation at the beginning of 1997. The changes included advancing the normal time for initiating daily operations by one hour to between 10:30 a.m. and 10:45 a.m. Moving to the earlier time would place Desk operations closer to the period during the day when the financing market was most active and thus in a position to accommodate a larger volume of System transactions when necessary. As at present, the Manager might choose to undertake Desk operations at other times during the day when special circumstances dictate. The Manager also indicated that the normal time for domestic operations might be moved to an even earlier hour after expedited procedures were developed for assembling the necessary statistical information on a timely basis for such operations. In the interest of making information about System operations available more promptly to market participants and the broader public, the Desk also would begin at the start of 1997 to announce the par amount of its market transactions shortly after the completion of the operations. With respect to purchases of Treasury coupon securities for System account, the Desk had adopted about one year ago the practice of making such purchases in separate maturity tranches but might at its option in the future spread such purchases over a number of weeks rather than over the course of several days. This more flexible timing would allow the Desk to inject reserves into the banking system through outright operations as the need arose without waiting for that need to accumulate to particularly high levels.

All the members who commented endorsed the changes, with several noting that they were appropriate responses to evolving market circumstances. Because the new procedures did not involve any alterations in the Committee's current directives, authorizations, or rules, a formal vote was not required.

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

The information reviewed at this meeting suggested that economic activity had continued to expand at a moderate pace in recent months. Consumer spending had rebounded from its summer lull, but housing demand was somewhat weaker on balance and the growth of business spending on durable equipment had slowed from a very rapid pace. Although inventory investment had picked up, stocks in most sectors had remained well aligned with sales. Both industrial production and employment had recorded sizable advances. Increases in labor compensation had trended up this year, and consumer price inflation also had picked up, but the faster rise in overall consumer prices owed entirely to larger increases in food and energy prices.

Private-sector demand for labor remained solid in November. Private nonfarm payroll employment increased appreciably further in November after an October surge, and the average workweek of private production or nonsupervisory workers retraced more than half of its October decline. Service industries recorded another large gain in employment despite a sharp drop in payrolls at help-supply firms, and the number of jobs in retail trade expanded further in November after a steep rise in October. In the goods-producing sector, employment in construction and manufacturing rose moderately. The civilian unemployment rate increased slightly, to 5.4 percent, in November.

Industrial production rose sharply in November after a small October decline. A rebound in motor vehicle assemblies from the disruptive effects of work stoppages accounted for much of the increase in production in November, but output from utilities also surged in response to unusually cool weather. The production of nondurable consumer goods and business equipment other than motor vehicles also was up significantly in November, while the manufacture of consumer durables and defense and space equipment decreased further. Reflecting the strong advance in production, the utilization of total industrial capacity picked up considerably in November.

Consumer spending increased appreciably on balance in recent months after a lackluster performance in the summer. Total retail sales fell in November but nonetheless were considerably above their average in the third quarter. The November decline reflected weakness in auto sales; retail spending on other items, notably nonauto durable goods, rose significantly further. Spending on services picked up in October (latest data) following a relatively weak third quarter. Housing starts rebounded in November after having declined in September and October. Single-family starts in November were a little below the average pace of previous months in the year, while multifamily starts surged to a level not seen since late 1990. By contrast, sales of both new and existing homes dropped again in October (latest data).

Growth of business fixed investment appeared to have slowed to a moderate pace in the fourth quarter after a sharp rise in the previous quarter. Shipments of nondefense capital goods fell in October, reversing a sizable September gain; however, recent data on orders pointed to further increases in business spending for equipment, especially for communications equipment where shipments already were at a high level. Business investment in transportation equipment evidently weakened, as sales of heavy trucks remained sluggish and production shortfalls held back fleet sales of light vehicles. By contrast, nonresidential construction continued to expand at a solid rate in October, with building activity particularly strong in the office, other commercial, institutional, and industrial categories.

Business inventory investment picked up sharply in October from the slow September pace, but total stocks remained at a low level in relation to sales. Most of the October increase occurred at the wholesale level; inventories of farm products turned up sharply after months of sizable drawdowns, and petroleum stocks were built up from unseasonably low levels. Despite the October rise, the ratio of wholesale inventories to shipments remained at the lower end of its range over recent years. In manufacturing, stocks increased at a pace in line with shipments, and the aggregate inventory–shipments ratio stayed at a very low level. Retail inventories were up moderately in October. The inventory–sales ratio for the sector was unchanged and remained in the middle of its range over recent years.

The nominal deficit on U.S. trade in goods and services was somewhat larger in September than in August; exports decreased slightly in September while imports were little changed. For the third quarter, the deficit widened substantially from its rate in the second quarter as exports fell and imports rose moderately. Nearly all of the decline in exports reflected lower sales of aircraft and gold. Increases in imports were widespread but they were largely offset by declines in imports of gold and semiconductors. Economic growth picked up in most of the major foreign industrial countries in the third quarter, but available indicators generally suggested some slowing of growth in the fourth quarter. In Japan, by contrast, economic activity had been sluggish in the third quarter but appeared to have picked up more recently.

Consumer price inflation in October and November was lifted slightly by sizable advances in energy prices and, to a lesser degree, increases in food prices; however, consumer prices for items other than food and energy rose modestly during the two months. The rise in core consumer prices over the twelve months ended in November was somewhat smaller than it had been over the previous twelve months, although the total index registered a bigger advance as a result of larger increases in food and energy prices. At the producer level, prices of finished energy goods rose sharply in October and November while prices of finished foods advanced less rapidly. Excluding food and energy, prices of finished goods edged lower on balance over October and November, and in the twelve months ended in November, these prices rose substantially less than in the previous twelve months. Average hourly earnings of production and nonsupervisory workers were up considerably in November after having edged down in October. The twelve-month rise in this index was somewhat larger than the advance over the previous twelve months.

At its meeting on November 13, 1996, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions but that included a bias toward the possible firming of reserve conditions during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and relatively strong expansion of M3 over coming months.

Open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions. However, the federal funds rate tended to average a little above the level expected with an unchanged policy stance in apparent response to scattered operating problems and occasional unexpectedly large clearing needs at banks. Other short-term interest rates registered small mixed changes since the November 13 meeting; Treasury bill rates drifted lower, partly because of heightened demands for safety and liquidity as asset markets became more volatile during the period, while year-end pressures boosted rates on private instruments with maturities in early 1997. At longer maturities, yields drifted lower over most of the intermeeting period in response to incoming data that suggested economic growth would remain moderate and inflation subdued, but they rebounded late in the period in response to the release of firmer economic data and growing concerns regarding the sustainability of current domestic asset prices. Despite these concerns, most major indexes of equity prices advanced further on balance.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose slightly over the intermeeting period. The dollar rose even more against the German mark and the French franc amid increased market apprehension that the European Monetary Union's common currency, the euro, will not be as strong a currency as the mark. The dollar also might have been boosted by statements by French and German officials that suggested the dollar was undervalued against their currencies.

Expansion of the broad monetary aggregates was relatively strong in November. Growth of M2 picked up, reflecting a sharp increase in demand deposits and smaller runoffs in other checkable deposits. Inflows to retail money market funds remained substantial. Expansion of M3 moderated somewhat from its brisk pace in October as growth in business demands for credit slowed and banks reduced their reliance on large time deposits and other managed liability components. For the year through November, M2 was estimated to have grown at a rate in the upper half of the Committee's annual range, and M3 at a rate a little above the top of its range. Total domestic nonfinancial debt expanded moderately on balance over recent months and remained in the middle portion of its range.

The staff forecast prepared for this meeting suggested that the expansion would be sustained at a pace close to the economy's estimated growth potential. Consumer spending was projected to increase at a rate generally in line with the anticipated rise in disposable income; the favorable effects on household wealth of the advance that had occurred in stock prices and the ample availability of credit for most borrowers were expected to balance the damping effects of continuing consumer concerns about the adequacy of their savings, the security of their jobs, and the extent of their debt burdens. Homebuilding was forecast to decline somewhat but to stabilize at a relatively high level in the context of continued income growth and the generally favorable cash–flow affordability of home ownership. Business spending on equipment and structures was projected to expand less rapidly in light of some anticipated slowing in the growth of sales and profits. Fiscal policy and the external sector were expected to continue to exert small restraining influences on economic activity over the projection period. Consumer price inflation, excluding the relatively volatile food and energy components of the price index, was forecast to rise slightly over 1997 and 1998 in the context of anticipated high resource use and an accompanying appreciable pickup in the growth of labor compensation that would be augmented by the legislated rise in the federal minimum wage. Somewhat larger increases would have been projected in consumer price inflation in the absence of anticipated technical measurement changes to the index.

In the Committee's discussion of current and prospective developments, members commented that the information received during the relatively short interval since the previous meeting had not materially altered either their assessment that the economy was performing quite favorably or their forecasts of further growth at a pace averaging near the economy's potential. The economy currently displayed fairly solid underpinnings, with few imbalances of the kind that historically had tended to create problems. Against the background of generally supportive financial conditions and a high degree of consumer and business confidence, further economic growth was thought likely to be sustained by appreciable increases in consumer spending and business investment. The overall pace of the expansion was expected to be restrained to an extent, however, by declining federal government outlays for goods and services and ongoing weakness in net exports.

Despite the prospects for moderate economic growth, members observed that the risks on inflation still seemed to be tilted toward some rise over time. Measures of core inflation had displayed little trend and even some decline over the past year. However, wage increases had moved higher over that period, a development suggesting the possibility that labor markets might be tighter than could be sustained over the long term. At some point accelerating labor compensation costs, were they to continue, likely would spill over into higher inflation. Such an outcome remained subject to a great deal of uncertainty, however, in light of the relatively benign behavior in recent years of both wages and prices in comparison with historical experience at prevailing levels of resource utilization.

In the Committee's discussion of developments in major sectors of the economy bearing on the outlook for business activity, members noted that consumer spending had picked up as expected after a lull during the summer months. Survey data and anecdotal reports suggested that consumer confidence was currently high, and there were widespread indications of robust retail sales during the early weeks of the holiday season, though holiday sales were always difficult to read at this stage. Thus far, however, sales of motor vehicles had not strengthened to the extent that was anticipated after full production was restored following a work stoppage at a major manufacturer. Members cited a number of factors—the rise in consumer debt burdens, tightening consumer credit standards, continued worker concerns about job security, and the satisfaction of earlier pent-up demands—that were tending to inhibit the growth in consumer spending and perhaps helped to explain why the sharp increases in stock market wealth had not been accompanied by stronger growth in such spending. The behavior of the stock market injected an additional note of uncertainty into the forecast for consumer spending and the economy more generally. The rise over recent years had been extraordinary and had brought market valuations to fairly high levels relative to earnings and dividends. In these circumstances, the members recognized the need to monitor with special care price movements in the stock market and asset markets more generally for their implications for consumer and other spending. On balance, favorable employment and income conditions seemed likely to foster a level of consumer spending that would provide key support for sustained economic expansion.

The members anticipated smaller though still sizable gains in business fixed investment over the year ahead. Slowing growth in profit levels and cash flows was likely to retard spending for many types of business equipment, but favorable prices, advancing technology, and readily available financing probably would continue to foster rapid expansion in office, computing, and communications equipment. The outlook for nonresidential construction remained uneven across the country, but such construction seemed likely to edge higher on balance over the next several quarters. Members noted in this regard that the construction of office buildings had strengthened in a number of urban areas. Business inventories currently seemed on the whole to be at desired and sustainable levels in relation to sales. In the circumstances, inventory accumulation was projected to remain moderate and, barring unexpected surges or declines in final sales, was not likely to be a significant factor affecting the course of the economy.

The recent information on residential construction was mixed. Weakness in late summer and early fall evidently reflected the effects of earlier increases in mortgage interest rates, but some measures of housing activity in November indicated unexpected strength. In addition, reports from around the country pointed to uneven conditions ranging from further strength to some emerging weakness in regional housing markets. On balance, the statistical and anecdotal information was interpreted, by some members at least, as consistent with a tendency for housing activity to stabilize. In this view, a level of housing construction somewhat below the peak reached earlier in 1996 was likely to be sustained, buoyed in part by the recent decline in mortgage interest rates and the continuing rise in consumer incomes and favorable consumer sentiment.

A modest degree of fiscal restraint seemed likely over the next two fiscal years. Some members expressed optimism with regard to the prospects for an agreement between the President and the Congress that would provide a basis for reaching a balanced budget by the year 2002. Such an agreement would need to include controversial constraints on the growth of entitlements, but its achievement would have favorable effects on financial markets and on business and consumer sentiment more generally, thereby tending to offset at least in part any direct effects of reduced federal spending on aggregate demand.

Members anticipated that the external sector of the economy would continue to exert some restraint on domestic economic activity, though perhaps to a lesser extent than over the past year. In particular, the growth of U.S. exports was expected to accelerate somewhat in association with some strengthening on average in the economies of the nation's key trading partners. The economic recovery in Mexico from its earlier financial crisis was already providing a considerable boost to exports from some parts of the United States.

Inflation had remained subdued, but the members continued to view the risks as tilted toward increases in the future. Labor compensation costs clearly were rising at a faster pace in the context of persistently tight labor markets, and an upturn in core price inflation seemed quite possible at some point in the absence of some easing of pressures in labor markets. However, the members recognized that the increase in wage inflation had been significantly less than would have been anticipated on the basis of historical relationships with labor market conditions, and price performance also had been more favorable than those relationships would have suggested. In the circumstances, there was a good deal of uncertainty regarding the outlook for inflation, including the potential degree of utilization in labor markets, the associated pressures on labor costs, and the ability of firms to pass higher labor costs into prices in markets that generally continued to be described as highly competitive. With the economy operating in the neighborhood of its sustainable potential, relatively minor differences in overall economic growth could have a significant effect over time on whether inflation would tend to trend up or down.

In the Committee's discussion of policy for the intermeeting period ahead, all the members supported a proposal to maintain an unchanged policy stance while also retaining a bias toward restraint in the directive. An unchanged policy was warranted by the quite satisfactory performance of the economy and inflation and the uncertainties surrounding the outlook. Thus, while the longer-term risks might point toward rising inflation, there were reasonable prospects that inflation would remain contained, and any pickup in inflation, should it occur, was likely to be limited at least for a time. In the circumstances, the members concluded that watchful waiting remained the prudent course for policy as they continued to assess ongoing developments. Because the risks of waiting did not appear to be substantial at this juncture, anticipatory tightening was not yet called for.

In the Committee's discussion of possible adjustments to policy during the intermeeting period, members agreed that the retention of an asymmetric directive toward tightening was consistent with their view that the risks remained biased toward higher inflation. Accordingly, while they were not suggesting that policy should be especially quick to react to incoming information over the intermeeting period, they did view the next policy move as more likely to be in the direction of some firming than toward easing. In this connection, some members emphasized that it would be especially important for the Committee to act promptly to counter any tendency for price inflation to rise and for higher inflation expectations to become embedded in financial markets and economic decisionmaking more generally.

At the conclusion of the Committee's discussion, all the members indicated that they supported a directive that called for maintaining the existing degree of pressure on reserve positions and that retained a bias toward the possible firming of reserve conditions during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with relatively strong expansion in M2 and M3 over coming months.

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

The information reviewed at this meeting suggests that economic activity has continued to expand at a moderate pace. Private nonfarm payroll employment increased appreciably further in November, although the civilian unemployment rate edged up to 5.4 percent. Industrial production rose sharply in November, in part because of a rebound in motor vehicle assemblies that had been depressed earlier by work stoppages. Consumer spending has posted appreciable gains over recent months after a summer lull. Housing starts rebounded in November after declining in September and October. Business fixed investment appears to be growing moderately after a sharp rise in the third quarter. The nominal deficit on U.S. trade in goods and services widened substantially in the third quarter from its rate in the second quarter. Increases in labor compensation have trended up this year, and consumer price inflation also has picked up owing to larger increases in food and energy prices.

Short-term market interest rates have registered mixed changes since the Committee meeting on November 13, 1996, while long-term yields have risen slightly. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has risen slightly over the intermeeting period.

Growth of M2 picked up in November, while expansion of M3 moderated somewhat from its brisk pace in October. For the year through November, M2 is estimated to have grown at a rate in the upper half of the Committee's annual range, and M3 at a rate a little above the top of its range. Total domestic nonfinancial debt has expanded moderately on balance over recent months and has remained in the middle portion of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in January for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1997, the Committee agreed on a tentative basis to set the same ranges as in 1996 for growth of the monetary aggregates and debt, measured from the fourth quarter of 1996 to the fourth quarter of 1997. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with relatively strong expansion in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Meyer, Mses. Phillips, Rivlin, Mr. Stern, and Ms. Yellen. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, February 4–5, 1997.

The meeting adjourned at 12:40 p.m.

Donald L. Kohn
Secretary

# Consumer and Community Affairs

In 1996 the Board moved to administer major changes under revised interagency regulations to carry out the Community Reinvestment Act (CRA). On January 1, small banks became subject to examination under the new rules; large banks began data collection and in some instances began developing strategic plans as the measure of their CRA performance. The new rules, issued in 1995, emphasize performance in lending, service, and investment and will help promote consistency in assessments and reduce compliance burdens for many banks.

The Board acted on a large number of bank and bank holding company applications that involved CRA protests, adverse CRA ratings, and issues of fair lending and noncompliance with consumer regulations. Several applications involved major bank mergers that elicited strong support and opposition from members of the public, and all were protested on CRA grounds. The Board approved them after extensive analyses, finding in each case that convenience and needs factors were consistent with approval.

In the fair lending area, the Board referred discrimination cases regarding state member banks to the Department of Justice and also forwarded the results of a major investigation into a mortgage lender's overage-pricing practices. The Board referred other cases, which raised claims of alleged mortgage discrimination, to the Department of Housing and Urban Development (HUD) for investigation. The Board continued to improve the System's examination process for fair lending, using enhanced statistical techniques to test large institutions for compliance.

Acting on behalf of the Federal Financial Institutions Examination Council and HUD, the Board met statutory deadlines with the early release of Home Mortgage Disclosure Act statements for individual lenders and aggregate reports for metropolitan areas. From the data, the Board noted a marked increase in lending to minority and low-income homebuyers, although denial rates continued to show disparities among racial and ethnic groups.

Subsequent to multiyear reviews of Regulation M (Consumer Leasing) and Regulation E (Electronic Fund Transfers), the Board completed rulemakings that better match its consumer regulations to industry developments. In other rulewriting, the Board published two proposals, one governing "self tests" that lenders may conduct under Regulation B (Equal Credit Opportunity) to determine their compliance with fair lending laws and another raising the threshold for the coverage of small institutions under Regulation C (Home Mortgage Disclosures) based on asset size; the two proposals implement amendments to the Equal Credit Opportunity Act and Home Mortgage Disclosure Act respectively.

These matters are discussed below, along with other actions by the Board in the areas of community affairs and consumer protection.

## CRA Reform

During 1996 the Board began its implementation of a revised regulation under the Community Reinvestment Act, working closely with the three other financial supervisory agencies that have CRA responsibilities (the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision). The revised regulation provides more direct guidance to banks and thrift institutions on the nature and extent of their CRA responsibilities and the means by which those obligations will be assessed and enforced. It creates a more quantitative system for assessing CRA performance that includes reviewing data on the institution's lending, service, and investment activities; requires larger institutions to collect additional data for loans to small businesses and small farms; and allows alternative bases of evaluation for certain institutions to minimize the regulatory burden.

During 1996 the agencies began using new examination procedures designed to make the examinations for small institutions less intrusive and more focused on performance. In addition, a small number of banks elected to be examined under the revised regulation's lending, investment, and service tests.

The Board approved a strategic plan submitted by a state member bank for defining its program for addressing CRA responsibilities, as provided by the regulation. Further, three banks were granted designation as wholesale institutions under the revised regulation and two were designated as limited-purpose institutions.

Some measures taken by the Federal Reserve will assist in implementing the new CRA rules. A software program was developed that assists examiners in choosing a statistically reliable sample of loans for review; another program prepares summaries of demographic and economic information for use in CRA examinations. In addition the Board, in conjunction with the other federal supervisory agencies, issued a document that addresses many of the questions more frequently encountered under the new regulation. The agencies anticipate adding to this document over time as new questions arise and are addressed.

## Fair Lending

Under the Equal Credit Opportunity Act (ECOA), the Board is required to refer to the Department of Justice violations that it has reason to believe constitute a "pattern or practice" of discrimination. The Board made five referrals during 1996, three related to race discrimination and the others to marital status violations. Two of the cases involving alleged race discrimination were under active investigation by the Department of Justice at the close of 1996. After review, the three remaining matters were returned for enforcement by the Board.

Also in 1996, the Department of Justice reached a court-approved settlement agreement with a lender on a matter referred by the Board in late 1995. The Board had forwarded information from a major investigation of loan pricing involving "overages" that were allegedly discriminatory. In the settlement, which was based on evidence developed by the Board and a Reserve Bank, the lender agreed to steps that included paying $3.8 million to minority customers identified by the Department of Justice as having been overcharged on a discriminatory basis.

The ECOA also requires the referral of certain types of violations of the act, other than "pattern and practice," to HUD. The three cases of that type referred during 1996 involved alleged discrimination on the basis of race, national origin, and gender. At year-end, all three were pending final resolution by HUD.

The Board continued the refinement of its specialized fair lending school during 1996. The two-week school comprises an extensive range of both conceptual and practical topics. Subjects include a historical perspective on the development of fair lending law; current legal theories of lender liability; and an introduction to fair lending examination techniques, including off-site preparation, detection techniques for various loan products, and methodologies for analyzing examination findings. Class work includes lectures, analysis of case histories, and role-playing. During 1996, eighty students attended the fair lending school and received more than seventy hours of training. An extensive revision of this school, begun late in 1996 on the basis of proposals from instructors and students to make it more interactive, is due for completion in 1997.

In evaluating compliance with fair lending laws, bank examiners assess decisions in relation to the underwriting standards of the lending institution. They sample approved and denied applications and check whether the institution, in applying its lending criteria, has implemented standards consistently and fairly and whether any differential treatment warrants further investigation. Examiners also review underwriting standards used by the institution in order to identify standards that may raise concerns in the context of fair lending enforcement.

To facilitate fair lending reviews, examiners often use data collected and reported under the Home Mortgage Disclosure Act (HMDA). The HMDA data do not include the wide range of financial and property-related factors that lenders consider in evaluating loan applications, and therefore these data alone cannot determine the presence or absence of discrimination. Nonetheless, access to loan application files and related information enables examiners to augment the data in making determinations regarding unlawful discrimination.

In addition, since 1994 the Federal Reserve has used a two-stage statistical analysis system to aid in the fair-lending examination of large-volume mortgage lenders. In the first stage of the analysis, examiners use HMDA data recorded by the institution on its loan-application register to help determine whether race appears to be a significant factor in a bank's lending decisions. The Board substantially enhanced the first-stage system during 1996. Instead of basing the initial assessment of racial disparities on a random sample of white and minority applications, the first-stage program now uses a sample of white and minority applicants that have been matched on the basis of characteristics (such as income, loan amount, and property location) that are available from the HMDA data.

When the first-stage analysis indicates a statistically significant difference in the results for white applicants compared with those for minority applicants, examiners will generally proceed to the second stage of the analysis. In the second stage, examiners draw extensive additional information from the bank's loan application files. The augmented information allows for a more sophisticated matched-pair statistical analysis that identifies specific loan files for examiners to review and discuss with management during their on-site fair lending evaluation.

## HMDA Data and Lending Patterns

The Home Mortgage Disclosure Act requires covered mortgage lenders in metropolitan areas to disclose data regarding mortgages for home purchase, home improvement, and home refinancing. In 1996, depository institutions and mortgage companies generally were covered if they were located in metropolitan areas and had assets of more than $10 million. Independent mortgage companies were covered, regardless of their asset size, if they originated 100 or more home purchase loans in the preceding calendar year. In 1996, 9,539 lenders, consisting of 868 independent mortgage companies and 8,671 other mortgage lenders, reported data for calendar year 1995.[1]

Under HMDA, covered lenders submit geographic information about the property related to a loan transaction, the disposition of loan applications, and, in most cases, the race or national origin, income, and sex of applicants and borrowers. The Board processes the data and prepares disclosure statements on behalf of HUD and member agencies of the Federal Financial Institutions Examination Council (FFIEC).[2]

In 1996 the Board prepared roughly 36,600 disclosure statements. The 1995 data contained 11.2 million reported loans and applications, an 8 percent decrease from 1994 that is largely attributable to a decline in refinancing activity.[3] In July, individual institutions made these disclosure statements public, and in August, aggregate reports that contain data for all lenders in a given metropolitan statistical area (MSA) became available in printed form at a central depository in each of the nation's 330 MSAs. The FFIEC also makes the information available on microfiche, magnetic tape (reel and cartridge), PC diskette, and CD-ROM.

Lending institutions tend to specialize in different types of home loans. In 1995, depository institutions continued to be the predominant source of home improvement and multifamily loans. Mortgage companies accounted for about 52 percent of the conventional home purchase loans reported and about 80 percent of the government-backed home purchase loans.

Mortgage originators and institutions in the secondary market for mortgages, such as Fannie Mae (the Federal National Mortgage Association) and Freddie Mac (the Federal Home Loan Mortgage Corporation) offer a variety of home loan programs to benefit lower-income and minority households and neighborhoods. These programs may account for a continued increase in loans to these homebuyers. From 1993 to 1995 the number of conventional home purchase loans extended to lower-income borrowers increased 21 percent, compared with a 10 percent increase for higher-income homebuyers over the same period.

Lending to minority homebuyers has also increased markedly. From 1993 to 1995 the number of loans to black applicants increased 70 percent, to Hispanic applicants 48 percent, and to Asian applicants 24 percent. The increase for white applicants was 12 percent over the same period.

The 1995 data continue to show rates of credit denial that are higher for black and Hispanic loan applicants than for

1. In September 1996 the Congress amended HMDA to raise the asset threshold for depository institutions according to changes in the consumer price index for urban wage and clerical workers since 1975. Beginning in January 1997, a depository institution will be subject to HMDA if its assets were greater than $28 million at year-end 1996. The asset-size measure that determines the coverage for independent mortgage companies is unchanged.

2. The member agencies are the Board, the FDIC, the National Credit Union Administration, the OCC, and the OTS.

3. A summary of the 1995 HMDA data appears in a series of special tables included in the *Federal Reserve Bulletin,* vol. 8 (September 1996), pp. A68–A75.

Asian and white applicants even within the same income brackets. In 1995 the denial rates for conventional home purchase loans overall were 41 percent for black applicants, 30 percent for Hispanic applicants, 13 percent for Asian applicants, and 21 percent for white applicants. These rates were all somewhat higher than in 1994. For neighborhoods, the data also show that the rate of loan denial generally increased with an increase in the proportion of minority residents.

The data collected under HMDA do not include the wide range of financial and property-related factors that lenders consider in evaluating loan applicants. Consequently, the data alone do not provide an adequate basis for determining whether a lender is discriminating unlawfully. But because the data can be supplemented by other information available to the agencies, they are an important tool for enforcement of fair lending laws.

The important uses of the HMDA data make their accuracy critically important. The FFIEC's processing software is programmed to identify errors in the data submitted by lenders for correction before disclosure statements and reports for specific MSAs are prepared. Since lenders first began submitting their HMDA data in case-by-case (single-record) form rather than aggregated by census tract, the quality has improved considerably. The proportion of 1995 loan records containing detected errors was less than 0.5 percent, down from about 4.4 percent in 1991 (the first year in which data were reported on a case-by-case basis).

## Other Uses of HMDA Data

Since 1990 the HMDA data reported by lenders have included information about the race, sex, and income of borrowers and loan applicants. For loans sold, lenders also identify purchasers by type of entity. These expanded data provide opportunities to assess the relative performance of mortgage lending institutions in serving the credit needs of lower-income and minority homebuyers.[4]

In its oversight of housing activities by government-sponsored entities, HUD uses the expanded HMDA data to help assess the efforts of Fannie Mae and Freddie Mac in attaining goals for supporting mortgages for low- and moderate-income families and for properties in targeted communities. HUD also makes extensive use of the HMDA data as one component of its fair lending reviews. The data assist in the handling of loan applicants' and borrowers' allegations of lending discrimination filed with HUD, the Department of Justice, or state and local agencies; the data also assist in the agencies' targeting of lenders for investigation.

## Private Mortgage Insurance

The FFIEC also compiles HMDA-like data pertaining to applications for private mortgage insurance (PMI) on behalf of the nation's eight active PMI companies. PMI typically is required by lenders when they extend conventional mortgages with small down payments.

Working through their national trade association, the Mortgage Insurance Companies of America, the PMI companies voluntarily submit their data to the FFIEC, which prepares company-

4. See, for example, the discussion of which institutions bear the credit risk of mortgages extended to lower-income and minority homebuyers in Glenn B. Canner, Wayne Passmore, and Brian J. Surette, "Distribution of Credit Risk Among Providers of Mortgages to Lower-Income and Minority Homebuyers," *Federal Reserve Bulletin*, vol. 82 (December 1996), pp. 1077–1102.

specific disclosure statements for each of the firms and aggregate reports for each metropolitan area. These reports are available for public review at the central depositories where HMDA data are available. Like the HMDA data, this information is also available from the FFIEC in other formats, including data tape, CD-ROM, and PC diskette.[5]

## Community Development

The Federal Reserve System's Community Affairs programs identify community development and reinvestment needs along with fair lending issues; and they develop educational, informational, and technical assistance programs to facilitate constructive responses by banks and their communities. During 1996 the System's Community Affairs programs continued to expand and enhance products and services to help banks and community representatives assess needs and implement fair lending, community development, and reinvestment programs.

Six Reserve Banks engaged in major efforts to help identify and address barriers to equal access to credit for homebuyers. The Boston, New York, Cleveland, Chicago, St. Louis, and San Francisco Banks each identified key participants in the homebuying process in their Districts and brought them together with community representatives to discuss problems affecting minority and lower-income homebuyers and forge collaborative solutions. These community-targeted programs are based on an effort pioneered by the Cleveland Reserve Bank in its home city. The program generally includes the formation of task groups that focus on key aspects of the lending process and then develop findings and action plans.

During 1996 the Community Affairs programs sponsored or cosponsored more than 200 conferences, seminars and informational meetings on community development, reinvestment, and fair lending topics. The programs were attended by about 10,800 bankers, examiners, and representatives of small businesses and community and consumer groups. In addition, staff members of the Community Affairs programs at the Board and the Reserve Banks made more than 260 presentations at conferences, seminars, and meetings sponsored by banking, governmental, business, and community organizations.

The Reserve Banks' Community Affairs programs helped design and conduct a wide variety of conferences and training programs for bankers and community representatives that focused on the revised regulations implementing the Community Reinvestment Act. They also participated in Federal Reserve and interagency training for examiners who conduct CRA assessments of financial institutions.

The Reserve Banks of Boston, Philadelphia, Richmond, Atlanta, Chicago, Dallas, Kansas City, Minneapolis, and San Francisco held a variety of conferences and workshops on aspects of community development finance.

Several Reserve Banks developed programs focused on the development of small and minority businesses. The Boston Reserve Bank sponsored a conference for Maine bankers, nonprofit lenders, and public officials regarding microenterprise lending and other resources available to help the financing of Maine's small and start-up businesses. In addition the Boston Bank worked with Maine bankers to help develop the new Maine Community Reinvestment Corporation, a statewide

5. For an analysis of the 1995 private mortgage insurance data, see appendix A of Canner, Passmore, and Surette, "Distribution of Credit Risk."

multibank lending consortium for affordable housing; and the Dallas Reserve Bank sponsored several seminars for small-business owners. The San Francisco Reserve Bank held a conference to foster closer working relationships among bankers, small businesses, and organizations providing technical assistance to small firms.

A conference at the Kansas City Reserve Bank targeted public policy issues affecting rural capital markets, and the New York Reserve Bank convened a conference on delivering capital resources for economic development in non-urban areas. The San Francisco Reserve Bank sponsored a conference on electronic banking that focused on how technological changes affect the relationship between consumers and their financial institutions.

In response to a rising number of requests for assistance and information on community development investments by financial institutions, the Community Affairs programs developed or expanded a variety of publications and other informational resources. The Board significantly expanded its annual compendium entitled *Directory: Community Development Investments,* by adding discussions of investments by state member banks to those about investments made by bank holding companies. The directory now covers more than 150 existing community development corporations and investments. The Board's Community Affairs program also assisted other divisions at the Board in addressing community development policy issues.

Other informational products distributed by the System's Community Affairs programs covered a broad array of topics. The Dallas Reserve Bank published *Texas Colonias: A Thumbnail Sketch of the Conditions, Issues, Challenges and Opportunities.* The report, which received national recognition, describes conditions in, and possibilities for assistance to, low-income, unincorporated subdivisions that have sprung up along the Texas–Mexico border. To assist bankers and others, the Dallas Reserve Bank also developed and published *Banking on Partnerships: A Digest of Community-Based Organizations in Houston,* which profiles the structure and activities of community development organizations in the Houston area.

The Minneapolis Reserve Bank produced and distributed a new educational video, *Lending in Indian Country,* which focuses on the challenges and unique opportunities in financing business and real estate development on reservations. The Minneapolis Reserve Bank also played a leadership role in an effort to bring together tribal and business leaders to explore economic development initiatives for the economically distressed Pine Ridge Reservation, in South Dakota.

The Federal Reserve Bank of Kansas City developed and published *Doing the Undoable Deals: A Resource Guide to Financing Housing and Economic Development.* The guide describes a variety of financial and management assistance programs available to community development projects.

All twelve Federal Reserve Banks continued to expand and enhance their Community Affairs newsletters. These publications typically feature information on community development lending and investment programs and related CRA, HMDA, and fair lending policies and issues. During 1996, Reserve Bank Community Affairs newsletters reached more than 74,000 representatives of financial institutions, community organizations, local government agencies, and others interested in bank involvement in community development and reinvestment efforts.

During 1996 the Banks' Community Affairs staffs held more than 1,400 meetings with bankers, government officials, and business and community representatives to discuss community development, community reinvestment, and related programs being undertaken by bankers and their communities. The Richmond Reserve Bank issued community profiles highlighting community needs and development organizations and resources in the areas of Richmond; Columbia, South Carolina; and Hagerstown, Maryland. The Philadelphia Reserve Bank published a profile on Williamsport, Pennsylvania. And the St. Louis Reserve Bank issued metropolitan-area profiles for Owensboro, Kentucky; Fayetteville-Springdale-Rogers, Arkansas; and Springfield, Missouri.

To supplement its outreach activities, the Boston Reserve Bank formed a Community Development Advisory Council, composed of lenders and representatives of public and nonprofit agencies who are knowledgeable about housing and economic development issues. The council will meet three times each year with the Reserve Bank President and staff members of the Community Affairs program to discuss regional community development and reinvestment issues. The Atlanta Reserve Bank developed an extensive database of community contacts; and all of the federal banking regulators are considering adoption of its database structure.

Another significant part of Board and Reserve Bank Community Affairs activities is assisting the Federal Reserve's bank supervisory units regarding CRA and fair lending. The Board's Community Affairs program helped conduct consumer compliance and fair lending schools, participated in interagency efforts to adapt policies for the implementation of revised CRA rules, and provided other briefings and educational training programs for examiners. The Community Affairs programs at the Atlanta, Richmond, and Kansas City Reserve Banks helped develop and implement an interagency training program on community development for examiners located in the Southeast.

In 1996 the capacity and efficiency of the computerized Community Lending Analysis System (CLAS) was increased in response to examiner feedback. The system gives examiners detailed economic and demographic information on a bank's community and helps increase consistency in the development of CRA assessments and ratings. In addition, the federal banking agencies coordinated with each other in reviewing examiner experience with CLAS and developed a consensus on which data elements and report formats were most useful to examiners.

## Other Regulatory Matters

In December, the Board solicited comment regarding issues that the Board will address in a study concerning the public availability and use of sensitive identifying information about consumers. The study is required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996, which sets a March 1997 deadline for reporting to the Congress. Other regulatory actions taken during the year, some of them also required by the 1996 act, are discussed below.

### Regulation B (Equal Credit Opportunity)

In December the Board published proposed revisions to Regulation B to carry out amendments to the Equal Credit Opportunity Act. These amendments create a legal privilege for information developed by creditors as a result of ''self tests'' that they voluntarily conduct to determine their level of compliance with the ECOA. (In January 1977 the Department of Housing and Urban Development published a substantially similar proposal to revise the regulations carrying out the Fair Housing Act.)

In December the Board withdrew a proposed amendment to Regulation B that would have eliminated a general prohibition on collecting data relating to an applicant's sex, race, color, religion, or national origin. The proposed amendment would have allowed creditors to collect these data for any credit product. The Board determined that the issue of data collection is more appropriate for the Congress to consider.

## Regulation C (Home Mortgage Disclosure)

In December the Board published proposed revisions to Regulation C to carry out amendments to the Home Mortgage Disclosure Act. Those amendments require an increase in the exemption threshold for depository institutions, from $10 million to $28 million, based on the increase in the consumer price index for urban wage and clerical workers from 1975 to year-end 1996. Under the statutory amendments, the Board will make future changes to the asset threshold annually as appropriate. The amendments also modify the requirements applicable to disclosures for metropolitan areas in which an institution has branch offices.

## Regulation E (Electronic Fund Transfers)

In April the Board published revisions to Regulation E and the associated staff commentary following a review under the Board's Regulatory Planning and Review program. The final rule contains substantive amendments, including changes to the existing exemptions for securities or commodities transfers. Primarily, however, the revisions simplify the language and format of the regulation and commentary and delete obsolete provisions.

The review of Regulation E served to identify other issues that might warrant regulatory changes. In April the Board published proposed amendments to Regulation E to govern stored-value cards. The proposal also addresses general provisions of the regulation, providing longer error-resolution deadlines for new accounts and allowing electronic disclosures to consumers in place of printed notices.

## Regulation M (Consumer Leasing)

In September the Board published a revised Regulation M following a multiyear review under the Board's Regulatory Planning and Review program. Regulation M requires lessors to give consumers uniform disclosures of cost and other lease elements before the lease becomes legally binding. In its review the Board sought to identify ways that it could simplify the regulation to fulfill the Congress's intentions more effectively. The final rule modernized the regulation to address changes that have taken place in consumer leasing since 1976, the year the Congress passed the Consumer Leasing Act,

The final rule adds disclosures, primarily in connection with motor vehicle leasing. The Board determined that these revisions were especially necessary given that about one-third of all passenger cars now delivered to consumers are leased instead of purchased and financed. The disclosures concern charges a consumer might face for early termination, for example, and how scheduled payments are derived. The Board also specified certain aspects of the format of the disclosures. The Board revised the advertising provisions to carry out a statutory amendment, allowing toll-free numbers to substitute for certain disclosures in radio and television advertisements. The Board also provided that any disclosure or advertisement of a lease rate must inform the consumer that the rate may not measure the overall costs of the lease financing. This limitation is meant to preclude inappropriate and erroneous comparisons of lease costs based on rate information offered to consumers by different lessors.

In December the Board published proposed revisions to Regulation M, primarily to implement amendments to the Consumer Leasing Act, which had been enacted in September. The proposed revisions streamline the advertising disclosures and make several technical amendments.

## Regulation Z (Truth in Lending)

In January the Board requested comment on whether, under the Truth in Lending Act (TILA), cost disclosures and other rules for open-end home-secured lines provide adequate consumer protection. In November the Board reported to the Congress, as required by the Riegle Community Development and Regulatory Improvement Act of 1994. The report describes the regulatory framework for open-end home equity lines of credit compared with that for closed-end credit and discusses information drawn from consumer surveys. The report presents the Board's analysis of issues and its findings that the current requirements provide adequate consumer protection.

The Board is required to adjust annually the dollar amount that triggers additional disclosure requirements under TILA for mortgage loans that bear fees above a certain amount. The Home Ownership and Equity Protection Act of 1994 imposes restrictions and special disclosure requirements when total points and fees payable by the consumer exceed the greater of $400 or 8 percent of the total loan amount. Under the act, the Board must adjust the dollar amount each year according to the percentage change in the consumer price index. In January the Board adjusted the dollar amount to $412 for 1996; in December it adjusted the dollar amount to $424 for 1997.

In April the Board issued a report to the Congress, required by the Truth in Lending Act Amendments of 1995, that discussed the feasibility of treating as finance charges all costs required by the creditor or paid by the consumer as an incident of credit; the report also addressed abusive refinancing practices. The Board determined that, although changing the definition of finance charge may be desirable, changes affecting disclosure of the finance charge and the annual percentage rate would be significant for both creditors and consumers. The Board concluded that changes, if any, should be preceded by further deliberation and participation from the public. The Board will consider regulatory revisions consistent with the report in an upcoming review of Regulation Z.

In May the Board published proposed revisions to Regulation Z to carry out the statutory amendments enacted in 1995 that establish new creditor-liability rules for closed-end loans secured by real property or dwellings. The TILA amendments created new tolerances for accuracy in disclosing the amount of the finance charge. The amendments also clarify how lenders must disclose certain fees connected with mortgage loans. In addition the Board proposed a new rule regarding the treatment of fees charged in connection with debt cancellation agreements. In September the Board published a final rule adopting the revisions.

In December the Board and HUD issued a joint advance notice of proposed rulemaking to revise disclosures that consumers receive under the Real Estate Settlement Procedures Act (RESPA) and TILA. Amendments to RESPA and TILA require the agencies to simplify and improve the disclosures where possible and to provide a single format for compliance with both RESPA and TILA. The notice solicited public comment on the specific regulatory and legislative changes that might achieve these goals.

### Interpretations

In March the Board revised the official staff commentary to Regulation Z (Truth in Lending). The update gives guidance on issues relating to reverse mortgages and to home-secured loans bearing rates above a certain percentage or fees above a certain amount. The revisions also address issues of general interest, such as a card issuer's responsibilities when a cardholder asserts a claim or defense relating to a dispute with a merchant.

In November the Board published proposed changes to the staff commentary to Regulation Z. The proposed revisions provide guidance on the treatment of some fees paid for mortgage loans, of tolerances for accuracy in disclosing the finance charge and other costs, and of debt cancellation agreements.

In May the Board withdrew a proposed amendment to the official staff commentary to Regulation DD (Truth in Savings) because of its narrow scope and regulatory burden. The proposal addressed technical matters such as the effect of a leap year on the calculation of interest, on the annual percentage yield, and on the annual percentage yield earned.

In September the Board revised the official staff commentary to Regulation B (Equal Credit Opportunity). The update gives guidance on issues such as credit scoring and the regulation's spousal signature rules.

## Economic Effects of the Electronic Fund Transfer Act

In keeping with statutory requirements, the Board monitors the effect of the Electronic Fund Transfer Act on the compliance costs and consumer benefits related to electronic fund transfer (EFT) services.

The revisions to Regulation E made in 1996 and discussed above reduce somewhat the ongoing burden of compliance with the regulation without materially affecting consumer benefits. The revisions to Regulation E were limited because the original regulation already followed closely the detailed requirements of the law.

In 1996 the Congress amended the Electronic Fund Transfer Act to exempt needs-tested programs that are established or administered by state or local governments for the electronic transfer of benefits. (The Board expected to propose an implementing amendment to Regulation E in January 1997.) The exemption eliminates uncertainty about potential fraud arising from the EFTA's liability rules and will reduce the cost to state and local governments of providing benefits electronically. Under the exemption, benefit recipients may have somewhat diminished protections, especially for unauthorized use. Electronic delivery will, however, likely provide benefit recipients greater overall security than the paper-based systems that are now in use.

Some economic effects of the Electronic Fund Transfer Act, both consumer benefits and compliance burden, can be traced to continued growth in the use of EFT services. During the 1990s the proportion of U.S. households using EFT services has increased at an annual rate of about 2 percent. Surveys indicate that about 85 percent of households now have one or more EFT features on their deposit accounts.

Automated teller machines are the most widely used EFT service. Nearly two-thirds of all households currently have ATM cards, and most of the nation's depository institutions offer consumers access to ATMs. Over time, almost all ATM terminals have become connected to one or more shared networks, which enhances their accessibility to consumers. The monthly average number of ATM transactions increased about 10 percent, from 807.4 million in 1995 to 890.3 million in 1996. During the same period, the number of installed ATMs rose 13 percent, to 139,134.

Direct deposit is another widely used EFT service. More than one-half of all U.S. households receive funds in their accounts via direct deposit by the payer. Direct deposit is particularly widespread in the public sector, covering more than one-half of social security payments and two-thirds of federal salary and retirement payments. Although less common in the private sector, direct deposit has grown substantially in recent years. The proportion of households receiving either public-sector or private-sector direct deposits has grown about 5 percent per year during the 1990s.

Nearly one-third of households now have debit cards, which can be used at the point of sale to debit a consumers' transaction account. Point-of-sale (POS) systems still account for only a small share of electronic transactions, but rapid growth continued in 1996: the number of POS transactions rose nearly one-half, to about 96 million per month; and the number of POS terminals rose about two-thirds, to around 875,000.

The incremental costs associated with the EFT act are difficult to quantify because no one knows how industry practices would have evolved in the absence of statutory requirements. The benefits of the law are also difficult to measure because they cannot be isolated from consumer protections that would have been provided in the absence of regulation. The available evidence provides no indication of serious consumer problems with electronic transactions at this time.

The Board's database of consumer complaints and inquiries is one source of information on potential problems. In 1996, eighty of the complaints that were received related to electronic transactions. The Board forwarded forty-five complaints that did not involve state member banks to other agencies for resolution. Of the remaining thirty-five complaints, three involved a possible violation of the act or regulation. Examination data show that in 1996 about 94 percent of depository institutions examined by federal agencies were in full compliance with Regulation E. Violations primarily involved failure to provide all required disclosures to consumers.

## Compliance Examinations

Since 1977 the Federal Reserve System has maintained a specialized program for examining the compliance of state member banks and of certain foreign banking organizations with federal laws governing consumer protections in financial services. During the 1996 reporting period (from July 1, 1995, to June 30, 1996), the Federal Reserve examined 607 state member banks and 306 foreign banking organizations for such compliance.[6]

The Oversight Section of the Board's Division of Consumer and Community Affairs coordinates compliance examinations, which are conducted by the consumer affairs units of the twelve Federal Reserve Banks. The Oversight Section reviews a sample of the examinations for effectiveness, adherence to System policy, uniformity of approach, and the like.

New examiners from the Federal Reserve Banks attend the System's three-week basic consumer compliance school; examiners with eighteen to twenty-four months of field experience attend a week-long advanced compliance school, a two-week fair lending school, and a class in CRA examination techniques.[7]

In the 1996 reporting period, the Federal Reserve System conducted three basic consumer compliance schools for a total of seventy-five students; five advanced consumer compliance schools for seventy-three students; and two fair lending schools for sixty-two students.

The Reserve Banks supplement examiner training through departmental meetings and special training sessions. In addition the Board's resident examiner program gives the Reserve Bank examiners added perspective through several weeks' work at the Board, during which they can observe such matters as how policies are developed and how the Board coordinates its activities with those of other agencies that supervise financial institutions.

The FFIEC is the interagency coordinating body charged with developing uniform examination principles, standards, and report forms. In 1996 the member agencies of the FFIEC collaborated to revise examination procedures to reflect changes in consumer laws and regulations. They adopted changes to examination procedures covering amendments to the Flood Disaster Protection Act and to the Home Mortgage Disclosure Act.

## Agency Reports on Compliance with Consumer Regulations

Data from the Board, other member agencies of the FFIEC, and other federal supervisory agencies cover the compliance of institutions with the regulations that implement the Equal Credit Opportunity Act, the Electronic Fund Transfer Act, the Consumer Leasing Act, the Truth in Lending Act, the Community Reinvestment Act, and the Expedited Funds Availability Act; and compliance with the prohibition in Regulation AA against unfair and deceptive practices.[8] The degree of compliance with these laws and regulations varied widely in

6. The Federal Reserve examines state-chartered agencies and state-chartered uninsured branches of foreign banks, which are commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25(a) of the Federal Reserve Act (Edge Act corporations and agreement corporations). Typically, in comparison with state member banks, these institutions conduct relatively few activities that are covered by consumer protection laws.

7. In 1996, Federal Reserve examiners attended interagency training for the revised CRA in place of the advanced CRA class. In addition, CRA instruction was included in the advanced consumer compliance school while the CRA school was being revised to reflect the requirements of the CRA regulations published by the agencies in May 1995.

8. The federal agencies that supervise financial institutions do not use the same method to compile compliance data. Consequently, the data in this report, which are presented in terms of percentages of all financial institutions, represent general conclusions.

1996 but, overall, showed improvement over 1995. The following section summarizes compliance data for the period from July 1, 1995, to June 30, 1996.

## Equal Credit Opportunity Act (Regulation B)

The five financial regulatory agencies reported a level of full compliance with Regulation B by institutions examined in 1996, 78 percent, that was significantly higher than the 1995 level of 62 percent. The agencies reported that 77 percent of the institutions examined that were not in full compliance with the regulation had between one and five violations (the lowest frequency category), compared with 74 percent in 1995. The most frequent violations involved the failure to take the following actions:

- Provide a written notice of adverse action that contains a statement of action taken, the name and address of the creditor, an ECOA notice, and the name and address of the federal agency that enforces compliance
- Collect information, for monitoring purposes, about the race or national origin, sex, marital status, and age of credit applicants (on applications for the purchase or refinancing of a principal residence)
- Notify the applicant of the action taken within the periods specified in the regulation
- Give a statement of reasons for adverse action that is specific and indicates the principal reasons for the credit denial or other adverse action
- Take a written application for credit for the purchase or refinancing of a principal residence.

The Board issued one cease-and-desist order addressing violations of Regulation B. The OTS issued four formal enforcement actions that addressed violations of Regulation B as well as of other consumer compliance regulations. The FDIC issued five formal enforcement actions involving consumer compliance regulations, without distinguishing which of those actions involved Regulation B.

The other agencies that enforce the ECOA—the Farm Credit Administration (FCA); the Department of Transportation; the Small Business Administration; and the Grain Inspection, Packers, and Stockyards Administration of the Department of Agriculture—reported substantial compliance among the entities they supervise. The FCA's examination and enforcement activities revealed violations of the ECOA that resulted in one formal action. The FCA reported that the most frequent violations it found involved the failure to collect monitoring information and the timeliness or content of creditors' adverse action notices.

The Federal Trade Commission (FTC) concluded an investigation of a major retailer that resulted in the filing of a consent decree against the company for violating the notification provisions of the ECOA. In addition, the FTC reported a continuation of its work with other government agencies and with creditor and consumer organizations to increase awareness of, and compliance with, the ECOA.

## Electronic Fund Transfer Act (Regulation E)

The five financial regulatory agencies reported that approximately 94 percent of examined institutions were in compliance with Regulation E, a slight increase over the level of compliance reported for 1995. Financial institutions most frequently failed to comply with the following provisions:

- Provide a notice of the procedures for resolving alleged errors at least once each calendar year
- Investigate alleged errors in a prompt manner, determine whether an error actually occurred, and transmit the results of the investigation and determination to the consumer within ten business days
- Provide initial disclosures at the time a consumer contracts for an EFT service or before the first transfer is made
- Provide customers with a statement of all required information at least quarterly, or monthly if EFT activity occurred.

The OTS issued two formal enforcement actions addressing violations of Regulation E, and the FTC accepted for public comment a consent agreement against a telemarketing company for failing to obtain written authorization from consumers for preauthorized transfers. If accepted, the FTC's proposed order would be incorporated into settlement of a civil penalty action, currently pending in federal district court, against the telemarketer and its dealers. The FDIC reported five formal enforcement actions to deal with violations of Regulation E and other consumer compliance regulations without specifying how many of the five involved electronic fund transfers.

## Consumer Leasing Act (Regulation M)

The FFIEC agencies reported substantial compliance with Regulation M for the 1996 reporting period. As in the 1995 reporting period, more than 99 percent of the examined institutions were found to be in full compliance with the regulation. The violations noted by the agencies involved the failure to adhere to specific disclosure requirements.

The Farm Credit Administration reported that the institutions it supervises were in substantial compliance with the regulation. The agency found no violations through its examination and enforcement activities.

The FTC accepted for public comment five consent agreements with major automobile manufacturers addressing violations of both Regulation M and Regulation Z (Truth in Lending). The proposed orders would settle charges that all five companies violated Regulation M in lease promotions that featured low monthly payments or low down payments in large, bold print while disclosing additional costs and sometimes contradictory information in fine print that was difficult or impossible to read. The complaints in these cases also charged the automobile manufacturers with violations for failing to clearly and conspicuously disclose various lease costs and terms as required.

The FTC has continued its consumer and business education efforts. To this end, the FTC released two brochures addressing leasing issues. The first highlighted points to consider when deciding whether to lease or purchase a vehicle. The second provided information to consumers regarding the lease or purchase of residential telephones.

## Truth in Lending Act (Regulation Z)

The FFIEC agencies reported that nearly 70 percent of examined institutions were in full compliance with Regulation Z, a significant improvement over the 50 percent reported for 1995. The Board and the OCC showed increases in compliance, and the NCUA reported a decrease, while the FDIC and the OTS reported unchanged levels of compliance. Agencies indicated that, of the examined institutions not in compliance, 63 percent were in the lowest frequency category (having between one and five violations), compared with 58 percent in 1995.

The violations of Regulation Z most often observed were the failure to accurately disclose the finance charge or to disclose the payment schedule; to accurately disclose the annual percentage rate on closed-end credit; to accurately disclose the amount financed; and to provide a disclosure that reflects the terms of the legal obligation between the parties.

The OTS issued five formal enforcement actions that addressed violations of Regulation Z, and the FDIC reported five formal enforcement actions involving consumer compliance regulations without distinguishing which of those actions involved Regulation Z.

Under the Interagency Enforcement Policy on Regulation Z, 394 institutions supervised by the Board, the FDIC, the OCC, or the OTS were required to refund $2.8 million to consumers in 1996 for improper disclosures.

The Department of Transportation issued a cease and desist consent order against a travel agency and a charter operator. The complaint in this case alleged that the two organizations violated Regulation Z by routinely failing to transmit requests for refunds to credit card issuers within seven days of receipt of fully documented credit refund requests.

The FTC accepted for public comment two consent agreements with major automobile manufacturers addressing violations of Regulation Z. The proposed orders would settle charges that the companies violated Regulation Z in credit promotions by making inadequate and misleading disclosures comparable to those in promotions discussed above, in the section on consumer leasing. The FTC also accepted for public comment a consent agreement with a mortgage banking company. The proposed order in this case would settle charges that the company failed to accurately calculate and disclose several items in its mortgage agreements as required by Regulation Z. In addition, the FTC dismissed a complaint against a department store alleging that the store had imposed "unreasonable burdens" on cardholders who claimed their cards were used without authorization.

The FTC released a brochure addressing the protections of TILA and Regulation Z for "high rate, high fee" loans.

## Community Reinvestment Act (Regulation BB)

The Board assesses the CRA performance of state member banks during regular compliance examinations and takes the CRA record into account along with other factors when acting on applications from state member banks and bank holding companies. The Federal Reserve System maintains a three-faceted program for enforcing and fostering better bank performance under the CRA:

- Examining institutions to assess compliance
- Disseminating information on community development techniques to bankers and the public through community affairs offices at the Reserve Banks
- Performing CRA analyses in connection with applications from banks and bank holding companies.

Under the provisions of the CRA, Federal Reserve examiners review the performance of state member banks in helping to meet the credit needs of their communities. When appropriate, examiners suggest ways to improve CRA performance. During the 1996 reporting period, the Federal Reserve conducted 596 CRA examinations: 2 banks were rated as being in "substantial noncompliance" with the CRA, 4 were rated as "needs to improve" in meeting community credit needs, 417 were rated "satisfactory," and 173 were rated "outstanding."[9]

### Expedited Funds Availability Act (Regulation CC)

The FFIEC agencies reported that 87 percent of the institutions they examined were in full compliance with Regulation CC, an increase over the level of compliance in the 1995 reporting period. Of the institutions not in full compliance, 83 percent were in the lowest frequency category (between one and five violations). Among all institutions examined, the following five rules were the provisions of Regulation CC most often violated:

- Follow special procedures for large deposits
- Adequately train employees and provide procedures to ensure compliance with the regulation
- Provide immediate availability on $100 of deposits not subject to next-day availability
- Make funds from certain checks, including local or nonlocal checks, available for withdrawal within the times prescribed by the regulation
- Provide a disclosure of the institution's specific availability policy.

The OTS issued two formal enforcement actions regarding violations of Regulation CC, and the FDIC reported five formal enforcement actions involving consumer compliance regulations without identifying the regulations involved.

### Unfair and Deceptive Acts or Practices (Regulation AA)

The three financial regulatory agencies with responsibility for enforcing Regulation AA's Credit Practices Rule reported that more than 99 percent of examined banks were in full compliance with the regulation. The most frequent violation involved the failure to provide a clear and conspicuous disclosure on cosigner liability.

## Applications

The Federal Reserve System acted on forty-nine bank and bank holding company cases that involved CRA protests or adverse CRA ratings. The System reviewed another thirteen cases that involved fair lending and other issues related to compliance with consumer regulations.[10] Among the forty-nine cases that raised CRA concerns in 1996, seven involved adverse CRA ratings, forty-one were protested on CRA grounds, and one involved both adverse CRA rating issues and protests.

Several applications for major bank acquisitions were filed and all were protested on CRA grounds. The Board approved the applications, finding in each case that the convenience and needs factors involved were consistent with approval.

9. Foreign banking organizations and Edge Act and agreement corporations accounted for 306 of the institutions examined for compliance with consumer laws; they are not subject to the CRA.

10. In addition, seven cases involving CRA issues and three involving other compliance issues were withdrawn during 1996. The System also reviewed comments submitted in connection with three other applications (not reflected in the above statistics), which were deemed to be more in the nature of consumer complaints than protests.

In January the Board approved the application of Chemical Banking Corporation (New York) to acquire The Chase Manhattan Corporation (New York). As a result of the acquisition, The Chase Manhattan Corporation became the largest banking organization in the nation. The Federal Reserve had held public meetings in New York City on the application in conjunction with the New York State Banking Department in November 1995.

In January the Federal Reserve held public meetings in Los Angeles and San Francisco on the competing proposals by Wells Fargo & Company (San Francisco) and First Bank System (Minneapolis) to acquire First Interstate Bancorp (Los Angeles). Among the issues raised by the 311 parties that commented in connection with these meetings were branch closures in low- to moderate-income neighborhoods, the availability of banking services in California, and potential job losses.

First Bank System ultimately withdrew its application after the Securities and Exchange Commission raised issues about the bank's planned stock repurchase program, and in March the Board approved Wells Fargo's application. The Board indicated in its approval order that it would monitor the implementation of Wells Fargo's branch closing policy as well as the effect of its branching strategy on the availability of banking services in the communities served by the bank. As a result of the acquisition, Wells Fargo became the seventh largest banking organization in the nation and remained the second largest depository institution in California.

In December the Board approved the application of NationsBank Corporation (Charlotte, N.C.) to acquire Boatmen's Bancshares, Inc. (St. Louis), an acquisition that made NationsBank the fourth largest banking organization in the nation. A number of individuals and groups had protested the application, alleging violations of fair lending laws and weaknesses in NationsBank's CRA performance. The Board's approval order directed NationsBank to give the Federal Reserve Bank of Richmond a copy of any notices for branch closures effected in connection with the acquisition; the order also requires NationsBank to notify the Reserve Bank of any changes in its preliminary plan for closing branches.

## Consumer Complaints

The Federal Reserve investigates complaints against state member banks and forwards to the appropriate enforcement agencies complaints that involve other creditors and businesses (see accompanying table). The Federal Reserve also monitors and analyzes complaints about unregulated practices.

In 1996 the Federal Reserve received 2,955 consumer complaints: 2,378 by mail, 568 by telephone, and 9 in person.

### Complaints about State Member Banks

In 1996 the Federal Reserve investigated 1,232 complaints against state member banks (see accompanying table). About 59 percent involved loan functions: 5 percent alleged discrimination on a prohibited basis, and 54 percent concerned credit denial on nonprohibited bases (such as length of residency) and other unregulated lending practices (such as release or use of credit information). Another 27 percent of the 1,232 complaints involved disputes about interest on deposits and general deposit account practices. The remaining 14 percent concerned disputes about electronic fund transfers, trust services, and miscellaneous bank practices.

The System also received 2,609 inquiries about consumer credit and banking policies and practices. In responding to these inquiries, the Board and Federal Reserve Banks gave specific explanations of laws, regulations, and banking practices and provided relevant printed materials on consumer issues.

## Unregulated Practices

Under section 18(f) of the Federal Trade Commission Act, the Board monitors complaints about banking practices that are not subject to existing regulations and focuses on those complaints that may be unfair or deceptive. Three categories accounted for 13 percent of the 2,002 complaints about unregulated practices received in 1996 involving both state member banks and other institutions: problems involving interest rates and terms of credit cards (95 complaints), other problems involving credit card accounts (94), and miscellaneous unregulated practices (80). Each of these categories accounted for a small portion (5 percent or less) of all consumer complaints received by the System.

Many of the complaints about credit card interest rates and terms raised concerns about interest rate increases; allegations that banks charged an interest rate higher than had been agreed on transferred account balances; and concerns about the interest rates charged on cash advances. Complaints about credit card accounts involved a variety of customer service problems, including financial institutions' failure to close accounts as requested; failure to provide requested account information; and imposition of an annual fee after an account is closed. The miscellaneous category covered a wide range of issues including check cashing, release of liens, and customer service problems.

## Complaints Referred to HUD

The Federal Reserve continued to refer to HUD complaints that allege violations of the Fair Housing Act, as required by a memorandum of understanding between HUD and the federal

Consumer Complaints to the Federal Reserve System Regarding State Member Banks and Other Institutions, by Subject, 1996

| Subject | State member banks | Other institutions [1] | Total |
|---|---|---|---|
| Regulation B (Equal Credit Opportunity) | 63 | 42 | 105 |
| Regulation E (Electronic Fund Transfers) | 35 | 45 | 80 |
| Regulation Q (Interest on Deposits) | 2 | 0 | 2 |
| Regulation Z (Truth in Lending) | 144 | 351 | 495 |
| Regulation BB (Community Reinvestment) | 3 | 3 | 6 |
| Regulation CC (Expedited Funds Availability) | 18 | 41 | 59 |
| Regulation DD (Truth in Savings) | 26 | 31 | 57 |
| Fair Credit Reporting Act | 30 | 70 | 100 |
| Fair Debt Collection Practices Act | 9 | 11 | 20 |
| Fair Housing Act | 1 | 0 | 1 |
| Real Estate Settlement Procedures Act | 1 | 19 | 20 |
| Flood insurance | 1 | 2 | 3 |
| Holder in due course | 1 | 4 | 5 |
| Unregulated practices | 898 | 1,104 | 2,002 |
| **Total** | **1,232** | **1,723** | **2,955** |

1. Complaints against these institutions were referred to the appropriate enforcement agencies.

bank regulatory agencies. This memorandum establishes a set of procedures for coordination and cooperation in the investigation of lending discrimination complaints falling under the scope of the Fair Housing Act.

In 1996 the Federal Reserve referred twelve complaints about state member banks to HUD. Investigations completed by the Federal Reserve for seven of the twelve 1996 complaints (and for two that had been pending from 1995) revealed no evidence of unlawful discrimination; five of the twelve complaints received in 1996 were pending at year-end.

## Complaint Program Initiatives

To better understand the type and scope of complaint activity at the federal level, the Board has undertaken an exchange of complaint data among the federal financial regulatory agencies. In 1995 the Board joined with the FDIC in analyzing the agencies' respective systems for categorizing complaints and researched ways to facilitate data exchange and analysis. In mid-1996 the Board initiated similar efforts with the OCC.

In recent years the Federal Reserve has received an increasing number of consumer complaints about credit card mail solicitations that consumers allege are misleading because they do not clearly set out the interest rates being charged and the credit limits offered. The Board has undertaken a study of the complaints received by the System as well as by the other federal financial regulatory agencies, state attorneys general, and state banking departments. To complement the data gathering, the Board included questions for two successive months on the Survey of Consumer Attitudes conducted by the University of Michigan's Survey Research Center. These survey data will help

Consumer Complaints Received by the Federal Reserve System, by Type and Function, 1996

| Complaint | Complaints against state member banks | | | | | |
|---|---|---|---|---|---|---|
| | Total | | Not investigated | | Investigated | |
| | | | | | Bank legally correct | |
| | Number | Percent | Unable to obtain sufficient information | Explanation of law provided to consumer | No reimbursement or other accommodation | Goodwill reimbursement or other accommodation |
| Loans | | | | | | |
| Discrimination alleged | | | | | | |
| Real estate loans | 12 | 1 | 0 | 0 | 5 | 0 |
| Credit cards | 25 | 2 | 1 | 0 | 12 | 6 |
| Other loans | 32 | 2 | 0 | 3 | 17 | 0 |
| Discrimination not alleged | | | | | | |
| Real estate loans | 82 | 7 | 6 | 7 | 26 | 14 |
| Credit cards | 396 | 32 | 8 | 34 | 117 | 115 |
| Other loans | 181 | 15 | 4 | 18 | 82 | 25 |
| Deposits | 337 | 27 | 8 | 33 | 155 | 33 |
| Electronic fund transfers | 35 | 3 | 1 | 4 | 12 | 5 |
| Trust services | 12 | 1 | 1 | 1 | 5 | 2 |
| Other | 120 | 10 | 4 | 16 | 39 | 10 |
| **Total** | **1,232** | **100** | **33** | **116** | **470** | **210** |

define consumers' understanding of the credit terms used in mail solicitations and identify problems they have experienced. The Board expected to complete analysis of this issue in 1997.

In 1996 the Consumer Complaints Section implemented a comprehensive system to replace and consolidate the complaint program's current analysis tools. Along with other management tools, the Complaint Analysis Evaluation System and Reports (CAESAR) provides the capability to analyze the types of discrimination complaints received by the Federal Reserve, automatically generate response letters to the individual complaints, and analyze complaint data to determine patterns and trends.

In June the Board hosted the third annual conference for consumer complaint officers, managers, and other staff. The conference is an important forum for obtaining Reserve Bank input into the formation of policies and procedures that affect the program. In 1996 it focused on the investigation and analysis of complaints alleging unlawful discrimination (particularly those that may involve appraisals), credit scoring, and other fair lending issues; the effect of the Right to Financial Privacy Act and Trade Secrets Act on complaint investigations; and the System's jurisdiction in investigating complaints about nonbank subsidiaries of holding companies.

In September the Consumer Complaints section began quarterly conference calls with the complaint program management and staff at the Reserve Banks. These calls provide an opportunity to discuss policies and procedures and specific issues that have arisen during the course of complaint investigations.

The Consumer Complaints Section and the Consumer Policies program began a series of meetings with the

Consumer Complaints Received—Continued

| Complaints against state member banks | | | | | | Referred to other agencies | Total complaints |
|---|---|---|---|---|---|---|---|
| Investigated | | | | | Pending, December 31 | | |
| Customer error | Bank error | Factual or contractual dispute—resolvable only by courts | Possible bank violation—bank took corrective action | Matter in litigation | | | |
| 0 | 0 | 2 | 0 | 0 | 5 | 21 | 33 |
| 0 | 3 | 0 | 0 | 0 | 3 | 12 | 37 |
| 0 | 2 | 0 | 0 | 0 | 10 | 18 | 50 |
| | | | | | | | |
| 0 | 17 | 4 | 0 | 2 | 6 | 286 | 368 |
| 8 | 71 | 18 | 3 | 1 | 21 | 508 | 904 |
| 4 | 25 | 4 | 1 | 4 | 14 | 222 | 403 |
| 9 | 40 | 23 | 3 | 2 | 31 | 388 | 725 |
| 0 | 5 | 1 | 3 | 0 | 4 | 45 | 80 |
| 0 | 0 | 1 | 0 | 0 | 2 | 7 | 19 |
| 5 | 15 | 5 | 1 | 3 | 22 | 216 | 336 |
| **26** | **178** | **58** | **11** | **12** | **118** | **1,723** | **2,955** |

offices of selected state attorneys general and with state and local county consumer protection agencies to share information about complaint procedures and consumer education efforts. The goal of this effort is to establish contact for sharing data and information at the state and local levels and to expand the Board's ability to refer consumers to the proper authorities when they have issues that do not fall under the Federal Reserve's jurisdiction.

During 1996, individual staff members from the Reserve Banks' consumer complaint sections continued to work at the Board for several weeks at a time to gain familiarity with operations in Washington. Eleven Reserve Banks participated in the program.

## Consumer Policies

The Consumer Policies program explores alternatives to regulation for protecting consumers in retail financial services, and it brings research information to bear more directly on policymaking. During 1996, Consumer Policies participated in revising disclosures to aid consumers in shopping for automobile leases and also provided research analyses for reports on finance charges, home equity lines of credit, funds availability, and credit card solicitations.

The program expanded efforts to educate consumers about mutual funds, annuities, and other uninsured bank products. It produced public-service video announcements and distributed them to about 150 television stations in the top 50 markets in the United States, and at year-end it had plans to prepare public-service radio announcements for distribution to 2,200 stations. The mutual funds education program won the Outstanding Educational Program Award for 1996 from the Association for Financial Counseling and Planning Education.

In 1996 the Consumer Policies staff began to develop plans for a major consumer education initiative to complement the Board's issuance of a revised Regulation M. The educational program, which will be developed in cooperation with industry organizations, regulatory agencies, and consumer groups, is expected to be fully operational by October 1, 1997, when compliance with the new rules becomes mandatory for all lessors.

## Consumer Advisory Council

The Consumer Advisory Council convened in March, June, and October to advise the Board on matters concerning consumer credit protection laws and on other issues dealing with financial services to consumers. The council's thirty members come from consumer and community organizations, financial and academic institutions, and state government. Council meetings are open to the public.

The Council discussed the implementation of CRA at each of the three meetings. In March, members listed emerging issues related to the revised CRA rules, including the degree to which communities will be part of the examination process; the need for timely, easy access to examination schedules and CRA evaluations; difficulties in analyzing small banks' files for loan distribution by income because information is not always available; and the possibility that, because of the new emphasis on lending numbers, some institutions might give less attention to community work. Members also expressed concerns about the impact of mergers and acquisitions on communities and discussed possible strategies for dealing with the difficulties.

In the council's June meeting the CRA focus was on small-bank examinations. Council members reported experience under the new rules that was largely positive. They found that examinations were more performance oriented and examiners' time on site had been reduced. The council also discussed the availability of data on small business and farm loans. The council members were reminded that data on a census-tract basis remains at the financial institution and will be reported to the public only on an aggregated basis.

In the October meeting, some members expressed concern that a greater CRA emphasis on lending could create a disincentive for financial institutions to make important community development investments whereas, for some neighborhood revitalization projects, equity investments and loans to moderate- and upper-income households are essential to successful economic integration. The council also discussed a Board proposal to amend Regulation Y (Bank Holding Companies) designed to streamline the application process for mergers and acquisitions. Consumer and community group advocates voiced strong concerns about proposed revisions that would shorten the times available for informal discussions with the applicants.

In 1995 the council had established a task force to explore ways to improve the mortgage loan process for consumers and the industry in light of the vast number of documents typically presented for the consumer to review and sign at closing. The work was undertaken at a time when the Congress had introduced bills to consolidate rulewriting authority for most mortgage-related disclosures with the Federal Reserve Board. In October 1996, after a yearlong study, the task force submitted its final report to the council.

The report concluded that streamlining mortgage closings is easier in concept than in practice. The task force found that, whereas the perception may be otherwise, most closing or settlement documents are in fact produced for reasons other than federal requirements. Many result from lender practices, state or local laws, or secondary market requirements; others result from "an abundance of caution" on the part of the lender, and are meant to protect against future legal claims from consumers.

Out of fifty-four documents associated with a conventional, fixed-rate, thirty-year mortgage, for example, the task force found that twelve were required by federal laws or regulations such as the Board's Regulation B (Equal Credit Opportunity) and Regulation Z (Truth in Lending) or HUD's Regulation X (Real Estate Settlement Procedures). These twelve, the task force suggested, could possibly be reduced to five—for example, by consolidating notices about mortgage servicing, flood hazard, right to an appraisal, and controlled business arrangement.

The report also suggested undertaking a broad study of consumer experiences to determine whether "information overload" at settlement is a concern and whether required disclosures currently given at settlement are necessary or should be provided earlier in the application process. Other recommendations were to develop a single disclosure based on good-faith estimates of closing costs and other terms to be updated at settlement; to prohibit addenda to the good-faith estimate and the itemization of the amount financed; and to develop an educational piece identifying the documents used in a typical loan closing.

Council members discussed the Board's approach to consumer leasing disclosures in March and June. Leasing represents 25 percent to 30 percent of retail sales of autos in the United States and about 65 percent of retail sales of luxury cars. Members discussed the disclosures required under the Board's Regulation M (Consumer Leasing), including such issues as whether requiring disclosure of a lease rate (one not entirely comparable to an annual percentage rate in credit transactions) would be helpful to consumers; how best to alert consumers to the financial consequences of terminating a lease early; and the need for consumer education to ensure that consumers understand the differences between leasing and purchasing an automobile.

In June the council discussed the coverage of EBT (electronic benefit transfer) programs under the EFT act and Regulation E. The council adopted a resolution expressing concern that a statutory exemption being considered by the Congress could leave benefit recipients unprotected, and it urged the Board to support provisions protecting recipients from losses. (The Congress subsequently enacted the Personal Responsibility and Work Opportunity Act of 1996, creating an exemption from Regulation E for needs-tested benefits if the programs are established or administered by state or local governments.)

The council discussed the potential coverage of stored-value cards at all three meetings. In March, members talked about the different kinds of cards being developed and the types of protections that might apply. Overall, members agreed on the need for balance to provide consumers with reasonable protections without putting domestic businesses at a disadvantage in a global market where the technology is changing daily. In June, the council discussed the Board's proposed rule to require disclosures for certain stored-value products, mentioning potential security and other risks to the banking system. In October, members continued the discussion, noting the difficulty of developing rules for products that do not yet exist or that quickly evolve. Generally, members supported a basic level of mandatory disclosures for all stored-value cards.

Other topics on the council's agenda during 1996 included home equity lines of credit and the disclosure of finance charges (and associated tolerances) under the Truth in Lending Act; electronic banking and ATM surcharges and fees; and issues arising from a proposed substitution of a dollar coin for the dollar bill.

Roundtable discussions, known as the Members Forum, were held at each meeting and gave council members the opportunity to offer their views on their industries or localities.

## Testimony and Legislative Recommendations

The Board twice addressed issues related to the coverage of electronic benefit transfer (EBT) programs by the Electronic Fund Transfer Act and Regulation E, submitting a statement in March to the House Committee on Banking and Financial Services and testifying in June before that committee's Subcommittee on Financial Institutions and Consumer Credit.

In 1995 the Congress had passed, but the President had vetoed, a bill exempting from Regulation E any needs-based benefits established or administered by the states.[11] In the absence of such legislation, Regulation E coverage of EBT programs was to become mandatory on March 1, 1997; and even though the Board had established a modified set of rules for EBT programs, many states

11. The President's veto of the bill was unrelated to the EBT provisions.

continued to express concern about the potential impact.

In its invited statement the Board reiterated a belief that coverage of EBT programs was required under the EFTA but also suggested that a congressional reexamination of the scope of the EFTA could take account of developments since its enactment in 1978 and balance competing objectives in light of changing national priorities. The Board noted also that if an exemption were limited to particular categories or to state-administered programs, the existence of different rules could make it difficult to implement the one-card, unified national delivery system envisioned by the Federal Electronic Benefits Transfer Task Force.

In its June testimony the Board reiterated its suggestion that to the extent the Congress found it necessary to balance the EFTA's consumer protection against concern about compliance costs on the nationwide delivery of EBT, the Congress might reexamine the scope of the law's coverage. The Congress subsequently enacted the Personal Responsibility and Work Opportunity Act of 1996, which exempts needs-tested EBT programs that are established or administered by state or local governments; federal and other state programs remain subject to Regulation E.

In April the Board testified before the House Subcommittee on Financial Institutions and Consumer Credit on proposed legislation regarding the disclosure of fees imposed on ATM transactions. The Board's testimony on ATM fees focused on the current regulatory scheme regarding fee disclosures, data about consumer complaints, the level of compliance with the EFTA found in bank examinations, and the incidence and amount of ATM transaction fees reported in Federal Reserve surveys.

Regulation E requires disclosure of fees imposed by an institution on its own customers but does not require the institution to disclose ATM surcharges imposed by others, since it would be impractical to monitor and disclose the dollar amount of a surcharge that might be imposed at any given time by some other institution nationwide. A surcharge imposed at an ATM must be disclosed on a sign posted at the terminal or displayed on the screen, and institutions are encouraged to give customers the option to cancel the transaction after receiving notice of the fee.

Data on examinations of financial institutions show general compliance with Regulation E and few violations of fee disclosures. Consumer complaint data suggest few problems with electronic transfers generally or with ATM fees.

The Board commented on two bills. The first, H.R. 3246, would have required disclosure at ATMS of all fees imposed in connection with a transaction, whether imposed by the ATM operator, the account-holding institution, or a national, regional, or local network. The Board noted that Regulation E, network operating rules, and laws in a number of states already require fee disclosures and therefore the proposed legislation might be unnecessary. The Board also questioned whether it is operationally feasible for an operator of an ATM to disclose fees imposed by the thousands of account-holding institutions whose customers have access to the ATM.

H.R. 3221 would have prohibited ATM surcharges. Suggesting that substantive limitations on prices are better left to state legislatures, the Board noted that in fact few states have set limits on ATM surcharges. The Board observed that a prohibition might deter financial institutions and other ATM operators from making ATMs widely available to consumers. Also, a prohibition would not necessarily keep costs down for consumers, as ATM operators could negotiate through the networks for an increase in the amount they receive, and such an increase could be passed on via the account-holding institution to its customers.

## Recommendations of Other Agencies

Each year the Board asks for recommendations from the federal supervisory agencies for amending the financial services laws or the implementing regulations.

The OCC recommended that the Congress generally review and consider alternatives for providing useful but less burdensome disclosures, suggesting that the current disclosures are unnecessarily burdensome on banks and insufficiently beneficial to consumers.

The agency also encouraged the Board to clarify Regulation B's prohibition against discrimination based on national origin and issues related to credit scoring systems; and to clarify whether creditors may follow agency regulations for the voluntary collection of restricted information without violating Regulation B. The OCC also asked for Board reconsideration of its decision not to modify the prohibition on collecting monitoring information in nonmortgage loans. Finally, the OCC asked the Board to clarify the rule under Regulation Z for the treatment of fees paid by a consumer for optional services; in the agency's view, such fees should not be included in the finance charge unless expressly stated in the regulation.

The FDIC noted its 1996 testimony on proposed amendments to the Equal Credit Opportunity Act (implemented by the Board's Regulation B), the Electronic Fund Transfer Act (Regulation E), the Consumer Leasing Act (Regulation M), and the Truth in Lending Act (Regulation Z). The testimony supported allowing the voluntary collection of data for all credit transactions; expressed concerns that open-end credit plans generally and credit card lending specifically raised safety and soundness issues; and stated a need to address solicitation and marketing practices that may comply with the letter of the requirements of consumer-protection regulations but that, in the agency's view, constitute "bait and switch" tactics. ■

# Litigation

During 1996 the Board of Governors was a party in eighteen lawsuits filed that year and was a party in eleven other cases pending from previous years, for a total of twenty-nine cases. In 1995 the Board had been a party in a total of twenty-two lawsuits. Five of the eighteen lawsuits filed in 1996 raised questions under the Bank Holding Company Act. As of December 31, 1996, twenty-one cases were pending.

## Bank Holding Company Act—Review of Board Actions

In *The New Mexico Alliance v. Board of Governors,* No. 96–9552 (10th Circuit, filed December 24, 1996), petitioners seek review of a Board order dated December 16, 1996, approving the acquisition by NationsBank Corporation and NB Holdings Corporation, both of Charlotte, North Carolina, of Boatmen's Bancshares, Inc., St. Louis, Missouri (83 *Federal Reserve Bulletin* 221).

*First Baird Bancshares, Inc. v. Board of Governors,* No. 96–1426 (D.C. Circuit, filed November 18, 1996), is a petition for review of a Board order dated November 6, 1996, approving applications of First Commercial Corporation, Little Rock, Arkansas; Arvest Bank Group, Inc., Bentonville, Arkansas; and TRH Bank Group, Inc., Norman, Oklahoma, to acquire all the shares of The Oklahoma National Bank of Duncan, Duncan, Oklahoma (83 *Federal Reserve Bulletin* 41). On November 20, 1996, the court denied petitioners' motion for a stay.

*Kuntz v. Board of Governors,* No. 96–1147 (D.C. Circuit, filed April 25, 1996), was a petition for review of a Board order, dated March 25, 1996, approving the acquisition by CoreStates Financial Corp., Philadelphia, Pennsylvania, of Meridian Bancorp, Inc., Reading, Pennsylvania (82 *Federal Reserve Bulletin* 430). On October 24, 1996, the court of appeals dismissed the petition.

*The Southeast Raleigh Community Development Corporation v. Board of Governors,* No. 96–1054 (D.C. Circuit, filed February 16, 1996), is a petition for review of a Board order dated January 17, 1996, approving the merger of First Citizens BancShares, Inc., Raleigh, North Carolina, with Allied Bank Capital, Inc., Sanford, North Carolina (82 *Federal Reserve Bulletin* 232). Petitioners' motion for a stay was denied on March 5, 1996. On December 19, 1996, petitioners filed a motion for voluntary dismissal of the action.

*Inner City Press/Community on the Move v. Board of Governors,* No. 96–4008 (2d Circuit, filed January 19, 1996), is a petition for review of a Board order dated January 5, 1996 (82 *Federal Reserve Bulletin* 239) approving the merger of Chemical Banking Corporation and The Chase Manhattan Corporation, both of New York, New York. On March 26, 1996, the court denied petitioners' motion for a stay. The case was consolidated with *Lee v. Board of Governors,* No. 95–4134.

*Lee v. Board of Governors,* No. 95–4134 (2d Circuit, filed August 22, 1995), is a petition for review of two Board orders, dated July 24, 1995, approving certain steps of a corporate reorganization of U.S. Trust Corporation, New York, New York, and the acquisition of U.S. Trust by The Chase Manhattan Corporation, New York, New York

(81 *Federal Reserve Bulletin* 893). On September 12, 1995, the court denied petitioner's motion for an emergency stay of the Board's orders.

*Jones v. Board of Governors,* No. 95–1359 (D.C. Circuit, filed July 17, 1995), was a petition for review of a Board order, dated June 19, 1995, approving the application by First Commerce Corporation, New Orleans, Louisiana, to acquire Lakeside Bancshares, Lake Charles, Louisiana (81 *Federal Reserve Bulletin* 793). On November 15, 1995, the court granted the Board's motion to dismiss the petition, and on February 22, 1996, the court rejected petitioner's motion for reconsideration.

*Money Station, Inc. v. Board of Governors,* No. 95–1182 (D.C. Circuit, filed March 30, 1995), is a petition for review of a Board order, dated March 1, 1995, approving notices by Banc One Corporation, Columbus, Ohio; CoreStates Financial Corp., Philadelphia, Pennsylvania; PNC Bank Corp., Pittsburgh, Pennsylvania; and KeyCorp, Cleveland, Ohio, to acquire certain data processing assets of National City Corporation, Cleveland, Ohio, through a joint venture (81 *Federal Reserve Bulletin* 491). On April 23, 1996, a panel of the court of appeals granted the petition for review and vacated the Board's order. The full court subsequently granted the Board's request for rehearing *en banc* and vacated the panel's judgment (94 F.3d 658). On Dec. 19, 1996, the parties filed a motion for voluntary dismissal of the action.

*Jones v. Board of Governors,* No. 95–1142 (D.C. Circuit, filed March 3, 1995), was a petition for review of a Board order, dated February 2, 1995, approving applications by First Commerce Corporation, New Orleans, Louisiana, to merge with City Bancorp, Inc., New Iberia, Louisiana, and First Bankshares, Inc., Slidell, Louisiana (81 *Federal Reserve Bulletin* 379). Petitioner's motion for injunctive relief and for a stay of the Board's order was denied on August 17, 1995. On March 26, 1996, the court denied the petition for review (79 F.3d 1168).

## Litigation Under the Financial Institutions Supervisory Act

*Snyder v. Board of Governors,* No. 96–1403 (D.C. Circuit, filed October 23, 1996), is a petition for review of a Board order dated September 11, 1996, prohibiting petitioners from further participation in the banking industry (82 *Federal Reserve Bulletin* 1067).

In *Clifford v. Board of Governors,* No. 96–1342 (D.C. Circuit, filed September 17, 1996), petitioners seek review of a Board order dated August 21, 1996, denying petitioners' motion to dismiss an enforcement action against them.

*Long v. Board of Governors,* No. 96–9526 (10th Circuit, filed July 31, 1996), is a petition for review of a Board order dated July 2, 1996, assessing a civil money penalty and imposing a cease and desist order for violations of the Bank Holding Company Act (82 *Federal Reserve Bulletin* 871).

In *Board of Governors v. Scott*, No. 96–7108 (D.C. Circuit, filed May 31, 1996), the appellants sought review of an order of a magistrate judge enforcing an administrative investigatory subpoena issued by the Board. On November 15, 1996, the court dismissed the petition on appellant's motion.

In *Interamericas Investments, Ltd. v. Board of Governors*, No. 96–60326 (5th Circuit, filed May 8, 1996), petitioners seek review of a Board order dated April 9, 1996, imposing civil money penalties and a cease and desist order against petitioners (82 *Federal Reserve Bulletin* 609). Petitioners' motion to stay the order pending judicial review was denied on August 20, 1996.

In *Board of Governors v. Hotchkiss,* Adversary No. 95–3146 (U.S. Bankruptcy Court, N.D. Ohio, filed May 1, 1995), the Board sought a determination that a restitution obligation arising from a Board consent order (81 *Federal Reserve Bulletin* 406) was nondischargeable in bankruptcy. On December 15, 1995, the court granted the Board's motion for summary judgment. The debtor's notice of appeal, filed on December 22, 1995, was voluntarily dismissed on June 21, 1996.

In *Board of Governors v. Interamericas Investments, Ltd.,* No. H–95–565 (S.D. Texas, filed February 24, 1995), the Board sought to freeze certain assets of a company pending the administrative adjudication of a civil money penalty assessment by the Board. On March 1, 1995, the court issued a stipulated order requiring the company to deposit $1 million into the registry of the court.

In *Board of Governors v. Pharaon,* No. 91–CIV–6250 (S.D. New York, filed September 17, 1991), the Board sought to freeze the assets of an individual pending the administrative adjudication of a civil money penalty assessment by the Board. On September 17, 1991, the court issued an order temporarily restraining the transfer or disposition of the individual's assets. The order has been extended by agreement.

## Other Actions

*American Bankers Insurance Group, Inc. v. Board of Governors,* No. 96–CV–2383–EGS (D. District of Columbia, filed October 16, 1996), is an action seeking declaratory and injunctive relief invalidating a new regulation issued by the Board under the Truth in Lending Act relating to treatment of fees for debt cancellation agreements (12 C.F.R. section 226.4 (d)(3)). On October 18, 1996, the district court denied plaintiffs' motion for a temporary restraining order.

*Artis v. Greenspan,* No. 96–CV–02105 (D. District of Columbia, filed September 11, 1996), is a class complaint alleging race discrimination in employment. A related employment discrimination case, *Artis v. Greenspan,* No. 96–CV–02619 (D. District of Columbia), was filed November 19, 1996.

*Leuthe v. Board of Governors,* No. 96–5725 (E.D. Pennsylvania, filed August 16, 1996), is an action against the Board and other federal banking agencies challenging the constitutionality of the Office of Financial Institution Adjudication.

In *Esformes v. Board of Governors,* No. 96–1916 (S.D. Florida, filed July 12, 1996), plaintiffs challenged the Board's denial of an administrative request for confidential supervisory information. Plaintiffs' motion for an expedited hearing was denied on August 1, 1996. On October 22, the case was dismissed on plaintiffs' motion.

*Kuntz v. Board of Governors,* No. 96–1079 (D.C. Circuit, filed March 7, 1996), is a petition for review of a Board order, issued under the Federal Reserve Act and the Bank Merger Act, approving the application of The Fifth Third Bank, Cincinnati, Ohio, and The Fifth Third Bank of Columbus, Columbus, Ohio, to acquire certain assets and assume certain liabilities of twenty-five branches of NBD Bank, Columbus, Ohio (82 *Federal Reserve Bulletin* 366).

In *Research Triangle Institute v. Board of Governors,* No. 1:96CV00102 (M.D. North Carolina, filed February 12, 1996), the plaintiff seeks reimbursement of costs under a contract with the Board.

*In re Subpoena Duces Tecum*, Misc. No. 96–MS–43 (TPJ) (D. District of Columbia, filed February 7, 1996), was an action seeking to compel production of confidential Board documents relating to the supervision of Bankers Trust Company. The case was dismissed on the parties' stipulation on May 20, 1996.

*Menick v. Greenspan*, No. 95–CV–01916 (D. District of Columbia, filed October 10, 1995), was a complaint alleging discrimination in employment. On November 4, 1996, the action was dismissed on the parties' joint motion.

*Kuntz v. Board of Governors*, No. 95–1485 (D.C. Circuit, filed September 21, 1995), is a petition for review of a Board order issued under the Federal Reserve Act and the Bank Merger Act approving the application of the Fifth Third Bank, Cincinnati, Ohio, to acquire certain assets and assume certain liabilities of twelve branches of PNC Bank, Ohio, N.A., Cincinnati, Ohio, and to establish certain branches (81 *Federal Reserve Bulletin* 976).

*Beckman v. Greenspan*, No. 95–35473 (9th Circuit, filed May 4, 1995), is an appeal of an order dismissing an action against the Board and others seeking damages for alleged violations of constitutional and common law rights.

In *In re Subpoena Duces Tecum*, Misc. No. 95–06 (D. District of Columbia, filed January 6, 1995), the plaintiff sought to enforce a subpoena for predecisional supervisory documents relating to an action by Bank of England Corporation's trustee in bankruptcy against the Federal Deposit Insurance Corporation. ■

# Legislation Enacted

Among the legislation enacted during 1996, the Economic Growth and Regulatory Paperwork Reduction Act, the National Securities Markets Improvement Act, the Electronic Freedom of Information Act Amendments, and the Debt Collection Improvement Act directly affect the Federal Reserve System or the institutions it regulates.

## Economic Growth and Regulatory Paperwork Reduction Act of 1996

On September 30, 1996, the President signed into law the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (Pub. L. 104–208, 110 Stat. 3009). The following discussion summarizes the portions of the act that significantly affect the Federal Reserve and the institutions it regulates.

### Powers of State Member Banks

The act modifies the branching requirements for state member banks by eliminating the requirement that they maintain capital for their branches as if each branch were a separately chartered bank. The act also eliminates the requirement that state member banks file a branch application with the Federal Reserve System before installing an automatic teller machine (ATM) or remote service unit by excluding such entities from the definition of a branch.

In addition, the act eliminates the requirement that state member banks file branch closing notices for ATMs and for branch relocations that are within the immediate neighborhood and do not substantially affect the nature of the business or customers served; the act also excludes the notice requirement for a branch closing in an emergency acquisition or when assistance is provided by the Federal Deposit Insurance Corporation (FDIC).

The act permits well-capitalized banks rated CAMEL 1 or 2 to invest in bank premises in amounts up to 150 percent of the bank's capital and surplus as long as the bank provides the Board with a thirty-day after-the-fact notice of the investment.

The act also permits the Board to conduct a full-scope, on-site examination of certain well capitalized, well managed state member banks rated CAMEL 1 or 2 every eighteen months rather than every twelve months.

### SAIF/BIF

The act capitalizes the Savings Association Insurance Fund (SAIF) at 1.25 percent of insured thrift institution deposits through a one-time special assessment on SAIF-assessable deposits held as of March 31, 1995. Weak institutions, as well as certain others, may be exempt from the special assessment if the FDIC determines it would reduce risk to the SAIF. In addition, the act reduces the special assessment by 20 percent for certain Oakar banks (banks formed by the merger of SAIF-insured and BIF-insured institutions) and would reduce their assessments going forward.

The act also requires banks, after December 31, 1996, to pay 20 percent of the interest on the bonds that funded the initial capitalization of SAIF (FICO bonds), but banks would be required to pay a full pro rata share of the interest obligation beginning after the earlier of December 31, 1999, or the date on which the last savings association ceases to exist.

The act merges SAIF and the Bank Insurance Fund (BIF) on January 1, 1999, but only if no insured depository institution is a savings association on that date.

Previously, both the Bank Merger Act and the Federal Deposit Insurance Act (FDI Act) required advance written approval from the appropriate federal banking agency to form Oakar banks. The act eliminates the duplicative requirement of advance written approval under the FDI Act for Oakar transactions and retains only the requirement of advance written approval under the Bank Merger Act.

Under the act, the FDIC may refund excess payments from an insured bank or it may credit the excess toward future payments from that bank. In addition, if the balance in BIF exceeds the balance required to meet the designated reserve ratio applicable to such fund, the excess shall be refunded to insured banks.

## Bank Holding Company Act

The act allows well capitalized and well managed bank holding companies (BHCs) that control generally well capitalized and well managed depository institutions, to engage de novo, without advance Board approval, in nonbanking activities approved by regulation. In addition, to be eligible for this exception, the BHC or its subsidiaries must not be subject to an administrative enforcement action or a cease and desist order pursuant to section 8 of the FDI Act during the preceding twelve-month period. The act also establishes a streamlined process for these well run BHCs to obtain Board approval to acquire companies (except thrift institutions) engaged in permissible nonbanking activities subject to certain investment limitations and to engage de novo in nonbanking activities that have been approved only by order.

Existing law allows the Board to permit a BHC to acquire shares of a company engaged in nonbanking activities, including a savings association, if the Board determined, after notice and an opportunity for a hearing, that the company is engaged in activities so closely related to banking that they are a proper incident thereto. The act removes the requirement that the Board provide an opportunity for a hearing except in cases in which a BHC acquires a savings association.

The act exempts BHCs that own thrift institutions from the provisions of the Savings and Loan Holding Company Act and requires the Board to solicit comments from the Office of Thrift Supervision (OTS) on any BHC acquisition of a thrift institution and to consult with the OTS on examinations and enforcement actions for BHCs that own thrift institutions.

The act eliminates notices of new director or senior executive officers (914 notices) currently required for banks chartered within the past two years or that have undergone a change in control within the past two years. However, the act gives the Board discretion to require notice in connection with the review of a prompt corrective action plan or otherwise. The act retains 914 notices for undercapitalized and troubled banks and allows an extension of up to ninety days of the period to disapprove an officer or director.

The act eliminates the requirement that Board approval be obtained to make a divestiture of shares effective for purposes of the BHC Act.

The act permits the Board to allow a BHC and its subsidiaries five years, instead of two, to dispose of stock acquired in satisfaction of a debt previously contracted. It also grants the Board authority to extend the five-year period to ten years in certain situations.

The act amends the BHC Act to permit nonbank banks to grow more than 7 percent per year without losing their exemption under the BHC Act. The act also amends the definition of credit card bank for purposes of the BHC Act to permit these institutions to offer credit cards secured by certain types of deposits.

The act permits the Board to exempt BHCs that control nonbank banks, trust banks, credit card banks, Edge Act and agreement corporations, and industrial loan companies from the anti-tying provisions of the BHC Act. In addition, the act permits the OTS to make exceptions to the anti-tying provisions of the Home Owners' Loan Act if the exceptions would not be contrary to the purposes of the anti-tying provisions and if they conform to the exceptions granted by the Board.

The act excludes from the definition of a BHC a qualified family partnership (QFP). A QFP is defined as a general or limited partnership that (1) does not control more than one registered BHC, (2) does not engage (except indirectly) in any business activity, (3) has no investments other than those permitted by a BHC, (4) is not obligated on any debt (either directly or as a guarantor), and (5) has partners, all of whom are either individuals related to each other by blood, marriage or adoption, or is a trust for the primary benefit of such individuals. The act requires QFPs to file a statement with the Board indicating, among other things, the basis for their eligibility, the activities and investments of the QFP, and an agreement to be subject to limited examinations.

## Deposit Institution Management Interlocks Act

Under the Deposit Institution Management Interlocks Act (DIMIA), the act permits banks and BHCs with assets of up to $2.5 billion (increased from $1 billion) to have interlocking management with nonaffiliated institutions with assets of up to $1.5 billion (increased from $500 million) provided that the institutions are not located in the same community or metropolitan statistical area. It also permits grandfathered interlocks to continue indefinitely and restores the Board's authority to grant exemptions under DIMIA, subject to certain conditions.

## Insider Lending Restrictions

The act permits the Board to exempt from insider lending restrictions preferential loans to executive officers and directors of a subsidiary of a company that controls a state member bank under the following conditions: the officer or director does not participate in major policy-making functions of the bank, and the assets of the subsidiary do not exceed 10 percent of the consolidated assets of a company that controls the bank and the subsidiary (and is not controlled by any other company).

The act also excludes from the insider lending restrictions a state member bank's company-wide benefit or compensation plan as long as it is widely available to employees of the bank and as long as it does not give any officer, director or principal shareholder (or related interest) preference over other employees of the bank.

## Examination Activities

To make examinations by federal banking agencies well coordinated, the act requires them to have their examiners consult with each other, coordinate their examinations of depository institutions, and resolve any inconsistencies in their exam recommendations. The act also directs the federal banking agencies to consider appointing an "examiner-in-charge" to coordinate examinations of depository institutions.

### Audits

The act eliminates the requirement for attestation by an independent auditor under the FDI Act. The act also permits the internal audit committees of certain insured depository institutions to consist of some (but not a majority) of inside directors, rather than entirely outside directors, if the appropriate federal banking agency determines that the institution has encountered hardships in retaining and recruiting a sufficient number of competent outside directors to serve on the committee.

### Truth in Savings

Five years after enactment, the act eliminates civil liability for violations Truth in Savings Act. The act also repeals the definition of "indoor lobby sign," exempts certain credit unions from the act and eliminates any disclosure requirements for rollover certificates of deposit with terms of less than thirty days.

### Home Mortgage Disclosure Act

With regard to the Home Mortgage Disclosure Act (HMDA), the act increases the exempt asset level (the level below which institutions are exempt from HMDA) from $10 million to $28 million, a percentage rise equal to the cumulative percentage increase in the CPI since 1975. The act requires the exemption to be adjusted annually in the future in accordance with changes in the CPI. The act also gives institutions an alternative method for making HMDA data publicly available by allowing information to be maintained at the bank's home or branch offices as long as the public notice states that such information is available upon request.

### Equal Credit Opportunity Act

The act creates a legal privilege for information developed by creditors through "self-tests" that are conducted to determine the level or effectiveness of their compliance with the Equal Credit Opportunity Act (ECOA), provided that appropriate corrective action is taken to address any possible violations.

Privileged information may not be obtained by a government agency for use in an examination or investigation relating to fair lending compliance, or by a government agency or credit applicant in any civil proceeding in which a violation of ECOA is alleged. The act also provides that a challenge to a creditor's claim of privilege may be filed in any court or administrative law proceeding with appropriate jurisdiction. The act directs the Board to promulgate final regulations implementing these changes within six months of enactment.

### Real Estate Settlement Procedures Act

The act directs the Board and the Department of Housing and Urban Development (HUD) to simplify and improve the disclosure requirements on transactions subject to both the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA). This includes providing a "single format" for such disclosures. The Board and HUD must propose new regulations within six months of enactment or, when necessary, submit legislative recommendations to ‘‘simplify and unify’’ RESPA and TILA disclosures.

The measure also establishes less onerous procedures for lenders to inform borrowers that mortgage servicing may be transferred by the lender to another entity.

## Truth in Lending Act

The act permits the Board to exempt classes of transactions, except for certain high-cost mortgages, from coverage under all or part of TILA if the Board determines that coverage does not provide a meaningful benefit to consumers. The act lists several factors the Board must take into account in determining whether to exempt transactions. In addition, the act allows ‘‘sophisticated borrowers’’ (which it defines as those with an annual earned income of more than $200,000 and net assets of more than $1 million) to waive their rights to receive TILA disclosures.

The act also provides an alternative disclosure requirement for adjustable-rate residential mortgages (ARMs). The alternative may provide that payments may ‘‘increase or decrease substantially’’ as long as the statement also indicates the maximum future interest rate and payments on a $10,000 loan originated at a recent interest rate.

The act allows the Board and other agencies to reduce or spread out restitution required for TILA violations in cases where full, immediate restitution would jeopardize the safety and soundness of the institution. The act also corrects an error in the 1995 TILA amendments that unintentionally provided retroactive relief from civil liability for certain TILA violations with regard to ‘‘any’’ consumer credit transaction. The act limits the relief to ‘‘closed-end home secured’’ credit transactions. This change is effective September 30, 1995.

## Fair Credit Reporting Act

The act amends the Fair Credit Reporting Act (FCRA) and grants the Board interpretive authority, in consultation with the other federal banking agencies, for determining how the provisions of FCRA apply to banking institutions regulated by the federal banking agencies (for example, national and state member banks). The act also directs the Board to report to the Congress by March 31, 1997, on the availability to the public of sensitive identifying information about consumers, the possibility that such information could be used for financial fraud and the potential for fraud, or risk of loss, if any, to insured depository institutions. The report is also to include any suggestions for legislative change.

## Electronic Fund Transfer Act

The act directs the Board to report to the Congress no later than six months after enactment on whether the Electronic Fund Transfer Act (EFTA) could be applied to electronic stored-value products without adversely affecting their cost, development, and operation, and whether alternatives to regulation can better achieve the purposes of the EFTA. In addition, the act prohibits the Board from taking any regulatory action regarding stored-value products for either three months after the report to the Congress or nine months after enactment, whichever is later.

## Consumer Leasing Act

The act directs the Board to issue regulations updating and clarifying leasing requirements and definitions and addressing other consumer leasing issues. The Board must issue model disclosure forms for consumer leasing which, if properly used by lessors, will constitute compliance with required disclosure requirements.

The act modifies lease advertising requirements. It eliminates three disclosures currently required in lease advertising: consumer liability at lease-end for the difference between the property's anticipated fair market value and its appraised actual value; the "amount or method of determining the amount" of any such liability; and the disclosure of any purchase option, including the option price.

Instead, lease advertisements that contain certain "trigger terms" (such as the amount of any payment) must clearly and conspicuously state the following terms: that the transaction is a lease; the total of initial payments required on or before lease consummation and delivery of the property; any required security deposit; the number, amount and timing of scheduled payments; and, in leases in which the consumer has an end-of-term liability based on the property's residual value, that an extra charge may be imposed at lease-end.

## Foreign Banks

The act requires the Board to reduce burden and avoid unnecessary duplication in examining branches and agencies of foreign banks. It also eliminates the requirement of annual on-site exams for branches and agencies of foreign banks and provides instead that they be examined as frequently as would a state member bank.

The act provides that, even if a foreign bank is not subject to comprehensive supervision or regulation in its home country, the Board may still approve the bank's application to establish a U.S. office if the bank's home country is actively working to establish a system of bank supervision and if all other factors are consistent with approval. The act directs the Board, in exercising this authority, to consider whether the bank has implemented procedures to combat money laundering. The act also imposes a processing deadline for such applications.

The act permits the Board to allow banks to invest up to 20 percent of their capital and surplus in an Edge or agreement corporation if the Board determines that an investment greater than 10 percent would not be unsafe or unsound.

The act eliminates the requirement that banks (except foreign banks and their affiliates) file consolidated reports with the appropriate federal banking agency if any of their extensions of credit, in the aggregate, are secured directly or indirectly by 25 percent or more of any class of shares of the same insured depository institution.

## Bank Service Companies

The act expands the types of entities included under the definition of a bank service corporation (redefined as a bank service company) to include limited liability companies. It defines "limited liability company" as a company, partnership, trust, or similar business entity that provides that a member or manager of the entity is not personally liable for a liability of the entity solely because that person is a member or manager of it. This amendment allows bank service companies to take advantage of the limited liability rules typically available to corporations and the flow-through tax benefits available to partnerships.

### Regulatory Relief

The act requires each federal banking agency to review its regulations every ten years to identify outdated or otherwise unnecessary regulatory requirements imposed on insured depository institutions. The review must allow for public comment. Each agency must publish in the Federal Register a summary of the comments and the agency's response and report to the Congress on the comments and on any legislative changes necessary to eliminate regulatory burdens.

In addition, the act amends the Riegle Community Development and Regulatory Improvement Act of 1994 to require each federal banking agency to determine whether existing regulations require insured depository institutions and insured credit unions to produce unnecessary internal written policies and, if appropriate, to eliminate such policies.

### Reports Requirements

The act eliminates 12 U.S.C., section 251, which requires the Board to publish an annual report on the availability of credit to small businesses. However, the act creates a new requirement that, within twelve months of enactment and every sixty months thereafter, the Board—in consultation with other federal banking agencies, the Small Business Administration, and the Secretary of Commerce—report to the Congress on the availability of credit to small businesses. The report should include a description of the demand for, and availability of, credit, the range of credit options and types of credit products available, and the credit needs and types of risks associated with lending to small businesses.

The act requires the Board to submit to the Congress, within 180 days of enactment, a report on actions being taken or to be taken to eliminate and conform inconsistent and duplicative accounting and reporting requirements, as required by section 121 of the FDIC Improvement Act. Section 121 requires regulators to use uniform accounting principles consistent with, or no less stringent than, generally accepted accounting principles (GAAP).

The act repeals 12 U.S.C., section 1833, which requires the Board to report annually to the Congress on, among other things, the number of formal and informal supervisory, administrative, and civil enforcement actions initiated each year; the number of individuals and institutions against whom civil money penalties were assessed; and a description of all other enforcement efforts and initiatives relating to unsafe and unsound practices, criminal misconduct, and insider abuse. The act also repeals 12 U.S.C., section 3912, which requires the Board to report annually to the Congress on certain aspects of the international lending operations of banking institutions.

### Farmers and Ranchers in Drought-Stricken Areas

The act declares the sense of the Congress to be that bank regulators should work with farmers and ranchers in drought areas to allow them to meet their financial obligations to be met without imposing burdens on them.

## National Securities Markets Improvement Act of 1996

The National Securities Markets Improvement Act of 1996 (Pub. L. 104–290, 110 Stat. 3416) affects the Board's authority in two ways. First, the Board no longer has the authority to regulate loans to certain registered broker–dealers unless it finds that such rules are necessary or appropriate in the public interest or for the protection of investors. Second, it repeals section 8(a) of the Securities Exchange Act, which limited sources of broker–dealer funding and required nonmember banks that engage in such lending to file agreements with the Federal Reserve.

## Electronic Freedom of Information Act Amendments of 1996

Under the Electronic Freedom of Information Act Amendments of 1996, (Pub. L. 104–231, 110 Stat. 3048), federal agencies, including the Board, are required to make any records processed and disclosed in response to a request under the Freedom of Information Act (FOIA) routinely available for public inspection and copying if the agency determines that they "have become or are likely to become the subject of subsequent requests." The act also requires agencies to maintain reference material or a guide to aid the public in making a FOIA request. In addition, agencies must make certain records created on or after November 1, 1996, available to the public by electronic means.

The act also increases the time limit for responding to FOIA requests from ten to twenty working days and encourages agencies that experience difficulties in meeting FOIA's time limits to promulgate regulations providing for "multitrack processing" of FOIA requests. In addition, the act allows additional time for responding to a FOIA request if unusual circumstances are involved, such as the volume of records sought. The act defines the term "compelling need" for purposes of determining whether a FOIA request should receive expedited processing and they indicate when the agency must specify the amount of information that was withheld from the requestor.

The FOIA amendments also limit the situations in which the Board may obtain a stay of judicial proceeding on the basis of a FOIA backlog, and they modify the content, timetable, and procedures for filing annual reports to the Congress under FOIA.

## Debt Collection Improvement Act of 1996

On April 26, 1996, the Congress passed the Debt Collection Improvement Act of 1996, (Pub. L. 104–134, 110 Stat. 1321–376), which amended the Federal Financial Management Act of 1994 by requiring that all federal payments (defined as federal wage, salary, retirement, benefit, and reimbursement payments) be made electronically within ninety days of enactment. The act allows a waiver of this requirement if the recipient of the federal payment certifies in writing that he or she does not have an account with a financial institution. This general waiver expires as of January 1, 1999, at which time all federal payments must be made electronically unless the Secretary of the Treasury finds that compliance would impose a hardship or that the class or types of checks or other circumstance do not require electronic payment. ■

# *Banking Supervision and Regulation*

The 1990s have been a period of significant growth in the Federal Reserve's responsibilities for banking oversight as well as change in its approach to such oversight. Much of the increased responsibility stems from 1991 legislation in which the Congress expanded the Federal Reserve's supervisory authority over the U.S. activities of foreign banking organizations. The purpose of the bill was to fill certain gaps in the supervision and regulation of such activities and to ensure that U.S. banking policies are applied fairly and consistently to all entities that conduct banking in the United States. The legislation, the Foreign Bank Supervision Enhancement Act of 1991 (FBSEA), involved 400 institutions with assets of more than $700 billion.[1]

All told, from 1990 through 1995, aggregate assets under the Federal Reserve's supervision more than doubled, and despite a dramatic consolidation within the U.S. banking system during that period, the number of institutions the Federal Reserve supervised remained relatively stable, at approximately 7,000. Among state member banks, which account for a large portion of the Federal Reserve's oversight responsibility, the number of state member banks remained at around 1,000 between 1990 and 1995, while the assets of such institutions grew 77 percent. And although the number of bank holding companies and their nonbank subsidiaries declined between 1990 and 1995, the assets of these groups grew markedly over the period (54 percent); most of the asset growth was in the "section 20" companies, nonbank subsidiaries engaged in underwriting corporate securities.

The growth of the Federal Reserve's supervisory responsibilities has increased the demands on the System's resources. In response, the Federal Reserve has, over the past few years, adapted its approach to the supervisory process to make it more focused on risk, more sensitive to the burden it places on institutions, and more cost-effective.

In the past, examinations and inspections have focused on regulatory compliance and on assessing the financial strength of an institution by reconciling accounts, reviewing individual transactions, and analyzing the institution's financial condition. In recent years, however, improved technology and financial innovations have enabled banks to develop financial products that can quickly alter their balance sheets and change their exposure to risk. As a result, supervisory authorities can no longer rely solely on periodic assessments of an institution's balance sheet position at a point in time, but must ensure that the institution has adequate procedures to identify, measure, monitor, and control its risk exposure.

Important changes have been implemented or are in the process of being adopted based on a fundamental review of the Federal Reserve's examination procedures. These changes include

1. Before passage of FBSEA, primary responsibility for supervising and examining the U.S. branches and agencies of foreign banking organizations lay with the licensing agencies—the states or the Office of the Comptroller of the Currency. In carrying out its responsibilities for foreign banking organizations before FBSEA, the Federal Reserve relied mainly on examinations conducted by the states.

- Refocusing on the areas of greatest risk to a bank and on an assessment of the bank's risk-management procedures and capabilities
- Customizing examinations to fit the size, activities, and risks of the institution
- Developing a streamlined examination program for smaller institutions
- Adapting the existing approach to examination, which is based on an institution's legal structure, to a framework based on the institution's functional or business lines
- Conducting a greater portion of an examination off-site
- Improving communications with examined institutions
- Cooperating more closely with internal auditors and outside accountants
- Placing greater emphasis on market discipline, and using positive incentives to encourage prudent oversight by management.

The Federal Reserve has adopted a risk-focused approach to examinations as the principal vehicle for implementing these changes. The risk-focused approach highlights the importance of the management process for identifying, measuring, monitoring, and controlling risk. It gives examiners more flexibility in planning and conducting examinations. The risk-focused approach also places more attention on an institution's internal controls and on analysis and planning before the on-site examination begins.

## Scope of Responsibilities for Supervision and Regulation

The Federal Reserve is the federal supervisor and regulator of all U.S. bank holding companies and of state-chartered commercial banks that are members of the Federal Reserve System. In overseeing these organizations, the Federal Reserve primarily seeks to promote their safe and sound operation and their compliance with laws and regulations, including the Bank Secrecy Act and consumer and civil rights laws.[2] The Federal Reserve also examines the following specialized activities of these institutions: information systems, fiduciary activities, mutual fund activities, government securities dealing and brokering, municipal securities dealing, securities clearing activities, and securities underwriting and dealing through special subsidiaries.

The Federal Reserve also has responsibility for the supervision of (1) all Edge Act corporations and agreement corporations, (2) the international operations of state member banks and U.S. bank holding companies, and (3) the operations of foreign banking companies in the United States.[3]

The Federal Reserve exercises important regulatory influence over the entry into, and the structure of, the U.S. banking system through its administration of the Bank Holding Company Act, the Bank Merger Act for state member

2. The Board's Division of Consumer and Community Affairs is responsible for coordinating the Federal Reserve's supervisory activities with regard to the compliance of banking organizations with consumer and civil rights. To carry out this responsibility, the Federal Reserve specifically trains a number of its bank examiners to evaluate institutions with regard to such compliance. The chapter of this Report covering consumer and community affairs describes these regulatory responsibilities. Compliance with other statutes and regulations, which is treated in this chapter, is the responsibility of the Board's Division of Banking Supervision and Regulation and the Reserve Banks, whose examiners also check for safety and soundness.

3. Edge Act corporations are chartered by the Federal Reserve, and agreement corporations are chartered by the states, to provide all segments of the U.S. economy with a means of financing international trade, especially exports.

banks, and the Change in Bank Control Act for bank holding companies and state member banks. Also, the Federal Reserve is responsible for imposing margin requirements on securities transactions. In carrying out these responsibilities, the Federal Reserve coordinates its supervisory activities with other federal and state regulatory agencies and with the bank regulatory agencies of other nations.

## Supervision for Safety and Soundness

To ensure the safety and soundness of banking organizations, the Federal Reserve conducts on-site examinations, and inspections and off-site surveillance and monitoring; it also undertakes enforcement and other supervisory actions.

### *Examinations and Inspections*

The Federal Reserve conducts *examinations* of state member banks, branches and agencies of foreign banks, Edge Act corporations, and agreement corporations. Because many elements reviewed at bank holding companies and their nonbank subsidiaries differ from bank examinations, the Federal Reserve conducts *inspections* of holding companies and their subsidiaries. Pre-examination planning and on-site review of operations are integral parts of ensuring the safety and soundness of financial institutions. Regardless of whether it is an examination or inspection, the review entails (1) an assessment of the quality of the processes in place to identify, measure, monitor and control risk exposures, (2) an appraisal of the quality of the institution's assets, (3) an evaluation of management which includes an assessment of internal policies, procedures, controls, and operations, (4) an assessment of the key financial factors of capital, earnings, asset and liability management, liquidity, and sensitivity to market risk, and (5) a review for compliance with applicable laws and regulations.

### *State Member Banks*

At the end of 1996, 1,014 state-chartered banks were members of the Federal Reserve System (excluding nondepository trust companies and private banks). These banks represented about 11 percent of all insured commercial banks and held about 25 percent of all insured commercial bank assets.

The guidelines for Federal Reserve examinations are fully consistent with section 10 of the Federal Deposit Insurance Act as amended by section 111 of the Federal Deposit Insurance Corporation Improvement Act of 1991, and by the Riegle Community Development and Regulatory Improvement Act of 1994. A full-scope, on-site examination is required at least once during each twelve-month period for all depository institutions; however, certain well-capitalized and well-managed institutions with assets of less than $250 million may be examined every eighteen months.

During 1996, the Federal Reserve Banks conducted 606 examinations (some of them jointly with the state agencies), and state banking departments conducted 324 independent required examinations.

### *Bank Holding Companies*

At year-end 1996, the number of bank holding companies totaled 5,998. These organizations controlled 7,213 insured commercial banks and held approximately 93 percent of the assets of all insured commercial banks in the United States.

Federal Reserve guidelines call for annual inspections of large bank holding companies and smaller companies with significant nonbank assets. Small companies (those with assets less than $150 million) that do not have problems are selected for inspection on a sample basis, and medium-sized companies ($150 million to $500 million in assets) that do not have problems are inspected on a three-year cycle. The inspection focuses on the operations of the parent holding company, its nonbank subsidiaries, and the overall condition of the consolidated organization.

In judging the financial condition of subsidiary banks, Federal Reserve examiners consult the examination reports of the federal and state banking authorities that have primary responsibility for the supervision of these banks, thereby minimizing duplication of effort and reducing the burden on banking organizations. In 1996 the Federal Reserve inspected 1,674 bank holding companies. Altogether, Federal Reserve examiners conducted 1,922 bank holding company inspections, 149 of which were conducted off-site, and state examiners conducted 73 independent inspections.

## Enforcement Actions, Civil Money Penalties, and Suspicious Activity Reporting

In 1996, the Federal Reserve Banks recommended, and members of the Board's staff initiated and worked on, 133 enforcement cases involving 285 separate actions, such as cease and desist orders, written agreements, removal and prohibition orders, and civil money penalties. Of these, 66 cases involving 129 actions were completed by year-end.

Of particular note was the action that the Board of Governors took, in conjunction with state bank supervisory authorities in New York and California, against the Bangkok Metropolitan Bank, PCL, Bangkok, Thailand, which resulted in the bank's consent to terminate its U.S. banking operations. The action arose from serious unsafe and unsound banking practices and violations of law, including misleading and false statements made to regulatory officials, creation of false records, diversion of loan proceeds benefitting insiders, and extensions of credits to nominee borrowers.

In other significant matters, the Board of Governors assessed civil money penalties totaling $5.9 million, including a $3.5 million fine against a foreign bank for violations, by its section 20 subsidiary, of the Board of Governors' revenue limit, and a $300,000 fine against a foreign bank and one of its U.S. branches based on their lack of compliance with the Bank Secrecy Act and with an existing written agreement. Two cases involving fines totaling $1.7 million are under appeal in federal courts.

The Board of Governors also continued to address the misconduct of some former Bankers Trust officials who were involved with improper transactions involving leveraged derivatives; the Board issued consent orders limiting, among other things, the individuals' ability to market such transactions at other banking organizations and by assessing fines.

All final enforcement orders issued by the Board of Governors and all written agreements executed by the Federal Reserve Banks in 1996 are available to the public. In addition to formal enforcement actions, the Federal Reserve Banks completed eighty-four informal enforcement actions, such as memorandums of understanding and resolutions from the board of directors.

The Federal Reserve adopted an interagency rule, effective April 1, 1996, that simplifies the process for reporting suspected crimes and suspicious activities involving money laundering or the Bank Secrecy Act. The new reporting system enables a banking organization to report such activity by filing a single form, the interagency Suspicious Activity Report, with the Department of the Treasury's Financial Crimes Enforcement Network. The report goes into a computer database accessible by all appropriate federal and state banking and law enforcement authorities.

## Specialized Examinations

The Federal Reserve conducts specialized examinations of banking organizations regarding electronic data processing, fiduciary activities, government securities dealing and brokering, municipal securities dealing, securities clearing, and securities underwriting and dealing through so-called section 20 subsidiaries. The Federal Reserve also reviews state member banks and bank holding companies that act as transfer agents.

### *Electronic Data Processing*

Under the Interagency EDP Examination Program, the Federal Reserve examines the electronic data processing (EDP) activities of state member banks, U.S. branches and agencies of foreign banks, Edge Act and agreement corporations and independent data centers that provide EDP services to these institutions. During 1996, the Federal Reserve conducted 411 EDP examinations. The Federal Reserve also was the lead agency on four examinations of large Multiregional Data Processing Servicers examined on an interagency basis with the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).

### *Fiduciary Activities*

The Federal Reserve has supervisory responsibility for institutions that hold more than $7.3 trillion of discretionary and nondiscretionary assets in various fiduciary capacities. This group of institutions includes 319 state-chartered member banks and trust companies, 83 nonmember trust companies that are subsidiaries of bank holding companies, and 13 entities which are branches or agencies of foreign banking organizations or edge corporation subsidiaries of domestic banking institutions.

On-site examinations are essential to ensure the safety and soundness of financial institutions that have fiduciary operations. These examinations include (1) an evaluation of management, policies, audit and control procedures, and risk management, (2) an assessment of the quality of trust assets, (3) an assessment of earnings, (4) a review for conflicts of interest, and (5) a review for compliance with laws, regulations, and general fiduciary principles. During 1996, Federal Reserve examiners conducted 206 on-site trust examinations of state member banks and trust companies, branches and agencies of foreign banking organizations or edge corporation subsidiaries of domestic banking institutions which held approximately $6.6 trillion in fiduciary assets.

### *Government Securities Dealers and Brokers*

The Federal Reserve is responsible for examining the government securities dealing and brokering of state member banks and foreign banks for compliance with the Government Securities Act of 1986 and regulations of the Department of Treasury. Forty-two state member banks and six state branches of foreign banks have notified the Board that they are currently government securities dealers or brokers that are not otherwise exempt from Treasury's regulations. During 1996 the Federal Reserve conducted examinations of broker–dealer activities in government securities at state member banks and foreign banks.

### *Municipal Securities Dealers and Clearing Agencies*

The Securities Act Amendments of 1975 made the Board responsible for supervising state member banks and bank holding companies that act as municipal securities dealers or as clearing agencies. The Board supervises thirty-eight banks that act as municipal securities dealers and three clearing agencies that act as custodians of securities involved in transactions settled by booking entries. In 1996 the Federal Reserve examined all three of the clearing agencies and 21 of the banks that deal in municipal securities.

### *Securities Subsidiaries of Bank Holding Companies*

Section 20 of the Banking Act of 1933 (the Glass–Steagall Act) prohibits the affiliation of a member bank with a company that is "engaged principally" in underwriting or dealing in securities. The Board in 1987 approved proposals by banking organizations to underwrite and deal on a limited basis in specified classes of bank "ineligible" securities (that is, commercial paper, municipal revenue bonds, conventional residential mortgage-related securities, and securitized consumer loans) in a manner consistent with section 20 of the Glass–Steagall Act and the Bank Holding Company Act. At that time, the Board limited revenues from these newly approved activities to no more than 5 percent of total revenues for each section 20 securities subsidiary. This limit was subsequently increased in September 1989 to 10 percent. In January 1993, the Board adopted an optional indexed revenue test that reflects the changes in the level and structure of interest rates since 1989.

In January 1989, the Board approved applications by bank holding companies to underwrite and deal in corporate and sovereign debt and equity securities, subject, in each case, to reviews of managerial and operational infrastructure and other conditions and requirements or firewalls, specified by the Board. In approving this broader range of activities, the Board also adopted more restrictive firewalls than those contained in its 1987 approval order.

Based on its experience supervising these section 20 subsidiaries and developments in the securities markets since the revenue test was adopted, the Board concluded in December 1996 that a section 20 firm could derive up to 25 percent of its revenue from underwriting and dealing in ineligible securities. In light of this action and an accounting change concerning the treatment of interest earned on securities that may be held by a member bank, the Board concurrently eliminated the optional indexed revenue test. Also, during 1996, the Board eased or eliminated three of the firewalls imposed on the operations of section 20 subsidiaries, and continued work on an extensive review of all other firewalls in order to eliminate unnecessary regulatory burden and enable section 20 subsidiaries to operate in an efficient, effective manner. This effort resulted in the publication for comment early in January 1997 of a proposal to eliminate most firewalls and to modify the remaining ones to ease compliance burdens. It was proposed that remaining firewalls be formally adopted as operating standards applicable to section 20 subsidiaries.

At year-end 1996 forty bank holding companies held section 20 subsidiaries authorized to underwrite and deal in ineligible securities. Of these, twenty-two could underwrite any debt or equity security; three could underwrite any debt security; and fifteen could underwrite only the limited types of debt securities approved by the Board in 1987. The Federal Reserve uses specialized procedures for reviewing operations of these securities subsidiaries; it conducted 40 such inspections in 1996.

### *Transfer Agents*

Federal Reserve examiners also conduct examinations of state member banks and bank holding companies that are registered transfer agents. Among other things, transfer agents counter-sign and monitor the issuance of securities, register their transfer, and exchange or convert such securities. During 1995, Federal Reserve examiners conducted on-site examinations at 77 of the 170 banks and bank holding companies registered as transfer agents with the Board.

### *Surveillance and Monitoring*

The Federal Reserve monitors the financial condition and performance of individual banking organizations and of the aggregate banking system as a whole to identify areas of supervisory concern. Reserve Banks and the Board use automated surveillance screening systems to identify organizations with poor or deteriorating financial profiles and to identify adverse trends affecting the banking system. Information from these surveillance activities is then used to intensify analysis and allocate additional examination resources to institutions vulnerable to deterioration.

An integral part of the bank surveillance function is an automated system which is used to estimate examination ratings for all banks and to identify banks with the potential to become critically undercapitalized over a two year horizon. In 1996, the Federal Reserve undertook a validation effort for this surveillance model.

The Federal Reserve also continued to implement revisions and additions to its bank holding company surveillance system to further assist supervisory staff in evaluating the financial profiles of individual bank holding companies. During 1996, quarterly screens evaluating capital markets activities and liquidity for consolidated bank holding companies were completed. These changes were augmented by the development of a set of ‘‘parent only’ screens which focus on the bank holding companies’ individual (nonconsolidated) operations.

Other efforts were undertaken during 1996 to support and enhance the effectiveness of Federal Reserve surveillance and monitoring activities. For example, the System introduced PRISM, Performance Report Information and Surveillance Monitoring. PRISM provides access to National Information Center (NIC) data on banks, bank holding companies, banking subsidiaries of bank holding companies, and Off-Site Risk Analysis (Surveillance). The Federal Reserve also implemented a new internal system to access Uniform Bank Performance Reports in March, 1996.

The Federal Reserve also completed a review of the definitions of commercial banks, savings bank, and bank holding companies used by various divisions of the Board, the Reserve Banks, and the FDIC. The result was standard definitions of these commonly selected institutional groupings to assist the Board and Reserve Banks in providing consistent figures to division management, the

Board, and the public. Automated monitoring systems continue to rely heavily on the information in the regulatory reports filed by banking organizations. To ensure the timeliness and accuracy of the reports, the Federal Reserve maintains the Regulatory Reports Monitoring System to track domestic and foreign banking organizations that file late or inaccurately.

The Federal Reserve actively participates with other federal and state banking authorities in efforts to enhance surveillance tools; currently, the Federal Reserve chairs the Federal Financial Institutions Examination Council Task Force on Surveillance.

## International Activities

The Federal Reserve plays a critical role in the supervision and regulation of the international activities of U.S. banking organizations and the U.S. activities of foreign banking organizations. The Board provides authorization and regulation of foreign branches of member banks; overseas investments by member banks, Edge Act corporations and agreement corporations, and bank holding companies; and investments by bank holding companies in export trading companies. The Board also charters Edge Act corporations. In addition, the Board acts on applications by foreign banking organizations to acquire U.S. banks; to establish U.S. branches, agencies, representative offices, and commercial lending company subsidiaries; and to engage in nonbanking activities in the United States.

### Foreign Office Operations of U.S. Banking Organizations

The Federal Reserve examines the international operations of state member banks, Edge Act corporations, and bank holding companies, principally at the U.S. head offices of these organizations, where the ultimate responsibility for their foreign offices lies. In 1996 the Federal Reserve conducted on-site full-scope and targeted-scope examinations of eleven foreign branches of state member banks and sixty-nine foreign subsidiaries of Edge Act corporations and bank holding companies. All of the examinations abroad were conducted with the cooperation of the supervisory authorities of the countries in which they took place; when appropriate, the examinations were coordinated with the Office of the Comptroller of the Currency. Also, examiners made forty-nine visitations to the overseas offices of U.S. banks to obtain financial and operating information, and in some instances, to evaluate their compliance with corrective measures or to test-check adherence to safe and sound banking practices.

#### *Foreign Branches of Member Banks*

Under provisions of the Federal Reserve Act and of the Board's Regulation K (International Banking Operations), member banks must obtain Board approval to establish branches in foreign countries. In reviewing proposed foreign branches, the Board considers the requirements of the law, the condition of the bank, and the bank's experience in international business. In 1996 the Federal Reserve approved the opening of 25 foreign branches of 15 banks. By the end of 1996, 96 member banks were operating 771 branches in foreign countries and overseas areas of the United States; 66 national banks were operating 586 of these branches, and 30 state member banks were operating the remaining 185 branches. In addition, 23 nonmember banks were operating 34 branches in foreign countries.

### *Edge Act and Agreement Corporations*

Edge Act corporations are international banking organizations chartered by the Board to provide all segments of the U.S. economy with a means of financing international business, especially exports. An agreement corporation is a state-chartered or federally chartered company that enters into an agreement with the Board not to exercise any power that is impermissible for an Edge Act corporation.

Under sections 25 and 25(A) of the Federal Reserve Act, Edge Act and agreement corporations may engage in international banking and foreign financial transactions. These corporations, which usually are subsidiaries of member banks, may (1) conduct a deposit and loan business in states other than that of the parent provided that the business is strictly related to international transactions and (2) make foreign investments that are broader than those of member banks because they can invest in foreign financial organizations, such as finance companies and leasing companies, as well as in foreign banks.

In 1996, the Federal Reserve approved one new Edge Act corporation and seven new agreement corporations. At year-end, seventy-three Edge Act and agreement corporations, with total parent-only assets of $40 billion at year-end, were operating with forty-two domestic branches. During the year, the Federal Reserve examined all seventy-three corporations.

### *Foreign Investments*

Under the Federal Reserve Act and the Bank Holding Company Act, U.S. banking organizations may engage in activities overseas with the authorization of the Board. Significant investments require advance review by the Board, although pursuant to Regulation K, most foreign investments may be made under general-consent procedures that involve only after-the-fact notification to the Board.

### *Export Trading Companies*

In 1982 the Bank Export Services Act amended section 4 of the Bank Holding Company Act to permit bank holding companies, their subsidiary Edge Act or agreement corporations, and bankers' banks to invest in export trading companies, subject to certain limitations and after Board review. The purpose of this amendment was to allow effective participation by bank holding companies in the financing and development of export trading companies. The Export Trading Company Act Amendments of 1988 provide additional flexibility for bank holding companies engaging in export trading activities. Since 1982 the Federal Reserve has acted affirmatively on notifications by forty-eight bank holding companies.

## U.S. Activities of Foreign Banks

The Federal Reserve has broad authority to supervise and regulate the U.S. activities of foreign banks that engage in banking and related activities in the United States through branches, agencies, representative offices, commercial lending companies, Edge Act corporations, banks, and certain nonbank companies. Foreign banks continue to be significant participants in the U.S. banking system. As of year-end 1996, 281 foreign banks from 60 countries operated 432 state-licensed branches and agencies (of which 25 are insured by the FDIC) as well as 66 branches and agencies licensed by the OCC (of which 6 have FDIC insurance). These foreign banks also directly owned 10 Edge Act corporations and 4 commercial lending companies. In addition, they held an equity interest of at least 25 percent in 90 U.S. commercial banks. Altogether, these U.S. offices of foreign banks control approximately 20 percent of U.S. banking assets. These foreign banks also operated 138 representative offices. An additional 115 foreign banks operated in the United States solely through a representative office.

The Federal Reserve has acted to ensure that all state-licensed and federally licensed branches and agencies receive an on-site examination at least once during each twelve-month period either by the Federal Reserve or by a state or other federal regulator. The Federal Reserve conducted or participated with state and federal regulatory authorities in 704 examinations during 1996. The Foreign Bank Supervision Enhancement Act of 1991 requires Federal Reserve approval of the establishment of branches, agencies, commercial lending company subsidiaries, and representative offices by foreign banks in the United States. In 1996, the Federal Reserve approved applications by 19 foreign banks from 12 foreign countries to establish branches, agencies, and representative offices.

### Joint Program for Supervising the U.S. Operations of Foreign Banking Organizations

In 1995 the Federal Reserve, in cooperation with the other federal and state banking supervisory agencies, formally adopted the joint program for supervising the U.S. operations of foreign banking organizations. The program has two major parts. The first focuses primarily on those FBOs that have multiple U.S. operations and is intended to better coordinate the efforts of the various U.S. supervisory agencies.

The second part of the program is a review of the financial and operational profile of each FBO to assess its general ability to support its U.S. operations and to determine what risks, if any, the FBO poses through its U.S. operations. Together, these two processes provide critical information to the U.S. supervisors in a logical, uniform, and timely manner. During 1996 the Federal Reserve continued to implement program goals through coordination with other supervisory agencies and the development of financial and risk assessments of foreign banking organizations and their U.S. operations.

### Technical Assistance

In 1996 the System provided staff for technical assistance missions and training sessions on bank supervisory matters to a number of central banks in countries of the former Soviet Union, Eastern Europe, Asia, the Caribbean, and Latin America.

## Supervisory Policy

The Federal Reserve amended its guidelines on risk-based capital by incorporating a measure for market risk. In addition, the Federal Reserve approved for public comment two proposals to amend the capital guidelines in other areas. The Federal Reserve made substantial progress in revising its examination and inspection processes to enhance its effectiveness and address changes in the banking industry, and improving supervisory reporting and disclosure by the banking industry. In concert with the other agencies, the Federal Reserve also issued a major revision to the Uniform Financial Institutions Rating System.

## Risk-Based Capital Standards

The risk-based capital requirements adopted by the Federal Reserve in 1989 remained in effect and were expanded in 1996. These requirements implement the international risk-based capital standards that were proposed by the Basle Committee on Banking Regulation and Supervisory Practices (Basle Supervisors' Committee) and endorsed by the Group of Ten (G-10) countries in July 1988..[3] The standards include a framework for calculating risk-adjusted assets and assigning assets to broad categories based primarily on credit risk. Banking organizations are expected to maintain capital equal to at least 8 percent of their risk-adjusted assets.

To supplement the risk-based capital standards, the Federal Reserve in 1990 also issued leverage guidelines setting forth minimum ratios of capital to total assets to be used in the assessment of an institution's capital adequacy.

### *Amendments*

During 1996 the Board adopted amendments to its risk-based capital guidelines in the following areas.

*Market risk.* On September 6, 1996, the Federal Reserve, together with the FDIC and OCC, issued a final rule that incorporated into the risk-based capital framework a capital charge for market risk associated with foreign exchange and commodity activities and with the trading of debt and equity instruments. Regulated institutions with significant market risk exposure must measure their market risk exposure using an internal risk measurement model subject to certain regulatory criteria and begin holding capital in support of their market risk by January 1, 1998. The final rule was based on a supplement to the Basle Accord that was issued January 1996.

*Interest rate risk.* On June 26, 1996, the Federal Reserve along with the FDIC and OCC issued a Joint Agency Policy Statement describing a common framework for the supervision of interest rate risk in banking institutions. This framework calls for a review of the qualitative characteristics and adequacy of an institution's interest rate risk management as well as an assessment of risk to its earnings and the economic value of its capital. The framework is consistent with 1995 revisions to risk-based capital regulations that incorporated the exposure of that economic value to changes in interest rates as an important element in the evaluation of capital adequacy.

The policy statement describes sound practices for managing interest rate risk, emphasizing the importance of adequate oversight by the board of directors and senior management and a comprehensive risk management process that identifies, measures, and controls interest rate risk. The agencies also indicated that they are no longer pursuing a standardized supervisory measure for interest rate risk, as had been proposed in 1995. In lieu of any standardized measure, the agencies will rely on surveillance screens and, during the examination process, the bank's own measurement system to evaluate the level of a bank's risk. Consistent with this framework, some modest revisions are being made to the Call Report in 1997 to enhance supervisory monitoring capabilities with respect to interest rate risk.

### *Proposed Rules*

During 1996, the Federal Reserve approved for public comment two proposals to amend its capital adequacy guidelines.

*Collateralized transactions.* On August 16, 1996, the Federal Reserve, together with the OCC, FDIC, and OTS, issued a proposal to amend the risk-based capital standards to make uniform the agencies' treatment for transactions secured by qualifying collateral. Under the proposal, regulated institutions would be allowed to hold less capital for certain transactions collateralized with a positive margin by cash or qualifying securities. The comment period for the proposal closed on October 15, 1996. A final amendment is expected in 1997.

*Technical modifications.* In November 1996 the Federal Reserve approved a proposal to amend its risk-based and leverage capital guidelines for state member banks in order to eliminate inconsistencies among the capital standards of the banking agencies. At the same time, the Federal Reserve approved a similar proposal for bank holding companies. The proposed amendments pertain to the risk-based capital treatment of presold one- to four-family residential properties, junior liens on one- to four-family residential properties, and investments in mutual funds. In addition, the proposals would simplify the leverage capital guidelines. The Federal Reserve expects that the proposals will be issued on a joint basis with the other agencies in early 1997.

## Risk Management Guidance

Throughout 1996 the Federal Reserve continued to focus on the adequacy of risk management practices and controls at banking organizations.

### *Risk-Focused Safety and Soundness Examinations and Inspections*

Over the last several years, a committee of senior staff from the Federal Reserve System has undertaken a review of the examination and inspection processes to identify near- and long-term opportunities for enhancing the effectiveness, efficiency, and responsiveness of the supervisory process and to address the changing and ever complex banking and financial environment. The committee made a number of recommendations, which the Federal Reserve has begun to implement in its efforts to provide a more risk-focused approach to the supervision of banking organizations.

On May 24, 1996, the Federal Reserve's Division of Banking Supervision and Regulation issued examiner guidance to explain the changes now being implemented in the examination and inspection process and to outline other areas where further changes will occur. In summary, the Federal Reserve has adopted a risk-focused approach to examinations that places greater reliance on effective planning, as well as on the tailoring of each examination to the size and activities of the subject bank or bank holding company. Under this approach, examiners place greater emphasis on evaluating the adequacy of an institution's management process for identifying, measuring, monitoring, and controlling risk. When this process is determined to be sound, the level of transaction testing conducted by examiners can be reduced, commensurate with the quality of management practices and the materiality of the activities being reviewed.

## Coordination with Other Supervisors

The Federal Reserve has also sought to increase coordination with other banking agencies and to improve supervision in an environment of interstate banking. As part of these efforts, the Federal Reserve in April 1996 approved two initiatives, the State/Federal Protocol and the Model Agreement, which address the supervision of state-chartered banks operating across state lines.

The protocol is a statement of principles by the Federal Reserve, the FDIC, and the Conference of State Bank Supervisors on behalf of the state banking departments. It provides that the appropriate federal regulator and home state supervisor will endeavor to coordinate the supervision of interstate banks, particularly those with assets of $1 billion or more, so as to reduce regulatory burden and minimize duplicative regulatory actions, while fostering the safe and sound operation of the banks.

The Model Agreement specifies the actions that the appropriate federal regulator and the home state supervisor would take to fulfill the goals of the protocol, that is, the seamless supervision and examination of interstate, state-chartered banks. Further, on November 14, 1996, the Federal Reserve along with the FDIC and all of the state banking departments signed a Nationwide State/Federal Supervisory Agreement, which was based on the April 1996 Model Agreement.

## Derivatives Disclosures

The Federal Reserve, the other federal banking regulators, and industry groups continued their efforts to improve the quality of bank disclosures of derivatives activities to make these activities more transparent to the public and regulatory authorities. In September 1996 the Division of Banking Supervision and Regulation published in the *Federal Reserve Bulletin* its second annual analysis of derivatives-related disclosures of the top ten U.S. banks that deal in derivatives. This analysis summarizes the accounting standards that influenced the 1995 disclosures in the annual reports of these banks; it also reviews the improvements since 1993 in qualitative and quantitative disclosures about the credit and market risks of derivatives and about the earnings effect of derivatives activities.

In November 1996 the Basle Committee on Banking Supervision and the International Organisation of Securities Commissions issued their second joint report on the public disclosure of trading and derivatives activities of banks and securities firms worldwide. Using an analytical framework developed by the Federal Reserve, the report surveys the trading and derivatives activities disclosed in the 1995 annual reports of a sample of the largest, internationally active banks and securities firms in the G-10 countries and notes improvements made since 1993.

## Retail Sales of Nondeposit Investment Products

On December 30, 1996, the Board the OCC, and the FDIC published a notice seeking comment on amendments to Regulation H and Regulation K that would establish professional qualification requirements for state member banks and for branches and agencies of foreign banks that engage in sales of certain securities to retail customers. The amendments are based on the professional qualification requirements for registered representatives of broker–dealers.

The proposed regulation would require that certain forms be filed with the Board, including registration information for a bank employee who solicits, recommends, purchases, or sells certain securities for retail customers. The regulation also would require such employees and their immediate supervisors to take one of two qualifying examinatons given by the securities industry as a precondition to selling. Continuing education requirements also would be imposed.

## National Information Center

The Division of Banking Supervision and Regulation has overall responsibility for the management of the National Information Center (NIC). NIC contains data bases that are maintained at the Board of Governors and made available to staff members at the Board, the Reserve banks, and other federal and state banking agencies. NIC comprises structure data for banks, nonbanks, and bank holding companies; international data for U.S. holding companies and foreign banking organizations with activities in the United States; financial information, such as Call Report data for banks and FR-Y report data for bank holding companies; and supervisory information based on inspections and examinations.

During 1996, software development continued to improve the usefulness of NIC through the use of distributed technologies. This effort, begun in 1995, is designed to exploit the Federal Reserve System's recently implemented intranet and the expanding use of client/server applications. Implementation of these improvements began in 1996 and will be accomplished through several phases through 1998. In addition, much progress was made in 1996 toward providing the public access to nonconfidential NIC information. In early 1997 a public Internet page will be available to provide access to banking structure information, balance sheets, and income statements.

To expand the use of NIC, training seminars were conducted for staff members throughout the System, and new applications were developed to make the vast amount of NIC data more easily accessible to the staff. In addition, efforts have been made to make NIC data and software available to state banking agencies for their use as a supervisory tool.

## Use of Automation

To increase efficiency in the examination of state member banks, the Federal Reserve has applied new technology to many routine aspects of an examiner's work. This effort has led to development of an automated system, referred to as the Examiner Workstation, that automates much of the quantitative analysis of banking organizations, including sampling and evaluation of loan and investment portfolios. Automation has also been applied to the planning and documentation of examinations. These changes should help examiners identify and evaluate risks more efficiently.

To assist in the supervision of U.S. branches and agencies of foreign banking organizations (FBOs), the Federal Reserve is developing an automated system, referred to as the FBO Desktop, that provides information for use in off-site reviews, including information on foreign financial systems, foreign accounting standards, and the financial performance of FBOs with U.S. operations. Supervisory staff throughout the System will be able to access this information electronically and will be able to review and comment on performance reports online.

## Staff Training

The Supervisory Education Program trains staff members having supervisory or regulatory responsibilities at the Reserve Banks, at the Board of Governors, and at state banking departments. Students from supervisory counterparts in foreign countries attend on a space-available basis. The program provides training at the basic, intermediate, and advanced levels for the four disciplines of bank supervision: bank examinations, bank holding company inspections, surveillance and monitoring activities, and applications analysis. Classes may be conducted in Washington, D.C., or at regional locations and may be held jointly with regulators of other financial institutions. The program is designed to increase the student's knowledge of the total supervisory and regulatory process and thereby provide a higher degree of cross training among staff members.

The System participates in training offered by the Federal Financial Institutions Examination Council (FFIEC) and, to a limited extent, in the training offered by certain other regulatory agencies. Activities include developing and implementing basic and advanced training in various emerging issues as well as in such specialized areas as trust activities, international banking, information systems, activities of municipal securities dealers, capital markets, payment systems risk, white collar crime, preparation and presentation of testimony, real estate lending, management, and instructor training. The System also

Number of Sessions of Training Programs for Banking Supervision and Regulation, 1996

| Program | Total | Regional |
|---|---|---|
| *Schools or seminars conducted by the Federal Reserve* | | |
| Core schools | | |
| Introduction to examinations | 10 | 6 |
| Financial institution analysis | 15 | 10 |
| Loan analysis | 8 | 5 |
| Bank management | 6 | 3 |
| Effective writing for banking supervision staff | 19 | 19 |
| Management skills | 22 | 19 |
| Conducting meetings with management | 19 | 19 |
| Other schools | | |
| Real estate lending seminar | 6 | 4 |
| Specialized lending seminar | 3 | ... |
| Senior forum for current banking and regulatory issues | 4 | 4 |
| Bank operations | 3 | 3 |
| Bank applications | 1 | ... |
| Bank holding company inspections | 8 | 6 |
| Basic entry-level trust | 1 | ... |
| Advanced trust | 1 | ... |
| Consumer compliance examination I | 3 | ... |
| Consumer compliance examination II | 5 | ... |
| Fair lending | 3 | ... |
| Information systems and emerging technology risk management | 3 | 3 |
| Information systems continuing education | 2 | ... |
| Intermediate information systems examination | 1 | ... |
| Capital markets seminars | 23 | 10 |
| Section 20 securities seminar | 4 | 3 |
| Internal controls | 3 | 3 |
| Seminar for senior supervisors of foreign central banks[1] | 2 | 1 |
| *Other agencies conducting courses*[2] | | |
| Federal Financial Institutions Examination Council | 68 | 11 |
| Office of the Comptroller of the Currency | 2 | ... |
| Federal Bureau of Investigation[3] | 1 | 1 |

NOTE. ... Not applicable.

1. Conducted jointly with the World Bank.

2. Open to Federal Reserve employees.

3. Co-sponsored by the Federal Reserve, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the Office of the Comptroller of the Currency, and the Resolution Trust Corporation.

co-hosts the World Bank Seminar for students from developing countries.

During 1996 the Federal Reserve conducted a variety of schools and seminars, and Federal Reserve staff members participated in several courses offered by or cosponsored with other agencies, as shown on the accompanying table.

In 1996 the Federal Reserve trained 3,730 students in System schools, 1,446 in schools sponsored by the FFIEC, and 124 in other schools, for a total of 5,300, including 242 representatives from foreign central banks. The number of student days of training was 27,169 in 1996; 27,856 in 1995; 25,036 in 1994; and 26,938 in 1993.

The Federal Reserve System also gave scholarship assistance to the states for training their examiners in Federal Reserve and FFIEC schools. Through this program 768 state examiners were trained: 407 in Federal Reserve courses, 352 in FFIEC programs, and 9 in other courses. During 1996 the Federal Reserve also continued its participation in joint core-supervision schools with the FDIC.

Every staff member seeking an examiner's commission is required to pass the Core Proficiency Examination, which includes a core content area and a specialty of the student's choice (Safety and Soundness, Consumer Affairs, Trust, or EDP). In 1996, 115 students took the examination.

## Federal Financial Institutions Examination Council

The FFIEC prescribes uniform federal principles and standards for the examination of depository institutions, promotes coordination of bank supervision among the federal banking agencies, and encourages better coordination of federal and state regulatory activities. During 1996, Federal Reserve staff members participated in the following FFIEC projects.

### Uniform Financial Institutions Rating System

On December 9, 1996, the FFIEC recommended that the Federal Reserve and the other banking agencies adopt revisions to update the Uniform Financial Institutions Rating System (UFIRS). UFIRS is an internal supervisory rating system used by the federal banking agencies to provide consistency among them in their evaluation of financial institutions and in their choice of institutions requiring special supervisory attention or concern. Adopted in November 1979, UFIRS is commonly referred to as the CAMEL rating system, with each of the letters of the word referring to one of the five rating components of the system. On December 19, 1996, the Federal Reserve adopted the revisions, which

Status of Students Registered for the Core Proficiency Examination, 1996

| Student status | Core | Specialty area | | | |
|---|---|---|---|---|---|
| | | Safety and soundness | Consumer | Trust | Electronic data processing |
| In queue, year-end 1995 | 24 | 20 | 3 | 0 | 1 |
| Registrants added | 124 | 106 | 14 | 4 | 0 |
| Test taken | 115 | 100 | 13 | 3 | 1 |
| Passed | 110 | 79 | 11 | 3 | 1 |
| Failed | 5 | 21 | 2 | 0 | 0 |
| In queue, year-end 1996 | 33 | 26 | 4 | 1 | 0 |

NOTE. Students choose a test in one specialty area to accompany the core examination.

are to be used in examinations beginning after January 1, 1997.

The revisions include the adoption of a sixth rating component, which covers a bank's sensitivity to market risks. With the addition of this component, the rating system will be referred to as CAMELS: (C) capital adequacy, (A) asset quality, (M) management, (E) earnings, (L) liquidity, and (S) sensitivity to market risks. The revised system highlights a bank's processes to identify, measure, monitor, and control risks in each of the component and composite ratings, particularly in the management component. At community banks, the sensitivity component will primarily be used to indicate the examiner's assessment of the exposure to, and management of, interest rate risk. At larger regional and money center banks, the component will also encompass price and foreign exchange risks when these risks are significant to the bank.

## Disclosure of the Components of the Supervisory Rating Systems

Acting upon a recommendation of the FFIEC, the Federal Reserve in November instructed Reserve Bank staff members to disclose to a bank's management and its directors, beginning January 1, 1997, the ratings given to the bank under the various supervisory rating systems. The Federal Reserve believes that such disclosure will better focus management attention on possible areas of weakness and the need for timely corrective action. The policy applies to the following rating systems: CAMELS for state member banks, BOPEC for bank holding companies, CAMEO for Edge and agreement corporations and overseas subsidiaries of U.S. banks, ROCA for U.S. branches and agencies of foreign banking organizations, the Uniform Interagency Trust Rating System, and the Uniform Interagency Rating System for Data Processing Operations.

## Revisions to the Call Report

In December the Federal Reserve and the other federal banking agencies announced revisions to the bank Reports of Condition and Income (Call Report) to adopt generally accepted accounting principles (GAAP) as the reporting basis in areas of the Call Reports where they were not already in effect, effective with the March 1997 report date. The change brings the accounting principles used for bank regulatory reports into conformity with the GAAP reporting basis used in bank holding company FR Y reports, savings association Thrift Financial Reports, and general-purpose financial statements. The change is also consistent with the objectives of section 307 of the Riegle Community Development and Regulatory Improvement Act of 1994, which requires the federal banking agencies to work jointly to develop a single form for the filing of core information by banks, savings associations, and bank holding companies.

During 1996, the FFIEC also implemented several improvements to the Call Report to focus on bank liquidity ratios and certain capital and asset amounts used in the calculation of regulatory capital ratios. The improvements, effective with the March 1996 report, provide the agencies with better data on short-term liabilities and assets for liquidity purposes and information necessary for the supervision of bank activities in other areas.

The FFIEC issued three substantially revised report forms that improve the ability of the banking agencies to monitor compliance with regulations that impose restrictions on the extension of bank loans to certain insiders of another bank and to provide better information on the risk exposure to U.S. banks from international lending. The FFIEC also announced revisions to the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks to adopt GAAP and certain other disclosures to maintain consistency with the bank Call Report.

In December the FFIEC announced that approximately thirty items deemed unnecessary will be deleted from the Call Report, effective with the March 1997 reporting date. Also in the announcement were new items to be added to the Call Report; among them are items related to the adoption of GAAP, the potential level of bank exposures to interest rate risk, and the need for better data on bank involvement in credit derivatives.

### *Mortgage Servicing Rights*

In June, the Financial Accounting Standards Board issued Statement No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," thereby revising the accounting and reporting standards for all servicing assets, including mortgage servicing rights and related assets. In response to this statement, the FFIEC in December issued interim guidance on reporting and capital treatment for servicing rights. The agencies are expected to issue, in 1997, a proposed amendment to their capital adequacy rules with regard to the treatment of servicing rights and related assets.

### *Review of Regulations and Policies*

In accordance with section 303(a)(2) of the Riegle Community Development and Regulatory Improvement Act of 1994, the federal banking agencies reviewed their implementations of their common statutory and supervisory policies. Under the auspices of the FFIEC, staff members of the agencies formed sixty-five interagency working groups to eliminate inconsistencies and outmoded and duplicative requirements. The agencies submitted a joint report to the Congress on September 23, 1996, that covered this work as well as the results of the agencies' own internal reviews of their regulations and policies to address the streamlining requirements of section 303(a)(1) (for further details, see chapter on Regulatory Simplification).

### *Appraisal Subcommittee*

The FFIEC Appraisal Subcommittee was established under title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, in part to monitor the states' programs for the licensing and certification of appraiser for compliance with the statute. The subcommittee is made up of one staff member from each of the FFIEC agencies and the Department of Housing and Urban Development.

Section 315 of the Riegle Community Development and Regulatory Improvement Act of 1994 directed the subcommittee to encourage states to develop reciprocity agreements with each other. The agreements would allow appraisers licensed or certified in one state to perform appraisals in other states and would determine appropriate fees and requirements for temporary practice provisions established by states for appraisers. On October 21, the subcommittee issued a proposed policy statement with guidelines on temporary practice and reciprocity, and it expects to take action on the proposal in early 1997.

## Regulation of the U.S. Banking Structure

The Board administers the Bank Holding Company Act, the Bank Merger Act, and the Change in Bank Control Act for bank holding companies and state member banks. In doing so, the Federal Reserve acts on a variety of proposals that directly or indirectly affect the structure of U.S. banking at the local, regional, and national levels. The Board also has primary responsibility for regulating the international operations of domestic banking organizations and the overall U.S. banking operations of foreign banks, whether conducted directly through a branch or agency or indirectly through a banking or commercial lending subsidiary (treated above in the section on International Activities).

### Bank Holding Company Act

By law, a company must obtain the Federal Reserve's approval if it is to form a bank holding company by acquiring control of one or more banks. Once formed, a bank holding company must receive the Federal Reserve's approval before acquiring additional banks or nonbanking companies. The Bank Holding Company Act was amended in 1996 to permit bank holding companies that are well run and satisfy specific criteria to commence certain nonbanking activities on a de novo basis without prior approval from the Board, and to establish an expedited prior-notice procedure for other activities and for small acquisitions.

In reviewing an application or notice filed by a bank holding company for prior Board approval, the Federal Reserve considers factors including the financial and managerial resources of the applicant, the future prospects of both the applicant and the firm to be acquired, the convenience and needs of the community to be served, and the potential public benefits and competitive effects of the proposal. In 1996 the Federal Reserve acted on 1,528 bank holding company and related applications or notices. The Federal Reserve approved 336 proposals to organize bank holding companies; approved 119 proposals to merge existing bank holding companies; approved 331 proposals by existing bank holding companies to acquire or retain banks; approved 536 and denied 2 requests by existing companies to acquire nonbank firms engaged in activities closely related to banking; and approved 204 other applications. Data on these and related bank holding company decisions are shown in the accompanying table.

### Bank Merger Act

The Bank Merger Act requires that all proposed mergers of insured depository institutions be acted upon by the appropriate federal banking agency. If the institution surviving the merger is a state member bank, the Federal Reserve has primary jurisdiction. During 1996, the Federal Reserve approved 133 merger applications. As required by law, each merger is described in this REPORT (in table 16 of the Statistical Tables chapter).

When the FDIC, the OCC, or the OTS has jurisdiction over a merger, the Federal Reserve is asked to comment on the competitive factors to assure comparable enforcement of the antitrust provisions of the act. The Federal Reserve and those agencies have adopted standard terminology for assessing competitive factors in merger cases to assure consistency in administering the act. The Federal Reserve submitted 842 reports on competitive factors to the other federal banking agencies in 1996.

## Change In Bank Control Act

The Change in Bank Control Act requires persons seeking control of a bank or bank holding company to obtain approval from the appropriate federal banking agency before the transaction occurs. Under the act, the Federal Reserve is responsible for reviewing changes in the control of state member banks and of bank holding companies. In so doing, the Federal Reserve must review the financial position, competence, experience, and integrity of the acquiring person; consider the effect on the financial condition of the bank or bank holding company to be acquired; and determine the effect on competition in any relevant market.

The appropriate federal banking agencies are required to publish notice of each proposed change in control and to invite public comment, particularly from persons located in the markets served by the institution to be acquired. The federal banking agencies are also required to assess the qualifications of each person seeking control. During 1996 the Federal Reserve worked with the FDIC, the OCC, and the OTS to develop more uniform and streamlined procedures for implementing the Change in Bank Control Act. As discussed further below, many of the proposed revisions became part of a broader effort by the Board to improve and revise Regulation Y. In 1996, the Federal Reserve acted on 162 proposed changes in control of state member banks and bank holding companies.

## Public Notice of Federal Reserve Decisions

Each decision by the Federal Reserve that involves a bank holding company, bank merger, or a change in control, is effected by an order or announcement. Orders state the decision along with the essential facts of the application or notice, and the basis for the decision; announcements state only the decision. All orders and announcements are released immediately to the public; they are subsequently reported in the Board's weekly H.2 statistical release and in the monthly *Federal Reserve Bulletin.*

### Bank Holding Company Decisions by the Federal Reserve, Domestic Applications, 1996

| Proposal | Direct action by the Board of Governors | | Action under authority delegated by the Board of Governors: Director of the Division of Banking Supervision and Regulation | | Office of the Secretary | Federal Reserve Banks | | Total |
|---|---|---|---|---|---|---|---|---|
| | Approved | Denied | Approved | Denied | Approved | Approved | Permitted | |
| Formation of holding company | 15 | 0 | 0 | 0 | 3 | 254 | 64 | 336 |
| Merger of holding company | 18 | 0 | 0 | 0 | 12 | 89 | 0 | 119 |
| Retention of bank | 2 | 0 | 0 | 0 | 0 | 0 | 0 | 2 |
| Acquisition | | | | | | | | |
| Bank | 49 | 0 | 0 | 0 | 9 | 271 | 0 | 329 |
| Nonbank | 147 | 2 | 0 | 0 | 29 | 0 | 360 | 538 |
| Bank service corporation | 0 | 0 | 0 | 0 | 7 | 54 | 37 | 98 |
| Other | 15 | 0 | 47 | 0 | 0 | 44 | 0 | 106 |
| **Total** | **246** | **2** | **47** | **0** | **60** | **712** | **461** | **1,528** |

The H.2 release also contains announcements of applications and notices received by the Federal Reserve but not yet acted on.

## Timely Processing of Applications

The Federal Reserve maintains target dates and procedures for the processing of applications. These target dates promote efficiency at the Board and the Reserve Banks and reduce the burden on applicants. The time allowed for a decision ranges from thirty to sixty days, depending on the type of application or notice. During 1996, 96 percent of the decisions met this standard.

## Delegation of Applications

Historically, the Board has delegated certain regulatory functions—including the authority to approve, but not to deny, certain types of applications—to the Reserve Banks, to the director of the Board's Division of Banking Supervision and Regulation and to the Secretary of the Board. The delegation of responsibility for applications permits staff members at both the Board and the Reserve Banks to work more efficiently by removing routine cases from the Board's agenda. In 1996, 80 percent of the applications processed were acted on under delegated authority.

## Banking and Nonbanking Proposals

During 1996, the Board approved several merger proposals involving some of the largest banking organizations in the United States, including a proposal to form the largest bank holding company. As with similar prior cases, these proposals generated many comments from the public, particularly with respect to Community Reinvestment Act, fair lending, and competitive issues.

In December of 1996, the Board granted Federal Reserve membership to a newly-formed state chartered uninsured trust company that proposed to act as a clearinghouse for the multilateral netting of foreign exchange transactions. The clearinghouse was intended to be a mechanism for reducing settlement risk in the global foreign exchange market. At the same time, the Board approved the related notices of eight U.S. and Canadian banking organizations to invest in the uninsured trust company.

During the year, the Board continued to act on proposals involving the establishment and/or expansion of a section 20 subsidiary by a bank holding company. In connection with one of those proposals, the Board significantly reduced the operating restrictions applicable to "riskless principal" activities. In subsequent months, the Board took several more actions to reduce further the operating restrictions, or "firewalls," related to section 20 activities, and raised the limit on a section 20 company's "ineligible revenue" from 10 percent to 25 percent. In connection with one of the section 20 proposals, the Board also permitted a bank holding company to act as a primary clearing firm for professional floor traders trading for their own accounts on two U.S. futures exchanges. The Board had previously denied this activity for the same bank holding company in 1991.

In the course of acting on various other nonbanking proposals filed by foreign and domestic bank holding companies, the Board expanded the scope of permissible data processing activities to facilitate electronic banking and permitted one bank holding company to maintain stronger relationships with mutual funds for which it planned to provide investment advisory and administrative services.

### Applications by State Member Banks

State member banks must obtain the permission of the Federal Reserve to open new domestic branches, to make investments in bank premises that exceed 100 percent of capital stock, and to add to their capital bases from sales of subordinated debt. State member banks must also give six months' notice of their intention to withdraw from membership in the Federal Reserve, although the notice period may be shortened or eliminated in specific cases.

### Stock Repurchases by Bank Holding Companies

A bank holding company sometimes purchases its own shares from its shareholders. When the company borrows the money to buy the shares, the transaction increases the debt of the bank holding company and simultaneously decreases its equity. Relatively larger purchases may undermine the financial condition of a bank holding company and its bank subsidiaries. The Federal Reserve may object to stock repurchases by holding companies that fail to meet certain standards, including the Board's capital guidelines. In 1996 the Federal Reserve reviewed fifty-four proposed stock repurchases by bank holding companies, all of which were acted upon under delegated authority either by the Reserve Banks or by the Secretary of the Board.

## Enforcement of Other Laws and Regulations

The Board is also responsible for the enforcement of various laws, rules and regulations other than those specifically related to bank safety and soundness and the integrity of the banking structure.

### Financial Disclosure by State Member Banks

State member banks must disclose certain information of interest to investors if they issue securities registered under the Securities Exchange Act of 1934. This information includes financial reports and proxy statements. By statute, the Federal Reserve's financial disclosure rules must be substantially similar to those issued by the Securities and Exchange Commission (SEC). At the end of 1996, thirty-six state member banks, most of which are small or medium-sized institutions, were registered with the Federal Reserve under the Securities Exchange Act.

### Bank Secrecy Act

The Currency and Foreign Transactions Reporting Act (the Bank Secrecy Act) was originally designed as a means to create and maintain records of various financial transactions that otherwise would not be identifiable in an effort to trace the proceeds of illegal activities. In recent years, the Bank Secrecy Act has been regarded as a primary tool in the fight against money laundering. The records required to be reported and maintained by financial institutions under the Bank Secrecy Act provide law enforcement authorities with data useful in the detection and prevention of unlawful activity. The Federal Reserve, through its examination process and other off-sight measures, monitors compliance with the requirements of the Bank Secrecy Act by the institutions it supervises.

In 1996 the Federal Reserve issued new procedures for the banking community to use in reporting suspicious activities related to money laundering and other financial crimes. The procedures are designed to lessen the reporting burden on financial institutions and to make the reports more useful in the investigation of money laundering and other banking crimes. The Federal Reserve acted as the lead regulatory agency in the development of the new procedures.

The Federal Reserve also used new interagency anti-money-laundering examination procedures as required by section 404 of the Riegle Community Development and Regulatory Improvement Act of 1994. The Federal Reserve acted as the lead regulatory agency in the development and subsequent revision of the interagency examination procedures.

The Federal Reserve, through its appointed senior staff representative, continued to provide expertise and guidance to the Bank Secrecy Act Advisory Council, a committee created by Congressional mandate to propose additional anti-money laundering measures to be taken under the Bank Secrecy Act. Also, through the Special Investigations and Examinations Section, the Federal Reserve has assisted in the investigation of money laundering activities and provided anti-money laundering training to designated staff members at each Reserve Bank.

The Federal Reserve has also participated extensively in the Financial Action Task Force, which in 1996 provided anti-money-laundering training to numerous foreign governments and central banking authorities. In addition, a representative of the Federal Reserve participated in the Financial Action Task Force review of the progress made in adopting and implementing anti-money-laundering measures by certain foreign governments.

## Securities Regulation

Under the Securities Exchange Act of 1934, the Board is responsible for regulating credit in certain transactions involving the purchase or carrying of securities. The Board limits the amount of credit that may be provided by securities brokers and dealers (Regulation T), by banks (Regulation U), and by other lenders (Regulation G). Regulation X applies these credit limitations, or margin requirements, to certain borrowers and to certain credit extensions, such as credit obtained from foreign lenders by U.S. citizens.

Several regulatory agencies enforce compliance with the Board's securities credit regulations. The SEC, the National Association of Securities Dealers, and the national securities exchanges examine brokers and dealers for compliance with Regulation T. The federal banking agencies examine banks under their respective jurisdictions for compliance with Regulation U. The compliance of other lenders with Regulation G is examined by the Board, the Farm Credit Administration, the National Credit Union Administration, or the OTS, according to the jurisdiction involved. At the end of 1996, 774 lenders were registered under Regulation G, and 503 came under the Board's supervision. Of these 503, the Federal Reserve regularly inspects 249 either biennially or triennially, according to the type of credit they extend. An additional 254 lenders are exempted from periodic on-site inspections by the Federal Reserve but are monitored through the filing of periodic regulatory reports. During 1996, Federal Reserve examiners inspected 148 lenders for compliance with Regulation G.

In general, Regulations G and U impose credit limits on loans secured by publicly held equity securities when the purpose of the loan is to purchase or carry those or other publicly held equity securities. Regulation T limits the amount of credit that brokers and dealers may extend when the credit is used to purchase or carry publicly held debt or equity securities. Collateral for such loans at brokers and dealers must be securities in one of the following categories: those traded on national securities exchanges, certain over-the-counter (OTC) and foreign stocks that the Board designates as having characteristics similar to those of stocks listed on the national exchanges, bonds that meet certain requirements, or mutual funds regulated by the SEC.

The Federal Reserve monitors the market activity of all OTC stocks to determine which of them are subject to the Board's margin regulations. The Board publishes the resulting List of Marginable OTC Stocks quarterly. In 1996, the OTC list was revised in February, May, August, and November. The November OTC list contained 4,718 stocks.

Pursuant to a 1990 amendment to Regulation T, the Board publishes a list of foreign stocks that are eligible for margin treatment at broker–dealers on the same basis as domestic margin securities. In 1996, the foreign list was revised in February, May, August, and November. The November foreign list contained 1,965 foreign stocks.

In April the Board adopted a revised version of Regulation T. The amendments are part of the Board's periodic review of its regulations and reflect consideration of the comments submitted in response to proposed amendments published in 1995. The final rule eliminates restrictions on the ability of broker–dealers to arrange for credit; increases the type and number of domestic and foreign securities that may be bought on margin and increases the loan value of some securities that are already marginable; deletes Board rules regarding options transactions in favor of the rules of the options exchanges; and reduces restrictions on transactions involving foreign persons, foreign securities, and foreign currency.

At the same time, the Board proposed further amendments to Regulation T, G, and U. The proposed amendments would allow broker–dealers to extend good faith credit on any non-equity security rather than only those currently permitted in the Board's rules; allow transactions involving non-equity securities to be effected in an account not subject to the restrictions of the Regulation T's margin account; remove restrictions on the ability of broker–dealers to calculate required margin for non-equity securities; and modify the method for determining which equity securities are subject to the Board's margin requirements under Regulations G, T and U.

Loans by State Member Banks to their Executive Officers, 1995–96

| Period | Number | Amount (dollars) | Range of interest rates charged (percent) |
|---|---|---|---|
| *1995* | | | |
| October 1–December 31 | 726 | 31,421,000 | 4.0–19.5 |
| *1996* | | | |
| January 1–March 31 | 717 | 34,334,000 | 3.0–18.0 |
| April 1–June 30 | 762 | 31,960,000 | 5.0–21.0 |
| July 1–September 30 | 756 | 37,498,000 | 4.5–18.0 |

SOURCE. Call Report.

Under section 8(a) of the Securities Exchange Act, a nonmember domestic or foreign bank may lend to brokers or dealers posting registered securities as collateral only if the bank has filed an agreement with the Board that it will comply with all the statutes, rules, and regulations applicable to member banks regarding credit on securities. The Board processed no new agreements from January to October 1996. In October 1996 the Congress enacted the National Securities Markets Improvement Act of 1996, which repealed section 8(a) of the Securities Exchange Act and limited the Board's authority under section 7 of the Securities Exchange Act to impose margin requirements on borrowings by certain broker–dealers.

In November the Board published an interpretation of Regulations G, T, and U in light of the enactment of the National Securities Markets Improvement Act of 1996. The interpretation reflects the statutory repeal of section 8(a) of the Securities Exchange Act and makes clear that the Board has not made a finding that it is necessary or appropriate either in the public interest or for the protection of investors to impose rules on borrowings by broker–dealers otherwise exempt under the new legislation. At the same time, the Board published proposed amendments to Regulations G, T, and U to implement the new legislation and further the policies behind its adoption.

In 1996, the Securities Regulation Section of the Board's Division of Banking Supervision and Regulation issued thirty interpretations of the margin regulations. Those that presented sufficiently important or novel issues were published in the Securities Credit Transactions Handbook, which is part of the Federal Reserve Regulatory Service. These interpretations serve as a guide to the margin regulations.

## Loans To Executive Officers

Under Section 22(g) of the Federal Reserve Act, state member banks must include in each quarterly Call Report all extensions of credit made by the bank to its executive officers since the date of the bank's previous report. The accompanying table summarizes this information.

## Federal Reserve Membership

At the end of 1996, 3,701 banks were members of the Federal Reserve System. Member banks operated 40,963 branches on December 31, 1996, and accounted for 39 percent of all commercial banks in the United States and for 69 percent of all commercial banking offices. ■

# Regulatory Simplification

In 1978 the Board of Governors established the Regulatory Improvement Project in the Office of the Secretary to help minimize the burdens imposed by regulation. In 1986 the Board reaffirmed its commitment to regulatory improvement, renaming the project the Regulatory Planning and Review Section and assigning supervision of its work to the Board's Committee on Banking Supervision and Regulation.

The purposes of the regulatory improvement and simplification function are to ensure that the economic consequences for small business are considered when regulations are written, to afford interested parties the opportunity to participate in designing regulations and comment on them, and to ensure that regulations are written in simple and clear language. Staff members continually review regulations for their adherence to these objectives.

In 1996 the Board's regulatory review activity increased from a handful of actions per year to more than a dozen significant reviews of Board regulations and policies. As part of the 1996 comprehensive regulatory review process, two regulations were rescinded (Regulations R and V); three were simplified and updated (E, M, and S); and four were in the process of comprehensive review at year-end (H, K, Y, and CC). Additional actions included deleting transitional rules for reserve requirements (Regulation D); increasing the tolerance for closed-end credit transactions (Regulation Z); revising the lending-rule prohibitions for insiders at member banks and their affiliates (Regulation O); and streamlining the application process for well-capitalized and well-managed banks (Regulation Y). Also, certain rules under Regulation Y for section 20 subsidiaries were revised to increase the revenue limits, clarify rules for administering the revenue test with respect to interest income on securities held for a bank's own account, and ease or amend the firewall restrictions.

## Comprehensive Reviews

Section 303(a)(1) of the Riegle Community Development and Regulatory Improvement Act of 1994 requires the federal banking agencies to cooperate in conducting a systematic review of their regulations and written policies to improve efficiency, reduce unnecessary costs, eliminate inconsistencies, eliminate outmoded and duplicative requirements, promote uniformity among the regulations and policies of the agencies, and reduce regulatory burden "consistent with the principles of safety and soundness, statutory law and policy, and the public interest." As required by the act, a progress report on these efforts, *Joint Report: Streamlining of Regulatory Requirements*, was submitted to the Congress in September.

As part of promoting uniformity among the banking agencies, the Board adopted an interagency system for rating a bank's financial condition and adopted interagency guidelines for determining the safety and soundness standards for asset quality and earnings.

In addition to the streamlining efforts required by the Riegle act, the Board in 1996 engaged in internal activities such as reviewing all supervisory and regulatory (SR) letters issued by the Division of Banking Supervision and Regulation.

The SR letters, which communicate supervisory policy and guidance to the Reserve Banks, were reviewed to determine whether the policy was still applicable, whether it had been incorporated into the appropriate examination manuals or the *Federal Reserve Regulatory Service*, and whether it had been superseded by a subsequent letter. An updated list of "active" letters was sent to the Reserve Banks after the review.

The significant regulatory improvements made by the Board in 1996, as noted in the joint interagency report to the Congress, are discussed below.

## Regulation D
### Reserve Requirements of Depository Institutions

The Board revised Regulation D in December to simplify and update it and thereby also to reduce the burden it imposes on institutions. In general, the changes delete certain transitional rules relating to reserve requirements, NOW accounts, de novo institutions, ‘‘dissimilar’’ mergers, and other matters that no longer have significant effect.

## Regulation E
### Electronic Fund Transfers

In April, following a comprehensive review, the Board approved a final rule which simplified the language and format of each section of Regulation E and stated the requirements more clearly. The Board shortened the final rule by 15 percent, largely by deleting obsolete provisions and transferring explanatory material to the commentary. Changes to the rule included revisions of the existing exemption for transfers of securities and commodities as well as an increase in the asset size cutoff for the exemption of small institutions, from $25 million to $100 million. The Board also exempted preauthorized transfers to or from accounts at small institutions to reduce the burden of compliance for institutions that do not offer any other electronic fund transfer service.

The final rule also exempts from Regulation E the transfer of funds for certain purchases and sales of unregulated securities if the broker–dealer that handles the transaction is regulated by another federal agency, such as the Securities and Exchange Commission or the Commodity Futures Trading Commission. The final rule also extends the exemption to all securities or commodities held in book-entry form by the Federal Reserve Banks on behalf of the Department of the Treasury and other federal agencies. (In April the Board also proposed amendments to Regulation E; see the chapter on Consumer and Community Affairs.)

## Regulation H
### Membership of State Banking Institutions in the Federal Reserve System

The Board began a review of Regulation H with an eye toward simplifying, updating, and reorganizing the regulation. In particular, the Board is revising the regulation to eliminate out-dated requirements and conditions that are not absolutely necessary for membership, to make regulatory language easier to understand, and to reorganize the contents to make the provisions more easily referenced. The Board anticipates final action on the revised regulation during the first quarter of 1997.

## Regulation K
### International Banking Operations

The Board took several actions in 1996 to remove obsolete or superseded portions of Regulation K and to reduce unnecessary regulatory burden. As part of these actions, the Board amended the rules allowing foreign banks to establish U.S. representative offices, required foreign banks to select a home state, removed the restrictions on certain mergers by U.S. bank subsidiaries of foreign banks outside of the home state, and prohibited foreign banks from using their U.S. branches or agencies to manage activities through offshore offices that could not be managed by a U.S. bank at its foreign branches or subsidiaries. In addition, the Board also established criteria for evaluating the continued operation of a foreign bank in the United States.

The Board began a comprehensive review of Regulation K that will focus on streamlining processes and making U.S. banking organizations more competitive internationally. At the same time, the review will consider all aspects of foreign bank regulation with an eye toward adopting further streamlining and burden reduction measures as well as further liberalizations, especially as provided in the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994.

## Regulation M
### Consumer Leasing

In September the Board revised Regulation M to simplify and clarify the required disclosures for car leasing and other types of consumer lease transactions. The changes focused on automobile leasing because of the increased use of such leases. The Board's action revised the disclosure format, adopted a total-payments disclosure that will facilitate comparisons, and required a mathematical progression that shows how the monthly lease payment is calculated. The revisions also implemented the advertising provisions of a 1995 amendment to the Consumer Leasing Act.

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

The Board revised Regulation O in November to allow insiders of a bank and of the bank's affiliates to obtain loans under a company-wide employee benefit plan. The final rule also simplifies the procedures for a bank's board of directors to exclude executive officers and directors of affiliates from policymaking functions of the bank and thereby from the restrictions of Regulation O.

## Regulation S
### Reimbursement for Providing Financial Records; Recordkeeping Requirements for Certain Financial Records

The Board took separate actions on two provisions of Regulation S during 1996. In July the Board updated and streamlined subpart A, which implements the Right to Financial Privacy Act (RFPA). As part of the revision, the Board increased the fees that financial institutions may charge a government authority for providing financial records pursuant to a request under the RFPA.

Earlier in the year the Board added subpart B to the regulation. The new subpart cross-references the substantive provisions of a joint rule adopted by the Board and the Department of the Treasury relating to the recordkeeping requirements for transmittals of funds under the Bank Secrecy Act. The joint rule is intended to assist in the investigation and prosecution of money-laundering activities.

## Regulation T
### Credit by Brokers and Dealers

In April the Board amended Regulation T to provide significant regulatory relief to broker–dealers. The changes eliminated restrictions on the ability of broker–dealers to arrange for credit, increased the type and number of domestic and foreign securities that may be bought on margin, increased the loan value of some securities that are already marginable, deleted Board rules regarding options transactions in favor of the rules of the options exchanges, and reduced restrictions on transactions involving foreign persons, foreign securities, and foreign currency. The Board also made technical changes to the rules to provide clarification and update references.

In November the Board issued an interpretation of the margin regulations in response to the enactment of the National Securities Markets Improvement Act of 1996. Under this legislation, the Board no longer has the authority to regulate certain loans to registered broker–dealers unless it finds that such rules are necessary or appropriate in the public interest or for the protection of investors.

The interpretation makes it clear that the Board has not made such a finding and that provisions in its margin regulations for which the Board no longer has general authority are without effect. The Board also requested public comment on the regulatory amendments to reflect the new legislation.

## Regulation Y
### Bank Holding Companies and Change in Bank Control

During 1996 the Board conducted an extensive review of Regulation Y and issued a proposal designed to improve the competitiveness of bank holding companies by eliminating unnecessary regulatory burden and operating restrictions and by streamlining the application and notice provision. The proposal, which was published for comment in August, reorganizes and expands the regulatory list of nonbanking activities and removes outmoded, superseded, or unnecessary restrictions on those activities that would not apply to insured banks that conduct the same types of activities.

The proposal also includes significant amendments to the tying restrictions. One proposed amendment eliminates the Board's regulatory extension of the anti-tying statute to bank holding companies and their nonbank subsidiaries, thus subjecting these entities to the same general antitrust laws that govern their competitors. Other proposed amendments broaden the product exception and the types of arrangements to which the traditional bank product exception applies.

The Board expects to take action on the comprehensive review proposal and tying provisions in 1997.

In addition to the proposal, the Board also issued several amendments or interpretations to Regulation Y. A final amendment to the Board's interpretive rule regarding investment adviser activities permits a bank holding company (and its bank and nonbank subsidiaries) to purchase, in a fiduciary capacity, securities of an investment company advised by the bank holding company. To take advantage of this provision, the purchase must be specifically authorized by the terms of the instrument creating the fiduciary relationship, by court order, or by the law of the jurisdiction under which the trust is administered.

In October the Board announced an interim rule to implement provisions of the Economic Growth and Regulatory Paperwork Act. The new rule establishes expedited procedures for well capitalized bank holding companies that also meet other criteria to obtain Board approval for certain acquisitions and certain nonbanking activities. The affected acquisitions are those of smaller companies that engage in any permissible nonbanking activities listed in Regulation Y, and the affected nonbanking activities are those that the Board has approved only by order.

During the year the Board also approved changes to three areas affecting section 20 subsidiaries of bank holding companies—firewalls, revenue limits, and treatment of income earned on securities. In general, the amendments modify the interlock restriction, eliminate the cross-marketing restriction, and ease the financial assets restriction.

In December the Board raised the limit on the amount of revenue that a section 20 subsidiary may derive from underwriting and dealing in securities. Under the new rules, the permissible revenue limit will change from 10 percent to 25 percent of the subsidiary's total revenue. The revenue limit is designed to ensure that a section 20 subsidiary will not be engaged principally in underwriting and dealing in securities in violation of section 20 of the Glass–Steagall Act.

In a separate announcement the Board clarified that interest income earned on the types of debt securities that a member bank could hold for its own account shall not be treated as revenue from underwriting or dealing in securities for purposes of section 20. Interest earned on these securities will continue to be included in total revenue.

## Regulation Z
### Truth in Lending

The Board revised Regulation Z in September to incorporate the Truth in Lending Act Amendments of 1995. The amendments establish new creditor-liability rules for closed-end loans secured by real property or dwellings and consummated on or after September 30, 1995, and establish several tolerances for accuracy in disclosing the amount of the finance charge. Creditors have no civil or administrative liability if the finance charge and affected disclosures are within the applicable tolerances. The amendments also clarify how lenders must disclose fees connected with mortgage loans.

In addition to the changes required by the statute, the revised regulation also includes a new rule regarding the treatment of fees charged in connection with debt cancellation agreements. This rule is similar to the existing rule for credit insurance premiums and provides for more uniform treatment of these fees.

## Regulation CC
### Availability of Funds and Collection of Checks

The Board continued its comprehensive review of Regulation CC. The proposed amendments arising from the review are primarily technical in nature and do not represent any major policy changes. In some cases, the amendments also reduce the compliance burden for depository institutions.

Proposed changes to subpart B, which governs availability schedules and disclosures, address a variety of issues, including the treatment of deposits received at "contractual" branches, such as affiliates. In general, proposed amendments provide more flexibility for banks giving hold notices under emergency conditions, clarify the various media through which written notices may be given, delete certain requirements for notice content, and revise the model forms in appendix C of the regulation.

Other proposed changes to subpart B clarify the interaction between Regulation CC and the Uniform Commercial Code, set forth rules for checks drawn on certain U.S. territories, and address other check collection matters. In conjunction with the proposal, the Board is requesting comment on several items: the time required for a bank to qualify a returned check for automated processing, the provisions regarding the extension of the midnight deadline, and the extent of a presenting bank's preferred claim against a closed paying bank.

## Rescission of Regulations R and V

As a result of the Board's periodic regulatory review process, the Board determined that two of its regulations, Regulations R and V, were obsolete and no longer necessary. Both regulations were subsequently rescinded.

Regulation R (Relations with Dealers in Securities Under Section 32 of the Banking Act of 1933), restated the statutory language of Section 32 of the Glass–Steagall Act and set forth the only exemption to the act adopted by the Board. The Board determined that the existing exemption in the regulation was no longer necessary in view of interpretations of the act developed since 1969. The Board also noted that having a substantive regulation solely to restate a statutory provision is unnecessary.

Regulation V (Loan Guarantees for Defense Production), implemented the Defense Production Act of 1950 and was intended to permit defense agencies to enter into defense-related contracts without regard to whether appropriations had been made for the underlying projects. A subsequent amendment to the act made it unlikely that a loan guarantee application would be filed; however, the Federal Reserve System would be able to process such an application under existing fiscal agency procedures. ■

# Federal Reserve Banks

The Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994 paved the way for interstate branch banking upon its 1997 implementation; it thus has significant implications for the account relationships between the Federal Reserve Banks and depository institutions. In 1996, Federal Reserve staff members conducted a series of interviews with selected depository institutions to anticipate the new account relationships that would best meet the organizational and business needs of the banking industry and the Federal Reserve as interstate branching develops. Through the interview process, the Federal Reserve devised an account model that would facilitate a single debtor–creditor relationship between the Federal Reserve and any depository institution while offering the flexible information benefits of a distributed account structure.

For a given institution, the new model provides a single (master) account, held at one Reserve Bank, where all credits and debits arising from financial transactions with the Federal Reserve would be settled and through which reserve and risk management activities would be conducted. Optional subaccounts could be used to define subsets of financial transaction information. The subaccounts could be used by depository institutions to segregate financial information by geographic region, operational function, or other criteria. Thus, an institution could centralize all financial information or could segregate information on financial transactions based on its own organizational structure.

The single-account model was approved in April and will be available in January 1998. Special transitional arrangements will allow for the temporary operation of multiple accounts. During 1996 the Federal Reserve held 10,077 accounts for financial institutions, a 0.8 percent increase over 1995.

Also in 1996, the Federal Reserve Banks completed significant milestones in their plan to transfer mainframe computer operations to the System's three consolidated data centers, managed by the Federal Reserve Automation Services (FRAS):

- Fully converted to the new centralized automated clearinghouse application (Fed ACH)
- Moved the Automated Standard Application for Payments system, which supports federal grant payments, to the central application processing environment
- Transfered applications in eleven Districts to shared processing environments (the remaining Reserve Bank, Kansas City, is scheduled to move to a shared environment in the first quarter of 1997)
- Converted four Reserve Banks to the new centralized book-entry securities application, the National Book-Entry System (the eight other Banks will convert to it by the first quarter of 1998)
- Scheduled the new Statistical Analysis and Reporting application for Systemwide implementation beginning in 1997.

In other activity, The Federal Reserve Banks essentially completed the deployment of all elements of Fednet, the new telecommunications network. Fednet provides a consistent level of service to all points in the Federal Reserve System and improves on the reliability, security, and disaster recovery capabilities of the previous system. The Federal Reserve Bank of New York, the last of the Reserve Banks to convert to the new network, plans to complete the conversion of depository institutions to Fednet in 1998.

The Reserve Banks began the development of a new version of Fedline software, which for the first time would operate under the Microsoft Windows operating system. Fedline provides the interface to Federal Reserve applications for many depository institutions. Fedline for Windows is scheduled to be available for implementation by depository institutions in 1998.

The remainder of this chapter details the 1996 results in Federal Reserve Bank priced services, currency and coin operations, and fiscal agency services, and reports on examinations, income and expenses, holding of securities and loans, and major construction activity.

## Developments in Federal Reserve Priced Services

The Monetary Control Act of 1980 requires the Federal Reserve to establish fees that, over the long run, recover all the direct and indirect costs of providing services to depository institutions, as well as the imputed costs, such as the income taxes that would have been paid and the pretax return on equity that would have been earned had the services been provided by a private firm. These imputed costs are collectively referred to as the private sector adjustment factor (PSAF).[1] Over the past ten years, the Federal Reserve System has recovered 100.7 percent of its priced services costs, including the PSAF.

Overall, 1996 fees charged for priced services increased approximately 2.1 percent over the 1995 levels. This rise is the net result of several changes in fees: increases for forward collection check products, reductions for ACH

1. The imputed costs that are part of the PSAF are interest on debt, return on equity, income and sales taxes, and assessments for deposit insurance from the Federal Deposit Insurance Corporation. In addition, assets and personnel costs of the Board of Governors that are directly related to priced services are allocated to the Reserve Banks' priced services. In the pro forma statements at the end of this chapter, expenses of the Board of Governors are included in operating expenses, and assets of the Board are part of long-term assets.

### Activity in Federal Reserve Priced Services, 1996, 1995, and 1994

Thousands of items except as noted

| Service | 1996 | 1995 | 1994 | Percentage change | |
|---|---|---|---|---|---|
| | | | | 1995–96 | 1994–95 |
| Commercial checks | 15,486,833 | 15,465,209 | 16,479,161 | .1 | –6.2 |
| Funds transfers | 84,871 | 77,742 | 73,611 | 9.2 | 5.6 |
| Securities transfers | 4,125 | 3,689 | **3,693** | 11.8 | **–.1** |
| Commercial ACH | **2,372,108** | **2,046,086** | **1,736,863** | **15.9** | 17.8 |
| Noncash collection | 1,069 | 838 | 643 | 27.6 | 30.3 |
| Cash transportation | **36** | **61** | **94** | **–41.0** | **–35.1** |

NOTE. Amounts in bold are restatements due to a change in definition or to correct previously reported errors.

Activity in *commercial checks* is defined as the total number of commercial checks collected, including both processed and fine-sort items; in *funds transfers* and *securities transfers,* the number of transactions originated on line and off line; in *ACH,* the total number of commercial items processed; in *noncash collection,* the number of items on which fees are assessed; in *cash transportation,* the number of registered mail shipments and FRB-arranged armored carrier stops.

transactions, increases for ACH account servicing and non-automated products, and no change for funds transfers, book-entry securities, and electronic connections.

The revenue from priced services in 1996 was $787.2 million, other income was $28.7 million, and costs were $789.3 million, resulting in net revenue of $26.6 million and a recovery rate of 103.4 percent of costs, including the PSAF.[2] In 1995 the System's revenue was $0.4 million more than total costs, resulting in a recovery rate of 100.1 percent, including the PSAF but before the cumulative effect of a change in accounting principle. The change in accounting resulted in a net loss of $18.9 million and a recovery rate of 97.6 percent.

## Check Collection

Federal Reserve Bank operating expenses and imputed costs for commercial check services in 1996 totaled $570.7 million. Revenue from check operations totaled $588.1 million, and other income amounted to $22.5 million, resulting in income before income taxes of $39.9 million.

The Reserve Banks handled 15.5 billion checks, about the same number as in 1995. The volume of checks deposited in fine-sort deposit products, requiring the depositing bank to presort items by paying bank, declined 11.9 percent, compared with a 16.5 percent decrease in 1995. The volume of checks deposited that required processing by Federal Reserve Banks increased 2.8 percent.

In preparation for the 1997 implementation of interstate banking, the Federal Reserve Banks introduced the Nationwide City Sort product, their first national check product with uniform pricing. It permits collecting banks to make a single deposit of checks drawn on city institutions across the country. In addition, one District began to offer a companion product for checks drawn on institutions located in regional check processing availability zones.

To enhance the efficiency of the check collection system, the Reserve Banks continued to expand the use of electronics in check processing. During 1996, 9.3 percent (approximately 1.4 billion) of all checks presented to paying banks were presented electronically, an increase of nearly 40 percent over the 1995 level. Depository institutions also continued to expand their use of electronic information products to provide timely cash-management information to their corporate customers. Also, by year-end 1996, all Federal Reserve offices offered depository institutions the ability to make all adjustment requests electronically. Reserve Banks began to accept electronic adjustment requests from institutions within their territories in 1995.

The Reserve Banks also continued to expand their offerings of check image capture and storage products to support paying banks' use of electronic check products. At least one office in each of the Philadelphia, Atlanta, Chicago, St. Louis, Kansas City, and San Francisco Districts introduced image products during the year. The Cleveland, Minneapolis, and Dallas Banks introduced similar products in 1995.

In October 1996 the New York Bank closed the Jericho Regional Check

2. See the pro forma statements at the end of this chapter. *Other income* is the revenue from investment of clearing balances net of earnings credits, an amount known as net income on clearing balances. *Total cost* is the sum of operating expenses, imputed costs (interest on debt, interest on float, sales taxes, and the Federal Deposit Insurance Corporation assessment), imputed income taxes, and the targeted return on equity. *Net revenue* is revenue plus net income on clearing balances minus total cost.

Processing Center (RCPC) and consolidated check processing operations at its East Rutherford (N.J.) Operations Center. In addition, the Bank consolidated the processing of all adjustment requests at the Utica RCPC.

## Funds Transfer and Net Settlement

Federal Reserve Bank operating expenses and imputed costs for Fedwire funds transfer and net settlement services totaled $71.1 million. Revenue from Fedwire and net settlement operations totaled $94.7 million, and other income amounted to $2.9 million, resulting in income before income taxes of $26.4 million.

### *Funds Transfer*

The number of Fedwire funds transfers originated increased 9.2 percent, to 84.9 million—82.6 million value (monetary) transfers and 2.3 million nonvalue messages. The higher volume is due largely to sharply increased mutual fund activity, aggressive marketing of cash management services by depository institutions, and, to a lesser extent, increased mortgage activity and securities-related settlement payments. Fees charged for Fedwire transfers remained unchanged from 1995 fees.

In October 1996 the Board approved a December 8, 1997, effective date to open the Fedwire funds transfer service at 12:30 a.m. eastern time. Previously, the Board determined that expanding the Fedwire funds transfer service to eighteen hours per day, from the current ten hours per day, could be useful to the private sector in reducing settlement risk in the foreign exchange markets and eliminating an operational barrier to potentially important innovations in privately provided payment and settlement services.

Also during 1996, 475 of the approximately 8,400 on-line depository institutions began receiving funds transfers in the new expanded message format. All on-line institutions must be able to receive transfers in the new format by June 1997 and to send transfers in the new format by December 1997. The expanded format will have several benefits:

- Reduce manual interventions in the transfer process
- Eliminate the need to truncate payment-related information when forwarding through Fedwire payment orders that were received via other large-value transfer systems
- Allow additional information about the originator and beneficiary of a transfer to be included in the transfer message, as required by the Bank Secrecy Act rules adopted by the Department of the Treasury.

### *Net Settlement*

The Federal Reserve provides net settlement services to approximately 170 local private-sector clearing and settlement arrangements and to four nationwide arrangements. These arrangements enable participants to settle their net positions either via Fedwire funds transfers using special settlement accounts at Federal Reserve Banks or via accounting entries, which are posted to participants' Federal Reserve accounts by Federal Reserve Banks.

Two of the national arrangements, the Clearing House Interbank Payments System (CHIPS) and the Participants Trust Company (PTC), process and net large-dollar transactions, CHIPS for interbank funds transfers and PTC for the settlement of mortgage-backed securities transactions. The two other national arrangements, Visa ACH and the National Clearing House Association, process and net small-dollar transactions—Visa for automated clearinghouse transactions and National Clearing House for check payments. The majority of local clearing arrangements are check clearinghouses.

## Book-Entry Securities

Federal Reserve Bank operating expenses and imputed costs for book-entry securities transfer services totaled $16.2 million. Revenue from book-entry securities operations totaled $16.6 million, and other income amounted to $0.5 million, resulting in income before income taxes of $0.9 million. The Federal Reserve Banks processed 4.1 million transfers of government agency securities on the Fedwire book-entry securities transfer system during the year, an 11.8 percent increase over the 1995 level.[3] Fees charged for book-entry securities transfers remained unchanged from 1995.

On January 2, 1996, a firm closing time of 3:15 p.m. eastern time for the origination of securities transfers and 3:30 p.m. eastern time for reversals became effective. These closing times were implemented to reduce market uncertainty about the final closing time due to ad hoc closing hour extensions. These extensions are needed at times to accommodate significant operational problems at depository institutions or at the Federal Reserve Banks. In 1996, participants requested 62 percent fewer extensions, and the duration of extensions fell 53 percent.

Also in 1996, four Federal Reserve Banks converted their Fedwire securities transfer applications to the new centralized application known as the National Book-Entry System. The remaining Federal Reserve Banks are scheduled to convert to the new application by early 1998.

## Automated Clearinghouse

Federal Reserve Bank operating expenses and imputed costs for automated clearinghouse (ACH) services totaled $63.7 million. Revenue from ACH operations totaled $77.4 million, and other income amounted to $2.4 million, resulting in income before income taxes of $16.2 million. The Reserve Banks processed 2.4 billion commercial ACH transactions during the year, an increase of 15.9 percent over 1995 volume levels. In October the Reserve Banks combined the interregional and intraregional transaction fees (representing a 16.7 percent reduction for interregional transactions) and reduced the presort deposit fee by 10 percent.

During 1996 the Reserve Banks completed their conversion to the new consolidated Fed ACH software, which is installed at FRAS. The software processes ACH transactions on a flow basis and gives customers more deposit and delivery options. Customers can trace ACH transactions or files of transactions electronically, check the status of a file in process, and obtain limited information from the Federal Reserve's database on other ACH participants. Many of these new features will be available in 1997.

The consolidated processing environment has cut processing costs, enabling

3. The revenues, expenses, and volumes reflected here are for transfers of securities issued by federal government agencies, government-sponsored enterprises, and international institutions, such as the World Bank. The Fedwire securities transfer service also provides custody, transfer, and settlement services for securities of the U.S. Treasury. The Reserve Banks act as fiscal agents when they transfer Treasury securities, and the Treasury Department assesses fees for the services. See the section on fiscal agency services in this chapter for more details.

the Reserve Banks to reduce transaction fees. It also has enabled the Reserve Banks to eliminate the interregional, presort, and local deposit deadlines. Additional changes to the ACH fee schedule that will be implemented during 1997 will fully reflect the processing efficiencies of the Fed ACH environment.

### Noncash Collection

Federal Reserve Bank operating expenses and imputed costs for noncash collection services totaled $4.9 million. Revenue from noncash operations totaled $5.2 million, and other income amounted to $0.2 million, resulting in income before income taxes of $0.5 million. The number of noncash collection items (maturing coupons and bonds) processed by the Reserve Banks increased 27.5 percent, to more than 1 million items. In 1996 the Reserve Banks implemented a national fee schedule for the noncash collection service.

Two Federal Reserve sites process noncash items—the Cleveland Bank and the Jacksonville Branch of the Atlanta Bank. In 1996 the New York Reserve Bank stopped presenting noncash items to members of the New York Clearing House; the Chicago Reserve Bank continued to present noncash items through the Chicago Clearing House.

### Cash Services

Federal Reserve Bank operating expenses and imputed costs for cash services totaled $5.2 million. Revenue from cash operations totaled $5.2 million, and other income amounted to $0.2 million, resulting in income before income taxes of $0.2 million. Special priced cash services include cash transportation, coin wrapping services, and the provision of nonstandard currency packaging and nonstandard frequency of access to services.

### Float

Federal Reserve float increased in 1996 to a daily average of $413.4 million; it was $338.8 million in 1995. The Federal Reserve recovers the cost of float associated with priced services through fees for those services.

## Developments in Currency and Coin

The Federal Reserve continued to work closely with Treasury and other agencies to deter the counterfeiting and laundering of U.S. currency. In March the Federal Reserve began distributing the new Series 1996 $100 note, the first note since the 1920s to be totally redesigned. The Series 1996 note has several new features—an enlarged portrait, color-shifting ink, a watermark, concentric fine lines, and a universal Federal Reserve seal. The distribution of the Series 1996 $50 note is scheduled for l997.

The Federal Reserve's cost to print new currency in 1996 was $403 million. Treasury's Bureau of Engraving and Printing produced 9.8 billion Federal Reserve notes in 1996 and charged the Federal Reserve $40 per thousand notes. During 1996, 13 percent of the notes produced were the new Series 1996 $100 note, 45 percent were the $1 denomination, and the remaining 42 percent were the $2 through $50 denominations.

Reserve Bank operating expenses for processing and storing currency and coin, including priced cash services, totaled $279 million. The Federal Reserve supplies currency and coin to the public through approximately 9,500 depository institutions throughout the United States. The value of currency and coin in circulation increased 9 percent in 1996 and exceeded $440 billion by year-end. During 1996, the Reserve Banks received more than 23.7 billion Federal Reserve notes in deposits from depository institutions and paid more than 24.3 billion Federal Reserve notes to depository institutions.

The Federal Reserve Banks continued converting their currency processing operations to the Banknote Processing Systems (BPS) 3000. Before a recent upgrade, the equipment was referred to as ISS 3000 machines. At the end of 1996, 126 of the BPS 3000 machines were in use at the Reserve Banks. The Federal Reserve plans to install a total of 128 processors at the Reserve Banks and to complete the conversion in 1997.

In April the Board approved a new cash access policy, to be effective in May 1998, that provides greater consistency in Reserve Bank cash service levels. It establishes a base level of currency access to all depository institutions at no charge but restricts the number of offices served and the frequency of access. Depository institutions that meet minimum volume thresholds will be able to obtain more frequent free access. Additional access, beyond the free service level, will be priced.

## Developments in Fiscal Agency and Government Depository Services

The Federal Reserve Act provides that, when required by the Secretary of the Treasury, Federal Reserve Banks will

### Expenses of the Federal Reserve Banks for Fiscal Agency and Depository Services, 1996, 1995, and 1994

Thousands of dollars

| Agency and service | 1996 | 1995 | 1994 |
|---|---|---|---|
| DEPARTMENT OF THE TREASURY | | | |
| *Bureau of the Public Debt* | | | |
| Savings bonds | 78,765.8 | 80,934.6 | 86,216.0 |
| Treasury Direct | 26,788.8 | 30,117.4 | 23,865.3 |
| Commercial book entry | 27,009.0 | 27,705.9 | 22,950.5 |
| Marketable Treasury issues | 22,349.9 | 22,830.3 | 19,813.4 |
| Definitive securities and Treasury coupons | 3,498.5 | 3,860.6 | 3,924.2 |
| Total | 158,502.0 | 165,448.8 | 156,769.4 |
| *Financial Management Service* | | | |
| Treasury tax and loan and Treasury general account | 38,828.2 | 35,749.3 | 34,487.1 |
| Government check processing | 22,604.1 | 24,347.4 | 22,998.9 |
| Automated clearinghouse | 20,557.0 | 22,238.0 | 24,502.0 |
| Government agency deposits | 3,366.1 | 3,823.5 | 4,602.2 |
| Fedwire funds transfers | 455.3 | 357.9 | 416.9 |
| Other services | 17,346.3 | 16,376.7 | 13,842.9 |
| Total | 103,157.1 | 102,892.8 | 100,850.0 |
| *Other* | | | |
| Total | 3,554.6 | 4,017.5 | 3,545.7 |
| Total, Treasury | 265,213.6 | 272,359.1 | 261,165.1 |
| OTHER FEDERAL AGENCIES | | | |
| Securities services | 18,788.8 | 18,547.2 | 15,282.7 |
| Food coupons | 25,287.6 | 24,251.4 | 22,653.9 |
| Postal money orders | 5,722.9 | 5,467.8 | 5,486.3 |
| Total, other agencies | 49,799.3 | 48,266.4 | 43,422.9 |
| **Total** | **315,012.9** | **320,625.5** | **304,588.0** |

act as "fiscal agents" and "depositories" of the United States. As fiscal agents for the Department of the Treasury, Reserve Banks provide debt-related services, such as issuing, servicing, and redeeming marketable Treasury securities and U.S. savings bonds, and processing secondary market transfers initiated by depository institutions. As depositories, Reserve Banks collect and disburse funds on behalf of the federal government. The Reserve Banks also provide fiscal agency services on behalf of several domestic and international government agencies.

In October 1996 a new fiscal agency policy was adopted to clarify the Reserve Banks' unique statutory relationship with the Treasury and other government entities. The policy identifies guidelines for managing a request or directive for new services (without competitive bidding) from a government agency; outlines the criteria for determining whether to respond to a competitive procurement request from a government agency for financial services; establishes uniform and consistent practices for cost accounting, reporting, and billing for fiscal and depository services on a full-cost or other appropriate basis; and defines the terms and conditions for providing services to government agencies.

In 1996 the total cost of providing fiscal agency and depository services to Treasury amounted to $265.2 million. In addition, the Reserve Banks provide services to other government agencies; the cost of providing services to other government agencies was $49.8 million in 1996.

## Fiscal Agency Securities Services

The Federal Reserve Banks handle marketable Treasury securities and savings bonds and monitor collateral pledged to the federal government by depository institutions.

### *Marketable Treasury Securities*

Reserve Bank operating expenses for activities related to marketable Treasury securities amounted to $52.6 million. The Reserve Banks processed more than 445,000 commercial tenders for government securities in Treasury auctions. In 1996 the volume of commercial tenders decreased 26.2 percent from 1995 volume levels. Commercial tender processing was consolidated at the New York, Chicago, and San Francisco Banks in 1996.

The Reserve Banks operate two book-entry securities systems for the custody and transfer of Treasury securities—the Fedwire book-entry securities transfer system and Treasury Direct. Almost all book-entry Treasury securities—97.6 percent of the par value outstanding at year-end 1996—were maintained on Fedwire, and 2.4 percent of the total was maintained on Treasury Direct.

The Reserve Banks processed 9.0 million Fedwire transfers of Treasury securities, a decrease of 1.6 percent from the 1995 level. In addition, the Banks processed 21.6 million interest and principal payments for both Treasury and agency securities. The fees charged to depository institutions for sending and receiving Fedwire transfers of Treasury book-entry securities are the same as those charged to them for transfers of government agency securities. The Federal Reserve keeps a portion of the fee for transfers of Treasury securities to cover its settlement expenses; the remainder of the fee is remitted to Treasury.

The Philadelphia Bank operates Treasury Direct, a system of book-entry securities accounts for nondepository institutions and individuals planning to hold their Treasury securities to maturity. The Treasury Direct system contains more than 1.8 million accounts. During 1996 the Reserve Banks processed 450 thousand tenders for Treasury Direct customers seeking to purchase Treasury securities at Treasury auctions, and they handled 2.0 million reinvestment requests. The volume of tenders decreased 44.3 percent, and the volume of reinvestment requests increased 14.5 percent, compared with 1995 levels. In addition, the Philadelphia Bank issued 7.3 million payments for discounts, interest, and redemption proceeds; 2.7 million payments for savings bonds; and more than 61 thousand interest payments for definitive Treasury issues.

The Federal Reserve also worked with Treasury's Bureau of the Public Debt to implement, on a pilot basis, an option that permits selected Treasury Direct investors to pay for securities with an ACH debit to their bank account.

### *Savings Bonds*

Reserve Bank operating expenses for savings bond activities amounted to $78.8 million. The Reserve Banks printed and mailed 55.1 million savings bonds on behalf of Treasury's Bureau of the Public Debt, a decrease of 9.6 percent from 1995. The Banks processed 8.2 million original-issue transactions. Redemption, reissue, and exchange transactions totaled 664,000, an increase of 4.3 percent over 1995. The Reserve Banks also responded to 1.7 million service calls from owners of savings bonds, an increase of 12.7 percent from 1995.

Savings bond operations are performed at five Reserve Bank offices: All of these offices process savings bond transactions; only the offices print savings bonds.

### *Other Initiatives*

The Reserve Banks maintain custody of definitive (physical) and book-entry securities pledged as collateral by depository institutions holding deposits from Treasury and other government agencies. In 1996 the Reserve Banks monitored the value of the definitive securities by pricing them according to their market value (marking them to market). The Reserve Banks will mark book-entry securities to market after completion of the conversion to the National Book-Entry System.

The Federal Reserve also worked with Treasury's Financial Management Service to expand the Treasury Offset Program on a pilot basis. The Offset Program electronically compares information about delinquent debts owed to the U.S. government with information about payments being issued by the government. If a match occurs, the program applies the payment to the delinquent debt.

## Depository Services

The Reserve Banks maintain Treasury's funds account, accept deposits of federal taxes and fees, pay checks drawn on Treasury's account, and make electronic payments on behalf of Treasury.

### *Federal Tax Payments*

Reserve Bank operating expenses for federal tax payment activities were $38.8 million. The Reserve Banks processed 6.3 million advices of credit from depository institutions accepting tax deposits from businesses and individuals. The Reserve Banks also received a small portion of tax payments directly, representing about 1 percent of the total value. Depository institutions that receive tax payments may place the funds in a Treasury tax and loan account or remit the funds to a Reserve Bank.

The Reserve Banks assisted with the implementation of the Treasury's Electronic Federal Tax Payment System (EFTPS), which automates the flow of federal tax deposits from businesses. The system became operational in October. Tax payments made via EFTPS flow to Treasury one day sooner than they do under the paper-based process, improving Treasury's investment opportunities and enabling it to manage its cash flows more efficiently. The Reserve Banks have developed and implemented new payment mechanisms for use by taxpayers who must send their payments on the same day their tax liability is established.

### *Payments Processed for Treasury*

Operating expenses for government payment operations amounted to $47 million. During the year, Treasury continued to increase the proportion of its payments made electronically. The number of ACH transactions processed for Treasury amounted to 625 million, an increase of 4.4 percent over the 1995 volume. The majority of government payments made via the ACH are for social security, pension, and salary payments. Treasury also uses the ACH to make some payments to vendors.

The Reserve Banks processed 436 million government checks, a decrease of 5.2 percent from 1995. The Reserve Banks also issued 1.3 million fiscal agency checks, which are used primarily to pay semiannual interest on registered, definitive Treasury notes and bonds and Series H and HH savings bonds. They are also used to pay the principal of matured securities and coupons and discounts to first-time purchasers of government securities through Treasury Direct. All recurring Treasury Direct payments and many definitive securities interest payments are made via the ACH.

Following successful tests of digital imaging technology, Treasury's Financial Management Service issued their specific requirements for the use of check images archived at Reserve Banks, which will improve the Treasury's check reconciliation and claims processing. In response, the Reserve Banks, as fiscal agents, designed and began to build a check imaging system composed of two fundamental elements: (1) a capture subsystem, consisting of image-enabled check reader–sorters and temporary image storage facilities, and (2) an archive and retrieval subsystem, containing an indexed database configured for long-term storage and retrieval of images of paid Treasury checks. The image-based system will replace the existing microfilm-based check truncation service, eliminate the manual research associated with microfilm, and reduce the time required to make paid Treasury check information available for research and inquiry.

## Services Provided to Other Entities

When required to do so by the Secretary of the Treasury or when required or permitted to do so by federal statute, the Reserve Banks perform fiscal agency securities services and depository services for other domestic and international agencies. Depending on the authority under which services are provided, the Reserve Banks may (1) facilitate the issuance of government agency book-entry securities that are eligible to be transferred over Fedwire, (2) provide custody for the stock of unissued, definitive securities, (3) maintain and update balances of outstanding book-entry and definitive securities for issuers, (4) perform various other securities servicing activities, and (5) maintain funds accounts for some government agencies.

*Food Coupons*

Reserve Bank operating expenses for food coupon services were $25.3 million in 1996. The Reserve Banks redeemed 3.6 billion food coupons, a decrease of 7.1 percent from 1995.

The Account Management Agent (AMA) system was completed in March. The AMA system is used by the Department of Agriculture's Food and Consumer Service to establish and monitor adherence to limits on federal funding to states for food coupons. The Federal Reserve, the Department of Agriculture, and the Department of the Treasury are continuing to work on enhancements in the area of fraud detection.

*Examinations*

Section 21 of the Federal Reserve Act requires the Board of Governors to order an examination of each Federal Reserve Bank at least once per year, and the Board assigns this responsibility to its Division of Reserve Bank Operations and Payment Systems. Since 1995 the division has engaged a public accounting firm to audit the combined financial statements of the Reserve Banks. In addition, for 1996 the firm audited the year-end financial statements of the Dallas, Richmond, and New York Reserve Banks; the division audited the year-end financial statements of the other nine Banks and conducted reviews of their administrative controls and their compliance with federal statutes and regulations and with policies of the System.

Each year, the division assesses compliance with the policies established by the Federal Open Market Committee (FOMC) by examining the accounts and holdings of the System Open Market Account (SOMA) at the Federal Reserve Bank of New York and the foreign currency operations conducted by the Bank. In addition, a public accounting firm certifies the schedule of participated asset and liability accounts and the related schedule of participated income accounts at year-end. Division personnel follow up on the audit results. Copies of the external audit reports are furnished to the FOMC as are reports on the division's follow-up.

## Income and Expenses

The accompanying table summarizes the income, expenses, and distributions of net earnings of the Federal Reserve Banks for 1996 and 1995.

Income was $25,164 million in 1996 and $25,395 million in 1995. Total expenses were $2,111 million ($1,639 million in operating expenses, $309 million in earnings credits granted to depository institutions, and $163 million in assessments for expenditures by the Board of Governors). The cost of new currency was $403 million. Revenue from financial services was $787 million. Unreimbursed expenses for services provided to Treasury amounted to $38 million.

The profit and loss account showed a net loss of $1,639 million. The loss was primarily a result of realized and unrealized losses on assets denominated in foreign currencies revalued to reflect current market exchange rates. Statutory dividends to member banks totaled $256 million, $25 million more than in 1995. This rise reflects an increase in the capital and surplus of member banks and a consequent increase in the paid-in capital stock of the Reserve Banks.

Payments to Treasury totaled $20,083 million, compared with $23,389 million in 1995. The payments consist of all net income after the deduction of dividends and after the deduction of the amount necessary to bring the surplus of the Reserve Banks to the level of capital paid-in. Also in 1996, the System made a lump-sum payment of $106 million to the U.S. Treasury from the surplus account of the Federal Reserve Banks, as required by statute.

In the Statistical Tables chapter of this REPORT, table 6 details income and expenses of each Federal Reserve Bank for 1996, and table 7 shows a condensed statement for each Bank for the years 1914 to 1996. A detailed account of the assessments and expenditures of the Board of Governors appears in the next chapter—Board of Governors Financial Statements.

## Holdings of Securities and Loans

Average daily holdings of securities and loans by Federal Reserve Banks during 1996 were $390,268 million, an increase of $14,199 million from 1995 (see accompanying table). From 1995 to 1996, their holdings of U.S. government securities increased $14,196 million, and loans increased $4 million.

Also during the period from 1995 to 1996, the average rate of interest decreased from 6.34 percent to 6.12 percent on holdings of government securities and decreased from 5.62 percent to 5.27 percent on loans.

## Volume of Operations

Table 9, in the Statistical Tables chapter, shows the volume of operations in the principal departments of the Federal Reserve Banks for the years 1993 through 1996.

## Federal Reserve Bank Premises

Construction continued in 1996 on the new headquarters building for the Minneapolis Bank and the expansion and renovation of the headquarters building of the Cleveland Bank.

Income, Expenses, and Distribution of Net Earnings of Federal Reserve Banks, 1996 and 1995

Millions of dollars

| Item | 1996 | 1995 |
|---|---|---|
| Current income | 25,164 | 25,395 |
| Current expenses | 1,948 | 1,818 |
| Operating expenses [1] | 1,639 | 1,568 |
| Earnings credits granted | 309 | 251 |
| Current net income | 23,216 | 23,577 |
| Net additions to (deductions from, – ) current net income | –1,639 | 896 |
| Cost of unreimbursed services to Treasury | 38 | 38 |
| Assessments by the Board of Governors | 565 | 531 |
| For expenditures of Board | 163 | 161 |
| For cost of currency | 403 | 370 |
| Net income before payments to Treasury | 20,975 | 23,903 |
| Dividends paid | 256 | 231 |
| Transferred to surplus [2] | 635 | 283 |
| Payments to Treasury [2] | 20,083 | 23,398 |

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

1. Includes a net periodic credit for pension costs of $140.5 million in 1996 and $119.2 million in 1995.

2. In addition to the amounts shown, $106 million in Federal Reserve Bank surplus was transferred to the Treasury as statutorily required.

The Atlanta Bank purchased property for its new Birmingham Branch building and began the project's design phase. The Atlanta Bank also retained design consultants for its new headquarters building project in Atlanta.

Multiyear renovation programs continued for the New York Bank's headquarters building, the Kansas City Bank's Oklahoma City Branch, and the San Francisco Bank's Seattle, Portland, and Salt Lake City Branches.

The New York Bank closed its Jericho, New York, check processing facility, and the Kansas City Bank sold its old Omaha, Nebraska, Branch building. The Chicago Bank contracted to lease space for processing checks in a new building that is under construction in Des Moines, Iowa.

## Securities and Loans of Federal Reserve Banks, 1994–96

Millions of dollars except as noted

| Item and year | Total | U.S. government securities [1] | Loans [2] |
|---|---|---|---|
| *Average daily holdings* [3] | | | |
| 1994 | 354,001 | 353,740 | 261 |
| 1995 | 376,069 | 375,867 | 202 |
| 1996 | 390,268 | 390,063 | 206 |
| *Earnings* | | | |
| 1994 | 19,259 | 19,247 | 11 |
| 1995 | 23,837 | 23,826 | 11 |
| 1996 | 23,895 | 23,884 | 11 |
| *Average interest rate (percent)* | | | |
| 1994 | 5.44 | 5.44 | 4.39 |
| 1995 | 6.34 | 6.34 | 5.62 |
| 1996 | 6.12 | 6.12 | 5.27 |

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

1. Includes federal agency obligations.

2. Does not include indebtedness assumed by the Federal Deposit Insurance Corporation.

3. Based on holdings at opening of business.

# Pro Forma Financial Statements for Federal Reserve Priced Services

## Pro Forma Balance Sheet for Priced Services, December 31, 1996 and 1995

Millions of dollars

| Item | 1996 | | 1995 | |
|---|---|---|---|---|
| *Short-term assets* (Note 1) | | | | |
| Imputed reserve requirements on clearing balances | 658.3 | | 504.2 | |
| Investment in marketable securities | 5,924.7 | | 4,537.8 | |
| Receivables | 69.0 | | 63.7 | |
| Materials and supplies | 3.2 | | 10.6 | |
| Prepaid expenses | 26.5 | | 19.4 | |
| Items in process of collection | 7,548.4 | | 2,397.4 | |
| Total short-term assets | | 14,230.1 | | 7,533.1 |
| *Long-term assets* (Note 2) | | | | |
| Premises | 393.5 | | 356.6 | |
| Furniture and equipment | 171.1 | | 170.3 | |
| Leases and leasehold improvements | 31.0 | | 24.2 | |
| Prepaid pension costs | 287.4 | | 242.1 | |
| Total long-term assets | | 883.0 | | 793.1 |
| **Total assets** | | **15,113.1** | | **8,326.2** |
| *Short-term liabilities* | | | | |
| Clearing balances and balances arising from early credit of uncollected items | 12,366.3 | | 5,154.8 | |
| Deferred-availability items | 1,765.1 | | 2,284.5 | |
| Short-term debt | 98.7 | | 93.7 | |
| Total short-term liabilities | | 14,230.1 | | 7,533.1 |
| *Long-term liabilities* | | | | |
| Obligations under capital leases | 2.3 | | 3.8 | |
| Long-term debt | 196.9 | | 164.3 | |
| Postretirement/postemployment benefits obligation | 178.6 | | 176.1 | |
| Total long-term liabilities | | 377.8 | | 344.3 |
| **Total liabilities** | | **14,607.9** | | **7,877.4** |
| Equity | | 505.2 | | 448.8 |
| **Total liabilities and equity** (Note 3) | | **15,113.1** | | **8,326.2** |

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

The priced services financial statements consist of these tables and the accompanying notes.

## Pro Forma Income Statement for Federal Reserve Priced Services, 1996 and 1995

Millions of dollars

| Item | 1996 | | 1995 | |
|---|---|---|---|---|
| Revenue from services provided to depository institutions (Note 4) | | 787.2 | | 738.8 |
| Operating expenses (Note 5) | | 666.0 | | 655.2 |
| Income from operations | | 121.2 | | 83.6 |
| Imputed costs (Note 6) | | | | |
| Interest on float | 21.9 | | 19.0 | |
| Interest on debt | 17.3 | | 16.2 | |
| Sales taxes | 11.6 | | 22.1 | |
| FDIC insurance | 0.0 | 50.8 | 6.3 | 63.7 |
| Income from operations after imputed costs | | 70.4 | | 19.9 |
| Other income and expenses (Note 7) | | | | |
| Investment income | 315.8 | | 259.6 | |
| Earnings credits | −287.1 | 28.7 | −233.2 | 26.4 |
| Income before income taxes | | 99.1 | | 46.3 |
| Imputed income taxes | | 29.6 | | 14.4 |
| Income before cumulative effect of a change in accounting principle | | 69.5 | | 31.9 |
| Cumulative effect on previous years from retroactive application of accrual method of accounting for postemployment and vacation benefits (net of $8.7 million tax) (Note 9) | | ... | | 19.4 |
| **Net income** (Note 10) | | **69.5** | | **12.6** |
| MEMO: Targeted return on equity (Note 11) | | 42.9 | | 31.5 |

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

The priced services financial statements consist of these tables and the accompanying notes.

## Pro Forma Income Statement for Federal Reserve Priced Services, by Service, 1996

Millions of dollars

| Item | Total | Commercial check collection | Funds transfer and net settlement | Book-entry securities | Commercial ACH | Noncash collection | Cash services |
|---|---|---|---|---|---|---|---|
| Revenue from operations | 787.2 | 588.1 | 94.7 | 16.6 | 77.4 | 5.2 | 5.2 |
| Operating expenses (Note 5) | 666.0 | 527.0 | 68.2 | 15.6 | 60.8 | 4.4 | 5.0 |
| Income from operations | 121.2 | 61.1 | 26.4 | 1.0 | 16.6 | .8 | .2 |
| Imputed costs (Note 6) | 50.8 | 43.7 | 2.9 | .6 | 2.9 | .5 | .2 |
| Income from operations after imputed costs | 70.4 | 17.4 | 23.5 | .4 | 13.7 | .4 | .0 |
| Other income and expenses, net (Note 7) | 28.7 | 22.5 | 2.9 | .5 | 2.4 | .2 | .2 |
| Income before income taxes | 99.1 | 39.9 | 26.4 | .9 | 16.2 | .5 | .2 |

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

The priced services financial statements consist of these tables and the accompanying notes.

# FEDERAL RESERVE BANKS

## Notes to Financial Statements for Priced Services

### (1) Short-Term Assets

The imputed reserve requirement on clearing balances held at Reserve Banks by depository institutions reflects a treatment comparable to that of compensating balances held at correspondent banks by respondent institutions. The reserve requirement imposed on respondent balances must be held as vault cash or as nonearning balances maintained at a Reserve Bank; thus, a portion of priced services clearing balances held with the Federal Reserve is shown as required reserves on the asset side of the balance sheet. The remainder of clearing balances is assumed to be invested in three-month Treasury bills, shown as investment in marketable securities.

Receivables are (1) amounts due the Reserve Banks for priced services and (2) the share of suspense-account and difference-account balances related to priced services.

Materials and supplies are the inventory value of short-term assets.

Prepaid expenses include salary advances and travel advances for priced-service personnel.

Items in process of collection is gross Federal Reserve cash items in process of collection (CIPC) stated on a basis comparable to that of a commercial bank. It reflects adjustments for intra-System items that would otherwise be double-counted on a consolidated Federal Reserve balance sheet; adjustments for items associated with non-priced items, such as those collected for government agencies; and adjustments for items associated with providing fixed availability or credit before items are received and processed. Among the costs to be recovered under the Monetary Control Act is the cost of float, or net CIPC during the period (the difference between gross CIPC and deferred-availability items, which is the portion of gross CIPC that involves a financing cost), valued at the federal funds rate.

### (2) Long-Term Assets

Consists of long-term assets used solely in priced services, the priced-services portion of long-term assets shared with nonpriced services, and an estimate of the assets of the Board of Governors used in the development of priced services. Effective Jan. 1, 1987, the Reserve Banks implemented the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 87, *Employers' Accounting for Pensions* (SFAS 87). Accordingly, the Reserve Banks recognized credits to expenses of \$45.3 million in 1996 and \$35.4 million in 1995 and corresponding increases in this asset account.

### (3) Liabilities and Equity

Under the matched-book capital structure for assets that are not "self-financing," short-term assets are financed with short-term debt. Long-term assets are financed with long-term debt and equity in a proportion equal to the ratio of long-term debt to equity for the fifty largest bank holding companies, which are used in the model for the private-sector adjustment factor (PSAF). The PSAF consists of the taxes that would have been paid and the return on capital that would have been provided had priced services been furnished by a private-sector firm. Other short-term liabilities include clearing balances maintained at Reserve Banks and deposit balances arising from float. Other long-term liabilities consist of accrued postemployment (see note 9) and postretirement benefits costs and obligations on capital leases.

### (4) Revenue

Revenue represents charges to depository institutions for priced services and is realized from each institution through one of two methods: direct charges to an institution's account or charges against its accumulated earnings credits.

### (5) Operating Expenses

Operating expenses consist of the direct, indirect, and other general administrative expenses of the Reserve Banks for priced services plus the expenses for staff members of the Board of Governors working directly on the development of priced services. The expenses for Board staff members were \$2.8 million in 1996 and \$2.7 million in 1995. The credit to expenses under SFAS 87 (see note 2) is reflected in operating expenses.

The income statement by service reflects revenue, operating expenses, and imputed costs except for income taxes. Total operating expense does not equal the sum of operating expenses for each service because of the effect of SFAS 87. Although the portion of the SFAS 87 credit related to the current year is allocated to individual services, the amortization of the initial effect of implementation is reflected only at the System level.

### (6) Imputed Costs

Imputed costs consist of interest on float, interest on debt, sales taxes, and the FDIC assessment. Interest on float is derived from the value of float to be recovered, either explicitly or through per-item fees, during the period. Float costs include costs for checks, book-entry securities, noncash collection, ACH, and funds transfers.

Interest is imputed on the debt assumed necessary to finance priced-service assets. The sales taxes and FDIC assessment that the Federal Reserve would have paid had it been a private-sector firm are among the components of the PSAF (see note 3).

Float costs are based on the actual float incurred for each priced service. Other imputed costs are allocated among priced services according to the ratio of operating expenses less shipping expenses for each service to the total expenses for all services less the total shipping expenses for all services.

The following list shows the daily average recovery of float by the Reserve Banks for 1996 in millions of dollars:

| | |
|---|---|
| Total float | 795.4 |
| Unrecovered float | 12.4 |
| Float subject to recovery | 783.0 |
| Sources of recovery of float | |
| Income on clearing balances | 78.4 |
| As-of adjustments | 382.0 |
| Direct charges | 116.4 |
| Per-item fees | 206.2 |

Unrecovered float includes float generated by services to government agencies and by other central bank services. Float recovered through income on clearing balances is the result of the increase in investable clearing balances; the increase is produced by a deduction for float for cash items in process of collection, which reduces imputed reserve requirements. The income on clearing balances reduces the float to be recovered through other means. As-of adjustments and direct charges are midweek closing float and interterritory check float, which may be recovered from depositing institutions through adjustments to the institution's reserve or clearing balance or by valuing the float at the federal funds rate and billing the institution directly. Float recovered through per-item fees is valued at the federal funds rate and has been added to the cost base subject to recovery in 1996.

### (7) Other Income and Expenses

Consists of investment income on clearing balances and the cost of earnings credits. Investment income on clearing balances represents the average coupon-equivalent yield on three-month Treasury bills applied to the *total* clearing balance maintained, adjusted for the effect of reserve requirements on clearing balances. Expenses for earnings credits granted to depository institutions on their clearing balances are derived by applying the average federal funds rate to the *required* portion of the clearing balances, adjusted for the net effect of reserve requirements on clearing balances.

Because clearing balances relate directly to the Federal Reserve's offering of priced services, the income and cost associated with these balances are allocated to each service based on each service's ratio of income to total income.

### (8) Income Taxes

Imputed income taxes are calculated at the effective tax rate derived from the PSAF model (see note 3). Taxes have not been allocated by service because they relate to the organization as a whole.

### (9) Postemployment and Vacation Benefits

Effective Jan. 1, 1995, the Reserve Banks implemented SFAS 112, *Employers' Accounting for Postemployment Benefits,* and SFAS 43, *Accounting for Compensated Absences.* Accordingly, in 1995 the Reserve Banks recognized a one-time cumulative charge of $28.1 million to reflect the retroactive application of these changes in accounting principles.

### (10) Adjustments to Net Income for Price Setting

In setting fees, certain costs are excluded in accordance with the System's overage and shortfalls policy and its automation consolidation policy. Accordingly, to compare the financial results reported in this table with the projections used to set prices, adjust net income as follows (amounts shown are net of tax):

| | 1996 | 1995 |
|---|---|---|
| Net income | 69.5 | 12.6 |
| Amortization of the initial effect of implementing SFAS 87 | −10.5 | −10.4 |
| Deferred costs of automation consolidation | −6.3 | −.1 |
| Cumulative effect of retroactive application of SFAS 112 and SFAS 43 | . . . | 19.4 |
| Adjusted net income | 52.6 | 21.5 |

### (11) Return on Equity

The after-tax rate of return on equity that the Federal Reserve would have earned had it been a private business firm, as derived from the PSAF model (see note 3). This amount is adjusted to reflect the recovery of $6.3 million of automation consolidation costs for 1996 and $0.1 million for 1995. The Reserve Banks plan to recover these amounts, along with a finance charge, by the end of the year 2001. After-tax return on equity has not been allocated by service because it relates to the organization as a whole.

# Board of Governors Financial Statements

The financial statements of the Board were audited by Price Waterhouse, independent public accountants, for 1996 and 1995.

**Price Waterhouse LLP**

## Report of Independent Accountants

To the Board of Governors of the
Federal Reserve System

We have audited the accompanying balance sheets of the Board of Governors of the Federal Reserve System (the Board) as of December 31, 1996 and 1995, and the related statements of revenues and expenses and fund balance and of cash flows for the years then ended. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Board as of December 31, 1996 and 1995, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards,* we have also issued a report dated March 25, 1997 on our consideration of the Board's internal controls and a report dated March 25, 1997 on its compliance with laws and regulations.

Price Waterhouse LLP

March 25, 1997
Arlington, Virginia

## BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

## BALANCE SHEET

| | As of December 31, 1996 | 1995 |
|---|---|---|
| **ASSETS** | | |
| **CURRENT ASSETS** | | |
| Cash | $ 15,712,258 | $16,142,195 |
| Accounts receivable | 2,561,975 | 1,900,155 |
| Transfers receivable—surplus Federal Reserve Bank earnings (Note 1) | 659,862,602 | — |
| Prepaid expenses and other assets | 2,247,391 | 1,225,022 |
| Total current assets | 680,384,226 | 19,267,372 |
| PROPERTY, BUILDINGS, AND EQUIPMENT, NET (Note 4) | 61,110,184 | 59,781,623 |
| Total assets | $741,494,410 | $79,048,995 |
| **LIABILITIES AND FUND BALANCE** | | |
| **CURRENT LIABILITIES** | | |
| Accounts payable and accrued liabilities | $ 10,435,545 | $ 7,580,371 |
| Accrued payroll and related taxes | 6,804,678 | 4,868,497 |
| Transfers payable—surplus Federal Reserve Bank earnings (Note 1) | 659,862,602 | — |
| Accrued annual leave | 6,966,327 | 6,601,004 |
| Capital lease payable (current portion) | — | 75,840 |
| Unearned revenues and other liabilities | 2,263,338 | 2,184,882 |
| Total current liabilities | 686,332,490 | 21,310,594 |
| CAPITAL LEASE PAYABLE (non-current portion) | — | 232,638 |
| ACCUMULATED RETIREMENT BENEFIT OBLIGATION (Note 2) | 466,056 | — |
| ACCUMULATED POSTRETIREMENT BENEFIT OBLIGATION (Note 3) | 18,171,722 | 17,074,588 |
| ACCUMULATED POSTEMPLOYMENT BENEFIT OBLIGATION (Note 3) | 1,409,343 | 1,093,400 |
| FUND BALANCE | 35,114,799 | 39,337,775 |
| Total liabilities and fund balance | $741,494,410 | $79,048,995 |

The accompanying notes are an integral part of these statements.

## BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

## STATEMENT OF REVENUES AND EXPENSES AND FUND BALANCE

| | For the years ended December 31, 1996 | 1995 |
|---|---|---|
| **Board Operating Revenues** | | |
| Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures | $ 162,642,400 | $161,347,900 |
| Other revenues (Note 5) | 9,789,141 | 10,240,830 |
| Total operating revenues | 172,431,541 | 171,588,730 |
| **Board Operating Expenses** | | |
| Salaries | 106,353,644 | 100,412,576 |
| Retirement and insurance contributions | 18,417,943 | 16,394,955 |
| Contractual services and professional fees | 11,159,490 | 11,240,373 |
| Depreciation and net losses on disposals | 8,626,785 | 7,525,971 |
| Travel | 4,942,020 | 4,920,996 |
| Equipment and facilities rental | 4,356,715 | 3,853,657 |
| Postage and supplies | 4,263,382 | 4,523,272 |
| Utilities | 4,189,203 | 4,155,038 |
| Software | 3,907,874 | 3,362,342 |
| Repairs and maintenance | 3,417,539 | 3,689,603 |
| Printing and binding | 2,665,188 | 3,144,178 |
| Other expenses (Note 5) | 4,354,734 | 3,915,489 |
| Total operating expenses | 176,654,517 | 167,138,450 |
| **Board Operating Revenues (Under) Over Expenses** | (4,222,976) | 4,450,280 |
| **Issuance and Redemption of Federal Reserve Notes** | | |
| Assessments levied on Federal Reserve Banks for currency costs | 403,232,215 | 370,206,037 |
| Expenses for currency printing, issuance, retirement, and shipping | 403,232,215 | 370,206,037 |
| **Currency Assessments Over (Under) Expenses** | — | — |
| **Total Revenues (Under) Over Expenses** | (4,222,976) | 4,450,280 |
| **Fund Balance**, Beginning of year | 39,337,775 | 34,887,495 |
| **Transfers to the U.S. Treasury** | | |
| Transfers and accrued transfers from surplus Federal Reserve Bank earnings (Note 1) | 5,623,716,034 | — |
| Transfers and accrued transfers to the U.S. Treasury (Note 1) | (5,623,716,034) | — |
| **Fund Balance**, End of year | $ 35,114,799 | $ 39,337,775 |

The accompanying notes are an integral part of these statements.

# BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

## STATEMENT OF CASH FLOWS

### Increase (Decrease) in Cash

| | For the years ended December 31, 1996 | 1995 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Board operating revenues (under) over expenses | $ (4,222,976) | $ 4,450,280 |
| Adjustments to reconcile operating revenues (under) over expenses to net cash provided by operating activities: | | |
| Depreciation and net losses on disposals | 8,626,785 | 7,525,971 |
| (Increase) in transfers receivable—surplus Federal Reserve Bank earnings | (659,862,602) | — |
| Increase in accumulated postretirement benefits | 1,097,134 | 800,142 |
| Increase in accumulated retirement benefits | 466,056 | — |
| Increase (decrease) in accumulated postemployment benefits | 315,943 | (226,618) |
| (Increase) decrease in accounts receivable, prepaid expenses, and other assets | (1,684,189) | 438,229 |
| Increase in accrued annual leave | 365,323 | 377,085 |
| Increase in accounts payable and accrued liabilities | 2,855,174 | 2,129,494 |
| Increase in transfers payable—surplus Federal Reserve Bank earnings | 659,862,602 | — |
| Increase in payroll payable and related taxes | 1,936,181 | 948,432 |
| Increase in unearned revenues and other liabilities | 78,456 | 332,268 |
| Net cash provided by operating activities | 9,833,887 | 16,775,283 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from disposals of furniture and equipment | 70,500 | 12,112 |
| Capital expenditures | (10,334,324) | (15,594,485) |
| Net cash used in investing activities | (10,263,824) | (15,582,373) |
| NET (DECREASE) INCREASE IN CASH | (429,937) | 1,192,910 |
| CASH BALANCE, Beginning of year | 16,142,195 | 14,949,285 |
| CASH BALANCE, End of year | $ 15,712,258 | $16,142,195 |

The accompanying notes are an integral part of these statements.

# BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

## NOTES TO FINANCIAL STATEMENTS

### (1) Significant Accounting Policies

*Board Operating Revenues and Expenses*—Assessments made on the Federal Reserve Banks for Board operating expenses and capital expenditures are calculated based on expected cash needs. These assessments, other operating revenues, and operating expenses are recorded on the accrual basis of accounting.

*Issuance and Redemption of Federal Reserve Notes*—The Board incurs expenses and assesses the Federal Reserve Banks for the costs of printing, issuing, shipping, and retiring Federal Reserve Notes. These assessments and expenses are separately reported in the statements of revenues and expenses because they are not Board operating transactions.

*Property, Buildings and Equipment*—The Board's property, buildings and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, which range from 4 to 10 years for furniture and equipment and from 10 to 50 years for building equipment and structures. Upon the sale or other disposition of a depreciable asset, the cost and related accumulated depreciation are removed from the accounts and any gain or loss is recognized.

*Federal Reserve Bank Surplus Earnings*—The Omnibus Budget Reconciliation Act of 1993 requires that surplus Federal Reserve Bank earnings be transferred from the Banks to the Board and then to the U.S. Treasury for the period October 1, 1996 to September 30, 1998. Prior to this time the Federal Reserve Banks made their transfers directly to the Treasury. The Board accounts for these transfers when earned and due, which may result in transfers receivable and payable as of the balance sheet date.

*Estimates*—The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period.

*Reclassifications*—Certain 1995 disclosures have been reclassified to conform with the 1996 presentation, the effect of which is immaterial.

### (2) Retirement Benefits

Substantially all of the Board's employees participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan). The System's Plan is a multiemployer plan which covers employees of the Federal Reserve Banks, the Board, and the Plan Administrative Office. Employees of the Board who entered on duty prior to 1984 are covered by a contributory defined benefits program under the System's Plan. Employees of the Board who entered on duty after 1983 are covered by a non-contributory defined benefits program under the System's Plan. Contributions to the System's Plan are actuarially determined and funded by participating employers at amounts prescribed by the System Plan's administrator. Based on actuarial calculations, it was determined that employer funding contributions were not required for the years 1996 and 1995, and the Board was not assessed a contribution for these years. Excess Plan assets will continue to fund future years' contributions. The Board is not accountable for the assets of this plan.

A small number of Board employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). The Board matches employee contributions to these plans. These defined benefits plans are administered by the Office of Personnel Management. The Board's contributions to these plans totaled $201,500 and $802,200 in 1996 and 1995 respectively. The Board has no liability for future payments to retirees under these programs, and it is not accountable for the assets of the plans.

Effective January 1, 1996, Board employees covered under the System's Plan are also covered under a Benefits Equalization Plan (BEP). Benefits paid under the BEP are limited to those benefits that cannot be paid from the System's Plan because of limitations imposed by Sections 401(a)(17), 415(b), and 415(e) of the Internal Revenue Code of 1986. Pension costs attributed to the BEP reduce the pension costs of the System's Plan. The net periodic pension cost of the BEP for 1996 included the following components:

| | |
|---|---|
| Service cost (benefits attributed to employee services during the year) | $260,868 |
| Interest cost on projected benefit obligation | 102,594 |
| Amortization of unrecognized net liabilitiy | 102,594 |
| Net periodic pension cost | $466,056 |

Although these pension costs are recorded using the accrual basis of accounting in accordance with Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" (FAS 87), the Board's current policy is to fund the cost of these benefits on a pay-as-you-go basis.

The net periodic pension cost was determined using a 7 percent discount rate and average compensation growth of 5 percent.

The FAS 87 accumulated benefit obligation at December 31, 1996, comprises:

| | |
|---|---|
| Accumulated benefit obligation | |
| Vested | $ 218,000 |
| Nonvested | 21,000 |
| Total | $ 239,000 |

| | |
|---|---|
| Plan assets at fair value | $ 0 |
| Less: Actuarial present value of projected benefit obligation | (1,589,924) |
| Projected benefit obligation in excess of plan assets | (1,589,924) |
| Less: Unrecognized net transition obligation | 1,363,041 |
| Unrecognized prior service cost | (190,000) |
| Unrecognized net (gain)/loss | (49,173) |
| Unfunded pension cost | $ (466,056) |

The liability as of December 31, 1996, was determined using a 7.25 percent discount rate. The average rate of compensation increase used was 5 percent per year. The

Board has elected to amortize the unrecognized prior service cost over 14.3 years.

(3) Other Benefit Plans

Employees of the Board may also participate in the Federal Reserve System's Thrift Plan. Under the Thrift Plan, members may contribute up to a fixed percentage of their salary. Board contributions are based upon a fixed percentage of each member's basic contribution and were $4,644,100 in 1996 and $4,320,400 in 1995.

The Board also provides certain defined benefit health and life insurance for its active employees and retirees under Federal and Board sponsored programs. The net periodic postretirement benefit cost for 1996 and 1995 included the following components:

| | 1996 | 1995 |
|---|---|---|
| Service cost (benefits attributed to employee services during the year) | $ 195,016 | $ 418,649 |
| Interest cost on accumulated postretirement benefit obligation | 1,461,103 | 1,441,350 |
| Amortization of gains and losses | 372,253 | (80) |
| Net periodic postretirement benefit cost | $2,028,372 | $1,859,919 |

Although postretirement benefits are recorded using the accrual basis of accounting in accordance with FAS 106, the Board's current policy is to fund the cost of these benefits on a pay-as-you-go basis.

The FAS 106 accumulated postretirement benefit obligation at December 31, 1996 and 1995 comprises:

| | 1996 | 1995 (reclassified) |
|---|---|---|
| Retirees | $14,393,309 | $14,061,087 |
| Fully eligible active plan participants | 3,512,825 | 3,528,612 |
| Other active plan participants | 3,422,992 | 3,773,612 |
| | 21,329,126 | 21,363,311 |
| Unrecognized net loss | (3,157,404) | (4,288,723) |
| Liability for accumulated postretirement benefit obligation | $18,171,722 | $17,074,588 |

The liability for the accumulated postretirement benefit obligation and the net periodic benefit cost was determined using a 7.25 percent discount rate. Unrecognized losses of $3,157,404 result from changes in the discount rate used to measure liabilities. Under FAS 106, the Board may have to record some of these unrecognized losses in operations in future years. The assumed health care cost trend rate for measuring the increase in costs from 1996 to 1997 was 9.5 percent. These rates were assumed to gradually decline to an ultimate rate of 5.5 percent in the year 2005 for the purpose of calculating the December 31, 1996, accumulated postretirement benefit obligation. The effect of a 1-percent increase in the assumed health care cost trend rate would increase the accumulated postretirement benefit obligation by $2,543,145 at December 31, 1996, and the net periodic benefit cost by $184,055 for the year. The assumed salary trend rate for measuring the increase in postretirement benefits related to life insurance was an average of 5 percent.

The above accumulated postretirement benefit obligation is related to the Board sponsored health benefits and life insurance programs. The Board has no liability for future payments to employees who continue coverage under the federally sponsored programs upon retiring. Contributions for active employees participating in federally sponsored programs totaled $3,553,400 and $3,477,300 in 1996 and 1995 respectively.

The Board provides certain postemployment benefits to eligible employees after employment but before retirement. Effective January 1, 1994, the Board adopted Statement of Financial Accounting Standards No. 112, Employers' Accounting for Postemployment Benefits (FAS 112), which requires that employers providing postemployment benefits to their employees accrue the cost of such benefits. Prior to January 1994, postemployment benefit expenses were recognized on a pay-as-you-go basis.

(4) Property, Buildings, and Equipment

The following is a summary of the components of the Board's fixed assets, at cost, net of accumulated depreciation.

| | As of December 31, | |
|---|---|---|
| | 1996 | 1995 |
| Land and improvements | $ 1,301,314 | $ 1,301,314 |
| Buildings | 65,343,600 | 65,298,136 |
| Furniture and equipment | 54,592,393 | 52,215,976 |
| | 121,237,307 | 118,815,426 |
| Less accumulated depreciation | 60,127,123 | 59,033,803 |
| Total property, buildings and equipment | $ 61,110,184 | $ 59,781,623 |

(5) Other Revenues and Other Expenses

The following are summaries of the components of Other Revenues and Other Expenses.

| | For the years ended December 31, | |
|---|---|---|
| | 1996 | 1995 |
| Other Revenues | | |
| Data processing revenue | $4,612,476 | $ 4,100,517 |
| National Information Center | 1,974,295 | 2,070,267 |
| Subscription revenue | 1,583,193 | 1,648,931 |
| Reimbursable services to other agencies | 424,940 | 383,752 |
| Miscellaneous | 1,194,237 | 2,037,363 |
| Total other revenues | $9,789,141 | $10,240,830 |

| | | |
|---|---|---|
| Other Expenses | | |
| Tuition, registration, and membership fees | $1,290,090 | $ 1,413,233 |
| Cafeteria operations, net | 870,429 | 788,506 |
| Subsidies and contributions | 646,194 | 755,857 |
| Miscellaneous | 1,548,021 | 957,893 |
| Total other expenses | $4,354,734 | $ 3,915,489 |

(6) COMMITMENTS

The Board has entered into several operating leases to secure office, training, and warehouse space for periods ranging from one to nine years. Minimum future commitments under those leases having an initial or remaining noncancelable lease term in excess of one year at December 31, 1996, are as follows:

| | Operating |
|---|---|
| 1997 | $ 3,724,037 |
| 1998 | 3,645,048 |
| 1999 | 3,681,559 |
| 2000 | 3,938,055 |
| after 2000 | 17,121,831 |
| | $32,110,530 |

Rental expenses under the operating leases were $3,930,689 and $3,301,186 in 1996 and 1995 respectively.

(7) FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL

The Board is one of the five member agencies of the Federal Financial Institutions Examination Council (the "Council"). During 1996 and 1995, the Board paid $224,600 and $269,040 respectively, in assessments for operating expenses of the Council. These amounts are included in subsidies and contributions for 1996 and 1995. During 1996 and 1995, the Board paid $127,100 and $126,900 respectively, for office space subleased from the Council. ■

# *Statistical Tables*

## 1. Detailed Statement of Condition of All Federal Reserve Banks Combined, December 31, 1996 and 1995

Thousands of dollars

| Item | 1996 | | 1995 | |
|---|---|---|---|---|
| ASSETS | | | | |
| Gold certificate account | | **11,048,036** | | **11,050,060** |
| Special drawing rights certificate account | | **9,718,000** | | **10,168,000** |
| Coin | | **591,170** | | **424,452** |
| *Loans and securities* | | | | |
| Loans to depository institutions | **85,337** | | **135,440** | |
| Federal agency obligations | | | | |
| Bought outright | **2,224,700** | | **2,633,995** | |
| Held under repurchase agreement | **1,612,000** | | **1,100,000** | |
| U.S. Treasury securities | | | | |
| Bought outright | | | | |
| Bills | **190,646,505** | | **183,115,712** | |
| Notes | **150,921,721** | | **151,013,150** | |
| Bonds | **49,338,894** | | **44,068,604** | |
| Total bought outright | **390,907,120** | | **378,197,466** | |
| Held under repurchase agreement | **19,971,000** | | **12,762,000** | |
| Total U.S. Treasury securities | **410,878,120** | | **390,959,466** | |
| Total loans and securities | | **414,800,157** | | **394,828,901** |
| *Items in process of collection* | | | | |
| Transit items | 11,740,684 | | 4,179,015 | |
| Other items in process of collection | 1,387,061 | | 1,101,279 | |
| Total items in process of collection | | **13,127,745** | | **5,280,294** |
| *Bank premises* | | | | |
| Land | 191,902 | | 166,903 | |
| Buildings (including vaults) | 934,260 | | 882,954 | |
| Building machinery and equipment | 241,454 | | 230,523 | |
| Construction account | 194,470 | | 128,934 | |
| Total bank premises | 1,562,087 | | 1,409,314 | |
| Less depreciation allowance | 329,185 | | 283,562 | |
| Bank premises, net | | **1,232,901** | | **1,125,753** |
| *Other assets* | | | | |
| Furniture and equipment | 1,230,372 | | 1,192,205 | |
| Less depreciation | 706,846 | | 671,613 | |
| Total furniture and equipment, net | 523,526 | | 520,592 | |
| Denominated in foreign currencies[1] | 19,263,604 | | 21,099,289 | |
| Interest accrued | 3,891,457 | | 4,101,149 | |
| Premium on securities | 6,004,465 | | 5,410,827 | |
| Overdrafts | 5,666 | | 22,920 | |
| Prepaid expenses | 991,247 | | 865,525 | |
| Suspense account | 3,029 | | 13,398 | |
| Real estate acquired for banking-house purposes | 10,103 | | 11,507 | |
| Other | 299,326 | | 312,533 | |
| Total other assets | | **30,992,423** | | **32,357,740** |
| **Total assets** | | **481,510,432** | | **455,235,200** |

## 1.—Continued

| Item | 1996 | | 1995 | |
|---|---|---|---|---|
| LIABILITIES | | | | |
| *Federal Reserve Notes* | | | | |
| Outstanding (issued to Federal Reserve Banks) | 526,825,836 | | 481,044,070 | |
| Less held by Federal Reserve Banks | −100,304,015 | | −80,108,642 | |
| Total Federal Reserve notes, net | | **426,521,822** | | **400,935,428** |
| *Deposits* | | | | |
| Depository institutions | | **24,523,700** | | **29,611,156** |
| U.S. Treasury, general account | | **7,741,937** | | **5,979,193** |
| Foreign, official accounts | | **167,401** | | **386,182** |
| *Other deposits* | | | | |
| Officers' and certified checks | 26,206 | | 25,622 | |
| International organizations | 107,766 | | 114,289 | |
| Other [2] | 758,690 | | 794,904 | |
| Total other deposits | | **892,662** | | **934,815** |
| Deferred credit items | | **7,830,936** | | **5,049,121** |
| *Other liabilities* | | | | |
| Discount on securities | 3,844,113 | | 3,613,735 | |
| Sundry items payable | 102,613 | | 95,718 | |
| Suspense account | 4,500 | | 15,153 | |
| All other | 783,259 | | 681,895 [4] | |
| Total other liabilities | | **4,734,485** | | **4,406,501** [4] |
| **Total liabilities** | | **472,412,942** | | **447,302,396** [4] |
| CAPITAL ACCOUNTS | | | | |
| Capital paid in | | **4,601,745** | | **3,966,402** |
| Surplus | | **4,495,745** | | **3,966,402** |
| Other capital accounts [3] | | **0** | | **0** |
| **Total liabilities and capital accounts** | | **481,510,432** | | **455,235,200** [4] |

NOTE. Amounts in boldface type indicate items in the Board's weekly statement of condition of the Federal Reserve Banks.

1. Of this amount $8,291.8 million in 1996 and $7,316.6 million in 1995 were invested in securities issued by foreign governments, and the balance was invested with foreign central banks and the Bank for International Settlements.

2. In closing out the other capital accounts at year-end, the Reserve Bank earnings that are payable to the Treasury are included in this account pending payment.

3. During the year, includes undistributed net income, which is closed out on December 31.

4. Corrections of data reported in *82nd Annual Report, 1995.*

## 2. Statement of Condition of Each Federal Reserve Bank, December 31, 1996 and 1995

Millions of dollars

| Item | Total 1996 | Total 1995 | Boston 1996 | Boston 1995 |
|---|---|---|---|---|
| ASSETS | | | | |
| Gold certificate account | 11,048 | 11,050 | 661 | 575 |
| Special drawing rights certificate account | 9,718 | 10,168 | 636 | 511 |
| Coin | 591 | 424 | 13 | 17 |
| *Loans* | | | | |
| To depository institutions | 85 | 135 | 0 | 6 |
| Other | 0 | 0 | 0 | 0 |
| Acceptances held under repurchase agreements | 0 | 0 | 0 | 0 |
| *Federal agency obligations* | | | | |
| Bought outright | 2,225 | 2,634 | 131 | 130 |
| Held under repurchase agreements | 1,612 | 1,100 | 0 | 0 |
| *U.S. Treasury securities* | | | | |
| Bought outright[1] | 390,907 | 378,197 | 23,000 | 18,600 |
| Held under repurchase agreements | 19,971 | 12,762 | 0 | 0 |
| Total loans and securities | 414,800 | 394,829 | 23,131 | 18,736 |
| Items in process of collection | 13,128 | 5,280 | 706 | 299 |
| Bank premises | 1,233 | 1,126 | 95 | 94 |
| *Other assets* | | | | |
| Denominated in foreign currencies[2] | 19,264 | 21,099 | 830 | 799 |
| All other | 11,729 | 11,258 | 534 | 459 |
| Interdistrict Settlement Account | 0 | 0 | 1,024 | 7,063 |
| **Total assets** | **481,510** | **455,235** | **27,629** | **28,552** |
| LIABILITIES | | | | |
| Federal Reserve notes | 426,522 | 400,935 | 25,417 | 26,175 |
| *Deposits* | | | | |
| Depository institutions | 24,524 | 29,611 | 1,048 | 1,414 |
| U.S. Treasury, general account | 7,742 | 5,979 | 0 | 0 |
| Foreign, official accounts | 167 | 386 | 6 | 5 |
| Other | 893 | 935 | 38 | 33 |
| Total deposits | 33,326 | 36,911 | 1,092 | 1,452 |
| Deferred credit items | 7,831 | 5,049 | 511 | 359 |
| Other liabilities and accrued dividends[3] | 4,734 | 4,407 | 268 | 225 |
| **Total liabilities** | **472,413** | **447,302** | **27,289** | **28,211** |
| CAPITAL ACCOUNTS | | | | |
| Capital paid in | 4,602 | 3,966 | 172 | 171 |
| Surplus | 4,496 | 3,966 | 168 | 171 |
| Other capital accounts | 0 | 0 | 0 | 0 |
| **Total liabilities and capital accounts** | **481,510** | **455,235** | **27,629** | **28,552** |
| FEDERAL RESERVE NOTE STATEMENT | | | | |
| Federal Reserve notes outstanding (issued to Bank) | 526,826 | 481,044 | 30,331 | 31,502 |
| Less: Held by Bank | 100,304 | 80,109 | 4,914 | 5,327 |
| **Federal Reserve notes, net** | **426,522** | **400,935** | **25,417** | **26,175** |
| *Collateral for Federal Reserve notes* | | | | |
| Gold certificate account | 11,048 | 11,050 | ... | ... |
| Special drawing rights certificate account | 9,718 | 10,168 | ... | ... |
| Other eligible assets | 0 | 0 | ... | ... |
| U.S. Treasury and federal agency securities | 405,756 | 379,717 | ... | ... |
| **Total collateral** | **426,522** | **400,935** | ... | ... |

For notes see end of table.

## 2.—Continued

| New York | | Philadelphia | | Cleveland | | Richmond | |
|---|---|---|---|---|---|---|---|
| 1996 | 1995 | 1996 | 1995 | 1996 | 1995 | 1996 | 1995 |
| 4,049 | 4,273 | 423 | 433 | 624 | 621 | 919 | 862 |
| 3,385 | 3,903 | 396 | 413 | 543 | 584 | 835 | 790 |
| 21 | 20 | 43 | 26 | 25 | 24 | 113 | 71 |
| 0 | 0 | 9 | 1 | 0 | 0 | 0 | 0 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 827 | 1,047 | 86 | 114 | 131 | 152 | 184 | 202 |
| 1,612 | 1,100 | 0 | 0 | 0 | 0 | 0 | 0 |
| 145,377 | 150,316 | 15,129 | 16,408 | 22,976 | 21,802 | 32,416 | 29,047 |
| 19,971 | 12,762 | 0 | 0 | 0 | 0 | 0 | 0 |
| 167,787 | 165,225 | 15,224 | 16,523 | 23,106 | 21,954 | 32,600 | 29,249 |
| 1,796 | 764 | 476 | 254 | 688 | 265 | 1,064 | 552 |
| 150 | 146 | 50 | 49 | 108 | 66 | 128 | 127 |
| 5,128 | 5,654 | 924 | 923 | 1,257 | 1,476 | 1,416 | 1,698 |
| 5,783 | 5,378 | 356 | 413 | 530 | 524 | 910 | 907 |
| –27,599 | –26,517 | –1,762 | –237 | 5,007 | 220 | 3,821 | 3,822 |
| **160,499** | **158,846** | **16,131** | **18,797** | **31,889** | **25,734** | **41,805** | **38,077** |
| 139,364 | 139,004 | 13,822 | 16,223 | 29,861 | 23,524 | 38,736 | 34,912 |
| 8,167 | 8,658 | 1,297 | 1,702 | 856 | 1,161 | 1,275 | 1,555 |
| 7,742 | 5,979 | 0 | 0 | 0 | 0 | 0 | 0 |
| 62 | 283 | 7 | 6 | 9 | 10 | 11 | 11 |
| 410 | 433 | 9 | 29 | 43 | 40 | 88 | 86 |
| 16,381 | 15,353 | 1,313 | 1,737 | 909 | 1,211 | 1,374 | 1,652 |
| 883 | 734 | 261 | 251 | 280 | 232 | 698 | 592 |
| 1,796 | 1,642 | 194 | 206 | 261 | 250 | 369 | 338 |
| **158,425** | **156,733** | **15,590** | **18,416** | **31,311** | **25,217** | **41,177** | **37,494** |
| 1,051 | 1,057 | 273 | 190 | 292 | 259 | 318 | 292 |
| 1,023 | 1,057 | 268 | 190 | 286 | 259 | 310 | 292 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **160,499** | **158,846** | **16,131** | **18,797** | **31,889** | **25,734** | **41,805** | **38,077** |
| 183,368 | 167,545 | 16,172 | 19,585 | 32,850 | 26,869 | 45,352 | 41,346 |
| 44,004 | 28,541 | 2,351 | 3,362 | 2,989 | 3,344 | 6,616 | 6,435 |
| **139,364** | **139,004** | **13,822** | **16,223** | **29,861** | **23,524** | **39,736** | **34,912** |
| ... | ... | ... | ... | ... | ... | ... | ... |
| ... | ... | ... | ... | ... | ... | ... | ... |
| ... | ... | ... | ... | ... | ... | ... | ... |
| ... | ... | ... | ... | ... | ... | ... | ... |
| ... | ... | ... | ... | ... | ... | ... | ... |

## 2. Statement of Condition of Each Federal Reserve Bank, December 31, 1996 and 1995—Continued

Millions of dollars

| Item | Atlanta | | Chicago | |
|---|---|---|---|---|
| | 1996 | 1995 | 1996 | 1995 |
| ASSETS | | | | |
| Gold certificate account | 769 | 556 | 1,140 | 1,220 |
| Special drawing rights certificate account | 745 | 523 | 979 | 1,079 |
| Coin | 81 | 66 | 70 | 35 |
| *Loans* | | | | |
| To depository institutions | 0 | 9 | 18 | 1 |
| Other | 0 | 0 | 0 | 0 |
| Acceptances held under repurchase agreements | 0 | 0 | 0 | 0 |
| *Federal agency obligations* | | | | |
| Bought outright | 148 | 122 | 241 | 304 |
| Held under repurchase agreements | 0 | 0 | 0 | 0 |
| *U.S. Treasury securities* | | | | |
| Bought outright[1] | 26,087 | 17,558 | 42,364 | 43,602 |
| Held under repurchase agreements | 0 | 0 | 0 | 0 |
| Total loans and securities | 26,236 | 17,689 | 42,623 | 43,906 |
| Items in process of collection | 1,556 | 688 | 1,537 | 519 |
| Bank premises | 80 | 77 | 110 | 110 |
| *Other assets* | | | | |
| Denominated in foreign currencies[2] | 1,890 | 1,954 | 2,296 | 2,401 |
| All other | 631 | 460 | 1,006 | 1,119 |
| Interdistrict Settlement Account | –511 | 13,362 | 157 | –3,016 |
| **Total assets** | **31,477** | **35,375** | **49,919** | **47,374** |
| LIABILITIES | | | | |
| Federal Reserve notes | 27,511 | 31,186 | 44,858 | 41,758 |
| *Deposits* | | | | |
| Depository institutions | 1,708 | 2,481 | 2,574 | 3,539 |
| U.S. Treasury, general account | 0 | 0 | 0 | 0 |
| Foreign, official accounts | 14 | 13 | 17 | 16 |
| Other | 54 | 21 | 120 | 160 |
| Total deposits | 1,775 | 2,515 | 2,712 | 3,716 |
| Deferred credit items | 1,033 | 660 | 808 | 463 |
| Other liabilities and accrued dividends[3] | 318 | 236 | 479 | 492 |
| **Total liabilities** | **30,637** | **34,597** | **48,857** | **46,428** |
| CAPITAL ACCOUNTS | | | | |
| Capital paid in | 425 | 389 | 537 | 473 |
| Surplus | 415 | 389 | 524 | 473 |
| Other capital accounts | 0 | 0 | 0 | 0 |
| **Total liabilities and capital accounts** | **31,477** | **35,375** | **49,919** | **47,374** |
| FEDERAL RESERVE NOTE STATEMENT | | | | |
| Federal Reserve notes outstanding (issued to Bank) | 34,458 | 36,869 | 51,546 | 48,453 |
| Less: Held by Bank | 6,947 | 5,683 | 6,688 | 6,695 |
| **Federal Reserve notes, net** | **27,511** | **31,186** | **44,858** | **41,758** |

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

1. Includes securities loaned—fully guaranteed by U.S. Treasury securities pledged with Federal Reserve Banks—and excludes securities sold and scheduled to be bought back under matched sale–purchase transactions.

2. Valued monthly at market exchange rates.

3. Includes exchange-translation account reflecting the monthly revaluation at market exchange rates of foreign-exchange commitments.

## 2.—Continued

| St. Louis | | Minneapolis | | Kansas City | | Dallas | | San Francisco | |
|---|---|---|---|---|---|---|---|---|---|
| 1996 | 1995 | 1996 | 1995 | 1996 | 1995 | 1996 | 1995 | 1996 | 1995 |
| 474 | 484 | 168 | 203 | 321 | 382 | 433 | 405 | 1,067 | 1,036 |
| 419 | 490 | 144 | 180 | 280 | 342 | 399 | 376 | 957 | 977 |
| 29 | 20 | 19 | 20 | 56 | 41 | 49 | 49 | 74 | 37 |
| 29 | 9 | 7 | 4 | 7 | 3 | 1 | 0 | 15 | 103 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 104 | 121 | 34 | 48 | 70 | 101 | 80 | 85 | 188 | 209 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 18,312 | 17,308 | 5,896 | 6,828 | 12,244 | 14,451 | 13,998 | 12,262 | 33,108 | 30,016 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 18,445 | 17,437 | 5,936 | 6,879 | 12,321 | 14,555 | 14,078 | 12,348 | 33,312 | 30,328 |
| 666 | 220 | 639 | 450 | 843 | 361 | 1,284 | 333 | 1,873 | 574 |
| 31 | 30 | 111 | 54 | 56 | 55 | 155 | 158 | 160 | 159 |
| 476 | 486 | 481 | 563 | 737 | 797 | 1,197 | 1,414 | 2,631 | 2,935 |
| 411 | 408 | 151 | 180 | 293 | 352 | 344 | 319 | 780 | 739 |
| –2,694 | 357 | –453 | –1,082 | –650 | –2,610 | 218 | 3,287 | 23,441 | 5,351 |
| **18,257** | **19,932** | **7,195** | **7,448** | **14,258** | **14,276** | **18,156** | **18,689** | **64,295** | **42,137** |
| 16,769 | 18,427 | 5,503 | 5,990 | 12,435 | 12,267 | 15,340 | 15,570 | 56,905 | 35,901 |
| 718 | 876 | 721 | 741 | 817 | 1,119 | 1,730 | 2,178 | 3,612 | 4,188 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 4 | 3 | 4 | 4 | 5 | 5 | 9 | 9 | 20 | 20 |
| 32 | 30 | 8 | 2 | 21 | 26 | 18 | 21 | 51 | 55 |
| 754 | 909 | 732 | 746 | 844 | 1,150 | 1,757 | 2,208 | 3,683 | 4,262 |
| 292 | 195 | 653 | 412 | 463 | 361 | 374 | 258 | 1,575 | 533 |
| 216 | 205 | 96 | 102 | 171 | 194 | 178 | 161 | 388 | 357 |
| **18,031** | **19,736** | **6,985** | **7,250** | **13,912** | **13,972** | **17,649** | **18,196** | **62,551** | **41,053** |
| 114 | 98 | 107 | 99 | 175 | 152 | 257 | 246 | 880 | 542 |
| 112 | 98 | 104 | 99 | 171 | 152 | 250 | 246 | 865 | 542 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **18,257** | **19,932** | **7,195** | **7,448** | **14,258** | **14,276** | **18,156** | **18,689** | **64,295** | **42,137** |
| 19,480 | 20,751 | 7,027 | 7,143 | 14,148 | 13,880 | 21,005 | 19,726 | 71,088 | 47,377 |
| 2,711 | 2,324 | 1,524 | 1,153 | 1,713 | 1,613 | 5,666 | 4,156 | 14,182 | 11,476 |
| **16,769** | **18,427** | **5,503** | **5,990** | **12,435** | **12,267** | **15,340** | **15,570** | **56,905** | **35,901** |

## 3. Federal Reserve Open Market Transactions, 1996

Millions of dollars

| Type of security and transaction | Jan. | Feb. | Mar. | Apr. |
|---|---|---|---|---|
| U.S. TREASURY SECURITIES | | | | |
| *Outright transactions (excluding matched transactions)* | | | | |
| Treasury bills | | | | |
| Gross purchases | 0 | 0 | 0 | 88 |
| Gross sales | 0 | 0 | 0 | 0 |
| Exchanges | 31,476 | 39,332 | 30,556 | 32,218 |
| Redemptions | 0 | 0 | 0 | 0 |
| Others within 1 year | | | | |
| Gross purchases | 0 | 0 | 0 | 35 |
| Gross sales | 0 | 0 | 0 | 0 |
| Maturity shift | 2,048 | 2,476 | 0 | 3,511 |
| Exchanges | –3,287 | –7,575 | 0 | –4,824 |
| Redemptions | 1,228 | 0 | 0 | 787 |
| 1 to 5 years | | | | |
| Gross purchases | 0 | 0 | 0 | 1,899 |
| Gross sales | 0 | 0 | 0 | 0 |
| Maturity shift | –2,048 | –1,908 | 0 | –3,511 |
| Exchanges | 3,287 | 5,175 | 0 | 4,824 |
| 5 to 10 years | | | | |
| Gross purchases | 0 | 0 | 0 | 479 |
| Gross sales | 0 | 0 | 0 | 0 |
| Maturity shift | 0 | –818 | 0 | 0 |
| Exchanges | 0 | 1,500 | 0 | 0 |
| More than 10 years | | | | |
| Gross purchases | 0 | 0 | 0 | 1,065 |
| Gross sales | 0 | 0 | 0 | 0 |
| Maturity shift | 0 | –20 | 0 | 0 |
| Exchanges | 0 | 900 | 0 | 0 |
| All maturities | | | | |
| Gross purchases | 0 | 0 | 0 | 3,566 |
| Gross sales | 0 | 0 | 0 | 0 |
| Redemptions | 0 | 0 | 0 | 787 |
| *Matched transactions* | | | | |
| Gross purchases | 260,425 | 274,290 | 251,623 | 253,482 |
| Gross sales | 259,186 | 275,979 | 251,086 | 251,510 |
| *Repurchase agreements* | | | | |
| Gross purchases | 16,040 | 6,230 | 31,602 | 46,449 |
| Gross sales | 28,802 | 6,230 | 27,706 | 50,345 |
| Net change in U.S. Treasury securities | –11,523 | –1,689 | 4,433 | 854 |
| FEDERAL AGENCY OBLIGATIONS | | | | |
| *Outright transactions* | | | | |
| Gross purchases | 0 | 0 | 0 | 0 |
| Gross sales | 0 | 0 | 0 | 0 |
| Redemptions | 1,228 | 0 | 108 | 82 |
| *Repurchase agreements* | | | | |
| Gross purchases | 9,793 | 765 | 5,640 | 2,372 |
| Gross sales | 10,893 | 765 | 4,640 | 3,372 |
| Net change in agency obligations | –2,328 | 0 | 892 | –1,082 |
| **Total net change in System Open Market Account** | **–13,851** | **–1,689** | **5,325** | **–228** |

NOTE. Sales, redemptions, and negative figures reduce holdings of the System Open Market Account; all other figures increase such holdings. Components may not sum to totals because of rounding.

## 3.—Continued

| May | June | July | Aug. | Sept. | Oct. | Nov. | Dec. | Total |
|---|---|---|---|---|---|---|---|---|
| 0 | 3,311 | 0 | 0 | 0 | 0 | 6,502 | 0 | 9,901 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 40,467 | 31,726 | 32,368 | 34,271 | 32,791 | 38,661 | 29,037 | 27,247 | 400,152 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| | | | | | | | | |
| 0 | 0 | 0 | 1,240 | 0 | 0 | 0 | 0 | 1,275 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 5,107 | 0 | 2,807 | 2,780 | 2,371 | 1,623 | 3,818 | 2,259 | 29,070 |
| –5,448 | 0 | –4,415 | –3,580 | 2,890 | –1,770 | –5,655 | –1,950 | –41,394 |
| 0 | 0 | 300 | 0 | 485 | 0 | 0 | 0 | 1,776 |
| | | | | | | | | |
| 0 | 0 | 0 | 1,279 | 0 | 0 | 0 | 0 | 3,177 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| –4,049 | 0 | –2,807 | –1,409 | –2,371 | –1,623 | –2,102 | –2,259 | –24,087 |
| 3,748 | 0 | 3,694 | 1,780 | 2,890 | 1,395 | 2,715 | 1,950 | 31,458 |
| | | | | | | | | |
| 0 | 0 | 0 | 297 | 0 | 0 | 0 | 0 | 776 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| –1,058 | 0 | 0 | –1,371 | 0 | 0 | 1,716 | 0 | –1,531 |
| 1,700 | 0 | 721 | 900 | 0 | 375 | 1,470 | 0 | 6,666 |
| | | | | | | | | |
| 0 | 0 | 0 | 900 | 0 | 0 | 0 | 0 | 1,965 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | –20 |
| 0 | 0 | 0 | 900 | 0 | 0 | 1,470 | 0 | 3,270 |
| | | | | | | | | |
| 0 | 3,311 | 0 | 3,716 | 0 | 0 | 6,502 | 0 | 17,094 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 787 |
| | | | | | | | | |
| 259,135 | 248,534 | 267,438 | 265,397 | 234,992 | 268,304 | 227,577 | 272,117 | 3,085,685 |
| 259,595 | 249,277 | 268,975 | 264,536 | 238,036 | 267,128 | 226,505 | 273,872 | 3,083,315 |
| | | | | | | | | |
| 30,688 | 43,048 | 46,151 | 45,202 | 36,014 | 33,836 | 36,383 | 78,067 | 449,711 |
| 24,984 | 41,666 | 37,779 | 56,286 | 33,374 | 33,020 | 36,665 | 68,901 | 445,759 |
| | | | | | | | | |
| 5,244 | 3,950 | 6,836 | –6,508 | –404 | 1,993 | 7,293 | 7,412 | 17,890 |
| | | | | | | | | |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 16 | 40 | 52 | 0 | 27 | 63 | 10 | 12 | 1,637 |
| | | | | | | | | |
| 5,722 | 5,138 | 3,145 | 8,500 | 4,536 | 12,683 | 9,264 | 8,041 | 75,599 |
| 4,372 | 6,488 | 2,863 | 7,544 | 4,436 | 11,051 | 9,471 | 8,787 | 74,682 |
| | | | | | | | | |
| 1,334 | –1,390 | 231 | 956 | 73 | 1,569 | –217 | –758 | –720 |
| | | | | | | | | |
| **6,578** | **2,560** | **7,066** | **–5,552** | **–331** | **3,562** | **7,076** | **6,654** | **17,169** |

## 4. Federal Reserve Bank Holdings of U.S. Treasury and Federal Agency Securities, December 31, 1994–96

Millions of dollars

| Description | December 31 | | | Change | |
|---|---|---|---|---|---|
| | 1996 | 1995 | 1994 | 1995–96 | 1994–95 |
| U.S. TREASURY SECURITIES | | | | | |
| **Held outright**[1] | **405,613** | **390,534** | **372,561** | **15,079** | **17,973** |
| *By remaining maturity* | | | | | |
| Bills | | | | | |
| 1–91 days | 106,063 | 101,564 | 98,129 | 4,499 | 3,435 |
| 92 days to 1 year | 99,289 | 93,888 | 87,291 | 5,401 | 6,597 |
| Notes and bonds | | | | | |
| 1 year or less | 29,045 | 41,419 | 34,212 | 12,374 | 7,207 |
| More than 1 year through 5 years | 95,608 | 90,031 | 10,205 | 10,335 | –4,758 |
| More than 5 years through 10 years | 33,782 | 31,469 | 28,053 | 2,313 | 3,416 |
| More than 10 years | 41,826 | 36,921 | 34,845 | 4,905 | 2,076 |
| *By type* | | | | | |
| Bills | 205,353 | 195,451 | 185,420 | 9,902 | 10,031 |
| Notes | 150,922 | 151,013 | 144,143 | –91 | 6,870 |
| Bonds | 49,339 | 44,069 | 42,998 | 5,270 | 1,071 |
| **Repurchase agreements** | **19,971** | **12,762** | **9,565** | **7,209** | **3,197** |
| **MSPs, foreign accounts** | **14,706** | **12,336** | **8,041** | **2,370** | **4,295** |
| **MSPs, in the market** | **0** | **0** | **0** | **0** | **0** |
| FEDERAL AGENCY SECURITIES | | | | | |
| **Held outright**[1] | **2,225** | **2,634** | **3,637** | **–409** | **–1,003** |
| *By remaining maturity* | | | | | |
| 1 year or less | 1,223 | 1,241 | 1,737 | –18 | –496 |
| More than 1 year through 5 years | 520 | 841 | 1,387 | –321 | –546 |
| More than 5 years through 10 years | 457 | 527 | 488 | –70 | 39 |
| More than 10 years | 25 | 25 | 25 | 0 | 0 |
| *By issuer* | | | | | |
| Federal Farm Credit Banks | 912 | 912 | 1,050 | 0 | –138 |
| Federal Home Loan Banks | 115 | 230 | 796 | 115 | –566 |
| Federal Land Banks | 17 | 66 | 66 | –49 | 0 |
| Federal National Mortgage Association | 1,181 | 1,425 | 1,725 | –244 | 280 |
| **Repurchase agreements** | **1,612** | **1,025** | **1,025** | **512** | **75** |

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

1. Excludes the effects of temporary transactions—repurchase agreements and matched sale–purchase agreements (MSPs).

## 5. Number and Annual Salaries of Officers and Employees of Federal Reserve Banks, December 31, 1996

| Federal Reserve Bank (including Branches) | President | Other officers | | Employees | | | Total | |
|---|---|---|---|---|---|---|---|---|
| | Salary (dollars) | Number | Salaries (dollars) | Number | | Salaries (dollars) | Number | Salaries (dollars) |
| | | | | Full-time | Part-time | | | |
| Boston | 187,300 | 60 | 6,385,550 | 1,060 | 163 | 46,899,060 | 1,284 | 53,471,910 |
| New York | 239,900 | 216 | 27,541,815 | 3,715 | 86 | 168,490,246 | 4,018 | 196,271,961 |
| Philadelphia | 212,900 | 58 | 5,988,500 | 1,142 | 69 | 41,877,821 | 1,270 | 48,079,221 |
| Cleveland | 191,000 | 48 | 4,930,500 | 1,307 | 72 | 44,684,645 | 1,428 | 49,806,145 |
| Richmond | 188,300 | 77 | 7,218,400 | 1,880 | 166 | 64,373,601 | 2,124 | 71,780,301 |
| Atlanta | 201,825 | 76 | 7,292,355 | 2,142 | 45 | 70,652,995 | 2,264 | 78,147,175 |
| Chicago | 212,200 | 96 | 9,690,300 | 2,067 | 59 | 82,345,034 | 2,223 | 92,247,534 |
| St. Louis | 218,500 | 54 | 4,926,200 | 1,072 | 64 | 36,161,093 | 1,191 | 41,305,793 |
| Minneapolis | 200,300 | 48 | 4,904,250 | 1,122 | 115 | 41,435,496 | 1,286 | 46,540,046 |
| Kansas City | 186,800 | 54 | 5,201,700 | 1,527 | 90 | 52,267,893 | 1,672 | 57,656,393 |
| Dallas | 188,100 | 57 | 5,537,400 | 1,402 | 43 | 50,584,238 | 1,503 | 56,309,738 |
| San Francisco | 265,900 | 87 | 9,922,200 | 2,266 | 100 | 97,824,927 | 2,454 | 108,013,027 |
| Federal Reserve Automation Service | ... | 24 | 2,633,200 | 490 | 6 | 25,659,004 | 520 | 28,292,204 |
| **Total** | **2,493,025** | **955** | **102,172,370** | **21,192** | **1,078** | **823,256,053** | **23,237** | **927,921,448** |

## 6. Income and Expenses of Federal Reserve Banks, 1996

Dollars

| Item | Total | Boston | New York | Philadelphia | Cleveland |
|---|---|---|---|---|---|
| CURRENT INCOME | | | | | |
| Loans | 10,855,101 | 169,855 | 935,475 | 224,228 | 143,085 |
| U.S. Treasury and federal agency securities | 23,883,718,256 | 1,328,674,303 | 9,207,282,770 | 944,101,600 | 1,381,391,105 |
| Foreign currencies | 442,816,416 | 18,896,077 | 118,021,601 | 21,090,551 | 29,047,617 |
| Priced services | 787,152,182 | 68,101,941 | 105,327,217 | 41,360,600 | 50,295,275 |
| Other | 39,761,493 | 576,197 | 29,467,510 | 1,401,162 | 480,092 |
| **Total** | **25,164,303,448** | **1,416,418,373** | **9,461,034,573** | **1,008,178,141** | **1,461,357,174** |
| CURRENT EXPENSES | | | | | |
| Salaries and other personnel expenses | 1,006,237,552 | 56,459,570 | 222,438,121 | 50,391,766 | 53,550,324 |
| Retirement and other benefits | 275,931,941 | 16,636,188 | 60,622,434 | 13,698,530 | 14,888,487 |
| Net periodic pension costs [1] | −139,543,043 | 37,961 | −140,036,216 | 43,984 | 20,260 |
| Fees | 31,753,785 | 1,835,046 | 4,857,577 | 490,508 | 1,999,164 |
| Travel | 46,582,951 | 2,199,279 | 6,740,068 | 2,176,419 | 2,720,440 |
| Software expenses | 57,120,579 | 1,194,182 | 12,293,707 | 1,620,432 | 1,715,340 |
| Postage and other shipping costs | 77,894,743 | 37,277,676 | 6,243,477 | 1,452,609 | 2,112,996 |
| Communications | 10,422,139 | 496,413 | 2,210,764 | 438,003 | 737,434 |
| Materials and supplies | 59,935,472 | 3,300,843 | 11,236,321 | 3,536,052 | 3,511,575 |
| *Building expenses* | | | | | |
| Taxes on real estate | 26,377,402 | 3,938,107 | 2,372,936 | 1,661,625 | 1,761,763 |
| Property depreciation | 56,045,236 | 4,324,247 | 11,108,195 | 2,370,332 | 2,552,760 |
| Utilities | 31,142,631 | 2,501,732 | 7,034,835 | 2,519,547 | 1,796,113 |
| Rent | 34,685,964 | 649,961 | 15,451,188 | 235,803 | 950,184 |
| Other | 28,899,672 | 710,151 | 7,415,742 | 1,331,057 | 543,605 |
| *Equipment* | | | | | |
| Purchases | 7,923,447 | 344,187 | 1,370,179 | 371,480 | 236,008 |
| Rentals | 33,626,775 | 75,687 | 2,898,504 | 268,867 | 204,359 |
| Depreciation | 135,798,828 | 4,028,526 | 18,772,134 | 4,976,336 | 4,671,434 |
| Repairs and maintenance | 79,279,701 | 4,181,153 | 12,569,765 | 3,085,572 | 3,993,813 |
| Earnings-credit costs | 308,815,188 | 22,298,335 | 57,722,661 | 26,490,515 | 13,693,294 |
| Other | 50,811,422 | 3,107,799 | 11,265,662 | 1,453,270 | 3,298,036 |
| Shared costs, net [2] | 0 | −1,393,774 | 11,229,265 | 11,985,034 | 14,202,201 |
| Recoveries | −53,191,381 | −9,384,887 | −7,849,084 | −2,870,308 | −1,053,259 |
| Expenses capitalized [3] | −2,851,630 | −279,886 | −11,574 | −248,610 | −307,071 |
| **Total** | **2,163,699,376** | **154,538,495** | **337,956,661** | **127,478,823** | **127,799,260** |
| Reimbursements | −215,838,443 | −9,277,655 | −45,178,441 | −17,575,267 | −23,081,004 |
| Net expenses | 1,947,860,932 | 145,260,840 | 292,778,220 | 109,903,556 | 104,718,256 |

For notes see end of table.

## 6.—Continued

| Richmond | Atlanta | Chicago | St. Louis | Minneapolis | Kansas City | Dallas | San Francisco |
|---|---|---|---|---|---|---|---|
| 98,986 | 497,264 | 1,453,956 | 1,665,412 | 3,106,781 | 1,132,022 | 234,579 | 1,193,457 |
| | | | | | | | |
| 1,920,176,715 | 1,447,549,323 | 2,604,222,099 | 1,099,849,063 | 375,188,745 | 783,759,786 | 824,448,395 | 1,967,074,352 |
| 32,780,978 | 43,238,826 | 52,591,299 | 10,880,489 | 11,105,863 | 16,927,827 | 27,679,158 | 60,556,131 |
| 61,682,563 | 94,986,455 | 99,321,687 | 36,284,780 | 44,328,737 | 50,787,341 | 52,781,544 | 81,894,041 |
| 834,082 | 1,009,511 | 1,149,075 | 474,745 | 411,312 | 131,661 | 366,610 | 3,459,538 |
| | | | | | | | |
| **2,015,573,324** | **1,587,281,379** | **2,758,738,116** | **1,149,154,489** | **434,141,438** | **852,738,637** | **905,510,286** | **2,114,177,519** |
| | | | | | | | |
| 110,117,153 | 83,881,847 | 99,978,837 | 44,011,658 | 48,727,463 | 62,433,596 | 59,301,723 | 114,945,493 |
| 30,822,962 | 24,678,827 | 26,322,214 | 13,838,725 | 12,642,030 | 15,852,699 | 17,828,950 | 28,099,895 |
| 33,731 | 71,874 | 81,108 | 12,683 | 22,995 | 21,910 | 42,212 | 104,455 |
| 12,366,967 | 1,852,166 | 2,437,091 | 958,584 | 1,846,427 | 567,911 | 1,059,163 | 1,483,182 |
| 5,480,584 | 4,169,096 | 5,327,316 | 2,441,321 | 2,916,360 | 3,035,657 | 3,191,057 | 6,185,354 |
| 26,667,126 | 2,384,244 | 2,601,072 | 1,546,866 | 1,823,462 | 1,178,404 | 1,251,513 | 2,844,231 |
| | | | | | | | |
| 3,383,975 | 4,804,834 | 4,467,170 | 2,475,824 | 3,726,625 | 4,379,151 | 2,306,464 | 5,263,942 |
| 1,148,842 | 952,818 | 829,346 | 529,532 | 547,661 | 946,005 | 811,422 | 773,899 |
| 6,538,378 | 6,308,862 | 6,169,448 | 3,667,918 | 2,167,666 | 4,108,932 | 3,611,090 | 5,778,387 |
| | | | | | | | |
| 2,243,390 | 2,026,479 | 3,945,631 | 399,311 | 2,657,695 | 766,510 | 2,012,054 | 2,591,901 |
| 5,508,151 | 4,615,785 | 5,934,590 | 2,512,757 | 902,838 | 3,731,839 | 5,158,229 | 7,325,512 |
| 2,948,280 | 2,356,215 | 2,404,383 | 1,650,416 | 990,220 | 1,433,872 | 2,316,422 | 3,190,596 |
| 10,437,429 | 3,507,679 | 1,251,464 | 433,358 | 875,624 | 454,280 | 315,119 | 123,876 |
| 2,968,646 | 3,183,981 | 5,096,523 | 1,009,406 | 790,187 | 950,657 | 2,284,549 | 2,615,168 |
| | | | | | | | |
| 1,155,327 | 649,833 | 733,135 | 287,123 | 602,695 | 572,038 | 450,120 | 1,151,324 |
| 27,788,934 | 619,349 | 822,942 | 116,848 | 288,514 | 87,133 | 120,425 | 335,213 |
| 62,533,625 | 8,459,956 | 9,130,673 | 2,678,690 | 3,042,241 | 3,617,359 | 5,034,986 | 8,852,867 |
| 18,670,041 | 9,224,871 | 7,577,002 | 2,861,990 | 2,593,476 | 2,682,032 | 3,680,762 | 8,159,224 |
| 28,452,428 | 30,097,127 | 38,264,577 | 12,101,176 | 5,575,322 | 14,193,748 | 29,408,823 | 30,517,182 |
| 4,769,686 | 4,861,696 | 6,079,156 | 2,430,871 | 1,757,905 | 3,319,431 | 3,384,377 | 5,083,533 |
| –146,742,179 | 16,918,488 | 24,550,070 | 12,551,571 | 10,344,011 | 19,061,475 | 15,320,978 | 11,972,859 |
| –13,996,837 | –3,050,351 | –3,774,065 | –1,251,069 | –835,725 | –641,514 | –5,275,667 | –3,208,615 |
| –264,804 | –467,926 | –131,863 | –126,062 | –361,352 | –476,346 | –95,162 | –80,973 |
| | | | | | | | |
| **203,031,835** | **212,107,750** | **250,097,821** | **107,139,497** | **103,644,337** | **142,276,779** | **153,519,610** | **224,108,507** |
| –23,770,024 | –12,103,535 | –15,867,204 | –9,132,559 | –16,164,191 | –19,087,772 | –6,605,375 | –17,995,417 |
| 179,261,811 | 200,004,215 | 234,230,617 | 98,006,938 | 87,480,146 | 123,189,007 | 146,914,235 | 226,113,090 |

## 6. Income and Expenses of Federal Reserve Banks, 1996—Continued

Dollars

| Item | Total | Boston | New York | Philadelphia | Cleveland |
|---|---|---|---|---|---|
| PROFIT AND LOSS | | | | | |
| Current net income | 23,216,442,516 | 1,271,157,533 | 9,168,256,354 | 898,274,585 | 1,356,638,917 |
| *Additions to and deductions from (–) current net income*[4] | | | | | |
| Profits on sales of U.S. Treasury and federal agency securities | 32,085,211 | 1,713,733 | 12,393,112 | 1,326,192 | 1,865,492 |
| Other additions | 120,935 | 13,452 | 29,675 | 13,075 | 20,969 |
| Total additions | 32,206,146 | 1,727,185 | 12,422,787 | 1,339,267 | 1,886,462 |
| Losses on foreign exchange transactions | −1,668,198,783 | −71,851,579 | −444,393,928 | −79,991,068 | −108,832,757 |
| Other deductions | −3,099,220 | −3,701 | −70,454 | −2,872 | −5,047 |
| Total deductions | −1,671,298,002 | −71,855,280 | −444,464,381 | −79,993,940 | −108,837,805 |
| Net addition to or deductions from (–) current net income | −1,639,091,856 | −70,128,095 | −432,041,594 | −78,654,673 | −106,951,343 |
| Cost of unreimbursed Treasury services | 37,624,539 | 1,737,950 | 3,832,199 | 2,567,250 | 1,656,301 |
| *Assessments by Board* | | | | | |
| Board expenditures[5] | 162,642,400 | 6,850,400 | 43,327,900 | 7,726,800 | 10,590,300 |
| Cost of currency | 402,517,040 | 26,277,921 | 139,553,061 | 16,286,645 | 23,617,286 |
| Net income before payment to U.S. Treasury | 20,974,566,681 | 1,166,163,167 | 8,549,501,600 | 793,039,217 | 1,213,823,687 |
| Dividends paid | 255,884,343 | 10,270,121 | 65,359,812 | 12,379,866 | 16,242,448 |
| Payments to U.S. Treasury (interest on Federal Reserve notes) | 14,565,623,555 | 826,506,487 | 6,119,190,289 | 552,651,198 | 853,616,778 |
| Statutory transfer | 5,517,716,032 | 328,055,909 | 2,370,171,099 | 145,005,453 | 310,237,212 |
| Surplus transfer | −106,000,000 | −4,565,563 | −28,237,496 | −5,082,760 | −6,915,406 |
| Transferred to surplus | 635,342,750 | 1,330,650 | −5,219,600 | 83,002,700 | 33,727,250 |
| Surplus, January 1 | 3,966,401,950 | 170,838,300 | 1,056,615,650 | 190,191,200 | 258,766,800 |
| Surplus, December 31 | 4,495,744,700 | 167,603,387 | 1,023,158,554 | 268,111,140 | 285,578,644 |

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

1. The effect of Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 87, *Employers' Accounting for Pensions* (SFAS 87). The System Retirement Plan for employees is recorded on behalf of the System on the books of the Federal Reserve Bank of New York. This resulted in a reduction in expenses of $140,566,144 in 1996. The Retirement Benefits Equalization Plan is recorded by each Federal Reserve Bank.

2. Includes distribution of costs for projects performed by one Bank for the benefit of one or more other Banks.

3. Includes expenses for labor and materials temporarily capitalized and charged to activities when the products are consumed.

4. Includes reimbursement from the U.S. Treasury for uncut sheets of Federal Reserve notes, gains and losses on the sale of Reserve Bank buildings, counterfeit currency that is not charged back to the depositing institution, and stale Reseve Bank checks that are written off.

5. For additional details, see the preceding chapter: Board of Governors Financial Statements.

## 6.—Continued

| Richmond | Atlanta | Chicago | St. Louis | Minneapolis | Kansas City | Dallas | San Francisco |
|---|---|---|---|---|---|---|---|
| 1,836,311,513 | 1,387,277,163 | 2,524,507,498 | 1,051,147,550 | 346,661,291 | 729,549,631 | 758,596,050 | 1,888,064,429 |
| 2,550,311 | 1,775,062 | 3,601,822 | 1,483,547 | 537,476 | 1,129,151 | 1,087,883 | 2,621,430 |
| 8,540 | 23,086 | 4,535 | 165 | 38 | 140 | 6,653 | 609 |
| 2,558,850 | 1,798,148 | 3,606,356 | 1,483,712 | 537,513 | 1,129,291 | 1,094,536 | 2,622,039 |
| −122,606,494 | −163,590,523 | −198,815,916 | −41,204,351 | −41,617,846 | −63,832,062 | −103,651,708 | −227,810,550 |
| −16,879 | −1,675,175 | −10,443 | −2,800 | −3,692 | −614,123 | −9,262 | −684,771 |
| −122,623,373 | −165,265,698 | −198,826,359 | −41,207,151 | −41,621,538 | −64,446,185 | −103,660,970 | −228,495,321 |
| −120,064,523 | −163,467,551 | −195,220,003 | −39,723,439 | −41,084,025 | −63,316,894 | −102,566,434 | −225,873,283 |
| 4,260,915 | 3,790,153 | 3,790,785 | 2,129,229 | 3,518,067 | 2,624,738 | 2,200,845 | 5,516,107 |
| 11,850,200 | 16,120,200 | 19,530,400 | 4,060,700 | 4,038,400 | 6,370,200 | 10,054,000 | 22,122,900 |
| 35,049,171 | 31,308,982 | 41,922,553 | 18,498,878 | 6,013,202 | 12,315,411 | 15,631,347 | 36,042,583 |
| 1,665,086,705 | 1,172,590,278 | 2,264,043,757 | 986,735,304 | 292,007,597 | 644,922,388 | 628,143,424 | 1,598,509,556 |
| 17,981,905 | 24,885,584 | 30,568,828 | 6,430,939 | 6,122,245 | 10,052,800 | 15,007,452 | 40,582,344 |
| 1,168,388,993 | 786,280,315 | 1,587,279,932 | 693,121,299 | 215,945,494 | 457,250,081 | 453,449,062 | 851,943,628 |
| 452,209,508 | 325,321,528 | 581,873,097 | 270,789,367 | 62,303,308 | 154,613,858 | 149,169,760 | 367,965,934 |
| −7,790,611 | −10,394,802 | −12,633,079 | −2,618,190 | −2,644,464 | −4,055,991 | −6,586,194 | −14,475,444 |
| 26,506,300 | 36,102,850 | 64,321,900 | 16,393,700 | 7,636,550 | 23,005,650 | 10,517,150 | 338,017,650 |
| 291,516,000 | 388,961,900 | 472,715,750 | 97,969,750 | 98,952,900 | 151,770,650 | 246,448,050 | 541,655,000 |
| 310,231,689 | 414,669,948 | 524,404,571 | 111,745,260 | 103,944,986 | 170,720,309 | 250,379,006 | 865,197,206 |

## 7. Income and Expenses of Federal Reserve Banks, 1914–96

Dollars

| Federal Reserve Bank and period | Current income | Net expenses | Net additions or deductions (–) | Assessments by Board of Governors | |
|---|---|---|---|---|---|
| | | | | Board expenditures | Costs of currency |
| *All Banks* | | | | | |
| 1914–15 | 2,173,252 | 2,018,282 | 5,875 | 302,304 | . . . |
| 1916 | 5,217,998 | 2,081,722 | –193,001 | 192,277 | . . . |
| 1917 | 16,128,339 | 4,921,932 | –1,386,545 | 237,795 | . . . |
| 1918 | 67,584,417 | 10,576,892 | –3,908,574 | 382,641 | . . . |
| 1919 | 102,380,583 | 18,744,815 | –4,673,446 | 594,818 | . . . |
| 1920 | 181,296,711 | 27,548,505 | –3,743,907 | 709,525 | . . . |
| 1921 | 122,865,866 | 33,722,409 | –6,314,796 | 741,436 | . . . |
| 1922 | 50,498,699 | 28,836,504 | –4,441,914 | 722,545 | . . . |
| 1923 | 50,708,566 | 29,061,539 | –8,233,107 | 702,634 | . . . |
| 1924 | 38,340,449 | 27,767,886 | –6,191,143 | 663,240 | . . . |
| 1925 | 41,800,706 | 26,818,664 | –4,823,477 | 709,499 | . . . |
| 1926 | 47,599,595 | 24,914,037 | –3,637,668 | 721,724 | 1,714,421 |
| 1927 | 43,024,484 | 24,894,487 | –2,456,792 | 779,116 | 1,844,840 |
| 1928 | 64,052,860 | 25,401,233 | –5,026,029 | 697,677 | 805,900 |
| 1929 | 70,955,496 | 25,810,067 | –4,861,642 | 781,644 | 3,099,402 |
| 1930 | 36,424,044 | 25,357,611 | –93,136 | 809,585 | 2,175,530 |
| 1931 | 29,701,279 | 24,842,964 | 311,451 | 718,554 | 1,479,146 |
| 1932 | 50,018,817 | 24,456,755 | –1,413,192 | 728,810 | 1,105,816 |
| 1933 | 49,487,318 | 25,917,847 | –12,307,074 | 800,160 | 2,504,830 |
| 1934 | 48,902,813 | 26,843,653 | –4,430,008 | 1,372,022 | 1,025,721 |
| 1935 | 42,751,959 | 28,694,965 | –1,736,758 | 1,405,898 | 1,476,580 |
| 1936 | 37,900,639 | 26,016,338 | 485,817 | 1,679,566 | 2,178,119 |
| 1937 | 41,233,135 | 25,294,835 | –1,631,274 | 1,748,380 | 1,757,399 |
| 1938 | 36,261,428 | 25,556,949 | 2,232,134 | 1,724,924 | 1,629,735 |
| 1939 | 38,500,665 | 25,668,907 | 2,389,555 | 1,621,464 | 1,356,484 |
| 1940 | 43,537,805 | 25,950,946 | 11,487,697 | 1,704,011 | 1,510,520 |
| 1941 | 41,380,095 | 28,535,547 | 720,636 | 1,839,541 | 2,588,062 |
| 1942 | 52,662,704 | 32,051,226 | –1,568,208 | 1,746,326 | 4,826,492 |
| 1943 | 69,305,715 | 35,793,816 | 23,768,282 | 2,415,630 | 5,336,118 |
| 1944 | 104,391,829 | 39,659,496 | 3,221,880 | 2,296,357 | 7,220,068 |
| 1945 | 142,209,546 | 41,666,453 | –830,007 | 2,340,509 | 4,710,309 |
| 1946 | 150,385,033 | 50,493,246 | –625,991 | 2,259,784 | 4,482,077 |
| 1947 | 158,655,566 | 58,191,428 | 1,973,001 | 2,639,667 | 4,561,880 |
| 1948 | 304,160,818 | 64,280,271 | –34,317,947 | 3,243,670 | 5,186,247 |
| 1949 | 316,536,930 | 67,930,860 | –12,122,274 | 3,242,500 | 6,304,316 |
| 1950 | 275,838,994 | 69,822,227 | 36,294,117 | 3,433,700 | 7,315,844 |
| 1951 | 394,656,072 | 83,792,676 | –2,127,889 | 4,095,497 | 7,580,913 |
| 1952 | 456,060,260 | 92,051,063 | 1,583,988 | 4,121,602 | 8,521,426 |
| 1953 | 513,037,237 | 98,493,153 | –1,058,993 | 4,099,800 | 10,922,067 |
| 1954 | 438,486,040 | 99,068,436 | –133,641 | 4,174,600 | 6,489,895 |
| 1955 | 412,487,931 | 101,158,921 | –265,456 | 4,194,100 | 4,707,002 |
| 1956 | 595,649,092 | 110,239,520 | –23,436 | 5,339,800 | 5,603,176 |
| 1957 | 763,347,530 | 117,931,908 | –7,140,914 | 7,507,900 | 6,374,195 |
| 1958 | 742,068,150 | 125,831,215 | 124,175 | 5,917,200 | 5,973,240 |
| 1959 | 886,226,116 | 131,848,023 | 98,247,253 | 6,470,600 | 6,384,083 |
| 1960 | 1,103,385,257 | 139,893,564 | 13,874,702 | 6,533,700 | 7,455,011 |
| 1961 | 941,648,170 | 148,253,719 | 3,481,628 | 6,265,100 | 6,755,756 |
| 1962 | 1,048,508,335 | 161,451,206 | –55,779 | 6,654,900 | 8,030,028 |
| 1963 | 1,151,120,060 | 169,637,656 | 614,835 | 7,572,800 | 10,062,901 |
| 1964 | 1,343,747,303 | 171,511,018 | 725,948 | 8,655,200 | 17,229,671 |
| 1965 | 1,559,484,027 | 172,110,934 | 1,021,614 | 8,576,396 | 23,602,856 |
| 1966 | 1,908,499,896 | 178,212,045 | 996,230 | 9,021,600 | 20,167,481 |
| 1967 | 2,190,403,752 | 190,561,166 | 2,093,876 | 10,769,596 | 18,790,084 |
| 1968 | 2,764,445,943 | 207,677,768 | 8,519,996 | 14,198,198 | 20,474,404 |
| 1969 | 3,373,360,559 | 237,827,579 | –557,553 | 15,020,084 | 22,125,657 |

For notes see end of table.

## 7.—Continued

| Dividends paid | Payments to U.S. Treasury | | Transferred to surplus (section 13b) | Transferred to surplus (section 7) |
|---|---|---|---|---|
| | Statutory transfers [4] | Interest on Federal Reserve notes | | |
| 217,463 | . . . | . . . | . . . | . . . |
| 1,742,775 | . . . | . . . | . . . | . . . |
| 6,804,186 | 1,134,234 | . . . | . . . | 1,134,234 |
| 5,540,684 | . . . | . . . | . . . | 48,334,341 |
| 5,011,832 | 2,703,894 | . . . | . . . | 70,651,778 |
| 5.654,018 | 60,724,742 | . . . | . . . | 82,916,014 |
| 6,119,673 | 59,974,466 | . . . | . . . | 15,993,086 |
| 6,307,035 | 10,850,605 | . . . | . . . | –659,904 |
| 6,552,717 | 3,613,056 | . . . | . . . | 2,545,513 |
| 6,682,496 | 113,646 | . . . | . . . | –3,077,962 |
| 6,915,958 | 59,300 | . . . | . . . | 2,473,808 |
| 7,329,169 | 818,150 | . . . | . . . | 8,464,426 |
| 7,754,539 | 249,591 | . . . | . . . | 5,044,119 |
| 8,458,463 | 2,584,659 | . . . | . . . | 21,078,899 |
| 9,583,911 | 4,283,231 | . . . | . . . | 22,535,597 |
| 10,268,598 | 17,308 | . . . | . . . | –2,297,724 |
| 10,029,760 | . . . | . . . | . . . | –7,057,694 |
| 9,282,244 | 2,011,418 | . . . | . . . | 11,020,582 |
| 8,874,262 | . . . | . . . | . . . | –916,855 |
| 8,781,661 | . . . | . . . | –60,323 | 6,510,071 |
| 8,504,974 | 297,667 | . . . | 27,695 | 607,422 |
| 7,829,581 | 227,448 | . . . | 102,880 | 352,524 |
| 7,940,966 | 176,625 | . . . | 67,304 | 2,616,352 |
| 8,019,137 | 119,524 | . . . | –419,140 | 1,862,433 |
| 8,110,462 | 24,579 | . . . | –425,653 | 4,533,977 |
| 8,214,971 | 82,152 | . . . | –54,456 | 17,617,358 |
| 8,429,936 | 141,465 | . . . | –4,333 | 570,513 |
| 8,669,076 | 197,672 | . . . | 49,602 | 3,554,101 |
| 8,911,342 | 244,726 | . . . | 135,003 | 40,327,237 |
| 9,500,126 | 326,717 | . . . | 201,150 | 48,409,795 |
| 10,182,851 | 247,659 | . . . | 262,133 | 81,969,625 |
| 10,962,160 | 67,054 | . . . | 27,708 | 81,467,013 |
| 11,523,047 | 35,605 | 75,283,818 | 86,772 | 8,366,350 |
| 11,919,809 | . . . | 166,690,356 | . . . | 18,522,518 |
| 12,329,373 | . . . | 193,145,837 | . . . | 21,461,770 |
| 13,082,992 | . . . | 196,628,858 | . . . | 21,849,490 |
| 13,864,750 | . . . | 254,873,588 | . . . | 28,320,759 |
| 14,681,788 | . . . | 291,934,634 | . . . | 46,333,735 |
| 15,558,377 | . . . | 342,567,985 | . . . | 40,336,862 |
| 16,442,236 | . . . | 276,289,457 | . . . | 35,887,775 |
| 17,711,937 | . . . | 251,740,721 | . . . | 32,709,794 |
| 18,904,897 | . . . | 401,555,581 | . . . | 53,982,682 |
| 20,080,527 | . . . | 542,708,405 | . . . | 61,603,682 |
| 21,197,452 | . . . | 524,058,650 | . . . | 59,214,569 |
| 22,721,687 | . . . | 910,649,768 | . . . | –93,600,791 |
| 23,948,225 | . . . | 896,816,359 | . . . | 42,613,100 |
| 25,569,541 | . . . | 687,393,382 | . . . | 70,892,300 |
| 27,412,241 | . . . | 799,365,981 | . . . | 45,538,200 |
| 28,912,019 | . . . | 879,685,219 | . . . | 55,864,300 |
| 30,781,548 | . . . | 1,582,118,614 | . . . | –465,822,800 |
| 32,351,602 | . . . | 1,296,810,053 | . . . | 27,053,800 |
| 33,696,336 | . . . | 1,649,455,164 | . . . | 18,943,500 |
| 35,027,312 | . . . | 1,907,498,270 | . . . | 29,851,200 |
| 36,959,336 | . . . | 2,463,628,983 | . . . | 30,027,250 |
| 39,236,599 | . . . | 3,019,160,638 | . . . | 39,432,450 |

## 7. Income and Expenses of Federal Reserve Banks, 1914–96—Continued

Dollars

| Federal Reserve Bank and period | Current income | Net expenses | Net additions or deductions (–)[1] | Assessments by Board of Governors: Board expenditures | Costs of currency |
|---|---|---|---|---|---|
| 1970 | 3,877,218,444 | 276,571,876 | 11,441,829 | 21,227,800 | 23,573,710 |
| 1971 | 3,723,369,921 | 319,608,270 | 94,266,075 | 32,634,002 | 24,942,528 |
| 1972 | 3,792,334,523 | 347,917,112 | –49,615,790 | 35,234,499 | 31,454,740 |
| 1973 | 5,016,769,328 | 416,879,377 | –80,653,488 | 44,411,700 | 33,826,299 |
| 1974 | 6,280,090,965 | 476,234,586 | –78,487,237 | 41,116,600 | 30,190,288 |
| 1975 | 6,257,936,784 | 514,358,633 | –202,369,615 | 33,577,201 | 37,130,081 |
| 1976 | 6,623,220,383 | 558,128,811 | 7,310,500 | 41,827,700 | 48,819,453 |
| 1977 | 6,891,317,498 | 568,851,419 | –177,033,463 | 47,366,100 | 55,008,163 |
| 1978 | 8,455,309,401 | 592,557,841 | –633,123,486 | 53,321,700 | 60,059,365 |
| 1979 | 10,310,148,406 | 625,168,261 | –151,148,220 | 50,529,700 | 68,391,270 |
| 1980 | 12,802,319,335 | 718,032,836 | –115,385,855 | 62,230,800 | 73,124,423 |
| 1981 | 15,508,349,653 | 814,190,392 | –372,879,185 | 63,162,700 | 82,924,013 |
| 1982 | 16,517,385,129 | 926,033,957 | –68,833,150 | 61,813,400 | 98,441,027 |
| 1983 | 16,068,362,117 | 1,023,678,474 | –400,365,922 | 71,551,000 | 152,135,488 |
| 1984 | 18,068,820,742 | 1,102,444,454 | –412,943,156 | 82,115,700 | 162,606,410 |
| 1985 | 18,131,982,786 | 1,127,744,490 | 1,301,624,294 | 77,377,700 | 173,738,745 |
| 1986 | 17,464,528,361 | 1,156,867,714 | 1,975,893,356 | 97,337,500 | 180,779,673 |
| 1987 | 17,633,011,623 | 1,146,910,699 | 1,796,593,917 | 81,869,800 | 170,674,979 |
| 1988 | 19,526,431,297 | 1,205,960,134 | –516,910,320 | 84,410,500 | 164,244,653 |
| 1989 | 22,249,275,725 | 1,332,160,712 | 1,254,613,365 | 89,579,700 | 175,043,736 |
| 1990 | 23,476,603,651 | 1,349,725,812 | 2,099,328,472 | 103,752,200 | 193,006,998 |
| 1991 | 22,553,001,815 | 1,429,322,157 | 405,729,320 | 109,631,000 | 261,316,379 |
| 1992 | 20,235,027,938 | 1,474,530,523 | –987,787,687 | 128,955,300 | 295,400,692 |
| 1993 | 18,914,250,574 | 1,657,799,914 | –230,267,919 | 140,465,600 | 355,947,291 |
| 1994 | 20,910,742,377 | 1,795,328,343 | 2,363,862,097 | 146,866,100 | 368,187,068 |
| 1995 | 25,395,148,359 | 1,818,416,193 | 857,787,845 | 161,347,900 | 370,202,935 |
| 1996 | 25,164,303,448 | 1,947,860,932 | –1,676,716,395 | 162,642,400 | 402,517,040 |
| **Total, 1914–96** | **417,408,838,469** | **30,546,980,808** | **6,085,772,300** | **2,314,254,908** | **4,389,133,107** |
| *Aggregate for each Bank, 1914–96* | | | | | |
| Boston | 22,414,593,032 | 2,030,182,865 | 187,976,722 | 85,524,286 | 259,235,953 |
| New York | 134,171,636,114 | 5,365,393,484[3] | 1,811,445,415 | 618,126,986 | 1,367,423,806 |
| Philadelphia | 16,115,422,370 | 1,687,961,908 | 205,658,739 | 106,218,018 | 178,533,574 |
| Cleveland | 27,027,211,371 | 1,918,000,632 | 300,307,613 | 162,215,990 | 272,544,152 |
| Richmond | 33,033,422,980 | 2,610,753,951 | 351,633,057 | 137,625,176 | 385,287,134 |
| Atlanta | 18,683,112,041 | 2,814,165,967 | 538,236,305 | 193,757,060 | 242,024,665 |
| Chicago | 55,939,695,781 | 3,946,149,380 | 739,777,471 | 304,762,572 | 557,191,544 |
| St. Louis | 14,325,900,930 | 1,544,659,281 | 117,815,766 | 65,227,172 | 167,905,719 |
| Minneapolis | 7,770,380,589 | 1,427,947,359 | 155,356,159 | 66,103,815 | 79,181,368 |
| Kansas City | 16,790,020,529 | 1,957,825,838 | 208,702,935 | 94,021,509 | 180,437,076 |
| Dallas | 21,389,825,744 | 1,909,602,182 | 509,794,465 | 156,962,073 | 217,674,139 |
| San Francisco | 49,747,616,989 | 3,334,337,961 | 959,067,653 | 323,710,251 | 481,693,977 |
| **Total** | **417,408,838,469** | **30,546,980,808** | **6,085,772,300** | **2,314,254,908** | **4,389,133,107** |

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

1. For 1987 and subsequent years, includes the cost of services provided to the Treasury by Federal Reserve Banks for which reimbursement was not received.

2. The $4,730,416,899 transferred to surplus was reduced by direct charges of $500,000 for charge-off on Bank premises (1927), $139,299,557 for contributions to capital of the Federal Deposit Insurance Corporation (1934), $3,657 net upon elimination of section 13b surplus (1958), and $106,000,000 transferred to the Treasury as statutorily required (1996); and was increased by transfer of $11,131,013 from reserves for contingencies (1955), leaving a balance of $4,495,744,698 on December 31, 1996.

3. Reduced $776,102,763 million related to the System Retirement Plan. See note 1, table 6.

4. Represents transfers made as a franchise tax from 1917 to 1932; transfers made under section 13b of the Federal Reserve Act from 1935 to 1947; and transfers made under section 7 of the Federal Reserve Act for 1996.

## 7.—Continued

| Dividends paid | Payments to U.S. Treasury: Statutory transfers [4] | Payments to U.S. Treasury: Interest on Federal Reserve notes | Transferred to surplus (section 13b) | Transferred to surplus (section 7) |
|---|---|---|---|---|
| 41,136,551 | . . . | 3,493,570,636 | . . . | 32,579,700 |
| 43,488,074 | . . . | 3,356,559,873 | . . . | 40,403,250 |
| 46,183,719 | . . . | 3,231,267,663 | . . . | 50,661,000 |
| 49,139,682 | . . . | 4,340,680,482 | . . . | 51,178,300 |
| 52,579,643 | . . . | 5,549,999,411 | . . . | 51,483,200 |
| 54,609,555 | . . . | 5,382,064,098 | . . . | 33,827,600 |
| 57,351,487 | . . . | 5,870,463,382 | . . . | 53,940,050 |
| 60,182,278 | . . . | 5,937,148,425 | . . . | 45,727,650 |
| 63,280,312 | . . . | 7,005,779,497 | . . . | 47,268,200 |
| 67,193,615 | . . . | 9,278,576,140 | . . . | 69,141,200 |
| 70,354,516 | . . . | 11,706,369,955 | . . . | 56,820,950 |
| 74,573,806 | . . . | 14,023,722,907 | . . . | 76,896,650 |
| 79,352,304 | . . . | 15,204,590,947 | . . . | 78,320,350 |
| 85,151,835 | . . . | 14,228,816,297 | . . . | 106,663,100 |
| 92,620,451 | . . . | 16,054,094,674 | . . . | 161,995,900 |
| 103,028,905 | . . . | 17,796,464,292 | . . . | 155,252,950 |
| 109,587,968 | . . . | 17,803,894,710 | . . . | 91,954,150 |
| 117,499,115 | . . . | 17,738,879,542 | . . . | 173,771,400 |
| 125,616,018 | . . . | 17,364,318,571 | . . . | 64,971,100 |
| 129,885,339 | . . . | 21,646,417,306 | . . . | 130,802,300 |
| 140,757,879 | . . . | 23,608,397,730 | . . . | 180,291,500 |
| 152,553,160 | . . . | 20,777,552,290 | . . . | 228,356,150 |
| 171,762,924 | . . . | 16,774,476,500 | . . . | 402,114,350 |
| 195,422,234 | . . . | 15,986,764,712 | . . . | 347,582,900 |
| 212,090,446 | . . . | 20,470,010,815 | . . . | 282,121,700 |
| 230,527,278 | . . . | 23,389,366,647 | . . . | 283,075,250 |
| 255,884,343 | 5,517,716,032 | 14,565,623,555 | . . . | 635,342,750 |
| **3,648,914,095** | **5,669,043,225** | **372,195,871,378** | **–3,657** | **4,730,416,899** [2] |
| | | | | |
| 145,739,134 | 335,448,147 | 19,564,040,184 | 135,411 | 182,263,775 |
| 994,043,947 | 2,438,546,477 | 124,111,327,621 | –433,412 | 1,088,652,621 |
| 180,644,268 | 151,286,760 | 13,728,621,798 | 290,661 | 287,524,122 |
| 267,503,570 | 315,162,589 | 24,086,374,111 | –9,906 | 305,727,843 |
| 210,908,799 | 458,582,190 | 29,258,068,063 | –71,517 | 323,902,108 |
| 290,271,992 | 334,351,353 | 14,916,440,658 | 5,491 | 430,331,290 |
| 475,290,267 | 607,337,668 | 50,236,363,729 | 11,682 | 552,366,404 |
| 104,921,102 | 273,552,460 | 12,167,994,403 | –26,515 | 119,483,078 |
| 100,731,338 | 67,561,823 | 6,073,679,505 | 64,874 | 110,466,663 |
| 146,394,749 | 161,617,171 | 14,279,519,545 | –8,674 | 178,916,250 |
| 235,741,109 | 149,831,892 | 18,968,510,799 | 55,337 | 261,242,678 |
| 496,723,819 | 375,764,696 | 44,804,930,959 | –17,089 | 889,540,067 |
| **3,648,914,095** | **5,669,043,225** | **372,195,871,378** | **–3,657** | **4,730,416,899** |

## 8. Acquisition Costs and Net Book Value of Premises of Federal Reserve Banks and Branches, December 31, 1996

Dollars

| Federal Reserve Bank or Branch | Acquisition costs | | | | Net book value | Other real estate[3] |
|---|---|---|---|---|---|---|
| | Land | Buildings (including vaults)[1] | Building machinery and equipment | Total[2] | | |
| BOSTON | 22,073,501 | 95,224,464 | 7,393,282 | 124,691,246 | 94,550,556 | . . . |
| NEW YORK | 20,330,426 | 122,029,100 | 48,319,639 | 190,679,165 | 145,563,196 | . . . |
| Buffalo | 887,844 | 3,807,652 | 2,886,511 | 7,582,008 | 4,809,426 | . . . |
| PHILADELPHIA | 2,251,556 | 59,430,181 | 6,635,069 | 68,316,805 | 49,746,796 | . . . |
| CLEVELAND | 2,298,644 | 81,855,115 | 7,000,010 | 91,153,769 | 82,114,215 | . . . |
| Cincinnati | 2,246,599 | 15,185,611 | 8,385,938 | 25,818,147 | 12,116,195 | . . . |
| Pittsburgh | 1,658,376 | 10,570,100 | 5,945,626 | 18,174,102 | 13,712,888 | . . . |
| RICHMOND | 6,111,681 | 61,613,424 | 18,820,236 | 86,545,340 | 70,815,818 | 5,708,457 |
| Baltimore | 6,476,335 | 27,100,992 | 4,568,965 | 38,146,293 | 27,697,064 | . . . |
| Charlotte | 3,129,645 | 27,402,251 | 4,737,485 | 35,269,381 | 29,517,951 | . . . |
| ATLANTA | 25,407,225 | 11,500,082 | 4,094,354 | 41,001,661 | 34,036,441 | 4,346,050 |
| Birmingham | 2,116,535 | 1,885,999 | 1,749,485 | 5,752,019 | 3,441,437 | . . . |
| Jacksonville | 1,732,270 | 17,104,571 | 2,851,236 | 21,688,077 | 17,679,620 | 48,365 |
| Miami | 3,810,291 | 12,929,718 | 2,728,485 | 19,468,493 | 13,921,990 | . . . |
| Nashville | 603,199 | 2,153,118 | 2,385,502 | 5,141,819 | 2,624,172 | . . . |
| New Orleans | 3,497,233 | 5,535,272 | 2,826,816 | 11,859,322 | 8,167,263 | . . . |
| CHICAGO | 5,033,326 | 116,667,902 | 13,887,161 | 135,588,390 | 101,468,479 | . . . |
| Detroit | 797,734 | 5,443,037 | 3,593,208 | 9,833,979 | 8,527,778 | . . . |
| ST. LOUIS | 700,378 | 18,554,937 | 5,298,206 | 24,553,521 | 17,843,826 | . . . |
| Little Rock | 1,148,492 | 3,085,929 | 1,110,099 | 5,344,519 | 4,234,004 | . . . |
| Louisville | 700,075 | 3,308,312 | 1,131,238 | 5,139,624 | 3,630,568 | . . . |
| Memphis | 1,135,623 | 4,334,482 | 2,538,967 | 8,009,072 | 5,111,680 | . . . |
| MINNEAPOLIS | 8,876,249 | 103,395,475 | 7,753,083 | 120,024,808 | 100,267,078 | . . . |
| Helena | 1,954,514 | 9,278,687 | 526,787 | 11,759,987 | 10,496,799 | . . . |
| KANSAS CITY | 2,048,446 | 17,690,589 | 8,227,232 | 27,966,267 | 19,636,087 | . . . |
| Denver | 3,187,962 | 5,777,563 | 3,311,080 | 12,276,605 | 8,247,316 | . . . |
| Oklahoma City | 646,386 | 10,627,823 | 2,880,901 | 14,155,109 | 12,202,209 | . . . |
| Omaha | 6,534,583 | 10,987,009 | 1,401,083 | 18,922,675 | 15,719,619 | . . . |
| DALLAS | 28,512,492 | 103,908,815 | 18,570,460 | 150,991,767 | 137,763,658 | . . . |
| El Paso | 262,477 | 2,737,583 | 902,921 | 3,902,982 | 3,360,141 | . . . |
| Houston | 2,205,500 | 5,025,337 | 1,318,755 | 8,549,592 | 7,109,258 | . . . |
| San Antonio | 482,284 | 5,019,470 | 2,649,439 | 8,151,194 | 6,353,620 | . . . |
| SAN FRANCISCO | 15,599,928 | 70,371,626 | 18,273,912 | 104,245,466 | 77,998,128 | . . . |
| Los Angeles | 3,891,887 | 51,907,298 | 9,168,091 | 64,967,276 | 51,962,990 | . . . |
| Portland | 2,733,212 | 9,085,898 | 2,453,483 | 14,272,593 | 12,419,951 | . . . |
| Salt Lake City | 494,556 | 7,002,496 | 2,357,975 | 9,855,028 | 8,143,018 | . . . |
| Seattle | 324,772 | 9,192,083 | 2,771,774 | 12,288,629 | 9,890,153 | . . . |
| **Total** | **191,902,236** | **1,128,729,998** | **241,454,495** | **1,562,086,729** | **1,232,901,388** | **10,102,871** |

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

1. Includes expenditures for construction at some offices, pending allocation to appropriate accounts.

2. Excludes charge-offs of $17,698,968 before 1952.

3. Covers acquisitions for banking-house purposes and Bank premises formerly occupied and being held pending sale.

## 9. Operations in Principal Departments of Federal Reserve Banks, 1993–96

| Operation | 1996 | 1995 | 1994 | 1993 |
|---|---|---|---|---|
| *Millions of pieces (except as noted)* | | | | |
| Loans (thousands) | 6 | 6 | 8 | 6 |
| Currency received and counted | 23,436 | 22,594 | 20,166 | 20,768 |
| Currency verified and destroyed | 8,686 | 8,911 | 7,244 | 7,376 |
| Coin received and counted | 8,654 | 7,578 | 6,950 | 7,690 |
| Checks handled | | | | |
| U.S. government checks | 436 | 460 | 470 | 480 |
| Postal money orders | 206 | 203 | 200 | 192 |
| All other | 15,487 | 15,465 | 16,479 | 19,009 |
| Government securities transfers [1] | 13 | 13 | 13 | 12 |
| Transfer of funds | 83 | 76 | 72 | 70 |
| Automated clearinghouse transactions | | | | |
| Commercial [2] | 2,372 | 2,046 | 1,737 | 1,486 |
| Government | 625 | 599 | 574 | 555 |
| Food stamps redeemed | 3,637 | 3,954 | 4,229 | 4,198 |
| *Millions of dollars* | | | | |
| Loans | 25,350 | 22,854 | 22,853 | 20,760 |
| Currency received and counted | 375,399 | 345,318 | 277,685 | 290,989 |
| Currency verified and destroyed | 148,394 | 113,828 | 76,620 | 79,599 |
| Coin received and counted | 1,175 | 1,112 | 1,045 | 1,143 |
| Checks handled | | | | |
| U.S. government checks | 462,647 | 490,299 | 504,479 | 534,236 |
| Postal money orders | 25,831 | 24,835 | 23,764 | 22,207 |
| All other | 11,584,276 | 11,567,820 | 12,079,107 | 14,066,518 |
| Government securities transfers [1] | 160,637,460 | 149,764,431 | 144,702,226 | 146,220,304 |
| Transfer of funds | 249,140,021 | 222,954,083 | 211,201,540 | 207,629,814 |
| Automated clearinghouse transactions | | | | |
| Commercial [2] | 8,287,711 | 7,817,323 | 7,094,246 | 6,454,742 |
| Government | 1,250,472 | 1,117,452 | 948,984 | 885,011 |
| Food stamps redeemed | 18,669 | 20,862 | 21,867 | 21,661 |

1. Beginning with the 1994 *Annual Report,* ‘‘Government securities transfers’’ replaced the previous time series that included ‘‘Issues, redemptions, and exchanges of U.S. Treasury and federal agency securities.’’ This change was made to enable consistent time series reporting for the fiscal area, where complex definitional changes have occurred over the reported years.

2. The volume and value of commercial automated clearinghouse transactions were adjusted for earlier years to correct a reporting error.

## 10. Federal Reserve Bank Interest Rates on Loans to Depository Institutions, December 31, 1996

| Reserve Bank | Adjustment credit [1] | Seasonal credit [2] | Extended credit [3] | |
|---|---|---|---|---|
| | | | First thirty days of borrowing | After thirty days of borrowing |
| All Federal Reserve Banks ....... | 5.00 | 5.35 | 5.00 | 5.85 |

1. Adjustment credit is available on a short-term basis to help depository institutions meet temporary needs for funds that cannot be met through reasonable alternative sources. As of May 20, 1986, the highest rate established for loans to depository institutions may be charged on adjustment credit loans of unusual size that result from a major operating problem at the borrower's facility.

2. Seasonal credit is available to help smaller depository institutions meet regular, seasonal needs for funds that cannot be met through special industry lenders and that arise from a combination of expected patterns of movement in their deposits and loans. The discount rate on seasonal credit takes into account rates on market sources of funds and ordinarily is reestablished on the first business day of each two-week reserve maintenance period; however, it is never lower than the discount rate applicable to adjustment credit. See section 201.3(b) of Regulation A.

3. Extended credit is available to depository institutions, if similar assistance is not reasonably available from other sources, when exceptional circumstances or practices involve only a particular institution or when an institution is experiencing difficulties adjusting to changing market conditions over a longer period of time. See section 201.3(c) of Regulation A.

Extended-credit loans outstanding more than thirty days ordinarily will be charged a flexible rate somewhat above rates on market sources of funds; however, the rate will always be at least 50 basis points above the discount rate applicable to adjustment credit. The flexible rate is reestablished on the first business day of each two-week reserve maintenance period. At the discretion of the Federal Reserve Bank, the flexible rate may be charged on extended-credit loans that are outstanding less than thirty days.

## 11. Reserve Requirements of Depository Institutions, December 31, 1996

| Type of deposit | Requirements | |
|---|---|---|
| | Percentage of deposits | Effective date |
| *Net transaction accounts* [1] | | |
| $0 million–$49.3 million [2] | 3 | 1-2-97 |
| More than $49.3 million [3] | 10 | 1-2-97 |
| Nonpersonal time deposits [4] | 0 | 12-27-90 |
| Eurocurrency liabilities [5] | 0 | 12-27-90 |

NOTE. Required reserves must be held in the form of deposits with Federal Reserve Banks or vault cash. Nonmember institutions may maintain reserve balances with a Federal Reserve Bank indirectly, on a pass-through basis, with certain approved institutions. For previous reserve requirements, see earlier editions of the *Annual Report* or the *Federal Reserve Bulletin.* Under the Monetary Control Act of 1980, depository institutions include commercial banks, mutual savings banks, savings and loan associations, credit unions, agencies and branches of foreign banks, and Edge Act corporations.

1. Transaction accounts include all deposits against which the account holder is permitted to make withdrawals by negotiable or transferable instruments, payment orders of withdrawal, or telephone or preauthorized transfers for the purpose of making payments to third persons or others. However, accounts subject to the rules that permit no more than six preauthorized, automatic, or other transfers per month (of which no more than three may be by check, draft, debit card, or similar order payable directly to third parties) are savings deposits, not transaction accounts.

2. The Monetary Control Act of 1980 requires that the amount of transaction accounts against which the 3 percent reserve requirement applies be modified annually by 80 percent of the percentage change in transaction accounts held by all depository institutions, determined as of June 30 each year. Effective with the reserve maintenance period beginning January 2, 1997, for depository institutions that report weekly, and with the period beginning January 16, 1997, for institutions that report quarterly, the amount was decreased from $52.0 million to $49.3 million.

Under the Garn–St Germain Depository Institutions Act of 1982, the Board adjusts the amount of reservable liabilities subject to a zero percent reserve requirement each year for the succeeding calendar year by 80 percent of the percentage increase in the total reservable liabilities of all depository institutions, measured on an annual basis as of June 30. No corresponding adjustment is made in the event of a decrease. The exemption applies only to accounts that would be subject to a 3 percent reserve requirement. Effective with the reserve maintenance period beginning January 2, 1997, for depository institutions that report weekly, and with the period beginning January 16, 1997, for institutions that report quarterly, the exemption was raised from $4.3 million to $4.4 million.

3. The reserve requirement was reduced from 12 percent to 10 percent on April 2, 1992, for institutions that report weekly, and on April 16, 1992, for institutions that report quarterly.

4. For institutions that report weekly, the reserve requirement on nonpersonal time deposits with an original maturity of less than 1½ years was reduced from 3 percent to 1½ percent for the maintenance period that began December 13, 1990, and to zero for the maintenance period that began December 27, 1990. For institutions that report quarterly, the reserve requirement on nonpersonal time deposits with an original maturity of less than 1½ years was reduced from 3 percent to zero on January 17, 1991.

The reserve requirement on nonpersonal time deposits with an original maturity of 1½ years or more has been zero since October 6, 1983.

5. The reserve requirement on Euroccurency liabilities was reduced from 3 percent to zero in the same manner and on the same dates as the reserve requirement on nonpersonal time deposits with an original maturity of less than 1½ years (see note 4).

## 12. Initial Margin Requirements under Regulations T, U, G, and X

Percent of market value

| Effective date | Margin stocks | Convertible bonds | Short sales, T only[1] |
|---|---|---|---|
| 1934, Oct. 1 | 25–45 | ... | ... |
| 1936, Feb. 1 | 25–55 | ... | ... |
| Apr. 1 | 55 | ... | ... |
| 1937, Nov. 1 | 40 | ... | 50 |
| 1945, Feb. 5 | 50 | ... | 50 |
| July 5 | 75 | ... | 75 |
| 1946, Jan. 21 | 100 | ... | 100 |
| 1947, Feb. 21 | 75 | ... | 75 |
| 1949, Mar. 3 | 50 | ... | 50 |
| 1951, Jan. 17 | 75 | ... | 75 |
| 1953, Feb. 20 | 50 | ... | 50 |
| 1955, Jan. 4 | 60 | ... | 60 |
| Apr. 23 | 70 | ... | 70 |
| 1958, Jan. 16 | 50 | ... | 50 |
| Aug. 5 | 70 | ... | 70 |
| Oct. 16 | 90 | ... | 90 |
| 1960, July 28 | 70 | ... | 70 |
| 1962, July 10 | 50 | ... | 50 |
| 1963, Nov. 6 | 70 | ... | 70 |
| 1968, Mar. 11 | 70 | 50 | 70 |
| June 8 | 80 | 60 | 80 |
| 1970, May 6 | 65 | 50 | 65 |
| 1971, Dec. 6 | 55 | 50 | 55 |
| 1972, Nov. 24 | 65 | 50 | 65 |
| 1974, Jan. 3 | 50 | 50 | 50 |

NOTE. These regulations, adopted by the Board of Governors pursuant to the Securities Exchange Act of 1934, limit the amount of credit to purchase and carry ‘‘margin securities’’ (as defined in the regulations) when such value is collateralized by securities. Margin requirements on securities are the difference between the market value (100 percent) and the maximum loan value of collateral as prescribed by the Board. Regulation T was adopted effective October 15, 1934; Regulation U, effective May 1, 1936; Regulation G, effective March 11, 1968; and Regulation X, effective November 1, 1971.

On January 1, 1977, the Board of Governors for the first time established in Regulation T the initial margin required for writing options on securities, setting it at 30 percent of the current market value of the stock underlying the option. On September 30, 1985, the Board changed the required margin on individual stock options, allowing it to be the same as the option maintenance margin required by the appropriate exchange or self-regulatory organization; such maintenance margin rules must be approved by the Securities and Exchange Commission.

1. From October 1, 1934, to October 31, 1937, the requirement was the margin ‘‘customarily required’’ by the brokers and dealers.

## 13. Principal Assets and Liabilities and Number of Insured Commercial Banks in the United States, by Class of Bank, June 30, 1996 and 1995

Millions of dollars, except as noted

| Item | Total | Member banks | | | Nonmember banks |
|---|---|---|---|---|---|
| | | Total | National | State | |
| | 1996 | | | | |
| ASSETS | | | | | |
| Loans and investments | 3,211,239 | 2,384,136 | 1,836,658 | 547,478 | 827,103 |
| Gross loans | 2,401,121 | 1,811,560 | 1,437,274 | 374,287 | 589,561 |
| Net loans | 2,397,057 | 1,809,279 | 1,435,469 | 373,810 | 587,778 |
| Investments | 810,117 | 572,576 | 399,384 | 173,191 | 237,542 |
| U.S. Treasury and federal agency securities | 310,423 | 193,631 | 136,587 | 57,044 | 116,791 |
| Other | 499,695 | 378,944 | 262,797 | 116,147 | 120,750 |
| Cash assets, total | 209,017 | 166,724 | 131,481 | 35,243 | 42,294 |
| LIABILITIES | | | | | |
| Deposits, total | 2,601,607 | 1,905,957 | 1,486,568 | 419,389 | 695,650 |
| Interbank | 41,671 | 35,069 | 26,976 | 8,093 | 6,602 |
| Other transaction | 724,824 | 543,799 | 423,598 | 120,201 | 181,024 |
| Other nontransaction | 2,038,896 | 1,456,829 | 1,136,788 | 320,044 | 582,066 |
| Equity capital | 365,328 | 275,227 | 207,627 | 67,601 | 90,101 |
| Number of banks | 9,653 | 3,776 | 2,755 | 1,021 | 5,877 |
| | 1995 | | | | |
| ASSETS | | | | | |
| Loans and investments | 3,057,022 | 2,227,141 | 1,667,536 | 559,605 | 829,881 |
| Gross loans | 2,249,343 | 1,663,974 | 1,276,481 | 387,493 | 585,369 |
| Net loans | 2,224,639 | 1,661,360 | 1,274,454 | 386,905 | 583,279 |
| Investments | 807,679 | 563,167 | 391,055 | 172,112 | 244,513 |
| U.S. Treasury and federal agency securities | 328,556 | 207,122 | 151,811 | 55,311 | 121,433 |
| Other | 479,124 | 356,044 | 239,244 | 116,801 | 123,079 |
| Cash assets, total | 198,843 | 157,221 | 117,556 | 39,664 | 41,622 |
| LIABILITIES | | | | | |
| Deposits, total | 2,465,251 | 1,758,543 | 1,328,485 | 430,058 | 706,708 |
| Interbank | 38,710 | 31,468 | 21,999 | 9,470 | 7,242 |
| Other transaction | 773,794 | 574,908 | 428,781 | 146,127 | 198,886 |
| Other nontransaction | 1,930,233 | 1,344,046 | 1,024,899 | 319,147 | 586,187 |
| Equity capital | 335,432 | 246,282 | 180,887 | 65,394 | 89,150 |
| Number of banks | 10,143 | 3,929 | 2,937 | 992 | 6,214 |

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

## 14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–96, and Month-End 1996

Millions of dollars

| Period | Factors supplying reserve funds | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Federal Reserve Bank credit outstanding | | | | | | | | Gold stock [4] | Special drawing rights certificate account | Treasury currency outstanding [5] |
| | U.S. Treasury and federal agency securities | | | Loans | Float [1] | All other [2] | Other Federal Reserve assets [3] | Total | | | |
| | Total | Bought outright | Held under repurchase agreement | | | | | | | | |
| 1918 | 239 | 239 | 0 | 1,766 | 199 | 294 | 0 | 2,498 | 2,873 | ... | 1,795 |
| 1919 | 300 | 300 | 0 | 2,215 | 201 | 575 | 0 | 3,292 | 2,707 | ... | 1,707 |
| 1920 | 287 | 287 | 0 | 2,687 | 119 | 262 | 0 | 3,355 | 2,639 | ... | 1,709 |
| 1921 | 234 | 234 | 0 | 1,144 | 40 | 146 | 0 | 1,563 | 3,373 | ... | 1,842 |
| 1922 | 436 | 436 | 0 | 618 | 78 | 273 | 0 | 1,405 | 3,642 | ... | 1,958 |
| 1923 | 134 | 80 | 54 | 723 | 27 | 355 | 0 | 1,238 | 3,957 | ... | 2,009 |
| 1924 | 540 | 536 | 4 | 320 | 52 | 390 | 0 | 1,302 | 4,212 | ... | 2,025 |
| 1925 | 375 | 367 | 8 | 643 | 63 | 378 | 0 | 1,459 | 4,112 | ... | 1,977 |
| 1926 | 315 | 312 | 3 | 637 | 45 | 384 | 0 | 1,381 | 4,205 | ... | 1,991 |
| 1927 | 617 | 560 | 57 | 582 | 63 | 393 | 0 | 1,655 | 4,092 | ... | 2,006 |
| 1928 | 228 | 197 | 31 | 1,056 | 24 | 500 | 0 | 1,809 | 3,854 | ... | 2,012 |
| 1929 | 511 | 488 | 23 | 632 | 34 | 405 | 0 | 1,583 | 3,997 | ... | 2,022 |
| 1930 | 739 | 686 | 43 | 251 | 21 | 372 | 0 | 1,373 | 4,306 | ... | 2,027 |
| 1931 | 817 | 775 | 42 | 638 | 20 | 378 | 0 | 1,853 | 4,173 | ... | 2,035 |
| 1932 | 1,855 | 1,851 | 4 | 235 | 14 | 41 | 0 | 2,145 | 4,226 | ... | 2,204 |
| 1933 | 2,437 | 2,435 | 2 | 98 | 15 | 137 | 0 | 2,688 | 4,036 | ... | 2,303 |
| 1934 | 2,430 | 2,430 | 0 | 7 | 5 | 21 | 0 | 2,463 | 8,238 | ... | 2,511 |
| 1935 | 2,431 | 2,430 | 1 | 5 | 12 | 38 | 0 | 2,486 | 10,125 | ... | 2,476 |
| 1936 | 2,430 | 2,430 | 0 | 3 | 39 | 28 | 0 | 2,500 | 11,258 | ... | 2,532 |
| 1937 | 2,564 | 2,564 | 0 | 10 | 19 | 19 | 0 | 2,612 | 12,760 | ... | 2,637 |
| 1938 | 2,564 | 2,564 | 0 | 4 | 17 | 16 | 0 | 2,601 | 14,512 | ... | 2,798 |
| 1939 | 2,484 | 2,484 | 0 | 7 | 91 | 11 | 0 | 2,593 | 17,644 | ... | 2,963 |
| 1940 | 2,184 | 2,184 | 0 | 3 | 80 | 8 | 0 | 2,274 | 21,995 | ... | 3,087 |
| 1941 | 2,254 | 2,254 | 0 | 3 | 94 | 10 | 0 | 2,361 | 22,737 | ... | 3,247 |
| 1942 | 6,189 | 6,189 | 0 | 6 | 471 | 14 | 0 | 6,679 | 22,726 | ... | 3,648 |
| 1943 | 11,543 | 11,543 | 0 | 5 | 681 | 10 | 0 | 12,239 | 21,938 | ... | 4,094 |
| 1944 | 18,846 | 18,846 | 0 | 80 | 815 | 4 | 0 | 19,745 | 20,619 | ... | 4,131 |
| 1945 | 24,252 | 24,252 | 0 | 249 | 578 | 2 | 0 | 15,091 | 20,065 | ... | 4,339 |
| 1946 | 23,350 | 23,350 | 0 | 163 | 580 | 1 | 0 | 24,093 | 20,529 | ... | 4,562 |
| 1947 | 22,559 | 22,559 | 0 | 85 | 535 | 1 | 0 | 23,181 | 22,754 | ... | 4,562 |
| 1948 | 23,333 | 23,333 | 0 | 223 | 541 | 1 | 0 | 24,097 | 24,244 | ... | 4,589 |
| 1949 | 18,885 | 18,885 | 0 | 78 | 534 | 2 | 0 | 19,499 | 24,427 | ... | 4,598 |
| 1950 | 20,778 | 20,725 | 53 | 67 | 1,368 | 3 | 0 | 22,216 | 22,706 | ... | 4,636 |
| 1951 | 23,801 | 23,605 | 196 | 19 | 1,184 | 5 | 0 | 25,009 | 22,695 | ... | 4,709 |
| 1952 | 24,697 | 24,034 | 663 | 156 | 967 | 4 | 0 | 25,825 | 23,187 | ... | 4,812 |
| 1953 | 25,916 | 25,318 | 598 | 28 | 935 | 2 | 0 | 26,880 | 22,030 | ... | 4,894 |
| 1954 | 24,932 | 24,888 | 44 | 143 | 808 | 1 | 0 | 25,885 | 21,713 | ... | 4,985 |
| 1955 | 24,785 | 24,391 | 394 | 108 | 1,585 | 29 | 0 | 26,507 | 21,690 | ... | 5,008 |
| 1956 | 24,915 | 24,610 | 305 | 50 | 1,665 | 70 | 0 | 26,699 | 21,949 | ... | 5,066 |
| 1957 | 24,238 | 23,719 | 519 | 55 | 1,424 | 66 | 0 | 25,784 | 22,781 | ... | 5,146 |
| 1958 | 26,347 | 26,252 | 95 | 64 | 1,296 | 49 | 0 | 27,755 | 20,534 | ... | 5,234 |
| 1959 | 26,648 | 26,607 | 41 | 458 | 1,590 | 75 | 0 | 28,771 | 19,456 | ... | 5,311 |
| 1960 | 27,384 | 26,984 | 400 | 33 | 1,847 | 74 | 0 | 29,338 | 17,767 | ... | 5,398 |
| 1961 | 28,881 | 30,478 | 159 | 130 | 2,300 | 51 | 0 | 31,362 | 16,889 | ... | 5,585 |
| 1962 | 30,820 | 28,722 | 342 | 38 | 2,903 | 110 | 0 | 33,871 | 15,978 | ... | 5,567 |
| 1963 | 33,593 | 33,582 | 11 | 63 | 2,600 | 162 | 0 | 36,418 | 15,513 | ... | 5,578 |
| 1964 | 37,044 | 36,506 | 538 | 186 | 2,606 | 94 | 0 | 39,930 | 15,388 | ... | 5,405 |

For notes see end of table.

## 14.—Continued

| Factors absorbing reserve funds | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Currency in circulation | Treasury cash holdings[6] | Deposits, other than reserves, with Federal Reserve Banks | | | Other Federal Reserve accounts[3] | Required clearing balances | Other Federal Reserve liabilities and capital[3] | Member bank reserves[7] | | | |
| | | Treasury | Foreign | Other | | | | With Federal Reserve Banks | Currency and coin[8] | Required[9] | Excess[9] |
| 4,951 | 288 | 51 | 96 | 25 | 118 | 0 | 0 | 1,636 | 0 | 1,585 | 51 |
| 5,091 | 385 | 51 | 73 | 28 | 208 | 0 | 0 | 1,890 | 0 | 1,822 | 68 |
| | | | | | | | | | | | |
| 5,325 | 218 | 57 | 5 | 18 | 298 | 0 | 0 | 1,781 | 0 | 0 | 0 |
| 4,403 | 214 | 96 | 12 | 15 | 285 | 0 | 0 | 1,753 | 0 | 1,654 | 99 |
| 4,530 | 225 | 11 | 3 | 26 | 276 | 0 | 0 | 1,934 | 0 | 0 | 0 |
| 4,757 | 213 | 38 | 4 | 19 | 275 | 0 | 0 | 1,898 | 0 | 1,884 | 14 |
| 4,760 | 211 | 51 | 19 | 20 | 258 | 0 | 0 | 2,220 | 0 | 2,161 | 59 |
| | | | | | | | | | | | |
| 4,817 | 203 | 16 | 8 | 21 | 272 | 0 | 0 | 2,212 | 0 | 2,256 | –44 |
| 4,808 | 201 | 17 | 46 | 19 | 293 | 0 | 0 | 2,194 | 0 | 2.250 | –56 |
| 4,716 | 208 | 18 | 5 | 21 | 301 | 0 | 0 | 2,487 | 0 | 2,424 | 63 |
| 4,686 | 202 | 23 | 6 | 21 | 348 | 0 | 0 | 2,389 | 0 | 2,430 | –41 |
| 4,578 | 216 | 29 | 6 | 24 | 393 | 0 | 0 | 2,355 | 0 | 2,428 | –73 |
| | | | | | | | | | | | |
| 4,603 | 211 | 19 | 6 | 22 | 375 | 0 | 0 | 2,471 | 0 | 2,375 | 96 |
| 5,360 | 222 | 54 | 79 | 31 | 354 | 0 | 0 | 1,961 | 0 | 1,994 | –33 |
| 5,388 | 272 | 8 | 19 | 24 | 355 | 0 | 0 | 2,509 | 0 | 1,933 | 576 |
| 5,519 | 284 | 3 | 4 | 128 | 360 | 0 | 0 | 2,729 | 0 | 1,870 | 859 |
| 5,536 | 3,029 | 121 | 20 | 169 | 241 | 0 | 0 | 4,096 | 0 | 2,282 | 1,814 |
| | | | | | | | | | | | |
| 5,882 | 2,566 | 544 | 29 | 226 | 253 | 0 | 0 | 5,587 | 0 | 2,743 | 2,844 |
| 6,543 | 2,376 | 244 | 99 | 160 | 261 | 0 | 0 | 6,606 | 0 | 4,622 | 1,984 |
| 6,550 | 3,619 | 142 | 172 | 235 | 263 | 0 | 0 | 7,027 | 0 | 5,815 | 1,212 |
| 6,856 | 2,706 | 923 | 199 | 242 | 260 | 0 | 0 | 8,724 | 0 | 5,519 | 3,205 |
| 7,598 | 2,409 | 634 | 397 | 256 | 251 | 0 | 0 | 11,653 | 0 | 6,444 | 5,209 |
| | | | | | | | | | | | |
| 8,732 | 2,213 | 368 | 1,133 | 599 | 284 | 0 | 0 | 4,026 | 0 | 7,411 | 6,615 |
| 11,160 | 2,215 | 867 | 774 | 586 | 291 | 0 | 0 | 12,450 | 0 | 9,365 | 3,085 |
| 15,410 | 2,193 | 799 | 793 | 485 | 256 | 0 | 0 | 13,117 | 0 | 11,129 | 1,988 |
| 20,499 | 2,303 | 579 | 1,360 | 356 | 339 | 0 | 0 | 12,886 | 0 | 11,650 | 1,236 |
| 25,307 | 2,375 | 440 | 1,204 | 394 | 402 | 0 | 0 | 14,373 | 0 | 12,748 | 1,625 |
| | | | | | | | | | | | |
| 28,515 | 2,287 | 977 | 862 | 446 | 495 | 0 | 0 | 15,915 | 0 | 14,457 | 1,458 |
| 28,952 | 2,272 | 393 | 508 | 314 | 607 | 0 | 0 | 16,139 | 0 | 15,577 | 562 |
| 28,868 | 1,336 | 870 | 392 | 569 | 563 | 0 | 0 | 17,899 | 0 | 16,400 | 1,499 |
| 28,224 | 1,325 | 1,123 | 642 | 547 | 590 | 0 | 0 | 20,479 | 0 | 19,277 | 1,202 |
| 27,600 | 1,312 | 821 | 767 | 750 | 106 | 0 | 0 | 16,568 | 0 | 15,550 | 1,018 |
| | | | | | | | | | | | |
| 27,741 | 1,293 | 668 | 895 | 565 | 714 | 0 | 0 | 17,681 | 0 | 16,509 | 1,172 |
| 29,206 | 1,270 | 247 | 526 | 363 | 746 | 0 | 0 | 20,056 | 0 | 19,667 | 389 |
| 30,433 | 1,270 | 389 | 550 | 455 | 777 | 0 | 0 | 19,950 | 0 | 20,520 | –570 |
| 30,781 | 761 | 346 | 423 | 493 | 839 | 0 | 0 | 20,160 | 0 | 19,397 | 763 |
| 30,509 | 796 | 563 | 490 | 441 | 907 | 0 | 0 | 18,876 | 0 | 18,618 | 258 |
| | | | | | | | | | | | |
| 31,158 | 767 | 394 | 402 | 554 | 925 | 0 | 0 | 19,005 | 0 | 18,903 | 102 |
| 31,790 | 775 | 441 | 322 | 426 | 901 | 0 | 0 | 19,059 | 0 | 19,089 | –30 |
| 31,834 | 761 | 481 | 356 | 246 | 998 | 0 | 0 | 19,034 | 0 | 19,091 | –57 |
| 32,193 | 683 | 358 | 272 | 391 | 1,122 | 0 | 0 | 18,504 | 0 | 18,574 | –70 |
| 32,591 | 391 | 504 | 345 | 694 | 841 | 0 | 0 | 18,174 | 310 | 18,619 | –135 |
| | | | | | | | | | | | |
| 32,869 | 377 | 485 | 217 | 533 | 941 | 0 | 0 | 17,081 | 2,544 | 18,988 | 637 |
| 33,918 | 422 | 465 | 279 | 320 | 1,044 | 0 | 0 | 17,387 | 2,544 | 18,988 | 96 |
| 35,338 | 380 | 597 | 247 | 393 | 1,007 | 0 | 0 | 17,454 | 3,262 | 20,071 | 645 |
| 37,692 | 361 | 880 | 171 | 291 | 1,065 | 0 | 0 | 17,049 | 4,099 | 20,677 | 471 |
| 39,619 | 612 | 820 | 229 | 321 | 1,036 | 0 | 0 | 18,086 | 4,151 | 21,663 | 574 |

## 14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–96 and Month-End 1996—Continued

Millions of dollars

| Period | Factors supplying reserve funds | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Federal Reserve Bank credit outstanding | | | | | | | | Gold stock [4] | Special drawing rights certificate account | Treasury currency outstanding [5] |
| | U.S. Treasury and federal agency securities | | | Loans | Float [1] | All other [2] | Other Federal Reserve assets [3] | Total | | | |
| | Total | Bought outright [10] | Held under repurchase agreement [11] | | | | | | | | |
| 1965 | 40,768 | 40,478 | 290 | 137 | 2,248 | 187 | 0 | 43,340 | 13,733 | . . . | 5,575 |
| 1966 | 44,316 | 43,655 | 661 | 173 | 2,495 | 193 | 0 | 47,177 | 13,159 | . . . | 6,317 |
| 1967 | 49,150 | 48,980 | 170 | 141 | 2,576 | 164 | 0 | 52,031 | 11,982 | . . . | 6,784 |
| 1968 | 52,937 | 52,937 | 0 | 186 | 3,443 | 58 | 0 | 56,624 | 10,367 | . . . | 6,795 |
| 1969 | 57,154 | 7,154 [3] | 0 | 183 | 3,440 | 64 | 2,743 | 64,584 | 10,367 | . . . | 6,852 |
| 1970 | 62,142 | 62,142 | 0 | 335 | 4,261 | 57 | 1,123 | 67,918 | 10,732 | 400 | 7,147 |
| 1971 | 70,804 | 69,481 | 1,323 | 39 | 4,343 | 261 | 1,068 | 76,515 | 10,132 | 400 | 7,710 |
| 1972 | 71,230 | 71,119 | 111 | 1,981 | 3,974 | 106 | 1,260 | 78,551 | 10,410 | 400 | 8,313 |
| 1973 | 80,495 | 80,395 | 100 | 1,258 | 3,099 | 68 | 1,152 | 86,072 | 11,567 | 400 | 8,716 |
| 1974 | 85,714 | 84,760 | 954 | 299 | 2,001 | 999 | 3,195 | 92,208 | 11,652 | 400 | 9,253 |
| 1975 | 94,124 | 92,789 | 1,335 | 211 | 3,688 | 1,126 | 3,312 | 102,461 | 11,599 | 500 | 10,218 |
| 1976 | 104,093 | 100,062 | 4,031 | 25 | 2,601 | 991 | 3,182 | 110,892 | 11,598 | 1,200 | 10,810 |
| 1977 | 111,274 | 108,922 | 2,352 | 265 | 3,810 | 954 | 2,442 | 118,745 | 11,718 | 1,250 | 11,331 |
| 1978 | 118,591 | 117,374 | 1,217 | 1,174 | 6,432 | 587 | 4,543 | 131,327 | 11,671 | 1,300 | 11,831 |
| 1979 | 126,167 | 124,507 | 1,660 | 1,454 | 6,767 | 704 | 5,613 | 140,705 | 11,172 | 1,800 | 13,083 |
| 1980 | 130,592 | 128,038 | 2,554 | 1,809 | 4,467 | 776 | 8,739 | 146,383 | 11,160 | 2,518 | 13,427 |
| 1981 | 140,348 | 136,863 | 3,485 | 1,601 | 1,762 | 195 | 9,230 | 153,136 | 11,151 | 3,318 | 13,687 |
| 1982 | 148,837 | 144,544 | 4,293 | 717 | 2,735 | 1,480 | 9,890 | 63,659 | 11,148 | 4,618 | 13,786 |
| 1983 | 160,795 | 159,203 | 1,592 | 918 | 1,605 | 418 | 8,728 | 172,464 | 11,121 | 4,618 | 15,732 |
| 1984 | 169,627 | 167,612 | 2,015 | 3,577 | 833 | 0 | 12,347 | 186,384 | 11,096 | 4,618 | 16,418 |
| 1985 | 191,248 | 186,025 | 5,223 | 3,060 | 988 | 0 | 15,302 | 210,598 | 11,090 | 4,718 | 17,075 |
| 1986 | 221,459 | 205,454 | 16,005 | 1,565 | 1,261 | 0 | 17,475 | 241,760 | 11,084 | 5,018 | 17,567 |
| 1987 | 231,420 | 226,459 | 4,961 | 3,815 | 811 | 0 | 15,837 | 251,883 | 11,078 | 5,018 | 18,177 |
| 1988 | 247,489 | 240,628 | 6,861 | 2,170 | 1,286 | 0 | 18,803 | 269,748 | 11,060 | 5,018 | 18,799 |
| 1989 | 235,417 | 233,300 | 2,117 | 481 | 1,093 | 0 | 39,631 | 276,622 | 11,059 | 8,518 | 19,628 |
| 1990 | 259,786 | 241,432 | 18,354 | 190 | 2,566 | 0 | 39,880 | 302,421 | 11,058 | 10,018 | 20,404 |
| 1991 | 288,429 | 272,531 | 15,898 | 218 | 1,026 | 0 | 34,524 | 324,197 | 11,059 | 10,018 | 21,017 |
| 1992 | 308,518 | 300,424 | 8,094 | 675 | 3,350 | 0 | 30,278 | 342,820 | 11,056 | 8,018 | 21,452 |
| 1993 | 349,865 | 336,653 | 13,212 | 94 | 963 | 0 | 33,394 | 384,316 | 11,053 | 8,018 | 22,101 |
| 1994 | 378,746 | 368,156 | 10,590 | 223 | 740 | 0 | 33,441 | 413,150 | 11,051 | 8,018 | 22,912 |
| 1995 | 394,693 | 380,831 | 13,862 | 136 | 231 | 0 | 33,483 | 428,543 | 11,050 | 10,168 | 23,951 |
| 1996 | 414,715 | 393,132 | 21,583 | 85 | 5,297 | 0 | 32,222 | 452,319 | 11,048 | 9,718 | 24,798 |

## 14.—Continued

| Factors absorbing reserve funds | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Currency in circulation | Treasury cash holdings[6] | Deposits, other than reserves, with Federal Reserve Banks | | | Other Federal Reserve accounts[3] | Required clearing balances | Other Federal Reserve liabilities and capital[3] | Member bank reserves[7] | | | |
| | | Treasury | Foreign | Other | | | | With Federal Reserve Banks | Currency and coin[8] | Required[9] | Excess[9,12] |
| 42,056 | 760 | 668 | 150 | 355 | 211 | 0 | 0 | 18,447 | 4,163 | 22,848 | –238 |
| 44,663 | 1,176 | 416 | 174 | 588 | –147 | 0 | 0 | 19,779 | 4,310 | 24,321 | –232 |
| 47,226 | 1,344 | 1,123 | 135 | 563 | –773 | 0 | 0 | 21,092 | 4,631 | 25,905 | –182 |
| 50,961 | 695 | 703 | 216 | 747 | –1,353 | 0 | 0 | 21,818 | 4,921 | 27,439 | –700 |
| 53,950 | 596 | 1,312 | 134 | 807 | 0 | 0 | 1,919 | 22,085 | 5,187 | 28,173 | –901 |
| 57,903 | 431 | 1,156 | 148 | 1,233 | 0 | 0 | 1,986 | 24,150 | 5,423 | 30,033 | –460 |
| 61,068 | 460 | 2,020 | 294 | 999 | 0 | 0 | 2,131 | 27,788 | 5,743 | 32,496 | 1,035 |
| 66,516 | 345 | 1,855 | 325 | 840 | 0 | 0 | 2,143 | 25,647 | 6,216 | 32,044 | 98 [12] |
| 72,497 | 317 | 2,542 | 251 | 1,419 [13] | 0 | 0 | 2,669 | 27,060 | 6,781 | 35,268 | –1,360 |
| 79,743 | 185 | 2,113 | 418 | 1,275 [13] | 0 | 0 | 2,935 | 25,843 | 7,370 | 37,011 | –3,798 |
| 86,547 | 483 | 7,285 | 353 | 1,090 | 0 | 0 | 2,968 | 26,052 | 8,036 | 35,197 | –1,103 [14] |
| 93,717 | 460 | 10,393 | 352 | 1,357 | 0 | 0 | 3,063 | 25,158 | 8,628 | 35,461 | –1,535 |
| 103,811 | 392 | 7,114 | 379 | 1,187 | 0 | 0 | 3,292 | 26,870 | 9,421 | 37,615 | –1,265 |
| 114,645 | 240 | 4,196 | 368 | 1,256 | 0 | 0 | 4,275 | 31,152 | 10,538 | 42,694 | –893 |
| 125,600 | 494 | 4,075 | 429 | 1,412 | 0 | 0 | 4,957 | 29,792 | 11,429 | 44,217 | –2,835 |
| 136,829 | 441 | 3,062 | 411 | 617 | 0 | 0 | 4,671 | 27,456 | 13,654 | 40,558 | 675 |
| 144,774 | 443 | 4,301 | 505 | 781 | 0 | 117 | 5,261 | 25,111 | 15,576 | 42,145 | –1,442 |
| 154,908 | 429 | 5,033 | 328 | 1,033 | 0 | 436 | 4,990 | 26,053 | 16,666 | 41,391 | 1,328 |
| 171,935 | 479 | 3,661 | 191 | 851 | 0 | 1,013 | 5,392 | 20,413 | 17,821 | 39,179 | –945 |
| 183,796 | 513 | 5,316 | 253 | 867 | 0 | 1,126 | 5,952 | 20,693 | | | |
| 197,488 | 550 | 9,351 | 480 | 1,041 | 0 | 1,490 | 5,940 | 27,141 | | | |
| 211,995 | 447 | 7,588 | 287 | 917 | 0 | 1,812 | 6,088 | 46,295 | | | |
| 230,205 | 454 | 5,313 | 244 | 1,027 | 0 | 1,687 | 7,129 | 40,097 | | | |
| 247,649 | 395 | 8,656 | 347 | 548 | 0 | 1,605 | 7,683 | 37,742 | | | |
| 260,456 | 450 | 6,217 | 589 | 1,298 | 0 | 1,618 | 8,486 | 36,713 | n.a. | n.a. | n.a. |
| 286,965 | 561 | 8,960 | 369 | 242 | 0 | 1,963 | 8,147 | 36,695 | | | |
| 307,759 | 636 | 17,697 | 968 | 1,706 | 0 | 3,945 | 8,113 | 25,467 | | | |
| 334,706 | 508 | 7,492 | 206 | 372 | 0 | 5,897 | 7,984 | 26,181 | | | |
| 365,299 | 377 | 14,809 | 386 | 397 | 0 | 6,332 | 9,292 | 28,614 | | | |
| 403,762 | 335 | 7,161 | 250 | 876 | 0 | 4,239 | 11,959 | 26,550 | | | |
| 424,192 | 270 | 5,979 | 386 | 932 | 0 | 5,171 | 12,342 | 24,441 | | | |
| 450,660 | 249 | 7,742 | 167 | 892 | 0 | 6,601 | 13,829 | 17,922 | | | |

## 14. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items—Year-End 1918–96, and Month-End 1996—Continued

Millions of dollars

| Period | Factors supplying reserve funds | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Federal Reserve Bank credit outstanding | | | | | | | | Gold stock[4] | Special drawing rights certificate account | Treasury currency outstanding[5] |
| | U.S. Treasury and federal agency securities | | | Loans | Float[1] | All other[2] | Other Federal Reserve assets[3] | Total | | | |
| | Total | Bought outright[10] | Held under repurchase agreement[11] | | | | | | | | |
| 1996 | | | | | | | | | | | |
| Jan. ... | 380,842 | 380,842 | 0 | 15 | 1,136 | 0 | 31,379 | 413,372 | 11,052 | 10,168 | 24,105 |
| Feb. ... | 379,153 | 379,153 | 0 | 18 | 372 | 0 | 30,317 | 410,860 | 11,053 | 10,168 | 24,194 |
| Mar. ... | 384,478 | 379,582 | 4,896 | 43 | 128 | 0 | 31,468 | 455,057 | 11,053 | 10,168 | 24,279 |
| Apr. ... | 384,250 | 384,250 | 0 | 93 | 1,011 | 0 | 31,623 | 452,063 | 11,052 | 10,168 | 24,372 |
| May ... | 390,828 | 383,774 | 7,054 | 155 | −203 | 0 | 30,270 | 421,050 | 11,051 | 10,168 | 24,455 |
| June ... | 393,388 | 386,302 | 7,086 | 636 | 22 | 0 | 31,462 | 394,046 | 11,050 | 10,168 | 24,531 |
| July .... | 400,454 | 384,714 | 15,740 | 1,718 | 446 | 0 | 33,722 | 436,340 | 11,050 | 10,168 | 24,620 |
| Aug. ... | 394,903 | 389,291 | 5,612 | 339 | 298 | 0 | 31,230 | 426,770 | 11,050 | 9,718 | 24,710 |
| Sept. ... | 394,571 | 386,219 | 8,352 | 1,654 | 625 | 0 | 31,370 | 428,220 | 11,050 | 9,718 | 24,801 |
| Oct. ... | 398,134 | 387,334 | 10,800 | 162 | 1,270 | 0 | 32,168 | 431,734 | 11,049 | 9,718 | 24,866 |
| Nov. ... | 405,210 | 394,899 | 10,311 | 188 | 907 | 0 | 30,894 | 440,210 | 11,049 | 9,718 | 24,922 |
| Dec. ... | 414,715 | 393,132 | 21,583 | 85 | 5,297 | 0 | 32,222 | 452,319 | 11,048 | 9,718 | 24,978 |

NOTE. For a description of figures and discussion of their significance, see *Banking and Monetary Statistics, 1941–1970* (Board of Governors of the Federal Reserve System, 1976), pp. 507–23. Components may not sum to totals because of rounding.

. . . Not applicable.

n.a. Not available.

1. Beginning in 1960, figures reflect a minor change in concept; see *Federal Reserve Bulletin*, vol. 47 (February 1961), p. 164.

2. Principally acceptances and, until August 21, 1959, industrial loans, authority for which expired on that date.

3. For the period before April 16, 1969, includes the total of Federal Reserve capital paid in, surplus, other capital accounts, and other liabilities and accrued dividends, less the sum of bank premises and other assets, and is reported as "Other Federal Reserve accounts"; thereafter, "Other Federal Reserve assets" and "Other Federal Reserve liabilities and capital" are shown separately.

4. Before January 30, 1934, includes gold held in Federal Reserve Banks and in circulation.

5. Includes currency and coin (other than gold) issued directly by the Treasury. The largest components are fractional and dollar coins. For details see "Currency and Coin in Circulation," *Treasury Bulletin*.

6. Coin and paper currency held by the Treasury, as well as any gold in excess of the gold certificates issued to the Reserve Bank.

7. Beginning in November 1979, includes reserves of member banks, Edge Act corporations, and U.S. agencies and branches of foreign banks. Beginning on November 13, 1980, includes reserves of all depository institutions.

Beginning in 1984, data on "Currency and coin" and "Required" and "Excess" reserves changed from daily to biweekly basis.

8. Between December 1, 1959, and November 23, 1960, part was allowed as reserves; thereafter all was allowed.

9. Estimated through 1958. Before 1929, data were available only on call dates (in 1920 and 1922 the call date was December 29). Beginning on September 12, 1968, the amount is based on close-of-business figures for the reserve period two weeks before the report date.

## 14.—Continued

| Factors absorbing reserve funds | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Currency in circulation | Treasury cash holdings[6] | Deposits, other than reserves, with Federal Reserve Banks | | | Other Federal Reserve accounts[3] | Required clearing balances | Other Federal Reserve liabilities and capital[3] | Member bank reserves[8] | | | | |
| | | Treasury | Foreign | Other | | | | With Federal Reserve Banks | Currency and coin[8] | Required[9] | Excess[9,12] |
| 412,690 | 273 | 8,210 | 165 | 406 | 0 | 5,193 | 11,832 | 19,929 | | | |
| 414,008 | 279 | 5,632 | 209 | 318 | 0 | 5,437 | 13,062 | 16,331 | | | |
| 416,289 | 314 | 7,021 | 191 | 348 | 0 | 5,561 | 12,714 | 19,180 | | | |
| 417,746 | 288 | 11,042 | 166 | 360 | 0 | 5,770 | 12,559 | 14,637 | | | |
| 422,411 | 265 | 3,757 | 160 | 300 | 0 | 5,879 | 13,148 | 20,806 | | | |
| 424,801 | 280 | 7,701 | 183 | 326 | 0 | 5,895 | 13,371 | 18,699 | | | |
| 428,767 | 261 | 6,836 | 166 | 278 | 0 | 5,972 | 14,817 | 25,080 | n.a. | n.a. | n.a. |
| 432,118 | 277 | 5,149 | 171 | 293 | 0 | 6,059 | 14,007 | 14,175 | | | |
| 430,429 | 286 | 7,700 | 265 | 368 | 0 | 6,269 | 13,744 | 14,728 | | | |
| 433,268 | 281 | 5,897 | 176 | 363 | 0 | 6,516 | 14,066 | 16,801 | | | |
| 440,943 | 273 | 4,857 | 170 | 292 | 0 | 6,556 | 14,219 | 15,575 | | | |
| 450,660 | 249 | 7,742 | 167 | 892 | 0 | 6,601 | 13,829 | 17,922 | | | |

10. Beginning in 1969, includes securities loaned—fully guaranteed by U.S. government securities pledged with Federal Reserve Banks—and excludes securities sold and scheduled to be bought back under matched sale-purchase transactions.

11. Beginning December 1, 1966, includes federal agency obligations held under repurchase agreements and beginning September 29, 1971, includes federal agency issues bought outright.

12. Beginning with week ending November 15, 1972, includes $450 million of reserve deficiencies on which Federal Reserve Banks are allowed to waive penalties for a transition period in connection with bank adaptation to Regulation J as amended, effective November 9, 1972. Allowable deficiencies are as follows (beginning with first statement week of quarter, in millions): 1973—Q1, $279; Q2, $172; Q3, $112; Q4, $84; 1974—Q1, $67; Q2, $58. The transition period ended with the second quarter of 1974.

13. For the period before July 1973, includes certain deposits of domestic nonmember banks and foreign-owned banking institutions held with member banks and redeposited in full with Federal Reserve Banks in connection with voluntary participation by nonmember institutions in the Federal Reserve System program of credit restraint.

As of December 12, 1974, the amount of voluntary nonmember bank and foreign-agency and branch deposits at Federal Reserve Banks that are associated with marginal reserves are no longer reported. However, two amounts are reported: (1) deposits voluntarily held as reserves by agencies and branches of foreign banks operating in the United States and (2) Eurodollar liabilities.

14. Adjusted to include waivers of penalties for reserve deficiencies, in accordance with change in Board policy effective November 19, 1975.

## 15. Number of Banking Offices in the United States, December 31, 1995 and 1996

| Type of office, number, and change | Total | Commercial banks[1] | | | | | | State-chartered savings banks |
|---|---|---|---|---|---|---|---|---|
| | | Total | Member | | | Nonmember | | |
| | | | Total | National | State | | | |
| **BANKS** | | | | | | | | |
| Number, Dec. 31, 1995 | 10,422 | 9,910 | 3,863 | 2,822 | 1,041 | 6,047 | | 512 |
| *Changes during 1996* | | | | | | | | |
| New banks | 166 | 148 | 59 | 52 | 7 | 89 | | 18 |
| Banks converted into branches | –529 | –518 | –263 | –191 | –72 | –255 | | –11 |
| Ceased banking operation[2] | –62 | –50 | –19 | –14 | –5 | –31 | | –12 |
| Other[3] | 0 | 0 | 61 | 18 | 43 | –61 | | 0 |
| Net change | –425 | –420 | –162 | –135 | –27 | –258 | | –5 |
| **Number, Dec. 31, 1996** | **9,997** | **9,490** | **3,701** | **2,687** | **1,014** | **5,789** | | **507** |
| **BRANCHES AND ADDITIONAL OFFICES** | | | | | | | | |
| Number, Dec. 31, 1995 | 61,518 | 58,072 | 39,718 | 29,790 | 9,928 | 18,354 | | 3,446 |
| *Changes during 1996* | | | | | | | | |
| New branches | 2,688 | 2,487 | 1,673 | 1,215 | 458 | 814 | | 201 |
| Branches converted from banks | 529 | 516 | 290 | 213 | 77 | 226 | | 13 |
| Discontinued[2] | –1,949 | –1,870 | –1,537 | –1,035 | –502 | –333 | | –79 |
| Other[3] | 0 | 43 | 819 | 1,147 | –328 | –776 | | –43 |
| Net change | 1,268 | 1,176 | 1,245 | 1,540 | –295 | –69 | | 92 |
| **Number, Dec. 31, 1996** | **62,786** | **59,248** | **40,963** | **31,330** | **9,633** | **18,285** | | **3,538** |

1. For purposes of this table, banks are entities that are defined as banks in the Bank Holding Company Act as amended and implemented in Federal Reserve Regulation Y. Banks generally consist of any institution that accepts demand deposits and is engaged in the business of making commercial loans or any institution that is defined as an insured bank in section 3(h) of the FDIC Act. Covers entities in the United States or its territories or possessions (affiliated insular areas).

2. Institutions that no longer meet the Regulation Y definition of bank.

3. Interclass changes and sales of branches.

## 16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1996

**Chemical Bank, New York, New York** *to merge with* **Chase Manhattan Bank, N.A., New York, New York**[1]

Summary Report by the Attorney General (12/22/95)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (1/5/96)
The applicant has assets of $142 billion; the target has assets of $98 billion. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Bank of Clarke County, Berryville, Virginia** *to acquire assets and liabilities of* **the Stephens City, Virginia, branch of First Union National Bank of Virginia, Roanoke, Virginia**

Summary Report by the Attorney General (12/12/95)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (1/11/96)
The applicant has assets of $114 million; the target has assets of $8 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Home Bank, Signal Hill, California** *to acquire assets and liabilities of* **the Signal Hill branch of Southern California Bank, Downey, California**

Summary Report by the Attorney General (1/8/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (1/17/96)
The applicant has assets of $425 million; the target has assets of $5 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

1. The institution or group of institutions named before the italicized words is referred to subsequently as the applicant, and the institution or group of institutions named after the italicized words is referred to subsequently as the target.

**Centura Bank, Rocky Mount, North Carolina** *to merge with* **First Commercial Bank, Asheville, North Carolina**

Summary Report by the Attorney General (12/22/95)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (1/19/96)
The applicant has assets of $5.3 billion; the target has assets of $177 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**PremierBank & Trust, Elyria, Ohio** *to acquire assets and liabilities of* **11 branches of Bank One Cleveland, N.A., Cleveland, Ohio**

Summary Report by the Attorney General (1/25/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (1/25/96)
The applicant has assets of $540 million; the targets have assets of $119 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**United Jersey Bank, Hackensack, New Jersey** *to merge with* **Summit Bank, Chatham, New Jersey**

Summary Report by the Attorney General (12/22/95)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (2/5/96)
The applicant has assets of $13.1 billion; the target has assets of $5.6 billion. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**United Jersey Bank, Hackensack, New Jersey** *to merge with* **Flemington National Bank and Trust Company of New Jersey, Flemington, New Jersey**

Summary Report by the Attorney General (12/22/95)

## 16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1996—Continued

The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (2/5/96)
The applicant has assets of $13.1 billion; the target has assets of $289 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Fifth Third Bank, Cincinnati, Ohio** *to acquire assets and liabilities of* **8 branches of NBD Bank, Dayton, Ohio**

Summary Report by the Attorney General (12/22/95)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (2/7/96)
The applicant has assets of $9.1 billion; the targets have assets of $177 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Fifth Third Bank of Columbus, Columbus, Ohio** *to acquire assets and liabilities of* **17 branches of NBD Bank, Columbus, Ohio**

Summary Report by the Attorney General (12/22/95)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (2/7/96)
The applicant has assets of $1.0 billion; the targets have assets of $319 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**The Bank of Waverly, Waverly, Virginia** *to acquire assets and liabilities of* **the Courtland and Franklin branches of First Union National Bank of Virginia, Roanoke, Virginia**

Summary Report by the Attorney General (1/25/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (2/15/96)
The applicant has assets of $57 million; the targets have assets of $36 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Valliwide Bank, Fresno, California** *to merge with* **Commerce Bank of San Luis Obispo, NA, San Luis Obispo, California**

Summary Report by the Attorney General (2/6/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (2/20/96)
The applicant has assets of $1.6 billion; the target has assets of $103 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**The Ohio Bank, Findlay, Ohio** *to acquire assets and liabilities of* **the Carey, Ottawa, Glandorf, Leipsic, and Columbus Grove branches of Society National Bank, Cleveland, Ohio**

Summary Report by the Attorney General (1/25/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (2/22/96)
The applicant has assets of $516 million; the targets have assets of $7 million. The parties operate in the same markets. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Chippewa Valley Bank, Rittman, Ohio** *to acquire assets and liabilities of* **the Doylestown and Clinton branches of First National Bank of Ohio, Akron, Ohio**

Summary Report by the Attorney General (2/6/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (2/23/96)
The applicant has assets of $132 million; the targets have assets of $30 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and

16.—Continued

needs of the community are consistent with approval.

**Security Dollar Bank, Niles, Ohio** *to acquire assets and liabilities of* **one branch of National City Bank, Northeast, Akron, Ohio**

Summary Report by the Attorney General (2/6/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (2/29/96)
The applicant has assets of $134 million; the target has assets of $1 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**The State Bank of Jerseyville, Jerseyville, Illinois** *to acquire assets and liabilities of* **the Brighton, Illinois, branch of Mercantile Bank of Illinois, Alton, Illinois**

Summary Report by the Attorney General (2/28/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (3/5/96)
The applicant has assets of $96 million; the target has assets of $10 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Texas State Bank, McAllen, Texas** *to merge with* **The Border Bank, Hidalgo, Texas**

Summary Report by the Attorney General (2/6/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (3/13/96)
The applicant has assets of $646 million; the target has assets of $120 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Texas State Bank, McAllen, Texas** *to merge with* **First State Bank & Trust, Mission, Texas**

Summary Report by the Attorney General (2/6/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (3/13/96)
The applicant has assets of $646 million; the target has assets of $406 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**F&M Bank, Kaukauna, Wisconsin** *to acquire assets and liabilities of* **the Little Chute Branch of TCF Bank Wisconsin, Milwaukee, Wisconsin**

Summary Report by the Attorney General (2/28/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (3/21/96)
The applicant has assets of $104 million; the target has assets of $500 thousand. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**F&M Bank-Lakeland, Woodruff, Wisconsin** *to merge with* **Bradley Bank, Tomahawk, Wisconsin**

Summary Report by the Attorney General (3/14/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (3/21/96)
The applicant has assets of $102 million; the target has assets of $36 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Capital City Bank, Tallahassee, Tallahassee, Florida** *to merge with* **First Federal Bank, Tallahassee, Florida**

Summary Report by the Attorney General (3/28/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (4/1/96)

## 16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1996—Continued

The applicant has assets of $670 million; the target has assets of $232 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Johnstown Bank & Trust Company, Johnstown, Pennsylvania** *to merge with* **The Moxham National Bank of Johnstown, Johnstown, Pennsylvania**

SUMMARY REPORT BY THE ATTORNEY GENERAL (4/4/96)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/2/96)
The applicant has assets of $592 million; the target has assets of $196 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Johnstown Bank & Trust Company, Johnstown, Pennsylvania** *to merge with* **The First National Bank of Garrett, Garrett, Pennsylvania**

SUMMARY REPORT BY THE ATTORNEY GENERAL (4/4/96)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/2/96)
The applicant has assets of $592 million; the target has assets of $44 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Johnstown Bank & Trust Company, Johnstown, Pennsylvania** *to merge with* **The Armstrong County Trust Company, Kittanning, Pennsylvania**

SUMMARY REPORT BY THE ATTORNEY GENERAL (2/28/96)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/10/96)
The applicant has assets of $592 million; the target has assets of $51 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Elkridge Bank, Elkridge, Maryland** *to merge with* **Odenton Federal Savings and Loan Association, Odenton, Maryland**

SUMMARY REPORT BY THE ATTORNEY GENERAL (2/28/96)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/10/96)
The applicant has assets of $195 million; the target has assets of $34 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Marine Midland Bank, Buffalo, New York** *to acquire assets and liabilities of* **River Bank America, New Rochelle, New York**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3/28/96)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/12/96)
The applicant has assets of $20.3 billion; the target has assets of $1.5 billion. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Vectra Bank, Denver, Colorado** *to merge with* **Southwest State Bank, Denver, Colorado**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3/14/96)
The proposed transaction would not be significantly adverse to competition.

BASIS FOR APPROVAL BY THE FEDERAL RESERVE (4/17/96)
The applicant has assets of $416 million; the target has assets of $114 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Crestar Bank (MD), Bethesda, Maryland** *to acquire assets and liabilities of* **Mellon Bank (MD), Rockville, Maryland**

SUMMARY REPORT BY THE ATTORNEY GENERAL (3/28/96)

16.—Continued

The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (4/19/96)
The applicant has assets of $1.6 billion; the target has assets of $220 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Midland American Bank, Midland, Texas** *to merge with* **Stanton National Bank, Stanton, Texas**

Summary Report by the Attorney General (3/14/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (4/24/96)
The applicant has assets of $140 million; the target has assets of $20 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Triangle Bank, Raleigh, North Carolina** *to acquire assets and liabilities of* **the Scotland Neck branch of Southern Bank and Trust Company, Mount Olive, North Carolina**

Summary Report by the Attorney General (3/28/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (4/24/96)
The applicant has assets of $820 million; the target has assets of $6 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Republic Bank, Philadelphia, Pennsylvania** *to merge with* **First Executive Bank, Philadelphia, Pennsylvania**

Summary Report by the Attorney General (3/28/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (5/2/96)
The applicant has assets of $131 million; the target has assets of $130 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Pioneer Bank, Mapleton, Minnesota** *to merge with* **The First National Bank of Elmore, Elmore, Minnesota**

Summary Report by the Attorney General (3/28/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (5/20/96)
The applicant has assets of $27 million; the target has assets of $25 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Wesbanco Bank Wheeling, Wheeling, West Virginia** *to merge with* **Bank of Weirton, Weirton, West Virginia**

Summary Report by the Attorney General (5/14/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (5/21/96)
The applicant has assets of $618 million; the target has assets of $177 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Harris Trust and Savings Bank, Chicago, Illinois** *to acquire assets and liabilities of* **63 branches of Household Bank, F.S.B., Prospect Heights, Illinois**

Summary Report by the Attorney General (6/10/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (5/29/96)
The applicant has assets of $13.1 billion; the targets have deposits of $3.0 billion. The parties operate in the same markets. The banking factors and considerations relating to the convenience and

## 16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1996—Continued

needs of the community are consistent with approval.

**Centura Bank, Rocky Mount, North Carolina** *to acquire assets and liabilities of* **the Greensboro, Raleigh, and Wilmington branches of Essex Savings Bank, F.S.B., Virginia Beach, Virginia**

Summary Report by the Attorney General (5/14/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (5/30/96)
The applicant has assets of $5.5 billion; the targets have assets of $76 million. The parties operate in the same markets. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Croghan Colonial Bank, Fremont, Ohio** *to merge with* **Union Bank and Savings Company, Bellevue, Ohio**

Summary Report by the Attorney General (4/24/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (6/10/96)
The applicant has assets of $246 million; the target has assets of $97 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Baylake Bank, Sturgeon Bay, Wisconsin** *to merge with* **The Bank, Manawa, Wisconsin**

Summary Report by the Attorney General (4/24/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (6/12/96)
The applicant has assets of $316 million; the target has assets of $58 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Silsbee State Bank, Silsbee, Texas** *to acquire assets and liabilities of* **the Buna branch of First Bank of Texas, Tomball, Texas**

Summary Report by the Attorney General (6/26/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (7/11/96)
The applicant has assets of $127 million; the target has assets of $13 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Tri-City Bank and Trust Company, Blountville, Tennessee** *to acquire assets and liabilities of* **the Kingsport and Johnson City branches of National Bank of Commerce, Memphis, Tennessee**

Summary Report by the Attorney General (6/26/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (7/18/96)
The applicant has assets of $237 million; the targets have assets of $3 million. The parties operate in the same markets. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Centura Bank, Rocky Mount, North Carolina** *to merge with* **First Community Bank, Gastonia, North Carolina**

Summary Report by the Attorney General (6/10/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (7/19/96)
The applicant has assets of $5.6 billion; the target has assets of $124 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Compass Bank, Jacksonville, Florida** *to merge with* **Community First Bank, Jacksonville, Florida**

Summary Report by the Attorney General (5/14/96)

16.—Continued

The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (7/22/96)
The applicant has assets of $607 million; the target has assets of $313 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**DeMotte State Bank, DeMotte, Indiana** *to acquire assets and liabilities of* **the Hebron branch of NBD Bank, N.A., Indianapolis, Indiana**

Summary Report by the Attorney General (7/11/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (7/23/96)
The applicant has assets of $140 million; the target has assets of $10 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Triangle Bank, Raleigh, North Carolina** *to merge with* **Granville United Bank, Oxford, North Carolina**

Summary Report by the Attorney General (7/23/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (8/2/96)
The applicant has assets of $836 million; the target has assets of $60 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**ValliWide Bank, Fresno, California** *to merge with* **The Bank of Commerce, N.A., Auburn, California**

Summary Report by the Attorney General (7/23/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (8/21/96)
The applicant has assets of $1.3 billion; the target has assets of $76 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Centura Bank, Rocky Mount, North Carolina** *to merge with* **FirstSouth Bank, Burlington, North Carolina**

Summary Report by the Attorney General (7/23/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (8/30/96)
The applicant has assets of $5.8 billion; the target has assets of $156 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**First Banking System–Burlington, Burlington, Wisconsin** *to acquire assets and liabilities of* **the Genoa City and Pell Lake, Wisconsin, branches of American National Bank and Trust Company of Chicago, Chicago, Illinois**

Summary Report by the Attorney General (7/31/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (9/5/96)
The applicant has assets of $229 million; the targets have deposits of $18 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**First Community Bank, Buckhannon, West Virginia** *to acquire assets and liabilities of* **the Grafton and Rowlesburg, West Virginia, branches of Huntington National Bank of West Virginia, Charleston, West Virginia**

Summary Report by the Attorney General (8/8/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (9/11/96)

## 16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1996—Continued

The applicant has assets of $340 million; the targets have deposits of $24 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**The First Trust & Savings Bank, Aurelia, Iowa** *to merge with* **Cleghorn State Bank, Cleghorn, Iowa**

Summary Report by the Attorney General (7/31/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (9/13/96)
The applicant has assets of $18 million; the target has assets of $12 million. The parties operate in the same markets. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**1st United Bank, Boca Raton, Florida** *to merge with* **First National Bank of Lake Park, Lake Park, Florida**

Summary Report by the Attorney General (8/26/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (10/17/96)
The applicant has assets of $446 million; the target has assets of $67 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Marine Midland Bank, Buffalo, New York** *to acquire assets and liabilities of* **Morgan Guaranty Trust Company of New York, New York, New York**

Summary Report by the Attorney General (10/1/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (10/18/96)
The applicant has assets of $22.6 billion; the target has assets of $3.0 billion. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Summit Bank, Hackensack, New Jersey** *to merge with* **Central Jersey Savings Bank, SLA, East Brunswick, New Jersey**

Summary Report by the Attorney General (10/1/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (10/18/96)
The applicant has assets of $19.6 billion; the target has assets of $462 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Compass Bank, Jacksonville, Florida** *to merge with* **Enterprise National Bank of Jacksonville, Jacksonville, Florida**

Summary Report by the Attorney General (10/1/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (10/22/96)
The applicant has assets of $651 million; the target has assets of $159 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Manufacturers and Traders Trust Company, Buffalo, New York** *to acquire assets and liabilities of* **the Ossining and White Plains branches of GreenPoint Bank, New York, New York**

Summary Report by the Attorney General (10/29/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (10/30/96)
The applicant has assets of $10.8 billion; the targets have assets of $8 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Texas Bank, Weatherford, Texas** *to acquire assets and liabilities of* **the Benbrook, Burleson, Cleburne, Crowley, Glen Rose, Granbury, Hillsboro, and Weatherford branches of Bank of America Texas, NA, Irving, Texas**

16.—Continued

Summary Report by the Attorney General (10/29/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (11/20/96)
The applicant has assets of $332 million; the targets have assets of $148 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Summit Bank, Hackensack, New Jersey** *to merge with* **Bank of Mid-Jersey, Bordentown, New Jersey**

Summary Report by the Attorney General (11/21/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (12/6/96)
The applicant has assets of $19.5 billion; the target has assets of $650 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Tehama County Bank, Red Bluff, California** *to acquire assets and liabilities of* **the Willows and Orland branches of Wells Fargo Bank, N.A., San Francisco, California**

Summary Report by the Attorney General (12/2/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (12/11/96)
The applicant has assets of $138 million; the targets have assets of $22 million. The parties do not operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Citizens Banking Co., Sandusky, Ohio** *to acquire assets and liabilities of* **three branches of EST National Bank, Elyria, Ohio**

Summary Report by the Attorney General (11/21/96)
The proposed transaction would not be significantly adverse to competition.

Basis for Approval by the Federal Reserve (12/24/96)
The applicant has assets of $245 million; the targets have assets of $18 million. The parties operate in the same market. The banking factors and considerations relating to the convenience and needs of the community are consistent with approval.

**Mergers Approved Involving Wholly Owned Subsidiaries of the Same Bank Holding Company**

The following transactions involve banks that are subsidiaries of the same bank holding company. In each case, the summary report by the Attorney General indicates that the transaction would not have a significantly adverse effect on competition because the proposed merger is essentially a corporate reorganization. The Board of Governors, the Federal Reserve Bank, or the Secretary of the Board of Governors, whichever approved the application, determined that the competitive effects of the proposed transaction, the financial and managerial resources and prospects of the banks concerned, as well as the convenience and needs of the community to be served were consistent with approval.

## 16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1996—Continued

| Institution[1] | Assets (millions of dollars) | Date of approval |
|---|---|---|
| Firstar Bank Minocqua, Minocqua, Wisconsin | 96 | 1-10-96 |
| *Merger* | | |
| Firstar Bank Madison, N.A., Madison, Wisconsin | 1,100 | |
| Firstar Bank Wisconsin, Madison, Wisconsin | 1,200 | 1-10-96 |
| *Merger* | | |
| Firstar Bank Wausau, N.A., Wausau, Wisconsin | 173 | |
| Firstar Bank Grantsburg, N.A., Grantsburg, Wisconsin | 128 | |
| Firstar Bank Eau Claire, N.A., Eau Claire, Wisconsin | 292 | |
| Firstar Bank Rice Lake, N.A., Rice Lake, Wisconsin | 163 | |
| Firstar Bank Manitowoc, Manitowoc, Wisconsin | 269 | |
| Firstar Bank Oshkosh, N.A., Oshkosh, Wisconsin | 322 | |
| Firstar Bank Green Bay, Green Bay, Wisconsin | 267 | |
| Firstar Bank Fond du Lac, N.A., Fond du Lac, Wisconsin | 417 | |
| Firstar Bank Sheboygan, N.A., Sheboygan, Wisconsin | 575 | |
| Firstar Bank Appleton, Appleton, Wisconsin | 188 | |
| Community Bank of Mississippi, Forest, Mississippi | 138 | 1-17-96 |
| *Merger* | | |
| Community Bank (3 branches), Indianola, Mississippi | 117 | |
| Chemical Bank Bay Area, Bay City, Michigan | 253 | 1-22-96 |
| *Merger* | | |
| Chemical Bank Huron, Standish, Michigan | 58 | |
| Farmers State Bank of Conrad, Conrad, Montana | 62 | 1-24-96 |
| *Merger* | | |
| Farmers State Bank of Cut Bank, Cut Bank, Montana | 27 | |
| Mercantile Bank, Overland Park, Kansas | 608 | 1-25-96 |
| *Merger* | | |
| Mercantile Bank of Kansas City, Kansas City, Missouri | 1,158 | |
| First Community Bank, Glasgow, Montana | 85 | 2-1-96 |
| *Merger* | | |
| Culbertson State Bank, Culbertson, Montana | 16 | |
| Vectra Bank, Denver, Colorado | 313 | 2-1-96 |
| *Merger* | | |
| Vectra Bank of Boulder, Boulder, Colorado | 80 | |
| First Virginia Bank–Commonwealth, Grafton, Virginia | 160 | 2-29-96 |
| *Merger* | | |
| First Virginia Bank of Tidewater (4 branches), Norfolk, Virginia | 63 | |
| Farmers Bank of Maryland, Annapolis, Maryland | 590 | 2-29-96 |
| *Merger* | | |
| First Virginia Bank–Maryland (Edgewater branch), Upper Marlboro, Maryland | 7 | |

16.—Continued

| Institution [1] | Assets (millions of dollars) | Date of approval |
|---|---|---|
| Westamerica Bank, San Rafael, California | 2,120 | 3-8-96 |
| *Merger* | | |
| Napa Valley Bank, Napa, California | 275 | |
| Rocky Mountain Bank, Billings, Mountain | 149 | 3-12-96 |
| *Merger* | | |
| Security State Bank, Plentywood, Montana | 63 | |
| Citizens Commercial & Savings Bank, Flint, Michigan | 2,053 | 4-11-96 |
| *Merger* | | |
| Second National Bank of Saginaw, Saginaw, Michigan | 710 | |
| National Bank of Royal Oak, Royal Oak, Michigan | 175 | |
| State Bank of Standish, Standish, Michigan | 110 | |
| Second National Bank of Bay City, Bay City, Michigan | 166 | |
| Grayling State Bank, Grayling, Michigan | 83 | |
| Morgan Guaranty Trust Co. of NY, New York, New York | 143,400 | 4-29-96 |
| *Merger* | | |
| J.P. Morgan Delaware, Wilmington, Delaware | 3,000 | |
| Signet Bank, Richmond, Virginia | 10,700 | 4-29-96 |
| *Merger* | | |
| Signet Bank, N.A., Falls Church, Virginia | 640 | |
| First Virginia Bank–Shenandoah Valley, Woodstock, Virginia | 392 | 5-23-96 |
| *Merger* | | |
| First Virginia Bank–Central, Charlottesville, Virginia | 114 | |
| West One Bank, Idaho, Boise, Idaho | 4,700 | 6-17-96 |
| *Merger* | | |
| U.S. Bank of Idaho, N.A., Coeur d'Alene, Idaho | 127 | |
| F & M Bank–Hallmark, Springfield, Virginia | 126 | 7-10-96 |
| *Merger* | | |
| F & M Bank–Potomac, Herndon, Virginia | 63 | |
| Fairfax Bank & Trust Company, Fairfax, Virginia | 255 | |
| California United Bank, Encino, California | 434 | 7-24-96 |
| *Merger* | | |
| California United Bank, NA, Encino, California | 381 | |
| BancFirst, Oklahoma City, Oklahoma | 1,200 | 7-26-96 |
| *Merger* | | |
| The Bank of Commerce, McLoud, Oklahoma | 18 | |
| Boulder Valley Bank & Trust, Boulder, Colorado | 72 | 7-26-96 |
| *Merger* | | |
| Mountain Parks Bank–East, Evergreen, Colorado | 191 | |
| Mountain Parks Bank–West, Breckenridge, Colorado | 157 | |
| The Bank of Louisville, Louisville, Colorado | 39 | |

## 16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1996—Continued

| Institution[1] | Assets (millions of dollars) | Date of approval |
|---|---|---|
| Yellowstone Bank, Laurel, Montana | 68 | 8-20-96 |
| *Merger* | | |
| Yellowstone Bank, Absarokee, Montana | 15 | |
| Yellowstone Bank, Billings, Montana | 34 | |
| Yellowstone Bank, Columbus, Montana | 41 | |
| Mercantile Bank of Polk County, Des Moines, Iowa | 327 | 8-28-96 |
| *Merger* | | |
| Mercantile Bank of the Bluffs, Council Bluffs, Iowa | 83 | |
| Mercantile Bank of Boone, Boone, Iowa | 103 | |
| Mercantile Bank of Centerville, Centerville, Iowa | 65 | |
| Mercantile Bank of Chariton, Chariton, Iowa | 40 | |
| Mercantile Bank of Clay County, Spencer, Iowa | 49 | |
| Mercantile Bank of Humboldt County, Humboldt, Iowa | 70 | |
| Mercantile Bank of Jasper County, Newton, Iowa | 143 | |
| Mercantile Bank of Lyon County, Rock Rapids, Iowa | 45 | |
| Mercantile Bank of Marshalltown, Marshalltown, Iowa | 68 | |
| Mercantile Bank of Mount Ayr, Mount Ary, Iowa | 49 | |
| Mercantile Bank of Onawa, Onawa, Iowa | 42 | |
| Mercantile Bank of Osceola County, Sibley, Iowa | 36 | |
| Mercantile Bank of Pella, Pella, Iowa | 99 | |
| Crestar Bank MD, Bethesda, Maryland | 1,700 | 9-25-96 |
| *Merger* | | |
| Crestar Bank, FSB, Baltimore, Maryland | 2,500 | |
| Crestar Bank DC, Vienna, Virginia | 1,400 | 9-26-96 |
| *Merger* | | |
| Crestar Bank, Richmond, Virginia | 14,200 | |
| Crestar Bank MD, Bethesda, Maryland | 4,200 | |
| The Bank of New York, New York, New York | 41,559 | 10-7-96 |
| *Merger* | | |
| The Bank of New York, NJ, West Paterson, New Jersey | 4,061 | |
| The Putnam Trust Company, Greenwich, Connecticut | 766 | |
| First Virginia Bank–Colonial, Richmond, Virginia | 736 | 10-10-96 |
| *Merger* | | |
| First Virginia Bank–South Hill, South Hill, Virginia | 86 | |
| Bank of Gainesville, Gainesville, Missouri | 82 | 10-16-96 |
| *Merger* | | |
| Douglas County Bank, Ava, Missouri | 33 | |
| First Knoxville Bank, Knoxville, Tennessee | 87 | 10-25-96 |
| *Merger* | | |
| Bank of Madisonville, Madisonville, Tennessee | 86 | |
| United Southern Bank, Morristown, Tennessee | 37 | |

16.—Continued

| Institution[1] | Assets (millions of dollars) | Date of approval |
| --- | --- | --- |
| Chase Manhattan Bank, New York, New York | 261,859 | 10-28-96 |
| *Merger* | | |
| Chase Manhattan Bank, NA, Morristown, New Jersey | 5,427 | |
| Fifth Third Bank of Kentucky, Inc., Louisville, Kentucky | 1,800 | 11-1-96 |
| *Merger* | | |
| Fifth Third Savings Bank of Western Kentucky, F.S.B., Mayfield, Kentucky | 254 | |
| Fifth Third Bank of Northeastern Ohio, Cleveland, Ohio | 2,557 | 11-1-96 |
| *Merger* | | |
| Fifth Third Savings Bank of Northern Ohio, F.S.B., Kent, Ohio | 219 | |
| Fifth Third Bank of Northern Kentucky, Inc., Florence, Kentucky | 1,046 | 11-1-96 |
| *Merger* | | |
| Fifth Third Savings Bank of Northern Kentucky, F.S.B., Hebron, Kentucky | 201 | |
| Kent City State Bank, Kent City, Michigan | 87 | 11-8-96 |
| *Merger* | | |
| The Grant State Bank, Grant, Michigan | 26 | |
| Aliant Bank, Alexander City, Alabama | 214 | 11-15-96 |
| *Merger* | | |
| First Montgomery Bank, Montgomery, Alabama | 178 | |
| Elmore County Bank, Wetumpka, Alabama | 64 | |
| Mercantile Bank of Lawrence, Lawrence, Kansas | 258 | 12-2-96 |
| *Merger* | | |
| Mercantile Bank, Overland Park, Kansas | 1,700 | |
| FCNB Bank, Frederick, Maryland | 521 | 12-11-96 |
| *Merger* | | |
| Elkridge Bank, Elkridge, Maryland | 219 | |

1. Each proposed transaction was to be effected under the charter of the first-named bank. The entries are in chronological order of approval. Some transactions include the acquisition of certain assets and liabilities of the affiliated bank.

## 16. Mergers, Consolidations, and Acquisitions of Assets or Assumptions of Liabilities Approved by the Board of Governors, 1996—Continued

**Mergers Approved Involving a Nonoperating Institution with an Existing Bank**

The following transactions have no significant effect on competition; they merely facilitate the acquisition of the voting shares of a bank (or banks) by a holding company. In such cases, the summary report by the Attorney General indicates that the transaction will merely combine an existing bank with a nonoperating institution; in consequence, and without regard to the acquisition of the surviving bank by the holding company, the merger would have no effect on competition. The Board of Governors, the Federal Reserve Bank, or the Secretary of the Board, whichever approved the application, determined that the proposal would, in itself, have no adverse competitive effects and that the financial factors and considerations relating to the convenience and needs of the community were consistent with approval.

| Institution[1] | Assets (millions of dollars)[2] | Date of approval |
|---|---|---|
| Adams Bank & Trust Company, Ogallala, Nebraska | 160 | 1-17-96 |
| *Merger* | | |
| Adams Savings & Loan Association of Grant, Chappell, Nebraska | . . . | |
| Adams Bank & Trust Company, Ogallala, Nebraska | 160 | 1-18-96 |
| *Merger* | | |
| Adams Savings & Loan Association of North Platte, Chappell, Nebraska | . . . | |
| Mercantile Bank of Jackson County, Kansas City, Missouri | . . . | 1-25-96 |
| *Merger* | | |
| Mercantile Bank of Kansas City, Kansas City, Missouri | 1,158 | |
| Bank of Isle of Wight, Smithfield, Virginia | 34 | 2-8-96 |
| *Merger* | | |
| BIW Acquisition Bank, Suffolk, Virginia | . . . | |
| Bank of Tazewell County, Tazewell, Virginia | 177 | 4-24-96 |
| *Merger* | | |
| NBI Interim Bank, Blacksburg, Virginia | . . . | |
| Citizens Acquisition Subsidiary, Inc., Tazewell, Virginia | . . . | 5-22-96 |
| *Merger* | | |
| Citizens Bank of Tazewell, Tazewell, Virginia | 49 | |
| Adams Bank & Trust Company, Ogallala, Nebraska | 160 | 5-29-96 |
| *Merger* | | |
| Adams Savings & Loan Association of Chappell, Chappell, Nebraska | . . . | |
| BH Acquisition Subsidiary, Inc., Mechanicsville, Virginia | . . . | 9-13-96 |
| *Merger* | | |
| Hanover Bank, Mechanicsville, Virginia | 99 | |

1. Each proposed transaction was to be effected under the charter of the first-named bank. The entries are in chronological order of approval.

2. Where no assets are listed, the bank is newly organized and not in operation.

# *Federal Reserve Directories and Meetings*

# *Board of Governors of the Federal Reserve System*

**December 31, 1996**

## Members

*Term expires January 31,*

ALAN GREENSPAN, of New York, *Chairman*[1] . . . . . . . . . . 2006
ALICE M. RIVLIN, of Pennsylvania, *Vice Chair*[1] . . . . . . . . . . 2010
SUSAN M. PHILLIPS, of Iowa . . . . . . . . . . 1998
LAWRENCE B. LINDSEY, of Virginia . . . . . . . . . . 2000
EDWARD W. KELLEY, JR., of Texas . . . . . . . . . . 2004
JANET L. YELLEN, of California . . . . . . . . . . 2008
LAURENCE H. MEYER, of Missouri . . . . . . . . . . 2002

## Officers

OFFICE OF BOARD MEMBERS

Joseph R. Coyne, *Assistant to the Board*
Donald J. Winn, *Assistant to the Board*
Theodore E. Allison, *Assistant to the Board for Federal Reserve System Affairs*
Lynn Fox, *Deputy Congressional Liaison*
Bob Stahly Moore, *Special Assistant to the Board*
Winthrop P. Hambley, *Special Assistant to the Board*
Diane E. Werneke, *Special Assistant to the Board*
Portia W. Thompson, *Equal Employment Opportunity Programs Adviser*

LEGAL DIVISION

J. Virgil Mattingly, Jr., *General Counsel*
Scott G. Alvarez, *Associate General Counsel*
Richard M. Ashton, *Associate General Counsel*
Oliver Ireland, *Associate General Counsel*
Kathleen M. O'Day, *Associate General Counsel*
Robert deV. Frierson, *Assistant General Counsel*
Katherine H. Wheatley, *Assistant General Counsel*

OFFICE OF THE SECRETARY

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Jennifer J. Johnson, *Deputy Secretary*
Barbara R. Lowrey, *Associate Secretary and Ombudsman*

DIVISION OF INTERNATIONAL FINANCE

Edwin M. Truman, *Staff Director*
Larry J. Promisel, *Senior Associate Director*
Charles J. Siegman, *Senior Associate Director*
Dale W. Henderson, *Associate Director*
David H. Howard, *Senior Adviser*
Donald B. Adams, *Assistant Director*
Thomas A. Connors, *Assistant Director*
Peter Hooper III, *Assistant Director*
Karen H. Johnson, *Assistant Director*
Catherine L. Mann, *Assistant Director*
Ralph W. Smith, Jr., *Assistant Director*

DIVISION OF MONETARY AFFAIRS

Donald L. Kohn, *Director*
David E. Lindsey, *Deputy Director*
Brian F. Madigan, *Associate Director*
Richard D. Porter, *Deputy Associate Director*
Vincent R. Reinhart, *Assistant Director*
Normand R.V. Bernard, *Special Assistant to the Board*

1. The designations as Chairman and Vice Chair expire on June 20, 2000, and June 24, 2000, respectively, unless the service of these members of the Board shall have terminated sooner.

## *Board of Governors—Continued*

### Division of Research and Statistics

Michael J. Prell, *Director*
Edward C. Ettin, *Deputy Director*
David J. Stockton, *Deputy Director*
Martha Bethea, *Associate Director*
William R. Jones, *Associate Director*
Myron L. Kwast, *Associate Director*
Patrick M. Parkinson, *Associate Director*
Thomas D. Simpson, *Associate Director*
Lawrence Slifman, *Associate Director*
Martha S. Scanlon, *Deputy Associate Director*
Peter A. Tinsley, *Deputy Associate Director*
David S. Jones, *Assistant Director*
Stephen A. Rhoades, *Assistant Director*
Charles S. Struckmeyer, *Assistant Director*
Alice Patricia White, *Assistant Director*
Joyce K. Zickler, *Assistant Director*
John J. Mingo, *Senior Adviser*
Glenn B. Canner, *Adviser*

### Division of Banking Supervision and Regulation

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William A. Ryback, *Associate Director*
Herbert A. Biern, *Deputy Associate Director*
Roger T. Cole, *Deputy Associate Director*
James I. Garner, *Deputy Associate Director*
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Gerald A. Edwards, Jr., *Assistant Director*
Stephen M. Hoffman, Jr., *Assistant Director*
James V. Houpt, Jr., *Assistant Director*
Jack P. Jennings, *Assistant Director*
Michael G. Martinson, *Assistant Director*
Rhoger H Pugh, *Assistant Director*
Sidney M. Sussan, *Assistant Director*
Molly S. Wassom, *Assistant Director*
William C. Schneider, Jr., *Project Director, National Information Center*

### Division of Consumer and Community Affairs

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Glenn E. Loney, *Associate Director*
Dolores S. Smith, *Associate Director*
Maureen P. English, *Assistant Director*
Irene Shawn McNulty, *Assistant Director*

### Division of Federal Reserve Bank Operations and Payment Systems

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David L. Robinson, *Deputy Director (Finance and Control)*
Louise L. Roseman, *Associate Director*
Charles W. Bennett, *Assistant Director*
Jack Dennis, Jr., *Assistant Director*
Earl G. Hamilton, *Assistant Director*
Jeffrey C. Marquardt, *Assistant Director*
John H. Parrish, *Assistant Director*
Florence M. Young, *Assistant Director*

### Office of Staff Director for Management

S. David Frost, *Staff Director*
Sheila Clark, *Equal Employment Opportunity Programs Director*

### Office of the Controller

George E. Livingston, *Controller*
Stephen J. Clark, *Assistant Controller (Programs and Budgets)*
Darrell R. Pauley, *Assistant Controller (Finance)*

### Division of Human Resources Management

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John R. Weis, *Associate Director*
Joseph H. Hayes, Jr., *Assistant Director*
Fred Horowitz, *Assistant Director*

## Board of Governors—Continued

Division of Information Resources Management
Stephen R. Malphrus, *Director*
Marianne M. Emerson, *Assistant Director*
Po Kyung Kim, *Assistant Director*
Raymond H. Massey, *Assistant Director*
Edward T. Mulrenin, *Assistant Director*
Day W. Radebaugh, Jr., *Assistant Director*
Elizabeth B. Riggs, *Assistant Director*
Richard C. Stevens, *Assistant Director*

Division of Support Services
Robert E. Frazier, *Director*
George M. Lopez, *Assistant Director*
David L. Williams, *Assistant Director*

Office of the Inspector General
Brent L. Bowen, *Inspector General*
Donald L. Robinson, *Assistant Inspector General*
Barry R. Snyder, *Assistant Inspector General*

## Federal Open Market Committee

**December 31, 1996**

### Members

Alan Greenspan, *Chairman,* Board of Governors
William J. McDonough, *Vice Chairman,* President, Federal Reserve Bank of New York
Edward G. Boehne, President, Federal Reserve Bank of Philadelphia
Jerry L. Jordan, President, Federal Reserve Bank of Cleveland
Edward W. Kelley, Jr., Board of Governors
Lawrence B. Lindsey, Board of Governors
Robert D. McTeer, Jr., President, Federal Reserve Bank of Dallas
Laurence H. Meyer, Board of Governors
Susan M. Phillips, Board of Governors
Alice M. Rivlin, Board of Governors
Gary H. Stern, President, Federal Reserve Bank of Minneapolis
Janet L. Yellen, Board of Governors

### Alternate Members

J. Alfred Broaddus, Jr., President, Federal Reserve Bank of Richmond
Jack Guynn, President, Federal Reserve Bank of Atlanta
Michael H. Moskow, President, Federal Reserve Bank of Chicago
Robert T. Parry, President, Federal Reserve Bank of San Francisco
Ernest T. Patrikis, First Vice President, Federal Reserve Bank of New York

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Normand R.V. Bernard, *Deputy Secretary*
Joseph R. Coyne, *Assistant Secretary*
Gary P. Gillum, *Assistant Secretary*
J. Virgil Mattingly, Jr., *General Counsel*
Thomas C. Baxter, Jr., *Deputy General Counsel*
Michael J. Prell, *Economist*
Edwin M. Truman, *Economist*

# *Federal Open Market Committee—Continued*

Richard W. Lang,
*Associate Economist*
David E. Lindsey,
*Associate Economist*
Frederic S. Mishkin,
*Associate Economist*
Larry J. Promisel,
*Associate Economist*
Arthur J. Rolnick,
*Associate Economist*
Harvey Rosenblum,
*Associate Economist*
Charles J. Siegman,
*Associate Economist*
Thomas D. Simpson,
*Associate Economist*
Mark S. Sniderman,
*Associate Economist*
David J. Stockton,
*Associate Economist*

Peter R. Fisher, *Manager, System Open Market Account*

During 1996 the Federal Open Market Committee held eight regularly scheduled meetings (see Minutes of Federal Open Market Committee Meetings in this Report.)

# *Federal Advisory Council*

**December 31, 1996**

## Members

District 1—William M. Crozier, Jr., *Chairman of the Board,*
Bank of Boston Corporation, Boston, Massachusetts

District 2—Walter V. Shipley, *Chairman and Chief Executive Officer,*
The Chase Manhattan Corporation, New York, New York

District 3—Walter E. Daller, Jr., *Chairman, President, and Chief Executive Officer,*
Harleysville National Bank and Trust Company, Harleysville, Pennsylvania

District 4—Frank V. Cahouet, *Chairman, President, and Chief Executive Officer,*
Mellon Bank, N.A., Pittsburgh, Pennsylvania

District 5—Richard G. Tilghman, *Chairman and Chief Executive Officer,*
Crestar Financial Corporation, Richmond, Virginia

District 6—Charles E. Rice, *Chairman and Chief Executive Officer,*
Barnett Banks, Inc., Jacksonville, Florida

District 7—Roger L. Fitzsimonds, *Chairman and Chief Executive Officer,*
Firstar Corporation, Milwaukee, Wisconsin

District 8—Thomas H. Jacobsen, *Chairman, President, and Chief Executive Officer,*
Mercantile Bancorporation Inc., St. Louis, Missouri

District 9—Richard M. Kovacevich, *Chairman, President, and Chief Executive Officer,*
Norwest Corporation, Minneapolis, Minnesota

District 10—Charles E. Nelson, *Chairman, Chief Executive Officer, and President,*
Liberty Bank and Trust Company of Oklahoma City, N.A., Oklahoma City, Oklahoma

District 11—Charles T. Doyle, *Chairman and Chief Executive Officer,*
Texas First Bank – Texas City, Texas City, Texas

District 12—William F. Zuendt, *President,* Wells Fargo & Company,
San Francisco, California

## Officers

Richard G. Tilghman, *President*
Frank V. Cahouet, *Vice President*
Herbert V. Prochnow, *Secretary Emeritus*
James E. Annable, *Co–Secretary*
William J. Korsvik, *Co–Secretary*

## *Federal Advisory Council—Continued*

### Directors

Roger L. Fitzsimonds   Richard M. Kovacevich   Charles E. Nelson

The Federal Advisory Council met on February 1–2, May 2–3, September 5–6, and November 7–8, 1996. The Board of Governors met with the council on February 2, May 3, September 6, and November 8, 1996. The council, which is composed of one representative of the banking industry from each of the twelve Federal Reserve Districts, is required by law to meet in Washington at least four times each year and is authorized by the Federal Reserve Act to consult with, and advise, the Board on all matters within the jurisdiction of the Board.

## *Consumer Advisory Council*

**December 31, 1996**

### Members

Richard S. Amador, *President and Chief Executive Officer,* CHARO Community Development Corporation, Los Angeles, California

Thomas R. Butler, *President and Chief Operating Officer,* NOVUS Services, Inc., Riverwoods, Illinois

Robert A. Cook, *Partner,* Hudson Cook, LLP, Crofton, Maryland

Alvin J. Cowans, *President and Chief Executive Officer,* McCoy Federal Credit Union, Orlando, Florida

Elizabeth G. Flores, *Consultant,* Laredo, Texas

Heriberto Flores, *President and Chief Executive Officer,* Brightwood Development Corporation, Springfield, Massachusetts

Emanuel Freeman, *President,* Greater Germantown Housing Development Corporation, Philadelphia, Pennsylvania

David C. Fynn, *Senior Vice President,* National City Bank, *Regulatory Risk Manager,* National City Corporation, Cleveland, Ohio

Robert G. Greer, *Chairman of the Board,* Bank of Tanglewood, Houston, Texas

Kenneth R. Harney, *Journalist,* Washington Post Writers Group, Chevy Chase, Maryland

Gail K. Hillebrand, *Litigation Counsel,* West Coast Regional Office, Consumers Union of U.S., Inc., San Francisco, California

Terry Jorde, *President and Chief Executive Officer,* Towner County State Bank, Cando, North Dakota

Francine C. Justa, *Executive Director,* Neighborhood Housing Services of New York, New York, New York

Eugene I. Lehrmann, *Immediate Past President,* American Association of Retired Persons, Madison, Wisconsin

Errol T. Louis, *Treasurer and Manager,* Central Brooklyn Federal Credit Union, Brooklyn, New York

William N. Lund, *Director,* Office of Consumer Credit Regulation, State of Maine, Augusta, Maine

Ronald A. Prill, *Vice President, Credit,* Dayton Hudson Corporation, Minneapolis, Minnesota

Lisa Rice, *Executive Director,* Fair Housing Center, Toledo, Ohio

John R. Rines, *President,* General Motors Acceptance Corporation, Detroit, Michigan

## *Consumer Advisory Council—Continued*

MARGOT SAUNDERS, *Managing Attorney,* National Consumer Law Center, Washington, D.C.

ANNE B. SHLAY, *Associate Director,* Institute for Public Policy Studies, Temple University, Philadelphia, Pennsylvania

REGINALD J. SMITH, *Vice Chairman and Chief Executive Officer,* United Missouri Bank Mortgage Company, Kansas City, Missouri

GREGORY D. SQUIRES, *Professor of Sociology,* University of Wisconsin-Milwaukee, Milwaukee, Wisconsin

GEORGE P. SURGEON, *Chief Financial Officer and Executive Vice President,* Shorebank Corporation, Chicago, Illinois

JOHN E. TAYLOR, *President and Chief Executive Officer,* The National Community Reinvestment Coalition, Washington, D.C.

LORRAINE VANETTEN, *Vice President and Community Lending Officer,* Standard Federal Bank of Troy, Troy, Michigan

THEODORE J. WYSOCKI, JR., *Executive Director,* CANDO, Chicago, Illinois

LILY K. YAO, *Chair and Chief Executive Officer,* Pioneer Federal Savings Bank, Honolulu, Hawaii

### Officers

KATHARINE W. MCKEE, *Chair*
Associate Director,
Center for Community Self-Help,
Durham, North Carolina

JULIA W. SEWARD, *Vice Chair*
Vice President and Corporate
Community Reinvestment Officer,
Signet Banking Corporation,
Richmond, Virginia

The Consumer Advisory Council met with members of the Board of Governors on March 28, June 27, and October 24, 1996. The council is composed of academics, state and local government officials, representatives of the financial industry, and representatives of consumer and community interests. It was established pursuant to the 1976 amendments to the Equal Credit Opportunity Act to advise the Board on consumer financial services.

## *Thrift Institutions Advisory Council*

**December 31, 1996**

### Members

E. LEE BEARD, *President and Chief Executive Officer*, First Federal Savings and Loan Association of Hazleton, Hazleton, Pennsylvania

BARRY C. BURKHOLDER, *President and Chief Executive Officer*, Bank United of Texas FSB, Houston, Texas

MICHAEL T. CROWLEY, JR., *President and Chief Executive Officer*, Mutual Savings Bank, Milwaukee, Wisconsin

GEORGE L. ENGELKE, JR., *President and Chief Executive Officer*, Astoria Federal Savings and Loan Association, Lake Success, New York

DOUGLAS A. FERRARO, *President and Chief Executive Officer*, Bellco First Federal Credit Union, Englewood, Colorado

BEVERLY D. HARRIS, *President*, Empire Federal Savings and Loan Association, Livingston, Montana

## *Thrift Institutions Advisory Council—Continued*

DAVID F. HOLLAND, *Chairman, President, and Chief Executive Officer*, Boston Federal Savings Bank, Burlington, Massachusetts

CHARLES R. RINEHART, *Chairman and Chief Executive Officer*, Home Savings of America, FSB, Irwindale, California

JOSEPH C. SCULLY, *Chairman and Chief Executive Officer*, St. Paul Federal Bank for Savings, Chicago, Illinois

LARRY T. WILSON, *President and Chief Executive Officer*, Coastal Federal Credit Union, Raleigh, North Carolina

WILLIAM W. ZUPPE, *President and Chief Operating Officer*, Sterling Savings Association, Spokane, Washington

### Officers

E. LEE BEARD, *President*

DAVID F. HOLLAND, *Vice President*

The members of the Thrift Institutions Advisory Council met with the Board of Governors on March 1, June 28, September 27, and December 6, 1996. The council, which is composed of representatives from credit unions, savings and loan associations, and savings banks, consults with, and advises, the Board on issues pertaining to the thrift industry and on various other matters within the Board's jurisdiction.

## *Officers of Federal Reserve Banks and Branches*

**December 31, 1996**

| BANK or Branch | Chairman[1]<br>Deputy Chairman | President<br>First Vice President | Vice President<br>in charge of Branch |
|---|---|---|---|
| BOSTON[2] | Jerome H. Grossman<br>William C. Brainard | Cathy E. Minehan<br>Paul M. Connolly | |
| NEW YORK[2] | John C. Whitehead<br>Thomas W. Jones | William J. McDonough<br>Ernest T. Patrikis | |
| Buffalo | Joseph J. Castiglia | | Carl W. Turnipseed[3] |
| PHILADELPHIA | Donald J. Kennedy<br>Joan Carter | Edward G. Boehne<br>William H. Stone, Jr. | |
| CLEVELAND[2] | A. William Reynolds<br>G. Watts Humphrey, Jr. | Jerry L. Jordan<br>Sandra Pianalto | |
| Cincinnati | John N. Taylor, Jr. | | Charles A. Cerino[3] |
| Pittsburgh | John T. Ryan III | | Harold J. Swart[3] |
| RICHMOND[2] | Claudine B. Malone<br>Robert L. Strickland | J. Alfred Broaddus, Jr.<br>Walter A. Varvel | |
| Baltimore | Michael R. Watson | | William J. Tignanelli[3] |
| Charlotte | James O. Roberson | | Dan M. Bechter[3] |

# *Officers of Federal Reserve Banks and Branches—Continued*

| BANK or Branch | Chairman[1]<br>Deputy Chairman | President<br>First Vice President | Vice President<br>in charge of Branch |
|---|---|---|---|
| ATLANTA | Hugh M. Brown<br>Daniel E. Sweat, Jr. | Jack Guynn<br>Patrick K. Barron | James M. McKee |
| Birmingham | Donald E. Boomershine | | Fred R. Herr[3] |
| Jacksonville | Joan Dial Ruffier | | James D. Hawkins[3] |
| Miami | R. Kirk Landon | | James T. Curry III |
| Nashville | Paula Lovell | | Melvyn K. Purcell |
| New Orleans | Lucimarian Roberts | | Robert J. Musso |
| CHICAGO[2] | Robert M. Healey<br>Lester H. McKeever, Jr. | Michael H. Moskow<br>William C. Conrad | |
| Detroit | Florine Mark | | David R. Allardice[3] |
| ST. LOUIS | John F. McDonnell<br>Susan S. Elliott | Thomas C. Melzer<br>W. Legrande Rives | |
| Little Rock | Janet M. Jones | | Robert A. Hopkins |
| Louisville | John A. Williams | | Thomas A. Boone |
| Memphis | John V. Myers | | John P. Baumgartner |
| MINNEAPOLIS | Jean D. Kinsey<br>David A. Koch | Gary H. Stern<br>Colleen K. Strand | |
| Helena | Lane W. Basso | | John D. Johnson |
| KANSAS CITY | A. Drue Jennings<br>Jo Marie Dancik | Thomas M. Hoenig<br>Richard K. Rasdall | |
| Denver | Peter I. Wold | | Carl M. Gambs[3] |
| Oklahoma City | Barry L. Eller | | Kelly J. Dubbert |
| Omaha | LeRoy W. Thom | | Bradley C. Cloverdyke |
| DALLAS | Cece Smith<br>Roger R. Hemminghaus | Robert D. McTeer, Jr.<br>Helen E. Holcomb | |
| El Paso | Patricia Z. Holland-Branch | | Sammie C. Clay |
| Houston | Isaac H. Kempner III | | Robert Smith III[3] |
| San Antonio | Carol L. Thompson | | James L. Stull[3] |
| SAN FRANCISCO | Judith M. Runstad<br>James A. Vohs | Robert T. Parry<br>John F. Moore | |
| Los Angeles | Anita E. Landecker | | Mark L. Mullinix[3] |
| Portland | Ross R. Runkel | | Raymond H. Laurence[3] |
| Salt Lake City | Gerald R. Sherratt | | Andrea P. Wolcott |
| Seattle | George F. Russell, Jr. | | Gordon R. G. Werkema[4] |

NOTE. A current list of these officers appears each month in the *Federal Reserve Bulletin*.

1. The Chairman of a Federal Reserve Bank serves, by statute, as Federal Reserve Agent.

2. Additional offices of these Banks are located at Lewiston, Maine; Windsor Locks, Connecticut; Utica at Oriskany, New York; East Rutherford New Jersey; Columbus, Ohio; Charleston, West Virginia; Columbia, South Carolina; Indianapolis, Indiana; Milwaukee, Wisconsin; Des Moines, Iowa; and Peoria, Illinois.

3. Senior Vice President.

4. Executive Vice President

## Conference of Chairmen

The chairmen of the Federal Reserve Banks are organized into the Conference of Chairmen, which meets to consider matters of common interest and to consult with, and advise, the Board of Governors. Such meetings, attended also by the deputy chairmen, were held in Washington on May 29 and 30, and on December 4 and 5, 1996.

The members of the Executive Committee of the Conference of Chairmen during 1996 were Cece Smith, chair; A. William Reynolds, vice chairman; and John F. McDonnell, member.

On December 5, 1996, the conference elected its Executive Committee for 1997; it named Judith M. Runstad as chair, John F. McDonnell as vice chairman, and Donald J. Kennedy as the third member.

## Conference of Presidents

The presidents of the Federal Reserve Banks are organized into the Conference of Presidents, which meets periodically to consider matters of common interest and to consult with, and advise, the Board of Governors.

Robert D. McTeer, President of the Federal Reserve Bank of Dallas, served as chairman of the conference in 1996, and Thomas M. Hoenig, President of the Federal Reserve Bank of Kansas City, served as its vice chairman. Helen E. Holcomb, of the Federal Reserve Bank of Dallas, served as its secretary. Esther L. George, of the Federal Reserve Bank of Kansas City, served as its assistant secretary.

On December 5, 1996, the conference elected Thomas M. Hoenig as its chairman for 1997 and Jerry L. Jordan, President of the Federal Reserve Bank of Cleveland, as its vice chairman.

## Conference of First Vice Presidents

The Conference of First Vice Presidents of the Federal Reserve Banks was organized in 1969 to meet periodically for the consideration of operations and other matters.

Sandra Pianalto, First Vice President of the Federal Reserve Bank of Cleveland, served as chair of the conference in 1996, Federal Reserve Bank of Cleveland, served and Colleen K. Strand, First Vice President of the Federal Reserve Bank of Minneapolis, served as its vice chair. Martha Maher, of the as its secretary and Niel D. Willardson, of the Federal Reserve Bank of Minneapolis, served as its assistant secretary.

## Directors

The following list of directors of Federal Reserve Banks and Branches shows for each director the class of directorship, the director's principal organizational affiliation, and the date the director's term expires. Each Federal Reserve Bank has a nine-member board: three Class A and three Class B directors, who are elected by the member commercial banks, and three Class C directors, who are appointed by the Board of Governors of the Federal Reserve System.

Class A directors represent the member banks in each Federal Reserve District. Class B and Class C directors represent the public and are chosen with due, but not exclusive, consideration to the interests of agriculture, commerce, industry, services, labor, and consumers; they may not be officers, directors, or employees of any bank or bank holding company. In addition, Class C directors may not be stockholders of any bank or bank holding company.

For the election of Class A and Class B directors, the Board of Governors classifies the member banks of each Federal Reserve District into three groups. Each group, which comprises banks with similar capitalization, elects one Class A director and one Class B director. Annually, the Board of Governors designates one of the Class C directors as chairman of the board and Federal Reserve Agent of each District Bank, and it designates another Class C director as deputy chairman.

Federal Reserve Branches have either five or seven directors, a majority of whom are appointed by the parent Federal Reserve Bank; the others are appointed by the Board of Governors. One of the directors appointed by the Board is designated annually as chairman of the board of that Branch in a manner prescribed by the parent Federal Reserve Bank.

For the name of the chairman and deputy chairman of the board of directors of each Reserve Bank and of the chairman of each Branch, see the preceding table, "Officers of Federal Reserve Banks and Branches."

| | | *Term expires Dec. 31* |
|---|---|---|

## DISTRICT 1—BOSTON

*Class A*

| | | |
|---|---|---|
| G. Kenneth Perine | President and Chief Executive Officer, National Bank of Middlebury, Middlebury, Vermont | 1996 |
| Jane C. Walsh | President, Northmark Bank, North Andover, Massachusetts | 1997 |
| Marshall N. Carter | Chairman and Chief Executive Officer, State Street Bank and Trust Company, Boston, Massachusetts | 1998 |

*Class B*

| | | |
|---|---|---|
| Stephen L. Brown | Chairman and Chief Executive Officer, John Hancock Mutual Life Insurance Company, Boston, Massachusetts | 1996 |
| Edward Dugger III | President and Chief Executive Officer, UNC Ventures, Inc., Boston, Massachusetts | 1997 |
| Robert R. Glauber | Adjunct Lecturer, John F. Kennedy School of Government, Harvard University, Cambridge, Massachusetts | 1998 |

*Class C*

| | | |
|---|---|---|
| John E. Flynn | Executive Director, The Quality Connection, East Dennis, Massachusetts | 1996 |
| Jerome H. Grossman, M.D. | Chairman and Chief Executive Officer, Health Quality, LLC, Boston, Massachusetts | 1997 |
| William C. Brainard | Chairman, Department of Economics, Yale University, New Haven, Connecticut | 1998 |

## DISTRICT 2—NEW YORK

*Class A*

| | | |
|---|---|---|
| J. William Johnson | Chairman and Chief Executive Officer, The First National Bank of Long Island, Glen Head, New York | 1996 |
| J. Carter Bacot | Chairman and Chief Executive Officer, The Bank of New York, New York, New York | 1997 |
| Robert G. Wilmers | Chairman, President, and Chief Executive Officer, Manufacturers and Traders Trust Company, Buffalo, New York | 1998 |

*Class B*

| | | |
|---|---|---|
| Ann M. Fudge | President, Maxwell House Coffee Company, White Plains, New York | 1996 |
| Eugene R. McGrath | Chief Executive Officer, Consolidated Edison Company of New York, Inc., New York, New York | 1997 |
| William C. Steere, Jr. | Chairman and Chief Executive Officer, Pfizer Inc., New York, New York | 1998 |

| | | *Term expires Dec. 31* |
|---|---|---|

DISTRICT 2, NEW YORK—Continued

*Class C*

| | | |
|---|---|---|
| John C. Whitehead | Chairman, AEA Investors Inc., New York, New York | 1996 |
| Thomas W. Jones | Vice Chairman, President, and Chief Operating Officer, Teachers Insurance and Annuity Association–College Retirement Equities Fund, New York, New York | 1997 |
| Peter G. Peterson | Chairman, The Blackstone Group, New York, New York | 1998 |

BUFFALO BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| Louise Woerner | Chairman and Chief Executive Officer, HCR, Rochester, New York | 1996 |
| William E. Swan | President and Chief Executive Officer, Lockport Savings Bank, Lockport, New York | 1997 |
| Mark W. Adams | Owner and Operator, Adams Poultry Farm, Naples, New York | 1997 |
| Kathleen R. Whelehan | Regional President, Rochester Southern Region, Marine Midland Bank, Rochester, New York | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| Joseph J. Castiglia | Former Vice Chairman, President, and Chief Executive Officer, Pratt & Lambert United, Inc., Buffalo, New York | 1996 |
| Louis J. Thomas | Director, District 4, United Steelworkers of America, Buffalo, New York | 1997 |
| Bal Dixit | President and Chief Executive Officer, Newtex Industries, Inc., Victor, New York | 1998 |

DISTRICT 3—PHILADELPHIA

*Class A*

| | | |
|---|---|---|
| Terry K. Dunkle | Chairman, United States National Bank, Johnstown, Pennsylvania | 1996 |
| Dennis W. DiLazzero | President and Chief Executive Officer, Minotola National Bank, Vineland, New Jersey | 1997 |
| Albert B. Murry | President and Chief Executive Officer, Lebanon Valley National Bank, Lebanon, Pennsylvania | 1998 |

*Class B*

| | | |
|---|---|---|
| J. Richard Jones | President and Chief Executive Officer, Jackson–Cross Company, Philadelphia, Pennsylvania | 1996 |
| Robert D. Burris | President and Chief Executive Officer, Burris Foods, Inc., Milford, Delaware | 1997 |

| | | *Term expires Dec. 31* |
|---|---|---|
| DISTRICT 3, *Class B*—Continued | | |
| Howard E. Cosgrove | Chairman, President, and Chief Executive Officer, Delmarva Power and Light Company, Wilmington, Delaware | 1998 |
| *Class C* | | |
| Joan Carter | President and Chief Operating Officer, UM Holdings Ltd., Haddonfield, New Jersey | 1996 |
| Donald J. Kennedy | Business Manager, International Brotherhood of Electrical Workers, Local Union No. 269, Trenton, New Jersey | 1997 |
| Charisse R. Lillie | Partner, Ballard, Spahr, Andrews & Ingersoll, Philadelphia, Pennsylvania | 1998 |

## DISTRICT 4—CLEVELAND

| | | |
|---|---|---|
| *Class A* | | |
| Alfred C. Leist | Chairman, President, and Chief Executive Officer, The Apple Creek Banking Company, Apple Creek, Ohio | 1996 |
| David S. Dahlmann | President and Chief Executive Officer, Southwest National Corporation, Greensburg, Pennsylvania | 1997 |
| David A. Daberko | Chairman and Chief Executive Officer, National City Corporation, Cleveland, Ohio | 1998 |
| *Class B* | | |
| Thomas M. Nies | President, Cincom Systems, Inc., Cincinnati, Ohio | 1996 |
| Michele Tolela Myers | President, Denison University, Granville, Ohio | 1997 |
| I. N. Rendall Harper, Jr. | President and Chief Executive Officer, American Micrographics Company, Inc., Monroeville, Pennsylvania | 1998 |
| *Class C* | | |
| Robert Y. Farrington | Executive Secretary–Treasurer, Ohio State Building and Construction Trades Council, Columbus, Ohio | 1996 |
| G. Watts Humphrey, Jr. | President, GWH Holdings, Inc., Pittsburgh, Pennsylvania | 1997 |
| A. William Reynolds | Chief Executive, Old Mill Group, Hudson, Ohio | 1998 |

### CINCINNATI BRANCH

| | | |
|---|---|---|
| *Appointed by the Federal Reserve Bank* | | |
| Judith G. Clabes | President and Chief Executive Officer, Scripps Howard Foundation, Cincinnati, Ohio | 1996 |
| Phillip R. Cox | President, Cox Financial Corporation, Cincinnati, Ohio | 1996 |

| | | *Term expires Dec. 31* |
|---|---|---|

DISTRICT 4, CINCINNATI BRANCH
*Appointed by the Federal Reserve Bank*—Continued

| | | |
|---|---|---|
| Jerry A. Grundhofer | Chairman, President, and Chief Executive Officer, Star Banc Corporation, Cincinnati, Ohio | 1997 |
| Jean R. Hale | President and Chief Executive Officer, Pikeville National Bank & Trust, Pikeville, Kentucky | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| John N. Taylor, Jr. | Chairman and Chief Executive Officer, Kurz–Kasch, Inc., Dayton, Ohio | 1996 |
| C. Wayne Shumate | Chairman and Chief Executive Officer, Kentucky Textiles, Inc., Paris, Kentucky | 1997 |
| Thomas Revely III | President and Chief Executive Officer, Cincinnati Bell Supply Co., Cincinnati, Ohio | 1998 |

PITTSBURGH BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| Randall L. C. Russell | President and Chief Executive Officer, Ranbar Technology, Inc., Glenshaw, Pennsylvania | 1996 |
| Vacancy | | 1996 |
| Thomas J. O'Shane | Chairman, President, and Chief Executive Officer, First Western Bancorp, Inc., New Castle, Pennsylvania | 1997 |
| Edward V. Randall, Jr. | President and CEO/Pittsburgh, PNC Bank, NA, Pittsburgh, Pennsylvania | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| Sandra L. Phillips | Executive Director, Pittsburgh Partnership for Neighborhood Development, Pittsburgh, Pennsylvania | 1996 |
| John T. Ryan III | Chairman, President, and Chief Executive Officer, Mine Safety Appliances Company, Pittsburgh, Pennsylvania | 1997 |
| Gretchen R. Haggerty | Vice President and Treasurer, USX Corporation, Pittsburgh, Pennsylvania | 1998 |

DISTRICT 5—RICHMOND

*Class A*

| | | |
|---|---|---|
| Robert M. Freeman | Chairman, Signet Banking Corporation, Richmond, Virginia | 1996 |
| Philip L. McLaughlin | President, Horizon Bancorp, Inc., Greenbrier Valley National Bank, Lewisburg, West Virginia | 1997 |
| George A. Didden III | Chairman and Chief Executive Officer, The National Capital Bank of Washington, Washington, D.C. | 1998 |

| | | *Term expires Dec. 31* |
|---|---|---|
| DISTRICT 5, RICHMOND—Continued | | |
| *Class B* | | |
| Paul A. DelaCourt | Chairman, The North Carolina Enterprise Corporation, Raleigh, North Carolina | 1996 |
| L. Newton Thomas, Jr. | Senior Vice President (Retired), ITT/Carbon Industries, Inc., Charleston, West Virginia | 1997 |
| Craig A. Ruppert | President and Owner, The Ruppert Companies, Ashton, Maryland | 1998 |
| *Class C* | | |
| Stephen Brobeck | Executive Director, Consumer Federation of America, Washington, D.C. | 1996 |
| Claudine B. Malone | President, Financial & Management Consulting, Inc., McLean, Virginia | 1997 |
| Robert L. Strickland | Chairman, Lowe's Companies, Inc., Winston-Salem, North Carolina | 1998 |
| BALTIMORE BRANCH | | |
| *Appointed by the Federal Reserve Bank* | | |
| Morton I. Rapoport, M.D. | President and Chief Executive Officer, University of Maryland Medical System, Baltimore, Maryland | 1996 |
| Thomas J. Hughes | Second Vice Chairman, Navy Federal Credit Union, Merrifield, Virginia | 1997 |
| F. Levi Ruark | Chairman, President, and Chief Executive Officer, The National Bank of Cambridge, Cambridge, Maryland | 1997 |
| Jeremiah E. Casey | Chairman, First Maryland Bancorp, Baltimore, Maryland | 1998 |
| *Appointed by the Board of Governors* | | |
| Michael R. Watson | President, Association of Maryland Pilots, Baltimore, Maryland | 1996 |
| Rebecca Hahn Windsor | Chairman and Chief Executive Officer, Hahn Transportation, Inc., New Market, Maryland | 1997 |
| Daniel R. Baker | President and Chief Executive Officer, Tate Access Floors, Inc., Jessup, Maryland | 1998 |
| CHARLOTTE BRANCH | | |
| *Appointed by the Federal Reserve Bank* | | |
| Jim M. Cherry, Jr. | President and Chief Executive Officer, Williamsburg First National Bank, Kingstree, South Carolina | 1996 |
| Dorothy H. Aranda | President, Dohara Associates, Inc., Hilton Head Island, South Carolina | 1997 |

*Term expires Dec. 31*

DISTRICT 5, CHARLOTTE BRANCH
*Appointed by the Federal Reserve Bank*—Continued

| | | |
|---|---|---|
| J. Walter McDowell | President and Chief Executive Officer, Wachovia Bank of North Carolina, N.A., Winston–Salem, North Carolina | 1997 |
| William G. Stevens | President and Chief Executive Officer, Greenwood Bank & Trust, Greenwood, South Carolina | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| Dennis D. Lowery | Chairman and Chief Executive Officer, Continental Industrial Chemicals, Inc., Charlotte, North Carolina | 1996 |
| Joan H. Zimmerman | President, Southern Shows, Inc., Charlotte, North Carolina | 1997 |
| James O. Roberson | President, Research Triangle Foundation of North Carolina, Research Triangle Park, North Carolina | 1998 |

DISTRICT 6—ATLANTA

*Class A*

| | | |
|---|---|---|
| James B. Williams | Chairman and Chief Executive Officer, SunTrust Banks, Inc., Atlanta, Georgia | 1996 |
| D. Paul Jones, Jr. | Chairman and Chief Executive Officer, Compass Bancshares, Inc., Birmingham, Alabama | 1997 |
| Waymon L. Hickman | Chairman and Chief Executive Officer, First Farmers and Merchants National Bank, Columbia, Tennessee | 1998 |

*Class B*

| | | |
|---|---|---|
| Andre M. Rubenstein | Chairman and Chief Executive Officer, Rubenstein Brothers, Inc., New Orleans, Louisiana | 1996 |
| Maria Camila Leiva | Executive Vice President, Miami Free Zone Corporation, Miami, Florida | 1997 |
| Larry W. Kinderman | President and Chief Executive Officer, Stockham Valves & Fittings, Inc., Birmingham, Alabama | 1998 |

*Class C*

| | | |
|---|---|---|
| Daniel E. Sweat, Jr. | Program Director, The America Project, Atlanta, Georgia | 1996 |
| Hugh M. Brown | President and Chief Executive Officer, BAMSI, Inc., Titusville, Florida | 1997 |
| David R. Jones | President and Chief Executive Officer, AGL Resources, Inc., Atlanta, Georgia | 1998 |

| | | *Term expires Dec. 31* |
|---|---|---|
| DISTRICT 6, ATLANTA—Continued | | |
| BIRMINGHAM BRANCH | | |
| *Appointed by the Federal Reserve Bank* | | |
| Julian W. Banton | Chairman, President, and Chief Executive Officer, SouthTrust Bank of Alabama, NA, Birmingham, Alabama | 1996 |
| Marlin D. Moore, Jr. | Chairman, Pritchett-Moore, Inc., Tuscaloosa, Alabama | 1997 |
| Columbus Sanders | President, Consolidated Industries, Inc., Huntsville, Alabama | 1997 |
| J. Stephen Nelson | Chairman and Chief Executive Officer, First National Bank of Brewton, Brewton, Alabama | 1998 |
| *Appointed by the Board of Governors* | | |
| Donald E. Boomershine | President, The Better Business Bureau, Inc., Birmingham, Alabama | 1996 |
| D. Bruce Carr | International Representative, Laborers' International Union of North America, Gadsden, Alabama | 1997 |
| Patricia B. Compton | President, Patco, Inc., Georgiana, Alabama | 1998 |
| JACKSONVILLE BRANCH | | |
| *Appointed by the Federal Reserve Bank* | | |
| William G. Smith, Jr. | President and Chief Executive Officer, Capital City Bank Group, Tallahassee, Florida | 1996 |
| Terry R. West | Chief Executive Officer, Jax Navy Federal Credit Union, Jacksonville, Florida | 1997 |
| Arnold A. Heggestad | Chester Holloway Professor of Finance and Director of Entrepreneurial Programs, University of Florida, Gainesville, Florida | 1997 |
| Royce B. Walden | Vice President, SouthTrust Securities, Orlando, Florida | 1998 |
| *Appointed by the Board of Governors* | | |
| Joan D. Ruffier | General Partner, Sunshine Cafes, Orlando, Florida | 1996 |
| Patrick C. Kelly | Chairman and Chief Executive Officer, Physician Sales & Service, Inc., Jacksonville, Florida | 1997 |
| Judy R. Jones | President, J. R. Jones and Associates, Tallahassee, Florida | 1998 |

DISTRICT 6, ATLANTA—Continued

MIAMI BRANCH

| | | Term expires Dec. 31 |
|---|---|---|
| *Appointed by the Federal Reserve Bank* | | |
| Pat L. Tornillo, Jr. | Executive Vice President, United Teachers of Dade, Miami, Florida | 1996 |
| Steven C. Shimp | President, O-A-K/Florida, Inc., Fort Myers, Florida | 1996 |
| Carlos A. Migoya | South Florida Regional President, First Union National Bank of Florida, Miami, Florida | 1997 |
| E. Anthony Newton | President and Chief Executive Officer, Island National Bank and Trust Company, Palm Beach, Florida | 1998 |
| *Appointed by the Board of Governors* | | |
| Michael T. Wilson | President, Vinegar Bend Farms, Inc., Belle Glade, Florida | 1996 |
| Kaaren Johnson-Street | Vice President of Minority Business Development, Enterprise Florida, Miami, Florida | 1997 |
| R. Kirk Landon | Chairman, American Bankers Insurance Group, Miami, Florida | 1998 |

NASHVILLE BRANCH

| | | |
|---|---|---|
| *Appointed by the Federal Reserve Bank* | | |
| Williams E. Arant, Jr. | Chairman, First Knoxville Bank, Knoxville, Tennessee | 1996 |
| Jack J. Vaughn | President, Hospitality & Attractions Group, Gaylord Entertainment Company, Nashville, Tennessee | 1997 |
| John E. Seward, Jr. | President and Chief Executive Officer, Paty Lumber Co., Inc., Piney Flats, Tennessee | 1997 |
| Dale W. Polley | President, First American National Bank, Nashville, Tennessee | 1998 |
| *Appointed by the Board of Governors* | | |
| Paula Lovell | President, Lovell Communications, Inc., Nashville, Tennessee | 1996 |
| James E. Dalton, Jr. | President and Chief Executive Officer, Quorum Health Group, Inc., Brentwood, Tennessee | 1997 |
| Frances F. Marcum | Chairman and Chief Executive Officer, Micro Craft, Inc., Tullahoma, Tennessee | 1998 |

| | | *Term expires Dec. 31* |
|---|---|---|

DISTRICT 6, ATLANTA—Continued

NEW ORLEANS BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| Howard C. Gaines | Chairman, First National Bank of Commerce, New Orleans, Louisiana | 1996 |
| Angus R. Cooper II | Chairman and Chief Executive Officer, Cooper/T. Smith Corporation, Mobile, Alabama | 1997 |
| Kay L. Nelson | President, Nelson Capital Corporation, New Orleans, Louisiana | 1997 |
| Howell N. Gage | Chairman and Chief Executive Officer, Merchants Bank, Vicksburg, Mississippi | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| Victor Bussie | President, Louisiana AFL–CIO, Baton Rouge, Louisiana | 1996 |
| Jo Ann Slaydon | President, Slaydon Consultants and Insight Productions and Advertising, Baton Rouge, Louisiana | 1997 |
| Lucimarian Roberts | President, Mississippi Coast Coliseum Commission, Biloxi, Mississippi | 1998 |

DISTRICT 7—CHICAGO

*Class A*

| | | |
|---|---|---|
| David W. Fox | Chairman and Chief Executive Officer (Retired), Northern Trust Corporation, Chicago, Illinois | 1996 |
| Stefan S. Anderson | Chairman, President, and Chief Executive Officer, First Merchants Corporation, Muncie, Indiana | 1997 |
| Arnold C. Schultz | Chairman, President, and Chief Executive Officer, Grundy National Bank, Grundy Center, Iowa | 1998 |

*Class B*

| | | |
|---|---|---|
| A. Charlene Sullivan | Associate Professor of Management, Krannert Graduate School of Management, Krannert Center, Purdue University, West Lafayette, Indiana | 1996 |
| Thomas C. Dorr | President and Chief Executive Officer, Dorr's Pine Grove Farm Co., Marcus, Iowa | 1997 |
| Donald J. Schneider | President, Schneider National, Inc., Green Bay, Wisconsin | 1998 |

*Class C*

| | | |
|---|---|---|
| Robert M. Healey | Member, Illinois State Labor Relations Board, Chicago, Illinois | 1996 |
| Lester H. McKeever, Jr. | Managing Partner, Washington, Pittman & McKeever, Chicago, Illinois | 1997 |

| | | *Term expires Dec. 31* |
|---|---|---|
| DISTRICT 7, *Class C*—Continued | | |
| Arthur C. Martinez | Chairman and Chief Executive Officer, Sears Roebuck and Co., Hoffman Estates, Illinois | 1998 |

DETROIT BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| William E. Odom | Chairman and Chief Executive Officer, Ford Motor Credit Company, Dearborn, Michigan | 1996 |
| Charles E. Allen | President and Chief Executive Officer, Graimark Realty Advisors, Inc., Detroit, Michigan | 1996 |
| Charles R. Weeks | Chairman and Chief Executive Officer, Citizens Banking Corporation, Flint, Michigan | 1997 |
| Richard M. Bell | President and Chief Executive Officer, The First National Bank of Three Rivers, Three Rivers, Michigan | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| Florine Mark | President and Chief Executive Officer, The WW Group, Inc., Farmington Hills, Michigan | 1996 |
| Timothy D. Leuliette | President and Chief Operating Officer, Penske Corporation, Detroit, Michigan | 1997 |
| Stephen R. Polk | Chairman and Chief Executive Officer, R. L. Polk & Co., Detroit, Michigan | 1998 |

DISTRICT 8—ST. LOUIS

*Class A*

| | | |
|---|---|---|
| W. D. Glover | Chairman and Chief Executive Officer, First National Bank of Eastern Arkansas, Forrest City, Arkansas | 1996 |
| Michael A. Alexander | Chairman and President, The First National Bank of Mount Vernon, Mount Vernon, Illinois | 1997 |
| Douglas M. Lester | Chairman and Chief Executive Officer, Sea Change Corp., Bowling Green, Kentucky | 1998 |

*Class B*

| | | |
|---|---|---|
| Warren R. Lee | President, United Benefit Services, Inc., Louisville, Kentucky | 1996 |
| Sandra B. Sanderson | President and Chief Executive Officer, Sanderson Plumbing Products, Inc., Columbus, Mississippi | 1997 |
| Richard E. Bell | President and Chief Executive Officer, Riceland Foods, Inc., Stuttgart, Arkansas | 1998 |

*Class C*

| | | |
|---|---|---|
| Veo Peoples, Jr. | Partner, Peoples & Hale, St. Louis, Missouri | 1996 |

| | | *Term expires Dec. 31* |
|---|---|---|
| DISTRICT 8, *Class C*—Continued | | |
| Susan S. Elliott | President and Chief Executive Officer, Systems Service Enterprises, Inc., St. Louis, Missouri | 1997 |
| John F. McDonnell | Chairman, McDonnell Douglas Corporation, St. Louis, Missouri | 1998 |

LITTLE ROCK BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| Lee Frazier | President, Trinity Healthcare, Little Rock, Arkansas | 1996 |
| James V. Kelley | Chairman, President, and Chief Executive Officer, First United Bancshares, Inc., El Dorado, Arkansas | 1996 |
| Lunsford W. Bridges | President and Chief Executive Officer, Metropolitan National Bank, Little Rock, Arkansas | 1997 |
| Mark A. Shelton III | President, M. A. Shelton Farming Company, Wabbaseka, Arkansas | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| Janet M. Jones | President, The Janet Jones Company, Little Rock, Arkansas | 1996 |
| Robert D. Nabholz, Jr. | Chief Executive Officer, Nabholz Construction Corporation, Conway, Arkansas | 1997 |
| Betta M. Carney | Chairman and Chief Executive Officer, World Wide Travel Service, Inc., Little Rock, Arkansas | 1998 |

LOUISVILLE BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| Charles D. Storms | President and Chief Executive Officer, Red Spot Paint and Varnish Company, Inc., Evansville, Indiana | 1996 |
| Robert M. Hall | Owner, East Fork Growers Farm, Seymour, Indiana | 1996 |
| Thomas E. Spragens, Jr. | President, Farmers National Bank, Lebanon, Kentucky | 1997 |
| Orson Oliver | President, Mid-America Bank of Louisville & Trust Co., Louisville, Kentucky | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| John A. Williams | Chairman and Chief Executive Officer, Computer Services, Inc., Paducah, Kentucky | 1996 |
| Debbie Scoppechio | Chairman, President, and Chief Executive Officer, Creative Alliance, Inc., Louisville, Kentucky | 1997 |
| Roger Reynolds | President and Chief Executive Officer, Material Resource Planners, Inc., Louisville, Kentucky | 1998 |

| | | *Term expires Dec. 31* |
|---|---|---|
| **DISTRICT 8, ST. LOUIS—Continued** | | |
| **MEMPHIS BRANCH** | | |
| *Appointed by the Federal Reserve Bank* | | |
| Katie S. Winchester | President and Chief Executive Officer, First Citizens National Bank, Dyersburg, Tennessee | 1996 |
| John C. Kelley, Jr. | President, Memphis Banking Group, First Tennessee Bank, Memphis, Tennessee | 1996 |
| Lewis F. Mallory, Jr. | Chairman, President, and Chief Executive Officer, NBC Capital Corporation, Starkville, Mississippi | 1997 |
| Anthony M. Rampley | President and Chief Executive Officer, Arkansas Glass Container Corporation, Jonesboro, Arkansas | 1998 |
| *Appointed by the Board of Governors* | | |
| Woods E. Eastland | President and Chief Executive Officer, Staple Cotton Cooperative Association, Greenwood, Mississippi | 1996 |
| Carol G. Crawley | President, Mid-South Minority Business Council, Memphis, Tennessee | 1997 |
| John V. Myers | President, Better Business Bureau, Memphis, Tennessee | 1998 |
| **DISTRICT 9—MINNEAPOLIS** | | |
| *Class A* | | |
| Jerry B. Melby | President, First National Bank, Bowbells, North Dakota | 1996 |
| William S. Pickerign | President, The Northwestern Bank of Chippewa Falls, Chippewa Falls, Wisconsin | 1997 |
| Dale J. Emmel | President, First National Bank of Sauk Centre, Sauk Centre, Minnesota | 1998 |
| *Class B* | | |
| Clarence D. Mortenson | President, M/C Professional Associates Inc., Pierre, South Dakota | 1996 |
| Kathryn L. Ogren | Owner, Bitterroot Motors, Missoula, Montana | 1997 |
| Dennis W. Johnson | President, TMI Systems Design Corporation, Dickinson, North Dakota | 1998 |
| *Class C* | | |
| David A. Koch | Chairman, Graco, Inc., Minneapolis, Minnesota | 1996 |
| Jean D. Kinsey | Professor, Consumption Economics, Director, Retail Food Industry Center, University of Minnesota, St. Paul, Minnesota | 1997 |

| | | *Term expires Dec. 31* |
|---|---|---|
| DISTRICT 9, *Class C*—Continued | | |
| James J. Howard | Chairman, President, and Chief Executive Officer, Northern States Power Company, Minneapolis, Minnesota | 1998 |

HELENA BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| Donald E. Olsson, Jr. | President, Ronan State Bank, Ronan, Montana | 1996 |
| Sandra M. Stash | Manager, Montana Facilities, Atlantic Richfield Company (ARCO), Anaconda, Montana | 1996 |
| Ronald D. Scott | President and Chief Executive Officer, The First State Bank of Malta, Malta, Montana | 1997 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| Lane W. Basso | President, Deaconess Medical Center, Billings, Montana | 1996 |
| Matthew J. Quinn | President, Carroll College, Helena, Montana | 1997 |

DISTRICT 10—KANSAS CITY

*Class A*

| | | |
|---|---|---|
| L. W. Menefee | Chairman, Union Colony Bank, Greeley, Colorado | 1996 |
| Samuel P. Baird | President, Farmers State Bank & Trust Co., Superior, Nebraska | 1997 |
| William L. McQuillan | President, Chief Executive Officer, and Director, City National Bank, Greeley, Nebraska | 1998 |

*Class B*

| | | |
|---|---|---|
| Charles W. Nichols | Managing Partner, Davison & Sons Cattle Company, Arnett, Oklahoma | 1996 |
| Vacancy | | 1997 |
| Frank A. Potenziani | M&T Trust, Albuquerque, New Mexico | 1998 |

*Class C*

| | | |
|---|---|---|
| Colleen D. Hernandez | Executive Director, Kansas City Neighborhood Alliance, Kansas City, Missouri | 1996 |
| A. Drue Jennings | Chairman, President, and Chief Executive Officer, Kansas City Power & Light Company, Kansas City, Missouri | 1997 |
| Jo Marie Dancik | Office Managing Partner, Ernst & Young, Denver, Colorado | 1998 |

DENVER BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| Peter R. Decker | President, Peter R. Decker & Associates, Denver, Colorado | 1996 |

| | | *Term expires Dec. 31* |
|---|---|---|

DISTRICT 10, DENVER BRANCH

*Appointed by the Federal Reserve Bank*—Continued

| | | |
|---|---|---|
| Richard I. Ledbetter | President and Chief Executive Officer, First National Bank of Farmington, Farmington, New Mexico | 1997 |
| Clifford E. Kirk | President and Chief Executive Officer, First National Bank of Gillette, Gillette, Wyoming | 1997 |
| Albert C. Yates | President, Colorado State University, Ft. Collins, Colorado | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| Teresa N. McBride | President and Chief Executive Officer, McBride and Associates, Inc., Albuquerque, New Mexico | 1996 |
| Vacancy | | 1997 |
| Peter I. Wold | Partner, Wold Oil & Gas Company, Casper, Wyoming | 1998 |

OKLAHOMA CITY BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| William H. Braum | President, Braum Ice Cream Co., Oklahoma City, Oklahoma | 1996 |
| Michael S. Samis | President and Chief Executive Officer, Macklanburg–Duncan Co., Oklahoma City, Oklahoma | 1997 |
| Betty Bryant Shaull | President-Elect and Director, Bank of Cushing and Trust Company, Cushing, Oklahoma | 1998 |
| Dennis M. Mitchell | President, Citizens Bank of Ardmore, Ardmore, Oklahoma | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| Hans Helmerich | President and Chief Executive Officer, Helmerich & Payne, Inc., Tulsa, Oklahoma | 1996 |
| Victor R. Schock | President and Chief Executive Officer, Credit Counseling Centers, Tulsa, Oklahoma | 1997 |
| Barry L. Eller | Senior Vice President and General Manager, MerCruiser, Stillwater, Oklahoma | 1998 |

OMAHA BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| Bruce R. Lauritzen | President, First National Bank of Omaha, Omaha, Nebraska | 1996 |
| Donald A. Leu | President and Chief Executive Officer, Consumer Credit Counseling Service, Omaha, Nebraska | 1997 |
| Thomas H. Olson | Chairman, First National Bank, Sidney, Nebraska | 1997 |
| Robert L. Peterson | Chairman, President, and Chief Executive Officer, IBP, Inc., Dakota City, Nebraska | 1998 |

| | | *Term expires Dec. 31* |
|---|---|---|
| **DISTRICT 10, OMAHA BRANCH—Continued** | | |
| *Appointed by the Board of Governors* | | |
| LeRoy W. Thom | President, T-L Irrigation Company, Hastings, Nebraska | 1996 |
| Arthur L. Shoener | Executive Vice President–Operations, Union Pacific Railroad, Omaha, Nebraska | 1997 |
| Gladys Styles Johnston | Chancellor, University of Nebraska at Kearney, Kearney, Nebraska | 1998 |

## DISTRICT 11—DALLAS

| | | |
|---|---|---|
| *Class A* | | |
| Gayle M. Earls | President and Chief Executive Officer, Texas Independent Bank, Dallas, Texas | 1996 |
| Kirk A. McLaughlin | President and Chief Executive Officer, Security Bank, Ralls, Texas | 1997 |
| Dudley K. Montgomery | President and Chief Executive Officer, The Security State Bank of Pecos, Pecos, Texas | 1998 |
| *Class B* | | |
| J. B. Cooper, Jr. | Farmer, Roscoe, Texas | 1996 |
| Robert C. McNair | Chairman and Chief Executive Officer, Cogen Technologies, Inc., Houston, Texas | 1997 |
| Milton Carroll | Chairman and Chief Executive Officer, Instrument Products, Inc., Houston, Texas | 1998 |
| *Class C* | | |
| James A. Martin | Second General Vice President, International Association of Bridge, Structural, and Ornamental Iron Workers, Austin, Texas | 1996 |
| Cece Smith | General Partner, Phillips–Smith Specialty Retail Group, Dallas, Texas | 1997 |
| Roger R. Hemminghaus | Chairman, President, and Chief Executive Officer, Diamond Shamrock, Inc., San Antonio, Texas | 1998 |

### EL PASO BRANCH

| | | |
|---|---|---|
| *Appointed by the Federal Reserve Bank* | | |
| Ben H. Haines, Jr. | President and Chief Executive Officer, First National Bank of Dona Ana County, Las Cruces, New Mexico | 1996 |
| Veronica K. Callaghan | Vice President and Principal, KASCO Ventures, Inc., El Paso, Texas | 1996 |
| Hugo Bustamante, Jr. | Owner and Chief Executive Officer, CarLube, Inc., ProntoLube, Inc., El Paso, Texas | 1997 |
| Lester L. Parker | President and Chief Operating Officer, Bank of the West, El Paso, Texas | 1998 |

*Term expires Dec. 31*

DISTRICT 11, EL PASO BRANCH—Continued

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| Patricia Z. Holland-Branch | President and Director of Design, PZH Contract Design, Inc., El Paso, Texas | 1996 |
| Alvin T. Johnson | President, Management Assistance Corporation of America, El Paso, Texas | 1997 |
| Beauregard Brite White | Rancher, J. E. White, Jr. & Sons, Marfa, Texas | 1998 |

HOUSTON BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| Judith B. Craven | President, United Way of the Texas Gulf Coast, Houston, Texas | 1996 |
| Walter E. Johnson | President and Chief Executive Officer, Southwest Bank of Texas, Houston, Texas | 1996 |
| Tieman H. Dippel, Jr. | Chairman and President, Brenham Bancshares, Inc., Brenham, Texas | 1997 |
| J. Michael Solar | Principal Attorney, Solar & Fernandes, LLP, Houston, Texas | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| Peggy Pearce Caskey | Chief Executive Officer, Laboratories for Genetic Services, Inc., Houston, Texas | 1996 |
| Isaac H. Kempner III | Chairman, Imperial Holly Corporation, Sugar Land, Texas | 1997 |
| Edward O. Gaylord | Chairman, EOTT Energy Corp., and General Partner, EOTT Energy Partners, LP, Houston, Texas | 1998 |

SAN ANTONIO BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| Juliet V. Garcia | President, The University of Texas at Brownsville, Brownsville, Texas | 1996 |
| Douglas G. Macdonald | President, South Texas National Bank, Laredo, Texas | 1996 |
| Calvin R. Weinheimer | President and Chief Operating Officer, Kerrville Communications Corporation, Kerrville, Texas | 1997 |
| Richard W. Evans, Jr. | Chairman and Chief Executive Officer, Frost National Bank, San Antonio, Texas | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| Erich Wendl | Vice President, Webro Investment Corporation, Corpus Christi, Texas | 1996 |
| H. B. Zachry, Jr. | Chairman and Chief Executive Officer, H. B. Zachry Company, San Antonio, Texas | 1997 |
| Carol L. Thompson | President, The Thompson Group, Austin, Texas | 1998 |

*Term expires Dec. 31*

DISTRICT 12—SAN FRANCISCO

*Class A*

| | | |
|---|---|---|
| Richard L. Mount | Chairman, President, and Chief Executive Officer, Saratoga Bancorp, Saratoga, California | 1996 |
| Gerry B. Cameron | Chairman and Chief Executive Officer, U.S. Bancorp, Portland, Oregon | 1997 |
| Warren K. K. Luke | Vice Chairman, President, and Chief Executive Officer, Hawaii National Bank, Honolulu, Hawaii | 1998 |

*Class B*

| | | |
|---|---|---|
| Gary G. Michael | Chairman and Chief Executive Officer, Albertson's, Inc., Boise, Idaho | 1996 |
| Krestine Corbin | President and Chief Executive Officer, Sierra Machinery, Inc., Sparks, Nevada | 1997 |
| Stanley T. Skinner | Chairman and Chief Executive Officer, Pacific Gas and Electric Co., San Francisco, California | 1998 |

*Class C*

| | | |
|---|---|---|
| James A. Vohs | Chairman (Retired), Kaiser Foundation Health Plan, Inc., and Kaiser Foundation Hospitals, Oakland, California | 1996 |
| Judith M. Runstad | Partner, Foster Pepper & Shefelman, Seattle, Washington | 1997 |
| Cynthia A. Parker | Executive Director, Anchorage Neighborhood Housing Services, Inc., Anchorage, Alaska | 1998 |

LOS ANGELES BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| Vacancy | | 1996 |
| Liam E. McGee | Group Executive Vice President, Bank of America, Los Angeles, California | 1997 |
| Antonia Hernandez | President and General Counsel, Mexican American Legal Defense and Educational Fund, Los Angeles, California | 1997 |
| Stephen G. Carpenter | Chairman and Chief Executive Officer, California United Bank, NA, Encino, California | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| Anita Landecker | Western Regional Vice President, Local Initiatives Support Corporation, Los Angeles, California | 1996 |
| David L. Moore | President, Western Growers Association, Irvine, California | 1997 |
| Anne L. Evans | Chair, Evans Hotels, San Diego, California | 1998 |

*Term expires Dec. 31*

DISTRICT 12, SAN FRANCISCO—Continued

PORTLAND BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| Elizabeth K. Johnson | President, TransWestern Aviation, Inc., Scappoose, Oregon | 1996 |
| Cecil W. Drinkward | President and Chief Executive Officer, Hoffman Corporation, Portland, Oregon | 1996 |
| Thomas C. Young | Chairman, President, and Chief Executive Officer, Northwest National Bank, Vancouver, Washington | 1997 |
| John D. Eskildsen | President and Chief Executive Officer, U.S. National Bank of Oregon, Portland, Oregon | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| Ross R. Runkel | Professor of Law, Willamette University, Salem, Oregon | 1996 |
| Vacancy | | 1997 |
| Carol A. Whipple | Proprietor, Rocking C Ranch, Elkton, Oregon | 1998 |

SALT LAKE CITY BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| J. Pat McMurray | President, First Security Bank, N.A., Boise, Idaho | 1996 |
| Nancy Mortensen | Vice President–Marketing Services, ZCMI, Salt Lake City, Utah | 1996 |
| R. D. Cash | Chairman, President, and Chief Executive Officer, Questar Corporation, Salt Lake City, Utah | 1997 |
| Roy C. Nelson | President, Bank of Utah, Ogden, Utah | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| Constance G. Hogland | Executive Director, Boise Neighborhood Housing Services, Inc., Boise, Idaho | 1996 |
| Gerald R. Sherratt | President, Southern Utah University, Cedar City, Utah | 1997 |
| Richard E. Davis | President and Chief Executive Officer, Salt Lake Convention & Visitors Bureau, Salt Lake City, Utah | 1998 |

SEATTLE BRANCH

*Appointed by the Federal Reserve Bank*

| | | |
|---|---|---|
| Tomio Moriguchi | Chairman and Chief Executive Officer, Uwajimaya, Inc., Seattle, Washington | 1996 |
| John V. Rindlaub | Chairman, Seafirst Bank, Seattle, Washington | 1996 |
| Thomas E. Cleveland | Chairman and Chief Executive Officer, Access Business Finance, Bellevue, Washington | 1997 |

| | | *Term expires Dec. 31* |
|---|---|---|

DISTRICT 12, SEATTLE BRANCH

*Appointed by the Federal Reserve Bank*—Continued

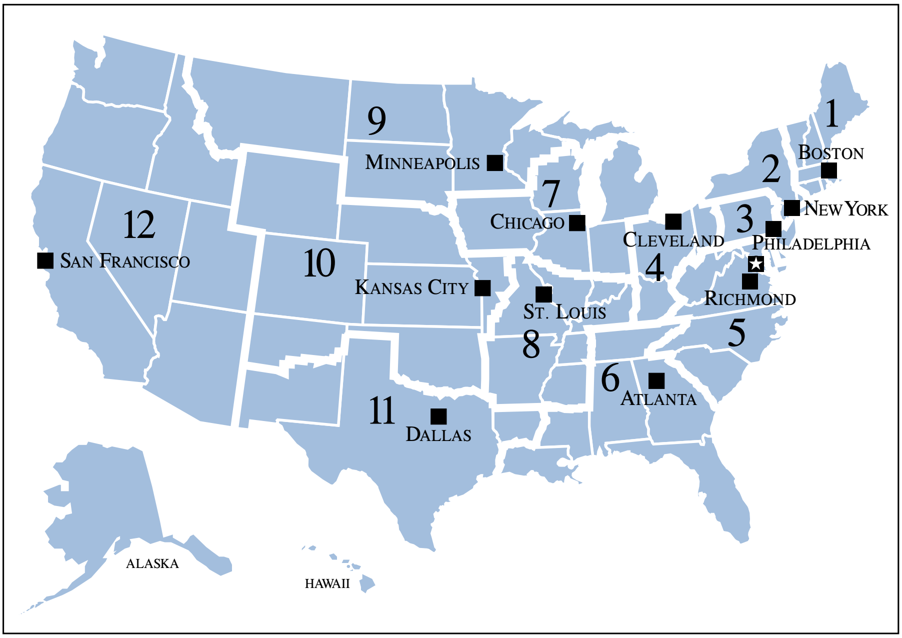
| | | |
|---|---|---|
| Constance L. Proctor ......... | Partner, Alston, Courtnage, MacAulay & Proctor, Seattle, Washington | 1998 |

*Appointed by the Board of Governors*

| | | |
|---|---|---|
| George F. Russell, Jr. ........ | Chairman, Frank Russell Company, Tacoma, Washington | 1996 |
| Vacancy ........................ | | 1997 |
| Helen M. Rockey ............ | President and Chief Executive Officer, Brooks Sports, Inc., Bothell, Washington | 1998 |

# *Maps of the Federal Reserve System*

# The Federal Reserve System




LEGEND

*Both pages*

- ■ Federal Reserve Bank city
- ☒ Board of Governors of the Federal Reserve System, Washington, D.C.

*Facing page*

- • Federal Reserve Branch city
- — Branch boundary

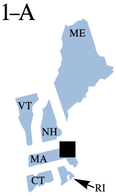
NOTE

The Federal Reserve officially identifies Districts by number and by Reserve Bank city (shown on both pages) and by letter (shown on the facing page).

In the 12th District, the Seattle Branch serves Alaska, and the San Francisco Bank serves Hawaii.

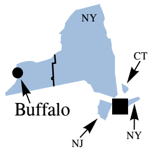
The System serves commonwealths and territories as follows: The New York Bank serves the Commonwealth of Puerto Rico and the U.S. Virgin Islands; the San Francisco Bank serves American Samoa, Guam, and the Commonwealth of the Northern Mariana Islands. The maps show the boundaries within the System as of year-end 1996.

1–A



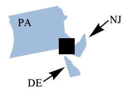

BOSTON

2–B



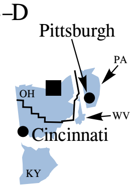

NEW YORK

3–C



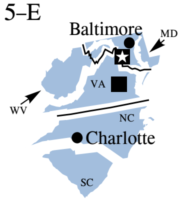

PHILADELPHIA

4–D




CLEVELAND

5–E

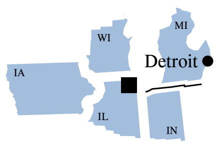



RICHMOND

6–F


ATLANTA

7–G

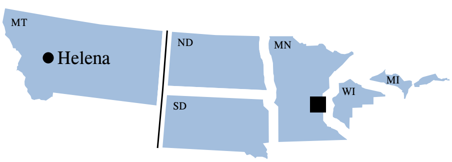



CHICAGO

8–H

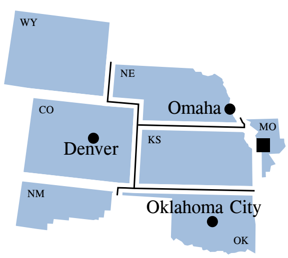

ST. LOUIS

9–I




MINNEAPOLIS

10–J

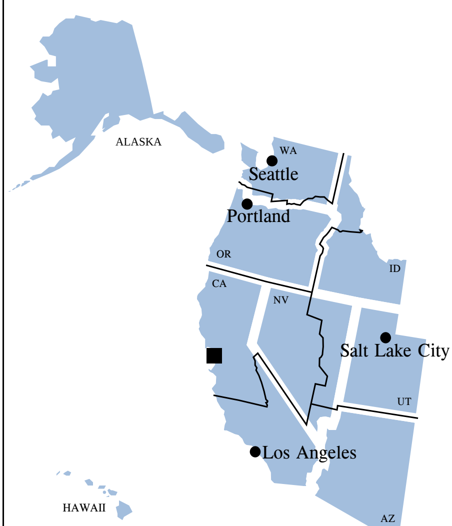



KANSAS CITY

11–K


DALLAS

12–L




SAN FRANCISCO

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