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THE BANKING STRUCTURE AND MONETARY MANAGEMENT

with paper clips

Remarks by

- mat imp.

Andrew F. Brimmer
Member
Board of Governors of the
Federal Reserve System

*points on
pp 26-33*

Before the

San Francisco Bond Club

Fairmont Hotel

San Francisco, California

April 1, 1970



THE BANKING STRUCTURE AND MONETARY MANAGEMENT

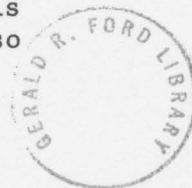
By
Andrew F. Brimmer*

The campaign against inflation has undoubtedly reached a troublesome phase, and the appropriate role for monetary policy is one of the principal questions on the minds of many observers. I agree that the task of monetary management is a difficult one under the present circumstances. But, in my personal opinion, monetary policy still has a contribution to make in our national efforts to check inflation. I will comment further on this task in the closing section of these remarks.

Before doing that, however, it might be well to review the impact of monetary restraint on the banking system and credit flows during the last year. A comprehensive analysis of that experience has convinced me that the time has come for a thorough reexamination of the main tools and techniques of monetary control in the United States. Also in these remarks, I will sketch the broad outlines of an alternative approach which appears to be quite promising. In fact, the key element on which this possible new direction is based -- a more flexible use of reserve requirements -- has been relied on increasingly by the Federal Reserve Board in recent years to accomplish objectives requiring a special focus on particular segments of the banking system.

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I am grateful to several members of the Board's staff for assistance in the preparation of these remarks. Mr. Frederick M. Struble had principal responsibility for the analysis of portfolio adjustments by banks, given their differential access to sources of funds. Mr. Peter J. Feddor designed and carried out the difficult computer programming tasks on which the analysis depended so heavily. Miss Harriett Harper, my assistant, also helped with the statistical analysis.



The reasoning behind these conclusions is set forth in some detail in the sections which follow. However, it might be helpful to summarize here the main points of the analysis:

- In 1969, despite the severity of monetary restraint, the volume of funds raised in the capital markets by borrowers other than the Federal Government rose moderately compared with the previous year. However, the distribution among sectors changed somewhat. The share obtained by both households and State and local governments declined slightly, while the business sector (particularly corporations) got a larger share.
- The Federal Reserve System, on balance, provided a slightly larger volume of credit (in both absolute and relative terms) last year than it did in 1968.
- Commercial banks supplied a drastically reduced proportion of the credit advanced in 1969 compared with the previous year (just over one-tenth vs. two-fifths in 1968). The banks experienced an actual loss of deposits last year in contrast to a sizable gain the year before. Their net acquisition of financial assets fell by over three-quarters from the 1968 level.
- Nevertheless, through heavy sales of securities and reliance on nondeposit sources of funds, the banks were able to expand funds available for loans. In particular, business loans on the books of commercial banks rose almost as much as they did in 1968. When the volume of loans sold by the banks is added to the total, the increase in business loans last year was even greater than that registered the year before.
- The pattern of portfolio adjustment differed markedly among banks, depending on their access to nondeposit sources of funds. Banks with ready access to Euro-dollar inflows or with the



ability to sell commercial paper were much more successful in cushioning the impact of monetary restraint than were other banks which did not tap these sources of funds. Again, the greater were the availability of nondeposit sources of funds to the banks -- the greater also was the rate of expansion of business loans.

- The differential response of commercial banks to monetary restraint in 1969 becomes even more sharply focused when the banks are re-grouped and viewed in the context of the strategic roles they play with respect to different types of financial transactions. For this purpose three groups can be identified: (1) a handful of multi-national banks active in the domestic money market on a national scale and also heavily involved in international finance; (2) a sizable number of institutions which play a dominant role in their regions, and (3) other banks which concentrate mainly on their local markets. Among these three groups of banks, the first was the most successful in expanding its total loans and the second group was next in line. This was especially true of business loans at the first group where the rate of increase exceeded the average -- while the rate of expansion in their consumer loans was below the average -- for all banks covered in the analysis. Sales of business loans were proportionately the heaviest at the multi-national banks, and adjusting for such sales raises significantly the rate at which they supplied credit to their corporate customers.

When I reflect on the results of the analysis summarized above, I find it far from comforting. As emphasized many times, one objective -- although certainly not the only one -- of monetary restraint in 1969 was a sizable moderation in the expansion of business loans. Such a moderation in turn was sought as a means of dampening



excess demand and inflationary pressures in the economy. In retrospect, it is obvious that the Federal Reserve was not completely successful in its effort as far as business loans are concerned.

I am fully aware of the views of some observers who argue that a central bank should not concern itself with the composition of bank credit, but only with its rate of growth -- and better still only with the rate of growth of the money supply (however defined). Yet, in my own view, a central bank should not be indifferent to the changing composition of bank credit; to adopt such a posture would mean that drastic variations in the availability of credit in important sectors could occur -- and persist -- with seriously adverse consequences for the economy as a whole. In my opinion, we need a better way to assure that the overall objectives of monetary policy can be achieved without having a few sectors bear a disproportionate share of the burden of adjustment, while other sectors escape or significantly moderate its impact.

I will return to this point below. In the meantime, we can turn to the body of the analysis.

Credit Flows in 1969

The volume of credit raised in the capital markets in 1969 was obviously restrained severely by the restrictive monetary policy followed by the Federal Reserve System as part of the campaign to check inflation. Nevertheless, after allowing for the market activities of the Federal



Government, there was a modest increase in the amount of funds raised. According to the preliminary flow of funds statistics compiled by the Federal Reserve Board, the net volume of funds raised by all nonfinancial sectors in 1969 amounted to about \$85.7 billion, a decrease of \$11.7 billion (or 12 per cent) compared with the level in the previous year. (See Table 1 attached.) However, this decline in the total was more than accounted for by the change in the position of the Federal Government. In calendar year 1969, the latter made net repayments of \$5.4 billion -- compared with net borrowings of \$13.4 billion the year before. Thus, the year-to-year change was a decrease of \$18.9 billion. Well over two-thirds of the swing centered in direct public debt securities, and the rest in Government agency issues.

Allowing for the experience of the Federal Government, total funds raised by other nonfinancial sectors in 1969 amounted to \$91.0 billion. This represented an expansion of \$6.9 billion (or 8 per cent) over the level raised in 1968. However, the share of the total funds received by the principal groups of borrowers changed noticeably.

State and local governments raised \$9.2 billion (\$1.0 billion or 11 per cent less than in 1968), and their share of the total also declined slightly (from 12.1 per cent to 10.1 per cent). In contrast, net funds raised by these State and local units rose by \$2.2 billion (or by 28 per cent) in 1968. Moreover, the decline of \$1.0 billion in net funds raised by State and local governments last year represented over four-fifths of the decline of \$1.3 billion in net debt financing



in the long-term capital markets. In fact, obligations of these units were the only issues among the three principal types of capital market instruments to register a significant decline in 1969. While a number of factors contributed to this reduced borrowing by State and local governments, the lessened interest of commercial banks in tax-exempt issues was undoubtedly of considerable importance. As shown in Table 2, commercial banks expanded their holdings of such obligations by only \$1.2 billion in 1969, compared with an increase of \$8.7 billion in the previous year. Such issues represented about 10 per cent of the net acquisition of financial assets by banks in 1969 -- only half the proportion recorded in 1968. Moreover, last year the change in the banks' holdings represented only 14 per cent of the net funds raised by these governments in contrast to 90 per cent of the total in the preceding year.

The consumer sector raised about \$31 billion in the capital market in 1969, or roughly \$1.0 billion less than in 1968. This was a decline of just under 3 per cent. Since this occurred while the total volume of funds raised was expanding moderately, the household sector's share of the total also declined somewhat -- from just under two-fifths to just over one-third. This sector, on balance, also borrowed less at commercial banks. This can be seen in net change in the volume of home mortgages held and the amount of consumer credit extended by the latter. In 1969, their household mortgages rose by \$2.5 billion, compared with \$3.5 billion the previous year. The corresponding changes in consumer



credit were \$3.1 billion and \$4.9 billion. So the growth in these forms of bank credit eased off by one-third (from \$8.4 billion to \$5.6 billion).

The principal sector which expanded its share of total funds raised both in the overall capital market and at commercial banks was nonfinancial business. In the capital markets (as shown in Table 1), this sector raised \$47.4 billion in 1969, compared with \$39.1 billion the year before. This was an increase of \$8.3 billion, or more than one-fifth. Whereas businesses accounted for 47 per cent of the total funds raised in 1968, their share rose to 52 per cent last year. Industrial and commercial corporations were mainly responsible for the rise. In 1969, they raised \$37.2 billion, or \$6.2 billion more than in the year before. Consequently, their share of the total climbed from 37 per cent to 41 per cent. Business firms also accounted for a sizable share of the expansion in commercial bank credit. As shown in Table 2, while the net acquisition of financial assets by the banks amounted to \$9.6 billion in 1969, bank loans (other than mortgages, consumer credit and credit extended to purchase or hold securities) rose by \$13 billion. Loans in this category consist mainly of funds supplied to businesses. Consequently, commercial bank loans to the business sector expanded by more in 1969 than did total credit at these institutions. In 1969, loans to business had accounted for just under two-fifths of the total.



Sources of Funds and Bank Behavior

Experiencing substantial deposit declines in the face of strong demands for loans in 1969, banks attempted to maintain -- or expand -- their earning assets in two principal ways: by tapping nondeposit sources of funds or by selling a large volume of existing financial assets -- loans as well as securities -- or some combination of both. While they also made increasingly serious attempts to ration credit, they devoted their energies primarily to a search for ways to meet their customers' demands.

These various methods of adjusting to credit restraint are clearly apparent in data reflecting developments at large banks in the United States. About 340 of these banks report weekly to the Federal Reserve System, showing their assets and liabilities in some detail. Although they constituted only 2-1/2 per cent of the 13,464 insured commercial banks as of June 30, 1969, they control a substantial proportion of the total banking resources. They hold about three-fifths of the total assets, total loans and investments, and demand deposits. They hold three-quarters of total business loans, about half of consumer and real estate loans, and about the same proportion of total time and savings deposits. However, they hold nearly 90 per cent of the large denomination certificates of deposit (CD's), and they account for virtually all of the Euro-dollar borrowings and commercial paper sold by banks via their affiliates. While most of these weekly reporting banks are members of the Federal Reserve System, some insured nonmembers are also included. All of the 340 have total deposits of \$100 million or more.



Thus, a study of the behavior of these institutions under conditions of monetary restraint provides valuable insights into the behavior of the banking system as a whole. The broad changes in bank credit at the weekly reporting group and at all commercial banks were quite similar in 1969, as shown in the following figures (annual percentage rates of change):

	<u>All Commercial Banks</u>	<u>Weekly Reporting Banks</u>
Total loans and investments	2.4	0.6
U.S. Government securities	-15.9	-20.4
Other securities	-1.1	-8.4
Total loans	7.7	5.6
Business loans	9.4	9.7
Time and Savings deposits	-5.3	-14.7

The noticeable differences among the two sets of growth rates are these: the weekly reporting banks expanded their earning assets somewhat more moderately, they experienced a much heavier attrition in time deposits (especially CD's), and they liquidated securities at a much faster rate. While total loans at the weekly reporting banks rose less rapidly, their business loans increased somewhat more rapidly than at all banks in the country.

As indicated in Tables 3 and 4, total deposits declined sharply at the weekly reporting banks in 1969. A substantial decline in CD's,



combined with a more moderate drop in other time and savings deposits, considerably offset a slight rise in demand deposits. The decline in these deposit liabilities was more than counterbalanced, however, by expansion in other forms of liabilities. Total borrowings (principally in the federal funds market and at Federal Reserve Banks) and other liabilities (largely Euro-dollar borrowings from foreign branches) both advanced sharply.

Although the funds obtained from these alternative liability sources were large enough to finance a modest expansion in total earnings assets, they were clearly not sufficient to enable the weekly reporting banks to meet the demands of their loan customers. To gain additional funds, large blocks of security holdings were liquidated. In addition, a large volume of loans was sold, primarily to bank holding companies and affiliates. (These latter transactions are reflected in the large volume of commercial paper sales which supplied the funds to finance the purchase of these loans.)

The expansion in loans maintained on bank books, made possible by sale of securities and tapping of alternative liability sources of funds, was quite substantial -- and again it should be remembered that this gain is net of the loans sold from bank portfolios. Yet, some evidence of loan rationing is reflected in the data. The growth in total loans, even with loans sales accounted for, fell somewhat short of the expansion which occurred in 1968, when these banks were well supplied with funds. The change in volume alone, of course, does



not permit one to distinguish between a change in supply and a change in demand for credit, but it seems a reasonable assumption that loan demands were at least as strong in 1969 as in 1968.

Most of the loan rationing which occurred appears to have been focused on nonbusiness borrowers. Business loans on the books of weekly reporting banks, on the other hand, increased by as much in 1969 as they did in 1968. Moreover, since business loans comprise the major proportion of loans sold, total business credit extended through weekly reporting banks in 1969 was significantly higher than in 1968. How much difference these loan sales disguise the growth of bank credit extended to business firms is indicated in one of the following sections of these remarks.

Behavior of Euro-Dollar Banks

As may be seen in Table 3, the 19 weekly reporting banks that are major borrowers in the Euro-dollar market experienced a large deposit drain. However, they were more than able to compensate for this loss by drawing funds from alternative liability sources. Similar adjustments can be seen in the case of all other weekly reporting banks. However, the Euro-dollar banks relied much more heavily on the Euro-dollar market, while the other banks mainly utilized domestic sources of funds.

Whether the Euro-dollar banks were able (by using alternative liability sources) to make a more substantial compensation for their deposit drains than were other weekly reporting banks is difficult to



discern from an examination of the absolute change figures in Table 3. To overcome this difficulty, the changes in the banks' balance sheet can be converted to percentage terms. The figures are presented in Table 4. These data show that the deposit decline at Euro-dollar banks was nearly twice as large in relative terms as at the other weekly reporting banks. However, despite this sharp difference in deposit experience, growth in total earning assets at Euro-dollar banks was relatively quite similar to that at the other weekly reporters. This was due, of course, to the strong advance which the Euro-dollar banks were able to achieve in nondeposit sources of funds. (The percentage changes in these nondeposit figures are not particularly revealing because the outstanding levels for some of these items were quite small compared with their change.)

What is perhaps of even greater interest is the relative growth in total loans at these two groups of banks. As may be seen, the Euro-dollar banks recorded somewhat larger gains in both total loans and in business loans than did the other weekly reporting banks. The differences were quite small, however, so that perhaps the best generalization is that both groups of banks made about the same kind of adjustments to the problem of meeting strong loan demands during a period of heavy deposit drain. In this regard, it is worth restating that, although the percentage increases for 1969 indicated in the table for each groups of banks fell well below those recorded in 1968, these data do not reflect the considerable volume of loan sales made in 1969.



Behavior of Commercial Paper Issuing Banks

As is generally known, a number of banks resorted to the sale of commercial paper, mainly through one-bank holding companies but also to some extent through affiliates, to raise funds in an effort to compensate for the loss in deposits. Some of the banks active in the Euro-dollar market have also issued commercial paper. As indicated in Table 3, at the end of last year, \$4.3 billion of commercial paper was outstanding at weekly reporting banks. Of this amount, \$2.4 billion (or 56 per cent) had been issued by Euro-dollar banks. The remainder (\$1.9 billion) had been sold by banks which do not rely on Euro-dollar inflows to supplement their deposits.*

It is evident that the banks which relied only on commercial paper did not register a growth in their earning assets as did either the Euro-dollar banks or the banks which did not resort to non-deposit sources at all. While the differences among the groups were small, those banks relying on commercial paper had expanded their assets more rapidly in 1968. Last year, these banks had a percentage decline in time deposits about as large as that for all weekly reporting banks (although smaller than that recorded at Euro-dollar banks), and their sales of U.S. Government securities were proportionately almost as large as for the other banks. While Euro-dollar banks increased their indebtedness to their foreign branches by \$7.0 billion last year, those

*Trends in bank sales of commercial paper through mid-March, 1970, are shown in Table 7.



banks relying on commercial paper increased the volume of the latter by only \$1.9 billion. Yet, the two groups came out not very far apart when their sales of securities and the expansion in non-deposit sources are set against the attrition in total deposits.

The Banking Structure and the Differential Impact of Monetary Restraint

To obtain a different -- and more informative -- perspective on banking developments in 1969, another grouping of weekly reporting banks was made. On the basis of a considerable number of criteria, 20 banks were identified and labeled "Multi-National Banks." The criteria used included size, volume of business loans, importance in the Federal Funds market in particular and the money market in general, the volume of foreign lending and participation in the Euro-dollar market. Using similar criteria but stressing domestic activities and relative importance in one area of the country, an additional 60 banks were designated as "Major Regional Banks." The remaining 260 banks were designated "Large Local Banks." The changes in balance sheet items at these groups of banks in 1968 and 1969 are presented in Table 5 and 6. As one would expect, this information presents a roughly similar picture to that provided by the other groupings of banks. Yet, the experience is put into much sharper focus. The Multi-National Bank group, which is heavily comprised of large Euro-dollar banks, was subject to the largest percentage decline in deposits.



The decline at Major Regional Banks nearly matched that recorded at the Multi-National Banks, while a much smaller deposit reduction occurred at the Local Bank group. But despite this disparity in deposit flow, the percentage advances in total earning assets at these groups of banks were essentially similar. This suggests that the imbalances in deposit flows were offset by an opposite imbalance in the growth of nondeposit sources of funds.

The noticeable differences are evident with respect to earning assets. Total loans and business loans expanded more sharply at the Multi-National Banks than at the other two groups of banks. This is particularly true when compared with the Local Banks. So that there is some suggestion that the Multi-National Banks were more successful in avoiding the restraints of a tight monetary policy. This conclusion is further supported by the fact that loan sales which were heaviest at the Multi-National Banks were not included in the computation. The expansion of real estate loans, which include a sizable proportion of non-residential property along with home mortgages, was also considerably larger at the Multi-National Banks than at either of the other two groups. On the other hand, both of the latter expanded their consumer loans more rapidly than did the Multi-National Banks.

Finally, at the end of 1969, the Multi-National Banks had a somewhat larger share of total loans, of business loans and of real estate loans -- and a slightly smaller share of consumer loans -- than



they had at the end of 1968. The Regional Banks made a modest gain in their relative share of business loans, about held their place in the case of real estate loans, and experienced a slight decline in the proportion of both total loans and loans to consumers. The Local Banks' share of all of these asset categories declined moderately.

The general conclusion which emerges from this analysis can be expressed succinctly: The largest banks with both national and international customers -- and which mobilize funds in both the domestic and international capital markets -- are able to avoid a substantial proportion of the impact of monetary restraint. In doing so, they can maintain -- or even expand -- their earning assets. The large regional banks can succeed almost as well in following a similar course. The larger local banks, although also much larger than the average bank in the country, can do so to a much lesser extent.

Loans Sales and the Growth of Business Loans

As indicated at several places in this discussion, the expansion of business loans at commercial banks during 1969 was considerably obscured by sales of loans to obtain funds to meet new demands. Trends in such loan sales are shown in Table 7. At the end of last October, 143 banks were involved in such loan sales, and the amount sold outright totaled \$5.7 billion. More than four-fifths of this total represented sales to the banks' affiliates and subsidiaries and the rest to the nonbank public. Most of the loans sold to bank subsidiaries and affiliates reflect acquisitions by the latter for which



payment was made from the proceeds of their sales of commercial paper to the public. However, some of the loans were sold by banks to their foreign branches, with the latter paying for the transfer out of the proceeds of Euro-dollar deposits. As of March 11, 1970, the volume of loans sold had climbed to \$7.8 billion; the distribution between affiliates and the nonbank public was about the same as it was at the end of October.

As mentioned earlier, the loans sold by the commercial banks consist mainly of loans to business borrowers. If these sales are added to the volume of business loans outstanding on the books of the banks, the rate of growth in business loans in 1969 is raised substantially, as shown in the following statistics (1968 data need no adjustment):

<u>Classification of Banks</u>	<u>1968</u>	<u>Annual Percentage Rate of Change in Business Loans After Adjustment for Loan Sales</u>		
		<u>Before Adjustment</u>	<u>After Adjustment</u>	<u>Difference</u>
All Weekly Reporting Banks	11.4	9.7	13.7	4.0
Euro-dollar Banks	10.6	9.9	15.4	5.5
Commercial Paper Issuers	16.4	7.8	10.2	2.4
All Other Banks	9.8	10.6	12.6	2.0
Multi-National Banks	11.2	10.4	16.0	5.6
Major Regional Banks	11.3	9.9	12.3	2.4
Large Local Banks	11.9	7.6	8.0	0.4

Clearly the loan sales have been heaviest at the largest banks, and the understatement of the rate of growth of business loans, shown in the published statistics, has also been greatest at these institutions. When the loans sold are folded back into the figures, it appears that the rate of expansion of business loans at the weekly



reporting banks was more than two-fifths higher than originally shown. At the Euro-dollar banks, the expansion was more than 50 per cent higher. Among those issuing commercial paper only, it was about one-third larger, and at other banks it was one-fifth higher. When the banks are classified according to the strategic roles they play with respect to different types of financial transactions, the same pattern emerges -- but with sharper focus. The growth rate is raised by more than one-half at the Multi-National Banks; by one-quarter at the Regional Banks, and by only 5 per cent at the Local institutions.

But what is even more striking, except for commercial paper issuers and the local banks, the growth rate for business loans in 1969 -- once the sales are accounted for -- was considerably higher than that recorded in 1968. The unadjusted figures, except for one group of banks, would have suggested a noticeably lessened pace of expansion in business loans in 1969 compared with 1968.

Thus, the ability of some of the strongest commercial banks to sell part of their existing portfolios to obtain funds to meet new demands for funds is another way open to them to escape -- or at least lighten -- the impact of monetary restraint.

Long-Run Task of Monetary Management

As I reflect on the differential impact of monetary policy as mirrored in the behavior of different segments of the banking structure, I become more and more convinced that the Federal Reserve



System should give serious consideration to revamping its instruments of monetary control. I personally see no need to cast aside any of the traditional tools -- i.e., the discount rate, open market operations, and reserve requirements. These have been used -- and can continue to be used -- to influence the cost and availability of credit.

But, in my opinion, neither of these instruments has been the cutting edge of monetary policy during the last few years. This has been provided by the ceilings set by the Federal Reserve Board under Regulation Q, limiting the rates of interest which member banks can pay on time deposits. This has been particularly true of the ceilings on negotiable certificates of deposit of \$100,000 and above -- frequently referred to as CD's. From early December, 1965, until mid-April, 1968, the maximum rate payable was set at 5-1/2 per cent. In 1966, as yields rose on other short-term money market instruments (especially U.S. Treasury bills), the maintenance of the ceiling induced a sharp attrition in bank CD's outstanding. From the end of July to the end of November of that year, CD's at the weekly reporting banks shrank by \$2.8 billion -- from \$18.3 billion to \$15.6 billion, a decline of 15 per cent. In early 1968, when a more restrictive monetary policy was in force, the banks again lost CD's. Between the end of February and the end of June in that year, the volume outstanding declined by \$1.8 billion -- from \$21.1 billion to \$19.3 billion, a decrease of 9 per cent. But the sharpest cut-back occurred during the period of



severe monetary restraint last year. At the end of 1968, the weekly reporting banks had \$22.8 billion of CD's outstanding. By February 4, 1970, the amount had declined to \$10.3 billion, a loss of 55 per cent.

Underlying the decision of the Federal Reserve Board to allow this attrition to take place -- and, in fact, to encourage it by restrictive open market operations -- was the assumption that banks would become less willing to make new commitments to lend as they became less assured of their ability to obtain deposits to meet such commitments. The results would be a moderation in the growth of bank credit, a lessening in excess demand for real resources, and a dampening of inflationary pressures. I believe that assumption was a reasonable one, and I supported the actions based on it. I think that the perception of bank behavior which it implied was also reasonable. In retrospect, it is evident that in both 1966 and 1969 -- as the Federal Reserve System attempted to employ monetary policy to restrain the availability of credit -- the banks did not modify their lending policy appreciably until it became obvious that they would see substantial attrition in deposits. Moreover, in early 1967 and again in the second half of 1968, the banks quickly recovered their previous CD losses as monetary policy became easier -- and they also quickly expanded loans and rapidly built up a sizable backlog of commitments to lend to their business customers. With the increase in the ceilings in January of this year (to a maximum of 7-1/2 per cent) the possibility of a quick recovery of CD losses will again exist if market yields decline sharply.



In my judgment, the spreading tendency on the part of banks to accept commitments is a development which may pose a serious problem for monetary management in the future. While I have no quantitative estimate, I do have the impression that such commitments are increasingly pinned down by the payment of a fee. To the extent that this practice spreads -- and the banks are thus locked into binding agreements to lend -- the ability of the Federal Reserve to influence the rate of growth of bank loans would be reduced.

However, the limitation on maximum interest rates payable on time deposits has become part of the Federal Reserve's kit of policy tools. On several occasions in the past, I have said that -- in my judgment -- the Federal Reserve should take the first opportunity it has to lift such ceilings and to put them on a standby basis. Unfortunately, such an opportunity has not arisen -- mainly because the move would probably stimulate a new round of intense competition among banks and savings intermediaries, some of whom (particularly savings and loan associations) are not in a good position to bear the full impact of such competition. However, this reasoning applies primarily to the rate ceilings on consumer-type time deposits and to a much lesser extent to the ceilings on CD's -- which are really money market instruments in competition with Treasury bills and other short-term investment outlets. Thus, I am still personally hopeful that this possibility will not be forgotten.



Evolution of Reserve Requirements in Recent Years

In the meantime, I think it would be well to explore the possibility of reordering the way in which the traditional instruments of monetary policy are employed to influence the cost and availability of credit. In particular, I think more emphasis should be focused on reserve requirements. As a matter of fact, the Federal Reserve Board has shown considerable flexibility in the use of reserve requirements in the last few years. For the most part, this has involved tailoring changes in such requirements to differentiate the impact by size of bank -- as implied by deposit size. For example, in July, 1966, the requirement on time deposits over \$5 million was raised from 4 per cent to 5 per cent -- and kept at 4 per cent on deposits below that amount. In September of the same year, the percentage was raised further to 6 per cent on the \$5 million and over category; again no change was made for amounts below that figure. In March, 1967, in two 1/2 percentage point steps, reserve requirements were cut from 4 per cent to 3 per cent on savings deposits and on time deposits under \$5 million. The requirement was left at 6 per cent on time deposits over \$5 million. That resulting structure of reserve requirements has remained unchanged for the last three years.

In January, 1968, the Federal Reserve Board also began to differentiate reserve requirements on demand deposits. At that time, the requirement was raised from 16-1/2 per cent to 17 per cent on



deposits over \$5 million at Reserve City banks, while the requirement on amounts below this figure was left unchanged. At country banks, the corresponding increase was from 12 per cent to 12-1/2 per cent for demand deposits over \$5 million, while it remained at 12 per cent on amounts below that cutoff. In April last year, a 1/2 percentage point increase was made effective at both Reserve City and country banks and on demand deposits both above and below \$5 million.

But undoubtedly the most imaginative use of reserve requirements in recent years has been their application on Euro-dollar borrowings by American banks. In March, 1969, I suggested that such a step be considered as a means of making domestic monetary policy more efficient. Effective last October, a 10 per cent marginal reserve requirement was set on member bank liabilities to overseas branches and on assets acquired by such branches from their head offices in excess of outstandings during a base period -- the four weeks ending May 28, 1969. A 10 per cent marginal reserve requirement was also set on loans extended to U.S. residents by overseas branches of member banks in excess of outstandings during a given base period. A similar 10 per cent reserve requirement was fixed on borrowings by domestic offices of member banks from foreign banks; in this instance, however, only a 3 per cent reserve is required against such borrowings that do not exceed a specified base amount. The reserve-free bases are subject to automatic reduction -- unless waived by the Board -- when, in any period used to calculate a



reserve requirement -- outstanding amounts subject to reserve requirements fall below the original base.

In the same vein, the Federal Reserve Board published for comment a proposal to apply reserve requirements to commercial paper when offered by a bank-related corporation and when the proceeds are used to supply funds to the member bank. Last October, the Board published for comment a proposal to apply interest rate ceilings to commercial paper used in this way. Late in February, the Board announced that consideration of the issue was being put aside at that time because of a desire to avoid exerting additional restraint on money and credit markets. However, the question is still open, and the possibility of applying a reserve requirement along with -- or in lieu of -- an interest rate ceiling also remains open for the Board to decide.

Extending the Range of Reserve Requirements

It was against this background that I suggested in February that consideration might be given to applying a supplemental reserve requirement on loans extended by U.S. banks to foreign borrowers as a replacement for the present voluntary foreign credit restraint program. At the time, I emphasized that such a market-oriented approach would be superior to one based on ceilings fixed by administrative decision -- and at the same time it would offer meaningful protection to our balance of payments.



In my judgment, thought might also be given to the possibility of adopting such a requirement for domestic purposes as well. The objective of the supplemental reserve on domestic loans would be to raise the cost of bank lending by reducing the marginal rate of return to the bank making the loan -- and thereby dampen the expansion of bank loans. The basic purpose of the supplemental reserve would not be simply to levy new reserve requirements on the banking system. If it were thought that its adoption would raise the average level of reserves required beyond what the Board thought was necessary for general stabilization purposes, the regular reserve requirements applicable to deposits of member banks of the Federal Reserve System could be reduced.

In suggesting that this possibility be explored, I am convinced that the Federal Reserve needs a better means of influencing the availability of credit in different sectors of the economy. At the same time, I am keenly aware of the desirability of assuring that -- as far as possible -- the instrument used would minimize interference with normal business decisions and the economic forces of the market place. The banking community -- within whatever outer limits of credit expansion the central bank considers are consistent with stabilization policy -- can best allocate financial resources among individual borrowers. Therefore, banks should be assured as much freedom of choice as the basic objectives of maintaining a balanced economy would permit.

Since, during a period of inflation, the object would continue to be to restrain the growth of bank lending, rather than to burden the



amount of lending achieved by some date in the past, the reserves might apply only to the amount of lending above some determined volume. That is, the cash reserves would constitute marginal, rather than average, required reserves.

Solely for the sake of illustration, let us assume that such a supplemental reserve requirement had gone into effect at the end of 1968. Let us take \$220 billion as the amount of loans on the books of member banks on that date. Suppose further that a bank were required to set aside cash reserves equal to 20 per cent of the amount by which its outstanding loans exceeded the amount of such loans outstanding just before the reserve program went into force. Since loans at member banks rose by about \$20 billion last year, they would have been required to put up an additional \$4 billion -- under these assumptions. Since their required reserves averaged about \$27 billion in 1969, this would have represented an increase of roughly 15 per cent.

This formulation might be varied so that a cash reserve requirement might be applied against whatever new loans the bank might extend rather than apply a marginal reserve against the amount of loans above the amount outstanding on a particular date.

To illustrate, a bank that extended a loan during 1969 would have been required to set aside cash reserves of 20 per cent of the amount of that loan. Loans already outstanding as of the beginning of 1969 would have required no reserves nor would they have been under any quantitative



restraint. Any extension of those outstanding loans, as well as any drawdowns of then-existing lines of credit, would have been treated as new loans and would have been subject to the reserve requirement. This variant would be especially attractive in being free of any relationship represented by differing volumes of loans outstanding among individual banks at a given base date.

Under either variant of this approach, the percentage reserve requirement would be set on the basis of the Federal Reserve's determination of the degree of influence to be applied, for domestic stabilization reasons, against unchecked bank loan expansion. The restraint would be levied in proportion to the lending. The approach would not require immediate asset adjustments by each bank; instead it would leave the decision to individual banks to adapt their lending to the circumstances at the time.

The loans that would be subject to the supplemental reserve requirement could be defined in a way that would take account of whatever set of priorities that might be established from time to time. For example: if the objective of public policy were to give priority to loans to meet the needs of State and local governments, it could be given effect through a reserve ratio against such loans smaller than the ratio for other loans. Loans to acquire homes could be exempted -- if public policy calls for giving housing the highest priority -- by setting the requirement at zero. In contrast, if policy called for



substantial restraint on consumer credit or on loans to business, the reserve ratio applicable to such loans could be set quite high. In fact, any array of loan priorities could be adopted and the reserve requirement scaled accordingly -- depending on the changing needs of public policy.

Such a supplemental cash reserve requirement system sketched above would have the effect of restraining bank lending, both in total and to particular sectors of the economy. However, it would do so without any direct interference by the Federal Reserve in lending decisions by individual banks. The new reserve requirement, being a fairly small proportion of the reserves now required against deposit liabilities, would not cause a significant disturbance of domestic monetary policy. While there would be an impact on the required reserves of member banks, if the Federal Reserve wished, this could be easily offset by an appropriate reduction in reserve requirements on deposits or by open market operations.

I have stressed consideration of the supplemental reserve requirement against loans as a long-run approach. Aside from the time that would be needed to explore its ramifications, the Federal Reserve Board does not now have the authority to apply reserve requirements to domestic loans of member banks, although it does appear to have such authority with respect to their foreign loans. Moreover, to avoid adding further to the already existing inequities between nonmember and



member banks of the Federal Reserve System, all commercial banks should be made subject to the new provision. Thus, if the system were to be adopted for domestic purposes, enabling legislation would have to be passed by Congress. It might be recalled that, for several years, the Board has urged in its Annual Report that legislation be passed which would permit the establishment of a system of graduated reserve requirements, while extending the coverage to nonmember banks -- who would also be given access to the Federal Reserve Banks' discount window. If Congress ever gets around to taking up that earlier proposal, it might also consider an even further broadening of the scope of reserve requirements to include the option to impose such requirements on particular types of bank loans or investments.

Short-Run Tasks of Monetary Management

The prospective course of monetary policy over the months ahead is obviously the main topic of interest to many observers. While I recognize and understand such interest, I must refrain from trying to satisfy it. By long-standing tradition, members of the Federal Reserve Board try to avoid commenting on future policy action. The Federal Open Market Committee has clearly stated rules specifying the length of time (currently 90 days) which must elapse before the considerations underlying its policy decisions are made public. I believe that the tradition of the Board and the rules of the Open Market Committee are both well-founded. Moreover, there is also a long tradition that,



when Board members do speak on monetary matters -- and when they do so without explicit delegation from the Board -- the views expressed are those of the speaker -- and should not be attributed to his colleagues.

With that background, I do have a personal assessment of the requirements of monetary policy at the present juncture of the fight against inflation. In my opinion, the time has certainly not come to lay aside the effort to achieve and maintain a reasonable degree of price stability in this country. And we should remind ourselves that the attainment of that objective was the mission on which the Federal Reserve set out in December, 1968.

It is obvious that the effort to date -- involving both fiscal and monetary policy -- has not been wasted. The over-hang of excess demand which had plagued the economy for several years has been eliminated. In particular, the defense sector, which became a major source of inflationary pressures in mid-1965 when the Vietnam War was accelerated and taxes were not increased to pay for it, is no longer playing the same role. The nondefense component of the Federal budget also rose much more slowly in the last year; and in the current calendar year, a further slowing seems in prospect. Personal consumption expenditures (particularly for durable goods) expanded just over half as rapidly in 1969 as they did in 1968, and the slower pace seems likely to persist through the rest of this year. Last year outlays by State and local governments rose somewhat less in percentage terms than they



did in the previous year -- and here also the current year may see a still smaller rate of growth. In the housing sector, while the backlog of potential demand remains strong, actual spending has declined more or less steadily since the second quarter of last year. Moreover, no substantial pickup appears on the horizon in the months immediately ahead. The one area still showing considerable strength is business fixed investment. Last year, expenditures for this purpose rose almost twice as rapidly as they did in 1968, and recent forecasts of plant and equipment outlays suggest that another sizable gain can be expected this year -- although perhaps not as large as some of the surveys might imply.

But taken as a whole, the rapid pace of expansion in economic activity evident in 1968 and through much of 1969 has moderated substantially. Moreover, when the rise in the general price level is allowed for, real output -- as measured by the GNP -- grew very little after the first quarter of last year, and a slight decline occurred in the fourth quarter. The downtrend in industrial production since last August tells the same story. The rate of capacity utilization in manufacturing has also declined noticeably from the levels reached in the spring of 1969, and the excessive accumulation of inventories seems to have moderated. Above all, the recent rise in the unemployment rate to just over 4 per cent clearly suggests that the pressures on real resources have slackened in the last several months.



Unfortunately, the same cannot be said about the pressures on prices. The simple fact is that -- so far -- these developments in the real economy have had little impact on the rate of increase in prices, and there is no basis for concluding that the battle against inflation has been won. It is true that in March wholesale prices advanced by 1/10 of 1 per cent, according to the preliminary estimates. The advance in February was 3/10 of 1 per cent, and it was 8/10 of 1 per cent in January. While these trends might suggest that the return of stability in prices may become more evident in the months ahead, that outcome remains to be achieved. Currently, the wholesale price index is 4.3 per cent above the level in March, 1969. Measured in terms of the GNP deflator (the most broadly based of the various price indexes), the persistence of inflation is even more clear. Last year, this index rose by 4.7 per cent, compared with 4 per cent the year before. During the fourth quarter of 1969, the annual rate of increase was 4.5 per cent, and the current quarter may register a gain almost as large. In fact, by the end of this year, this comprehensive measure of the pace of inflation may still be rising at a rate well above what most Americans would find acceptable in the long-run.

In stressing that inflation is still a problem, I fully recognize that one should expect a lag between the time stabilization measures are taken and the time when their impact on the general price level can be seen. I am also aware that risks are inherent in an attempt



to exert enough restraint through stabilization policies -- and to maintain it long enough -- to bring inflation under control. I am not blind to the possibility that the cumulative effects of fiscal and monetary restraint could reduce the rate of growth of real output so much -- with its consequent impact on resource use and the level of unemployment -- that the public would find the costs unacceptable. On the other hand, I am also fully aware of how deeply imbedded inflationary expectations have become. So, given the continued strength in business investment and the strong pent-up demand for housing, I think it is extremely important that national stabilization policies be conducted in a way that will avoid providing so much stimulus that a new burst of inflation will be generated before we have succeeded in checking the inflationary pressures we still face.



Table 1. Amount and Sources of Funds Raised in
Capital Markets by Major Sectors, 1968 and 1969
(Amounts in billions of dollars)

SECTOR	1968		1969	
	Amount	Per Cent of total	Amount	Per Cent of total
Total funds raised by nonfinancial sectors	97.4	100.0	85.7	100.0
U.S. Government	13.4	13.5	-5.4	-6.3
Public debt securities	10.3	10.6	-2.8	-3.3
Budget Agency issues	3.0	2.9	-2.6	-3.0
All other nonfinancial sectors	<u>84.1</u>	<u>86.5</u>	<u>91.0</u>	<u>106.3</u>
Distribution among sectors	84.1	100.0	91.0	100.0
State and local governments	10.2	12.1	9.2	10.1
Households	31.8	37.7	30.9	34.0
Nonfinancial business	39.1	46.5	47.4	52.0
Corporate	31.0	36.8	37.2	40.9
Nonfarm noncorporate	5.2	6.2	6.6	7.3
Farm	2.9	3.5	3.5	3.8
Foreign	<u>3.0</u>	<u>3.6</u>	<u>3.6</u>	<u>3.8</u>
Sources of funds advanced	97.4	100.0	85.1	100.0
Federal Reserve System	3.7	3.8	4.2	4.9
U.S. Government	5.0	5.1	2.3	2.7
Direct	5.2	5.3	2.5	2.9
Credit agencies (net)	-0.2	-0.2	-0.2	-0.2
Commercial banks	39.0	40.0	9.5	11.2
Private nonbank finance	33.5	34.4	31.5	37.0
Private domestic nonfinancial	13.8	14.2	38.2	44.8
Foreign	2.5	2.6	-0.1	-0.1

Source: Flow of Funds Accounts
Division of Research and Statistics
Federal Reserve Board



Table 2.

Sources and Uses of Funds by
Commercial Banks, 1968 and 1969
(Amounts in billions of dollars)

SOURCE OR USE	1968		1969	
	Amount	Per cent of total	Amount	Per cent of total
Net acquisition of financial assets	43.2	100.0	11.5	100.0
Total loans and investments	39.2	90.5	9.6	83.5
Credit market instruments	38.0	85.0	10.9	94.5
U.S. Government securities	2.8	6.5	-11.5	-100.0
State and local obligations	8.7	20.2	1.2	10.4
Corporate bonds	0.3	0.7	-0.3	-2.6
Home mortgages	3.5	8.1	2.5	20.4
Other mortgages	3.2	7.3	2.5	20.4
Consumer credit	4.9	11.3	3.1	27.0
Bank loans (n.e.c.)	15.7	36.4	13.0	113.0
Open market paper	-1.1	-2.6	0.5	0.4
Security credit	1.3	3.0	-1.2	-10.4
Vault cash and member bank reserves	2.1	4.8	0.2	1.7
Miscellaneous assets	1.9	4.4	1.6	13.9
Net increase in liabilities	41.4	100.0	9.6	100.0
Demand deposits, net	9.3	22.4	7.3	76.0
Time deposits	20.6	49.8	-11.2	-116.5
Large negotiable CD's	2.5	6.0	-12.0	-125.0
Other	18.1	43.8	0.8	8.5
Federal Reserve float	1.0	2.4	-0.1	1.0
Borrowing at Federal Reserve Banks	-	-	-	-
Security Issues	0.2	0.4	0.1	1.0
Other liabilities	10.3	24.8	13.4	139.0
Discrepancy	0.9	-	1.1	-
Current Surplus	3.3	-	3.7	-

Source: Flow of Funds Accounts
Division of Research and Statistics
Federal Reserve Board





Table 3

ANNUAL CHANGES IN MAJOR BALANCE SHEET ITEMS, WEEKLY REPORTING BANKS
1968 and 1969 ^{1/}
(In billions of dollars, not seasonally adjusted)

Items	All Weekly Reporting Banks		Banks With Selected Nondeposit Sources of Funds						All Other Banks	
	1969	1968	Total		Euro-dollar Borrowing ^{8/}		Commercial Paper Only ^{9/}		1969	1968
			1969	1968	1969	1968	1969	1968		
Total loans and investments ^{2/}	1.4	19.7	- .3	13.5	.2	8.6	- .5	4.9	1.7	6.2
U.S. Treasury securities	- 5.8	1.0	- 3.1	.8	- 2.0	.7	- 1.1	.1	- 2.7	.2
Other securities	- 2.9	5.6	- 2.5	3.6	- 2.2	2.7	- .3	.9	- .4	2.0
Total loans ^{2/}	10.5	17.1	5.6	11.2	4.5	6.8	1.1	4.4	4.9	5.9
Business loans	7.5	7.5	4.9	5.6	3.9	3.8	1.0	1.8	2.6	1.9
Real estate loans	2.1	3.4	1.3	1.6	1.0	.5	.3	1.1	.8	1.8
Consumer loans	1.8	2.3	.3	1.1	.2	.3	.1	.8	1.5	1.2
Total deposits ^{3/}	-15.5	15.1	-11.7	7.2	- 8.6	2.6	- 3.1	4.6	- 3.8	8.9
Demand deposits ^{3/}	.9	5.2	.9	2.3	1.2	.7	- .3	1.6	--	2.9
Time and savings deposits	-15.5	9.9	-12.7	4.9	- 9.8	1.9	- 2.9	3.0	- 2.8	5.0
Large CD's ^{4/}	-12.3	3.2	- 9.4	1.4	- 6.9	.1	- 2.5	1.3	- 2.9	1.8
Other	- 3.2	6.7	- 3.3	3.5	- 2.9	1.8	- .4	1.7	.1	3.2
Total borrowings ^{5/}	+10.1	3.7	6.3	3.3	4.0	2.3	2.3	1.0	3.8	.4
Other liabilities	9.3	5.0	8.2	4.5	7.2	4.2	1.0	.3	1.1	.5
Euro-dollars ^{6/}	7.6	2.7	7.0	2.7	7.0	2.7	--	--	.6	--
MEMO:										
Commercial paper ^{7/}	4.3	n.a.	4.3	n.a.	2.4	n.a.	1.9	n.a.	--	--

^{1/} Changes for 1969 are from December 25, 1968, to December 24, 1969. Comparable dates were used to compute 1968 changes.

^{2/} Exclusive of loans and Federal funds transactions with domestic commercial banks and net of valuation reserves.

^{3/} Less cash items in the process of collection.

^{4/} Negotiable time certificates of deposit in denomination of \$100,000 or more.

^{5/} Largely borrowing in the Federal funds market and from Federal Reserve Banks.

^{6/} Bank liabilities to foreign branches.

^{7/} Issued by a bank holding company or other bank affiliate.

^{8/} 19 major banks that account for approximately 90 per cent of borrowing from foreign banks.

^{9/} banks that do not borrow in Eurodollar market but whose affiliates or holding company sell commercial paper.

NOTE: Figures may not sum exactly due to rounding.



Table 4

Annual Changes in Major Balance Sheet Items,
Weekly Reporting Banks
1968 and 1969
(In per cent, not seasonally adjusted)

	All Weekly		Banks With Selected Nondeposit Sources of Funds							
	Reporting Banks		Total		Euro-dollar Borrower ^{8/}		Commercial paper only ^{9/}		All Other Banks	
	1969	1968	1969	1968	1969	1968	1969	1968	1969	1968
Total loans and investments	0.6	11.5	--	11.0	.3	11.7	- 0.8	14.5	--	9.8
U.S. Treasury securities	-20.4	3.7	-19.6	5.1	-18.9	7.1	-21.3	1.0	-21.2	2.0
Other securities	- 8.4	16.8	-11.3	19.2	-14.3	21.2	- 5.2	15.6	- 4.4	13.7
Total loans	5.6	11.8	5.5	12.4	6.4	10.6	5.8	14.1	5.8	10.7
Business loans	9.7	11.4	9.4	12.0	9.9	10.6	7.8	16.4	10.6	9.8
Real estate loans	5.5	11.7	7.9	10.6	10.1	6.0	4.5	18.6	3.0	12.8
Consumer loans	8.4	14.2	3.8	14.3	5.4	8.6	2.4	20.8	12.4	14.1
Total deposits	- 7.6	7.5	- 9.4	6.1	-10.3	3.2	- 7.6	12.2	- 5.2	9.5
Demand deposits	--	5.3	1.5	3.9	3.0	1.8	- 1.3	8.3	- 2.0	7.2
Time and savings deposits	-14.7	9.6	-19.7	8.2	-22.8	4.7	-13.4	16.0	8.0	11.6
Large CD's	-53.2	16.0	-57.9	9.2	-60.1	1.3	-52.7	35.2	-42.9	34.3
Other	- 4.5	8.1	- 6.8	7.8	- 9.1	5.9	- 2.5	11.6	- 1.8	8.4
Total borrowings	-71.6	48.8	+72.0	60.6	-84.0	58.4	-59.7	66.4	54.0	21.0
Other liabilities	52.1	38.9	56.2	44.9	55.7	46.7	60.1	31.7	32.7	16.4
Eurodollars	109.4	63.0	100.0	64.0	100.0	63.0	--	--	600.0	--

^{1/} Changes for 1969 are from December 25, 1968, to December 24, 1969. Comparable dates were used to compute 1968 changes

^{2/} Exclusive of loans and Federal funds transactions with domestic commercial banks and net of valuation reserves.

^{3/} Less cash items in the process of collection.

^{4/} Negotiable time certificates of deposit in denomination of \$100,000 or more.

^{5/} Largely borrowing in the Federal funds market and from Federal Reserve Banks.

^{6/} Bank liabilities to foreign branches.

^{7/} Issued by a bank holding company or other bank affiliate.

^{8/} 19 major banks that account for approximately 90 per cent of borrowing from foreign banks.

^{9/} banks that do not borrow in Eurodollar market but whose affiliates or holding company sell commercial paper.

NOTE: Figures may not sum exactly due to rounding.



TABLE 5

ANNUAL CHANGES IN MAJOR BALANCE SHEET ITEMS, WEEKLY REPORTING BANKS

1969 and 1968^{1/}

(In billions, not seasonally adjusted)

Items	Total		20 Multi-Nat'l Banks ^{8/}		60 Major Regional Bks. ^{9/}		260 Large Local Banks	
	1969	1968	1969	1968	1969	1968	1969	1968
Total loans and investments ^{2/}	1.4	19.7	.5	11.6	- .1	5.9	1.0	2.2
U.S. Treasury securities	-5.9	1.0	-2.1	.9	-1.7	.1	-2.1	.1
Other securities	-2.9	5.6	-2.6	2.8	-.4	1.2	.1	1.6
Total loans ^{2/}	10.5	17.1	5.3	7.9	2.0	4.5	2.2	4.7
Business loans	7.5	7.5	4.4	4.2	1.6	1.6	1.1	1.6
Real estate loans	2.1	3.4	1.1	.9	.4	1.1	.6	1.4
Consumer loans	1.8	2.3	.3	.5	.4	.7	1.1	1.1
Total deposits ^{3/}	-15.5	15.1	-8.9	4.0	-4.5	4.6	-2.1	6.5
Demand deposits ^{3/}	.9	5.2	1.2	1.0	-.5	1.6	-.6	2.5
Time and savings deposits	-15.5	9.9	-10.0	3.0	-4.0	2.9	-1.5	4.0
Large CD's ^{4/}	-12.3	3.2	-7.2	.5	-3.4	1.4	-1.7	1.3
Other	-3.2	6.7	-2.9	2.5	-.6	1.5	.3	2.7
Total borrowings ^{5/}	10.1	3.7	5.0	2.2	3.0	1.3	2.0	.2
Other liabilities	9.3	5.0	7.4	4.1	1.2	.5	.7	.3
Euro-dollars ^{6/}	7.6	2.7	6.7	2.6	.6	.1	.3	--
MEMO:								
Commercial paper ^{7/}	4.3	n.a.	2.4	n.a.	1.3	n.a.	.6	n.a.

^{1/} Changes for 1969 are from December 25, 1968 to December 24, 1969. Comparable data were used to compute 1968 changes.

^{2/} Exclusive of loans and Federal funds transactions with domestic commercial banks and net of valuation reserves.

^{3/} Less cash items in the process of collection.

^{4/} Negotiable time certificates of deposit in denomination of \$100,000 or more.

^{5/} Largely borrowing in the Federal funds market and from Federal Reserve Banks.

^{6/} Bank liabilities to foreign branches.

^{7/} Issued by a bank holding company or other bank affiliate.

^{8/} These banks were selected on the basis of a number of criteria including size, volume of business loans, relative participation in Federal Funds market, Euro-dollar market and commercial paper market.

^{9/} The same criteria as those listed in footnote 8 were used to select these 60 banks. However, these banks, in general, are smaller and each region of the country was given representation.

NOTE: Figures may not sum exactly due to rounding.



Table 6

ANNUAL CHANGES IN MAJOR BALANCE SHEET ITEMS, WEEKLY REPORTING BANKS

1968 and 1969 1/

(In per cent, not seasonally adjusted)

Items	Total		20 Multi-Nat'l Banks <u>7/</u>		60 Major Regional Bks. <u>8/</u>		260 Large Local Banks	
	1969	1968	1969	1968	1969	1968	1969	1968
Total loans and investments <u>2/</u>	.6	9.5	.5	12.1	-0.2	11.9	1.3	3.8
U.S. Treasury securities	-20.4	3.7	-17.9	7.8	-24.1	1.3	-20.6	.8
Other securities	-8.4	16.8	-15.6	19.7	-4.6	14.8	-1.5	14.6
Total loans <u>2/</u>	5.6	11.8	6.7	11.2	5.2	13.4	4.1	11.5
Business loans	9.7	11.4	10.4	11.2	9.9	11.3	7.6	11.9
Real estate loans	5.5	11.7	9.0	8.3	5.4	17.1	2.0	12.2
Consumer loans	8.4	14.2	5.6	9.4	8.1	16.8	10.5	15.9
Total deposits <u>3/</u>	-7.6	7.5	-9.4	4.4	-8.2	9.2	-4.6	10.5
Demand deposits <u>3/</u>	--	5.3	2.6	2.4	-1.7	6.5	-1.9	8.3
Time and savings deposits	-14.7	9.6	-20.1	6.3	-14.7	12.1	-7.1	12.7
Large CD's <u>4/</u>	-53.2	16.0	-59.0	4.8	-53.1	27.3	-39.1	36.0
Other	-4.5	8.1						
Total borrowings <u>5/</u>	-71.6	48.8	68.0	6.8	76.0	8.1	95.0	9.7
Other liabilities	52.1	38.9	-75.1	52.5	-70.6	61.6	-59.7	16.9
Euro-dollars <u>6/</u>	109.4	63.0	98.0	45.9	600.0	--	--	--

1/ Changes for 1969 are from December 25, 1968, to December 24, 1969. Comparable dates were used to compute 1968 changes.

2/ Exclusive of loans and Federal funds transactions with domestic commercial banks and net of valuation reserves.

3/ Less cash items in the process of collection.

4/ Negotiable time certificates of deposit in denomination of \$100,000 or more.

5/ Largely borrowing in the Federal funds market and from Federal Reserve Banks.

6/ Bank liabilities to foreign branches.

7/ These banks were selected on the basis of a number of criteria including size, volume of business loans, relative participation in Federal Funds market, Euro-dollar market and commercial paper market.

8/ The same criteria as those listed in footnote 7 were used to select these 60 banks. However, these banks, in general, are smaller and each region of the country was given representation.

NOTE: Figures may not sum exactly due to rounding.



Table 7.

Selected Nondeposit Sources of Bank Funds
By Number of Banks and Amounts Outstanding
(Amounts in billions of dollars)

	Oct. 29, 1969		Jan. 7, 1970		Mar. 11, 1970		Change:		Change:	
	No. of Banks	Amount	No. of Banks	Amount	No. of Banks	Amount	Oct. 29, 1969 Mar. 11, 1970	Oct. 29, 1969 Jan. 7, 1970	Jan. 7, 1969 Mar. 11, 1970	
Commercial paper	58	3.7	62	4.4	65	5.6	2.4	.8	1.7	
Issued by subsidiaries	9	.4	10	.5	10	.15	.0	.0	.0	
Issued by other affiliates	49	3.3	52	4.0	55	5.4	2.4	.7	1.7	
Loans sold outright	143	5.7	145	6.0	151	7.8	2.3	.3	2.0	
To affiliates ^{1/}	72	4.7	73	4.7	74	6.3	1.8	0.0	1.8	
To nonbank public	71	1.1	72	1.4	77	1.5	.5	.3	.2	

^{1/} Most of the loans sold to subsidiaries and affiliates reflect acquisitions by those subsidiaries and affiliates out of the proceeds of their sales of commercial paper to the public or other methods of financing, but they also include some acquisitions by foreign branches of the bank out of the proceeds of Euro-dollar deposits.

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SPECIAL

Chairman Burns

THE BANKING STRUCTURE AND MONETARY MANAGEMENT

Remarks by

Andrew F. Brimmer
Member
Board of Governors of the
Federal Reserve System

Before the

San Francisco Bond Club

Fairmont Hotel
San Francisco, California

April 1, 1970



THE BANKING STRUCTURE AND MONETARY MANAGEMENT

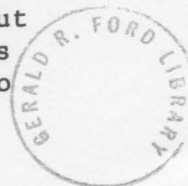
By
Andrew F. Brimmer*

The campaign against inflation has undoubtedly reached a troublesome phase, and the appropriate role for monetary policy is one of the principal questions on the minds of many observers. I agree that the task of monetary management is a difficult one under the present circumstances. But, in my personal opinion, monetary policy still has a contribution to make in our national efforts to check inflation. I will comment further on this task in the closing section of these remarks.

Before doing that, however, it might be well to review the impact of monetary restraint on the banking system and credit flows during the last year. A comprehensive analysis of that experience has convinced me that the time has come for a thorough reexamination of the main tools and techniques of monetary control in the United States. Also in these remarks, I will sketch the broad outlines of an alternative approach which appears to be quite promising. In fact, the key element on which this possible new direction is based -- a more flexible use of reserve requirements -- has been relied on increasingly by the Federal Reserve Board in recent years to accomplish objectives requiring a special focus on particular segments of the banking system.

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I am grateful to several members of the Board's staff for assistance in the preparation of these remarks. Mr. Frederick M. Struble had principal responsibility for the analysis of portfolio adjustments by banks, given their differential access to sources of funds. Mr. Peter J. Feddor designed and carried out the difficult computer programming tasks on which the analysis depended so heavily. Miss Harriett Harper, my assistant, also helped with the statistical analysis.



The reasoning behind these conclusions is set forth in some detail in the sections which follow. However, it might be helpful to summarize here the main points of the analysis:

- In 1969, despite the severity of monetary restraint, the volume of funds raised in the capital markets by borrowers other than the Federal Government rose moderately compared with the previous year. However, the distribution among sectors changed somewhat. The share obtained by both households and State and local governments declined slightly, while the business sector (particularly corporations) got a larger share.
- The Federal Reserve System, on balance, provided a slightly larger volume of credit (in both absolute and relative terms) last year than it did in 1968.
- Commercial banks supplied a drastically reduced proportion of the credit advanced in 1969 compared with the previous year (just over one-tenth vs. two-fifths in 1968). The banks experienced an actual loss of deposits last year in contrast to a sizable gain the year before. Their net acquisition of financial assets fell by over three-quarters from the 1968 level.
- Nevertheless, through heavy sales of securities and reliance on nondeposit sources of funds, the banks were able to expand funds available for loans. In particular, business loans on the books of commercial banks rose almost as much as they did in 1968. When the volume of loans sold by the banks is added to the total, the increase in business loans last year was even greater than that registered the year before.
- The pattern of portfolio adjustment differed markedly among banks, depending on their access to nondeposit sources of funds. Banks with ready access to Euro-dollar inflows or with the



ability to sell commercial paper were much more successful in cushioning the impact of monetary restraint than were other banks which did not tap these sources of funds. Again, the greater were the availability of nondeposit sources of funds to the banks -- the greater also was the rate of expansion of business loans.

- The differential response of commercial banks to monetary restraint in 1969 becomes even more sharply focused when the banks are re-grouped and viewed in the context of the strategic roles they play with respect to different types of financial transactions. For this purpose three groups can be identified: (1) a handful of multi-national banks active in the domestic money market on a national scale and also heavily involved in international finance; (2) a sizable number of institutions which play a dominant role in their regions, and (3) other banks which concentrate mainly on their local markets. Among these three groups of banks, the first was the most successful in expanding its total loans and the second group was next in line. This was especially true of business loans at the first group where the rate of increase exceeded the average -- while the rate of expansion in their consumer loans was below the average -- for all banks covered in the analysis. Sales of business loans were proportionately the heaviest at the multi-national banks, and adjusting for such sales raises significantly the rate at which they supplied credit to their corporate customers.

When I reflect on the results of the analysis summarized above, I find it far from comforting. As emphasized many times, one objective -- although certainly not the only one -- of monetary restraint in 1969 was a sizable moderation in the expansion of business loans. Such a moderation in turn was sought as a means of dampening



excess demand and inflationary pressures in the economy. In retrospect, it is obvious that the Federal Reserve was not completely successful in its effort as far as business loans are concerned.

I am fully aware of the views of some observers who argue that a central bank should not concern itself with the composition of bank credit, but only with its rate of growth -- and better still only with the rate of growth of the money supply (however defined). Yet, in my own view, a central bank should not be indifferent to the changing composition of bank credit; to adopt such a posture would mean that drastic variations in the availability of credit in important sectors could occur -- and persist -- with seriously adverse consequences for the economy as a whole. In my opinion, we need a better way to assure that the overall objectives of monetary policy can be achieved without having a few sectors bear a disproportionate share of the burden of adjustment, while other sectors escape or significantly moderate its impact.

I will return to this point below. In the meantime, we can turn to the body of the analysis.

Credit Flows in 1969

The volume of credit raised in the capital markets in 1969 was obviously restrained severely by the restrictive monetary policy followed by the Federal Reserve System as part of the campaign to check inflation. Nevertheless, after allowing for the market activities of the Federal



Government, there was a modest increase in the amount of funds raised. According to the preliminary flow of funds statistics compiled by the Federal Reserve Board, the net volume of funds raised by all nonfinancial sectors in 1969 amounted to about \$85.7 billion, a decrease of \$11.7 billion (or 12 per cent) compared with the level in the previous year. (See Table 1 attached.) However, this decline in the total was more than accounted for by the change in the position of the Federal Government. In calendar year 1969, the latter made net repayments of \$5.4 billion -- compared with net borrowings of \$13.4 billion the year before. Thus, the year-to-year change was a decrease of \$18.9 billion. Well over two-thirds of the swing centered in direct public debt securities, and the rest in Government agency issues.

Allowing for the experience of the Federal Government, total funds raised by other nonfinancial sectors in 1969 amounted to \$91.0 billion. This represented an expansion of \$6.9 billion (or 8 per cent) over the level raised in 1969. However, the share of the total funds received by the principal groups of borrowers changed noticeably.

State and local governments raised \$9.2 billion (\$1.0 billion or 11 per cent less than in 1968), and their share of the total also declined slightly (from 12.1 per cent to 10.1 per cent). In contrast, net funds raised by these State and local units rose by \$2.2 billion (or by 28 per cent) in 1968. Moreover, the decline of \$1.0 billion in net funds raised by State and local governments last year represented over four-fifths of the decline of \$1.3 billion in net debt financing



in the long-term capital markets. In fact, obligations of these units were the only issues among the three principal types of capital market instruments to register a significant decline in 1969. While a number of factors contributed to this reduced borrowing by State and local governments, the lessened interest of commercial banks in tax-exempt issues was undoubtedly of considerable importance. As shown in Table 2, commercial banks expanded their holdings of such obligations by only \$1.2 billion in 1969, compared with an increase of \$8.7 billion in the previous year. Such issues represented about 10 per cent of the net acquisition of financial assets by banks in 1969 -- only half the proportion recorded in 1968. Moreover, last year the change in the banks' holdings represented only 14 per cent of the net funds raised by these governments in contrast to 90 per cent of the total in the preceding year.

The consumer sector raised about \$31 billion in the capital market in 1969, or roughly \$1.0 billion less than in 1968. This was a decline of just under 3 per cent. Since this occurred while the total volume of funds raised was expanding moderately, the household sector's share of the total also declined somewhat -- from just under two-fifths to just over one-third. This sector, on balance, also borrowed less at commercial banks. This can be seen in net change in the volume of home mortgages held and the amount of consumer credit extended by the latter. In 1969, their household mortgages rose by \$2.5 billion, compared with \$3.5 billion the previous year. The corresponding changes in consumer



credit were \$3.1 billion and \$4.9 billion. So the growth in these forms of bank credit eased off by one-third (from \$8.4 billion to \$5.6 billion).

The principal sector which expanded its share of total funds raised both in the overall capital market and at commercial banks was nonfinancial business. In the capital markets (as shown in Table 1), this sector raised \$47.4 billion in 1969, compared with \$39.1 billion the year before. This was an increase of \$8.3 billion, or more than one-fifth. Whereas businesses accounted for 47 per cent of the total funds raised in 1968, their share rose to 52 per cent last year. Industrial and commercial corporations were mainly responsible for the rise. In 1969, they raised \$37.2 billion, or \$6.2 billion more than in the year before. Consequently, their share of the total climbed from 37 per cent to 41 per cent. Business firms also accounted for a sizable share of the expansion in commercial bank credit. As shown in Table 2, while the net acquisition of financial assets by the banks amounted to \$9.6 billion in 1969, bank loans (other than mortgages, consumer credit and credit extended to purchase or hold securities) rose by \$13 billion. Loans in this category consist mainly of funds supplied to businesses. Consequently, commercial bank loans to the business sector expanded by more in 1969 than did total credit at these institutions. In 1969, loans to business had accounted for just under two-fifths of the total.



Sources of Funds and Bank Behavior

Experiencing substantial deposit declines in the face of strong demands for loans in 1969, banks attempted to maintain -- or expand -- their earning assets in two principal ways: by tapping nondeposit sources of funds or by selling a large volume of existing financial assets -- loans as well as securities -- or some combination of both. While they also made increasingly serious attempts to ration credit, they devoted their energies primarily to a search for ways to meet their customers' demands.

These various methods of adjusting to credit restraint are clearly apparent in data reflecting developments at large banks in the United States. About 340 of these banks report weekly to the Federal Reserve System, showing their assets and liabilities in some detail. Although they constituted only 2-1/2 per cent of the 13,464 insured commercial banks as of June 30, 1969, they control a substantial proportion of the total banking resources. They hold about three-fifths of the total assets, total loans and investments, and demand deposits. They hold three-quarters of total business loans, about half of consumer and real estate loans, and about the same proportion of total time and savings deposits. However, they hold nearly 90 per cent of the large denomination certificates of deposit (CD's), and they account for virtually all of the Euro-dollar borrowings and commercial paper sold by banks via their affiliates. While most of these weekly reporting banks are members of the Federal Reserve System, some insured nonmembers are also included. All of the 340 have total deposits of \$100 million or more.



Thus, a study of the behavior of these institutions under conditions of monetary restraint provides valuable insights into the behavior of the banking system as a whole. The broad changes in bank credit at the weekly reporting group and at all commercial banks were quite similar in 1969, as shown in the following figures (annual percentage rates of change):

	<u>All Commercial Banks</u>	<u>Weekly Reporting Banks</u>
Total loans and investments	2.4	0.6
U.S. Government securities	-15.9	-20.4
Other securities	-1.1	-8.4
Total loans	7.7	5.6
Business loans	9.4	9.7
Time and Savings deposits	-5.3	-14.7

The noticeable differences among the two sets of growth rates are these: the weekly reporting banks expanded their earning assets somewhat more moderately, they experienced a much heavier attrition in time deposits (especially CD's), and they liquidated securities at a much faster rate. While total loans at the weekly reporting banks rose less rapidly, their business loans increased somewhat more rapidly than at all banks in the country.

As indicated in Tables 3 and 4, total deposits declined sharply at the weekly reporting banks in 1969. A substantial decline in CD's,



combined with a more moderate drop in other time and savings deposits, considerably offset a slight rise in demand deposits. The decline in these deposit liabilities was more than counterbalanced, however, by expansion in other forms of liabilities. Total borrowings (principally in the federal funds market and at Federal Reserve Banks) and other liabilities (largely Euro-dollar borrowings from foreign branches) both advanced sharply.

Although the funds obtained from these alternative liability sources were large enough to finance a modest expansion in total earnings assets, they were clearly not sufficient to enable the weekly reporting banks to meet the demands of their loan customers. To gain additional funds, large blocks of security holdings were liquidated. In addition, a large volume of loans was sold, primarily to bank holding companies and affiliates. (These latter transactions are reflected in the large volume of commercial paper sales which supplied the funds to finance the purchase of these loans.)

The expansion in loans maintained on bank books, made possible by sale of securities and tapping of alternative liability sources of funds, was quite substantial -- and again it should be remembered that this gain is net of the loans sold from bank portfolios. Yet, some evidence of loan rationing is reflected in the data. The growth in total loans, even with loans sales accounted for, fell somewhat short of the expansion which occurred in 1968, when these banks were well supplied with funds. The change in volume alone, of course, does



not permit one to distinguish between a change in supply and a change in demand for credit, but it seems a reasonable assumption that loan demands were at least as strong in 1969 as in 1968.

Most of the loan rationing which occurred appears to have been focused on nonbusiness borrowers. Business loans on the books of weekly reporting banks, on the other hand, increased by as much in 1969 as they did in 1968. Moreover, since business loans comprise the major proportion of loans sold, total business credit extended through weekly reporting banks in 1969 was significantly higher than in 1968. How much difference these loan sales disguise the growth of bank credit extended to business firms is indicated in one of the following sections of these remarks.

Behavior of Euro-Dollar Banks

As may be seen in Table 3, the 19 weekly reporting banks that are major borrowers in the Euro-dollar market experienced a large deposit drain. However, they were more than able to compensate for this loss by drawing funds from alternative liability sources. Similar adjustments can be seen in the case of all other weekly reporting banks. However, the Euro-dollar banks relied much more heavily on the Euro-dollar market, while the other banks mainly utilized domestic sources of funds.

Whether the Euro-dollar banks were able (by using alternative liability sources) to make a more substantial compensation for their deposit drains than were other weekly reporting banks is difficult to



discern from an examination of the absolute change figures in Table 3. To overcome this difficulty, the changes in the banks' balance sheet can be converted to percentage terms. The figures are presented in Table 4. These data show that the deposit decline at Euro-dollar banks was nearly twice as large in relative terms as at the other weekly reporting banks. However, despite this sharp difference in deposit experience, growth in total earning assets at Euro-dollar banks was relatively quite similar to that at the other weekly reporters. This was due, of course, to the strong advance which the Euro-dollar banks were able to achieve in nondeposit sources of funds. (The percentage changes in these nondeposit figures are not particularly revealing because the outstanding levels for some of these items were quite small compared with their change.)

What is perhaps of even greater interest is the relative growth in total loans at these two groups of banks. As may be seen, the Euro-dollar banks recorded somewhat larger gains in both total loans and in business loans than did the other weekly reporting banks. The differences were quite small, however, so that perhaps the best generalization is that both groups of banks made about the same kind of adjustments to the problem of meeting strong loan demands during a period of heavy deposit drain. In this regard, it is worth restating that, although the percentage increases for 1969 indicated in the table for each groups of banks fell well below those recorded in 1968, these data do not reflect the considerable volume of loan sales made in 1969.



Behavior of Commercial Paper Issuing Banks

As is generally known, a number of banks resorted to the sale of commercial paper, mainly through one-bank holding companies but also to some extent through affiliates, to raise funds in an effort to compensate for the loss in deposits. Some of the banks active in the Euro-dollar market have also issued commercial paper. As indicated in Table 3, at the end of last year, \$4.3 billion of commercial paper was outstanding at weekly reporting banks. Of this amount, \$2.4 billion (or 56 per cent) had been issued by Euro-dollar banks. The remainder (\$1.9 billion) had been sold by banks which do not rely on Euro-dollar inflows to supplement their deposits.*

It is evident that the banks which relied only on commercial paper did not register a growth in their earning assets as did either the Euro-dollar banks or the banks which did not resort to non-deposit sources at all. While the differences among the groups were small, those banks relying on commercial paper had expanded their assets more rapidly in 1968. Last year, these banks had a percentage decline in time deposits about as large as that for all weekly reporting banks (although smaller than that recorded at Euro-dollar banks), and their sales of U.S. Government securities were proportionately almost as large as for the other banks. While Euro-dollar banks increased their indebtedness to their foreign branches by \$7.0 billion last year, those

*Trends in bank sales of commercial paper through mid-March, 1970, are shown in Table 7.



banks relying on commercial paper increased the volume of the latter by only \$1.9 billion. Yet, the two groups came out not very far apart when their sales of securities and the expansion in non-deposit sources are set against the attrition in total deposits.

The Banking Structure and the Differential Impact of Monetary Restraint

To obtain a different -- and more informative -- perspective on banking developments in 1969, another grouping of weekly reporting banks was made. On the basis of a considerable number of criteria, 20 banks were identified and labeled "Multi-National Banks." The criteria used included size, volume of business loans, importance in the Federal Funds market in particular and the money market in general, the volume of foreign lending and participation in the Euro-dollar market. Using similar criteria but stressing domestic activities and relative importance in one area of the country, an additional 60 banks were designated as "Major Regional Banks." The remaining 260 banks were designated "Large Local Banks." The changes in balance sheet items at these groups of banks in 1968 and 1969 are presented in Table 5 and 6. As one would expect, this information presents a roughly similar picture to that provided by the other groupings of banks. Yet, the experience is put into much sharper focus. The Multi-National Bank group, which is heavily comprised of large Euro-dollar banks, was subject to the largest percentage decline in deposits.



The decline at Major Regional Banks nearly matched that recorded at the Multi-National Banks, while a much smaller deposit reduction occurred at the Local Bank group. But despite this disparity in deposit flow, the percentage advances in total earning assets at these groups of banks were essentially similar. This suggests that the imbalances in deposit flows were offset by an opposite imbalance in the growth of nondeposit sources of funds.

The noticeable differences are evident with respect to earning assets. Total loans and business loans expanded more sharply at the Multi-National Banks than at the other two groups of banks. This is particularly true when compared with the Local Banks. So that there is some suggestion that the Multi-National Banks were more successful in avoiding the restraints of a tight monetary policy. This conclusion is further supported by the fact that loan sales which were heaviest at the Multi-National Banks were not included in the computation. The expansion of real estate loans, which include a sizable proportion of non-residential property along with home mortgages, was also considerably larger at the Multi-National Banks than at either of the other two groups. On the other hand, both of the latter expanded their consumer loans more rapidly than did the Multi-National Banks.

Finally, at the end of 1969, the Multi-National Banks had a somewhat larger share of total loans, of business loans and of real estate loans -- and a slightly smaller share of consumer loans -- than



they had at the end of 1968. The Regional Banks made a modest gain in their relative share of business loans, about held their place in the case of real estate loans, and experienced a slight decline in the proportion of both total loans and loans to consumers. The Local Banks' share of all of these asset categories declined moderately.

The general conclusion which emerges from this analysis can be expressed succinctly: The largest banks with both national and international customers -- and which mobilize funds in both the domestic and international capital markets -- are able to avoid a substantial proportion of the impact of monetary restraint. In doing so, they can maintain -- or even expand -- their earning assets. The large regional banks can succeed almost as well in following a similar course. The larger local banks, although also much larger than the average bank in the country, can do so to a much lesser extent.

Loans Sales and the Growth of Business Loans

As indicated at several places in this discussion, the expansion of business loans at commercial banks during 1969 was considerably obscured by sales of loans to obtain funds to meet new demands. Trends in such loan sales are shown in Table 7. At the end of last October, 143 banks were involved in such loan sales, and the amount sold outright totaled \$5.7 billion. More than four-fifths of this total represented sales to the banks' affiliates and subsidiaries and the rest to the nonbank public. Most of the loans sold to bank subsidiaries and affiliates reflect acquisitions by the latter for which



payment was made from the proceeds of their sales of commercial paper to the public. However, some of the loans were sold by banks to their foreign branches, with the latter paying for the transfer out of the proceeds of Euro-dollar deposits. As of March 11, 1970, the volume of loans sold had climbed to \$7.8 billion; the distribution between affiliates and the nonbank public was about the same as it was at the end of October.

As mentioned earlier, the loans sold by the commercial banks consist mainly of loans to business borrowers. If these sales are added to the volume of business loans outstanding on the books of the banks, the rate of growth in business loans in 1969 is raised substantially, as shown in the following statistics (1968 data need no adjustment):

<u>Classification of Banks</u>	<u>1968</u>	<u>Annual Percentage Rate of Change in Business Loans After Adjustment for Loan Sales</u>		
		<u>Before</u>	<u>After</u>	<u>Difference</u>
		<u>Adjustment</u>	<u>Adjustment</u>	
All Weekly Reporting Banks	11.4	9.7	13.7	4.0
Euro-dollar Banks	10.6	9.9	15.4	5.5
Commercial Paper Issuers	16.4	7.8	10.2	2.4
All Other Banks	9.8	10.6	12.6	2.0
Multi-National Banks	11.2	10.4	16.0	5.6
Major Regional Banks	11.3	9.9	12.3	2.4
Large Local Banks	11.9	7.6	8.0	0.4

Clearly the loan sales have been heaviest at the largest banks, and the understatement of the rate of growth of business loans, shown in the published statistics, has also been greatest at these institutions. When the loans sold are folded back into the figures, it appears that the rate of expansion of business loans at the weekly



reporting banks was more than two-fifths higher than originally shown. At the Euro-dollar banks, the expansion was more than 50 per cent higher. Among those issuing commercial paper only, it was about one-third larger, and at other banks it was one-fifth higher. When the banks are classified according to the strategic roles they play with respect to different types of financial transactions, the same pattern emerges -- but with sharper focus. The growth rate is raised by more than one-half at the Multi-National Banks; by one-quarter at the Regional Banks, and by only 5 per cent at the Local institutions.

But what is even more striking, except for commercial paper issuers and the local banks, the growth rate for business loans in 1969 -- once the sales are accounted for -- was considerably higher than that recorded in 1968. The unadjusted figures, except for one group of banks, would have suggested a noticeably lessened pace of expansion in business loans in 1969 compared with 1968.

Thus, the ability of some of the strongest commercial banks to sell part of their existing portfolios to obtain funds to meet new demands for funds is another way open to them to escape -- or at least lighten -- the impact of monetary restraint.

Long-Run Task of Monetary Management

As I reflect on the differential impact of monetary policy as mirrored in the behavior of different segments of the banking structure, I become more and more convinced that the Federal Reserve



System should give serious consideration to revamping its instruments of monetary control. I personally see no need to cast aside any of the traditional tools -- i.e., the discount rate, open market operations, and reserve requirements. These have been used -- and can continue to be used -- to influence the cost and availability of credit.

But, in my opinion, neither of these instruments has been the cutting edge of monetary policy during the last few years. This has been provided by the ceilings set by the Federal Reserve Board under Regulation Q, limiting the rates of interest which member banks can pay on time deposits. This has been particularly true of the ceilings on negotiable certificates of deposit of \$100,000 and above -- frequently referred to as CD's. From early December, 1965, until mid-April, 1968, the maximum rate payable was set at 5-1/2 per cent. In 1966, as yields rose on other short-term money market instruments (especially U.S. Treasury bills), the maintenance of the ceiling induced a sharp attrition in bank CD's outstanding. From the end of July to the end of November of that year, CD's at the weekly reporting banks shrank by \$2.8 billion -- from \$18.3 billion to \$15.6 billion, a decline of 15 per cent. In early 1968, when a more restrictive monetary policy was in force, the banks again lost CD's. Between the end of February and the end of June in that year, the volume outstanding declined by \$1.8 billion -- from \$21.1 billion to \$19.3 billion, a decrease of 9 per cent. But the sharpest cut-back occurred during the period of



severe monetary restraint last year. At the end of 1968, the weekly reporting banks had \$22.8 billion of CD's outstanding. By February 4, 1970, the amount had declined to \$10.3 billion, a loss of 55 per cent.

Underlying the decision of the Federal Reserve Board to allow this attrition to take place -- and, in fact, to encourage it by restrictive open market operations -- was the assumption that banks would become less willing to make new commitments to lend as they became less assured of their ability to obtain deposits to meet such commitments. The results would be a moderation in the growth of bank credit, a lessening in excess demand for real resources, and a dampening of inflationary pressures. I believe that assumption was a reasonable one, and I supported the actions based on it. I think that the perception of bank behavior which it implied was also reasonable. In retrospect, it is evident that in both 1966 and 1969 -- as the Federal Reserve System attempted to employ monetary policy to restrain the availability of credit -- the banks did not modify their lending policy appreciably until it became obvious that they would see substantial attrition in deposits. Moreover, in early 1967 and again in the second half of 1968, the banks quickly recovered their previous CD losses as monetary policy became easier -- and they also quickly expanded loans and rapidly built up a sizable backlog of commitments to lend to their business customers. With the increase in the ceilings in January of this year (to a maximum of 7-1/2 per cent) the possibility of a quick recovery of CD losses will again exist if market yields decline sharply.



In my judgment, the spreading tendency on the part of banks to accept commitments is a development which may pose a serious problem for monetary management in the future. While I have no quantitative estimate, I do have the impression that such commitments are increasingly pinned down by the payment of a fee. To the extent that this practice spreads -- and the banks are thus locked into binding agreements to lend -- the ability of the Federal Reserve to influence the rate of growth of bank loans would be reduced.

However, the limitation on maximum interest rates payable on time deposits has become part of the Federal Reserve's kit of policy tools. On several occasions in the past, I have said that -- in my judgment -- the Federal Reserve should take the first opportunity it has to lift such ceilings and to put them on a standby basis. Unfortunately, such an opportunity has not arisen -- mainly because the move would probably stimulate a new round of intense competition among banks and savings intermediaries, some of whom (particularly savings and loan associations) are not in a good position to bear the full impact of such competition. However, this reasoning applies primarily to the rate ceilings on consumer-type time deposits and to a much lesser extent to the ceilings on CD's -- which are really money market instruments in competition with Treasury bills and other short-term investment outlets. Thus, I am still personally hopeful that this possibility will not be forgotten.



Evolution of Reserve Requirements in Recent Years

In the meantime, I think it would be well to explore the possibility of reordering the way in which the traditional instruments of monetary policy are employed to influence the cost and availability of credit. In particular, I think more emphasis should be focused on reserve requirements. As a matter of fact, the Federal Reserve Board has shown considerable flexibility in the use of reserve requirements in the last few years. For the most part, this has involved tailoring changes in such requirements to differentiate the impact by size of bank -- as implied by deposit size. For example, in July, 1966, the requirement on time deposits over \$5 million was raised from 4 per cent to 5 per cent -- and kept at 4 per cent on deposits below that amount. In September of the same year, the percentage was raised further to 6 per cent on the \$5 million and over category; again no change was made for amounts below that figure. In March, 1967, in two 1/2 percentage point steps, reserve requirements were cut from 4 per cent to 3 per cent on savings deposits and on time deposits under \$5 million. The requirement was left at 6 per cent on time deposits over \$5 million. That resulting structure of reserve requirements has remained unchanged for the last three years.

In January, 1968, the Federal Reserve Board also began to differentiate reserve requirements on demand deposits. At that time, the requirement was raised from 16-1/2 per cent to 17 per cent on



deposits over \$5 million at Reserve City banks, while the requirement on amounts below this figure was left unchanged. At country banks, the corresponding increase was from 12 per cent to 12-1/2 per cent for demand deposits over \$5 million, while it remained at 12 per cent on amounts below that cutoff. In April last year, a 1/2 percentage point increase was made effective at both Reserve City and country banks and on demand deposits both above and below \$5 million.

But undoubtedly the most imaginative use of reserve requirements in recent years has been their application on Euro-dollar borrowings by American banks. In March, 1969, I suggested that such a step be considered as a means of making domestic monetary policy more efficient. Effective last October, a 10 per cent marginal reserve requirement was set on member bank liabilities to overseas branches and on assets acquired by such branches from their head offices in excess of outstandings during a base period -- the four weeks ending May 28, 1969. A 10 per cent marginal reserve requirement was also set on loans extended to U.S. residents by overseas branches of member banks in excess of outstandings during a given base period. A similar 10 per cent reserve requirement was fixed on borrowings by domestic offices of member banks from foreign banks; in this instance, however, only a 3 per cent reserve is required against such borrowings that do not exceed a specified base amount. The reserve-free bases are subject to automatic reduction -- unless waived by the Board -- when, in any period used to calculate a



reserve requirement -- outstanding amounts subject to reserve requirements fall below the original base.

In the same vein, the Federal Reserve Board published for comment a proposal to apply reserve requirements to commercial paper when offered by a bank-related corporation and when the proceeds are used to supply funds to the member bank. Last October, the Board published for comment a proposal to apply interest rate ceilings to commercial paper used in this way. Late in February, the Board announced that consideration of the issue was being put aside at that time because of a desire to avoid exerting additional restraint on money and credit markets. However, the question is still open, and the possibility of applying a reserve requirement along with -- or in lieu of -- an interest rate ceiling also remains open for the Board to decide.

Extending the Range of Reserve Requirements

It was against this background that I suggested in February that consideration might be given to applying a supplemental reserve requirement on loans extended by U.S. banks to foreign borrowers as a replacement for the present voluntary foreign credit restraint program. At the time, I emphasized that such a market-oriented approach would be superior to one based on ceilings fixed by administrative decision -- and at the same time it would offer meaningful protection to our balance of payments.



In my judgment, thought might also be given to the possibility of adopting such a requirement for domestic purposes as well. The objective of the supplemental reserve on domestic loans would be to raise the cost of bank lending by reducing the marginal rate of return to the bank making the loan -- and thereby dampen the expansion of bank loans. The basic purpose of the supplemental reserve would not be simply to levy new reserve requirements on the banking system. If it were thought that its adoption would raise the average level of reserves required beyond what the Board thought was necessary for general stabilization purposes, the regular reserve requirements applicable to deposits of member banks of the Federal Reserve System could be reduced.

In suggesting that this possibility be explored, I am convinced that the Federal Reserve needs a better means of influencing the availability of credit in different sectors of the economy. At the same time, I am keenly aware of the desirability of assuring that -- as far as possible -- the instrument used would minimize interference with normal business decisions and the economic forces of the market place. The banking community -- within whatever outer limits of credit expansion the central bank considers are consistent with stabilization policy -- can best allocate financial resources among individual borrowers. Therefore, banks should be assured as much freedom of choice as the basic objectives of maintaining a balanced economy would permit.

Since, during a period of inflation, the object would continue to be to restrain the growth of bank lending, rather than to burden the



amount of lending achieved by some date in the past, the reserves might apply only to the amount of lending above some determined volume. That is, the cash reserves would constitute marginal, rather than average, required reserves.

Solely for the sake of illustration, let us assume that such a supplemental reserve requirement had gone into effect at the end of 1968. Let us take \$220 billion as the amount of loans on the books of member banks on that date. Suppose further that a bank were required to set aside cash reserves equal to 20 per cent of the amount by which its outstanding loans exceeded the amount of such loans outstanding just before the reserve program went into force. Since loans at member banks rose by about \$20 billion last year, they would have been required to put up an additional \$4 billion -- under these assumptions. Since their required reserves averaged about \$27 billion in 1969, this would have represented an increase of roughly 15 per cent.

This formulation might be varied so that a cash reserve requirement might be applied against whatever new loans the bank might extend rather than apply a marginal reserve against the amount of loans above the amount outstanding on a particular date.

To illustrate, a bank that extended a loan during 1969 would have been required to set aside cash reserves of 20 per cent of the amount of that loan. Loans already outstanding as of the beginning of 1969 would have required no reserves nor would they have been under any quantitative



restraint. Any extension of those outstanding loans, as well as any drawdowns of then-existing lines of credit, would have been treated as new loans and would have been subject to the reserve requirement. This variant would be especially attractive in being free of any relationship represented by differing volumes of loans outstanding among individual banks at a given base date.

Under either variant of this approach, the percentage reserve requirement would be set on the basis of the Federal Reserve's determination of the degree of influence to be applied, for domestic stabilization reasons, against unchecked bank loan expansion. The restraint would be levied in proportion to the lending. The approach would not require immediate asset adjustments by each bank; instead it would leave the decision to individual banks to adapt their lending to the circumstances at the time.

The loans that would be subject to the supplemental reserve requirement could be defined in a way that would take account of whatever set of priorities that might be established from time to time. For example: if the objective of public policy were to give priority to loans to meet the needs of State and local governments, it could be given effect through a reserve ratio against such loans smaller than the ratio for other loans. Loans to acquire homes could be exempted -- if public policy calls for giving housing the highest priority -- by setting the requirement at zero. In contrast, if policy called for



substantial restraint on consumer credit or on loans to business, the reserve ratio applicable to such loans could be set quite high. In fact, any array of loan priorities could be adopted and the reserve requirement scaled accordingly -- depending on the changing needs of public policy.

Such a supplemental cash reserve requirement system sketched above would have the effect of restraining bank lending, both in total and to particular sectors of the economy. However, it would do so without any direct interference by the Federal Reserve in lending decisions by individual banks. The new reserve requirement, being a fairly small proportion of the reserves now required against deposit liabilities, would not cause a significant disturbance of domestic monetary policy. While there would be an impact on the required reserves of member banks, if the Federal Reserve wished, this could be easily offset by an appropriate reduction in reserve requirements on deposits or by open market operations.

I have stressed consideration of the supplemental reserve requirement against loans as a long-run approach. Aside from the time that would be needed to explore its ramifications, the Federal Reserve Board does not now have the authority to apply reserve requirements to domestic loans of member banks, although it does appear to have such authority with respect to their foreign loans. Moreover, to avoid adding further to the already existing inequities between nonmember and



member banks of the Federal Reserve System, all commercial banks should be made subject to the new provision. Thus, if the system were to be adopted for domestic purposes, enabling legislation would have to be passed by Congress. It might be recalled that, for several years, the Board has urged in its Annual Report that legislation be passed which would permit the establishment of a system of graduated reserve requirements, while extending the coverage to nonmember banks -- who would also be given access to the Federal Reserve Banks' discount window. If Congress ever gets around to taking up that earlier proposal, it might also consider an even further broadening of the scope of reserve requirements to include the option to impose such requirements on particular types of bank loans or investments.

Short-Run Tasks of Monetary Management

The prospective course of monetary policy over the months ahead is obviously the main topic of interest to many observers. While I recognize and understand such interest, I must refrain from trying to satisfy it. By long-standing tradition, members of the Federal Reserve Board try to avoid commenting on future policy action. The Federal Open Market Committee has clearly stated rules specifying the length of time (currently 90 days) which must elapse before the considerations underlying its policy decisions are made public. I believe that the tradition of the Board and the rules of the Open Market Committee are both well-founded. Moreover, there is also a long tradition that,



when Board members do speak on monetary matters -- and when they do so without explicit delegation from the Board -- the views expressed are those of the speaker -- and should not be attributed to his colleagues.

With that background, I do have a personal assessment of the requirements of monetary policy at the present juncture of the fight against inflation. In my opinion, the time has certainly not come to lay aside the effort to achieve and maintain a reasonable degree of price stability in this country. And we should remind ourselves that the attainment of that objective was the mission on which the Federal Reserve set out in December, 1968.

It is obvious that the effort to date -- involving both fiscal and monetary policy -- has not been wasted. The over-hang of excess demand which had plagued the economy for several years has been eliminated. In particular, the defense sector, which became a major source of inflationary pressures in mid-1965 when the Vietnam War was accelerated and taxes were not increased to pay for it, is no longer playing the same role. The nondefense component of the Federal budget also rose much more slowly in the last year; and in the current calendar year, a further slowing seems in prospect. Personal consumption expenditures (particularly for durable goods) expanded just over half as rapidly in 1969 as they did in 1968, and the slower pace seems likely to persist through the rest of this year. Last year outlays by State and local governments rose somewhat less in percentage terms than they



did in the previous year -- and here also the current year may see a still smaller rate of growth. In the housing sector, while the backlog of potential demand remains strong, actual spending has declined more or less steadily since the second quarter of last year. Moreover, no substantial pickup appears on the horizon in the months immediately ahead. The one area still showing considerable strength is business fixed investment. Last year, expenditures for this purpose rose almost twice as rapidly as they did in 1968, and recent forecasts of plant and equipment outlays suggest that another sizable gain can be expected this year -- although perhaps not as large as some of the surveys might imply.

But taken as a whole, the rapid pace of expansion in economic activity evident in 1968 and through much of 1969 has moderated substantially. Moreover, when the rise in the general price level is allowed for, real output -- as measured by the GNP -- grew very little after the first quarter of last year, and a slight decline occurred in the fourth quarter. The downtrend in industrial production since last August tells the same story. The rate of capacity utilization in manufacturing has also declined noticeably from the levels reached in the spring of 1969, and the excessive accumulation of inventories seems to have moderated. Above all, the recent rise in the unemployment rate to just over 4 per cent clearly suggests that the pressures on real resources have slackened in the last several months.



Unfortunately, the same cannot be said about the pressures on prices. The simple fact is that -- so far -- these developments in the real economy have had little impact on the rate of increase in prices, and there is no basis for concluding that the battle against inflation has been won. It is true that in March wholesale prices advanced by 1/10 of 1 per cent, according to the preliminary estimates. The advance in February was 3/10 of 1 per cent, and it was 8/10 of 1 per cent in January. While these trends might suggest that the return of stability in prices may become more evident in the months ahead, that outcome remains to be achieved. Currently, the wholesale price index is 4.3 per cent above the level in March, 1969. Measured in terms of the GNP deflator (the most broadly based of the various price indexes), the persistence of inflation is even more clear. Last year, this index rose by 4.7 per cent, compared with 4 per cent the year before. During the fourth quarter of 1969, the annual rate of increase was 4.5 per cent, and the current quarter may register a gain almost as large. In fact, by the end of this year, this comprehensive measure of the pace of inflation may still be rising at a rate well above what most Americans would find acceptable in the long-run.

In stressing that inflation is still a problem, I fully recognize that one should expect a lag between the time stabilization measures are taken and the time when their impact on the general price level can be seen. I am also aware that risks are inherent in an attempt



to exert enough restraint through stabilization policies -- and to maintain it long enough -- to bring inflation under control. I am not blind to the possibility that the cumulative effects of fiscal and monetary restraint could reduce the rate of growth of real output so much -- with its consequent impact on resource use and the level of unemployment -- that the public would find the costs unacceptable. On the other hand, I am also fully aware of how deeply imbedded inflationary expectations have become. So, given the continued strength in business investment and the strong pent-up demand for housing, I think it is extremely important that national stabilization policies be conducted in a way that will avoid providing so much stimulus that a new burst of inflation will be generated before we have succeeded in checking the inflationary pressures we still face.



Table 1. Amount and Sources of Funds Raised in
Capital Markets by Major Sectors, 1968 and 1969
(Amounts in billions of dollars)

SECTOR	1968		1969	
	Amount	Per Cent of total	Amount	Per Cent of total
Total funds raised by nonfinancial sectors	97.4	100.0	85.7	100.0
U.S. Government	13.4	13.5	-5.4	-6.3
Public debt securities	10.3	10.6	-2.8	-3.3
Budget Agency issues	3.0	2.9	-2.6	-3.0
All other nonfinancial sectors	<u>84.1</u>	<u>86.5</u>	<u>91.0</u>	<u>106.3</u>
Distribution among sectors	84.1	100.0	91.0	100.0
State and local governments	10.2	12.1	9.2	10.1
Households	31.8	37.7	30.9	34.0
Nonfinancial business	39.1	46.5	47.4	52.0
Corporate	31.0	36.8	37.2	40.9
Nonfarm noncorporate	5.2	6.2	6.6	7.3
Farm	2.9	3.5	3.5	3.8
Foreign	<u>3.0</u>	<u>3.6</u>	<u>3.6</u>	<u>3.8</u>
Sources of funds advanced	97.4	100.0	85.1	100.0
Federal Reserve System	3.7	3.8	4.2	4.9
U.S. Government	5.0	5.1	2.3	2.7
Direct	5.2	5.3	2.5	2.9
Credit agencies (net)	-0.2	-0.2	-0.2	-0.2
Commercial banks	39.0	40.0	9.5	11.2
Private nonbank finance	33.5	34.4	31.5	37.0
Private domestic nonfinancial	13.8	14.2	38.2	44.8
Foreign	2.5	2.6	-0.1	-0.1

Source: Flow of Funds Accounts
Division of Research and Statistics
Federal Reserve Board



Table 2.

Sources and Uses of Funds by
Commercial Banks, 1968 and 1969
(Amounts in billions of dollars)


SOURCE OR USE	1968		1969	
	Amount	Per cent of total	Amount	Per cent of total
Net acquisition of financial assets	43.2	100.0	11.5	100.0
Total loans and investments	39.2	90.5	9.6	83.5
Credit market instruments	38.0	85.0	10.9	94.5
U.S. Government securities	2.8	6.5	-11.5	-100.0
State and local obligations	8.7	20.2	1.2	10.4
Corporate bonds	0.3	0.7	-0.3	-2.6
Home mortgages	3.5	8.1	2.5	20.4
Other mortgages	3.2	7.3	2.5	20.4
Consumer credit	4.9	11.3	3.1	27.0
Bank loans (n.e.c.)	15.7	36.4	13.0	113.0
Open market paper	-1.1	-2.6	0.5	0.4
Security credit	1.3	3.0	-1.2	-10.4
Vault cash and member bank reserves	2.1	4.8	0.2	1.7
Miscellaneous assets	<u>1.9</u>	<u>4.4</u>	<u>1.6</u>	<u>13.9</u>
Net increase in liabilities	41.4	100.0	9.6	100.0
Demand deposits, net	9.3	22.4	7.3	76.0
Time deposits	20.6	49.8	-11.2	-116.5
Large negotiable CD's	2.5	6.0	-12.0	-125.0
Other	18.1	43.8	0.8	8.5
Federal Reserve float	1.0	2.4	-0.1	1.0
Borrowing at Federal Reserve Banks	-	-	-	-
Security Issues	0.2	0.4	0.1	1.0
Other liabilities	<u>10.3</u>	<u>24.8</u>	<u>13.4</u>	<u>139.0</u>
Discrepancy	<u>0.9</u>	<u>-</u>	<u>1.1</u>	<u>-</u>
Current Surplus	3.3	-	3.7	-

Source: Flow of Funds Accounts
Division of Research and Statistics
Federal Reserve Board



Table 3

ANNUAL CHANGES IN MAJOR BALANCE SHEET ITEMS, WEEKLY REPORTING BANKS
1968 and 1969 ^{1/}
(In billions of dollars, not seasonally adjusted)



Items	All Weekly Reporting Banks		Banks With Selected Nondeposit Sources of Funds							
	1969	1968	Total		Euro-dollar Borrowing ^{8/}		Commercial Paper Only ^{9/}		All Other Banks	
			1969	1968	1969	1968	1969	1968	1969	1968
Total loans and investments ^{2/}	1.4	19.7	- .3	13.5	.2	8.6	- .5	4.9	1.7	6.2
U.S. Treasury securities	- 5.8	1.0	- 3.1	.8	- 2.0	.7	- 1.1	.1	- 2.7	.2
Other securities	- 2.9	5.6	- 2.5	3.6	- 2.2	2.7	- .3	.9	- .4	2.0
Total loans ^{2/}	10.5	17.1	5.6	11.2	4.5	6.8	1.1	4.4	4.9	5.9
Business loans	7.5	7.5	4.9	5.6	3.9	3.8	1.0	1.8	2.6	1.9
Real estate loans	2.1	3.4	1.3	1.6	1.0	.5	.3	1.1	.8	1.8
Consumer loans	1.8	2.3	.3	1.1	.2	.3	.1	.8	1.5	1.2
Total deposits ^{3/}	-15.5	15.1	-11.7	7.2	- 8.6	2.6	- 3.1	4.6	- 3.8	8.9
Demand deposits ^{3/}	.9	5.2	.9	2.3	1.2	.7	- .3	1.6	--	2.9
Time and savings deposits	-15.5	9.9	-12.7	4.9	- 9.8	1.9	- 2.9	3.0	- 2.8	5.0
Large CD's ^{4/}	-12.3	3.2	- 9.4	1.4	- 6.9	.1	- 2.5	1.3	- 2.9	1.8
Other	- 3.2	6.7	- 3.3	3.5	- 2.9	1.8	- .4	1.7	.1	3.2
Total borrowings ^{5/}	+10.1	3.7	6.3	3.3	4.0	2.3	2.3	1.0	3.8	.4
Other liabilities	9.3	5.0	8.2	4.5	7.2	4.2	1.0	.3	1.1	.5
Euro-dollars ^{6/}	7.6	2.7	7.0	2.7	7.0	2.7	--	--	.6	--
MEMO:										
Commercial paper ^{7/}	4.3	n.a.	4.3	n.a.	2.4	n.a.	1.9	n.a.	--	--

^{1/} Changes for 1969 are from December 25, 1968, to December 24, 1969. Comparable dates were used to compute 1968 changes.

^{2/} Exclusive of loans and Federal funds transactions with domestic commercial banks and net of valuation reserves.

^{3/} Less cash items in the process of collection.

^{4/} Negotiable time certificates of deposit in denomination of \$100,000 or more.

^{5/} Largely borrowing in the Federal funds market and from Federal Reserve Banks.

^{6/} Bank liabilities to foreign branches.

^{7/} Issued by a bank holding company or other bank affiliate.

^{8/} 19 major banks that account for approximately 90 per cent of borrowing from foreign banks.

^{9/} banks that do not borrow in Eurodollar market but whose affiliates or holding company sell commercial paper.

NOTE: Figures may not sum exactly due to rounding.

Table 4

Annual Changes in Major Balance Sheet Items,
Weekly Reporting Banks
1968 and 1969
(In per cent, not seasonally adjusted)

	All Weekly		Banks With Selected Nondeposit Sources of Funds							
	Reporting Banks		Total		Euro-dollar Borrower ^{8/}		Commercial paper only ^{9/}		All Other Bank	
	1969	1968	1969	1968	1969	1968	1969	1968	1969	1968
Total loans and investments	0.6	11.5	--	11.0	.3	11.7	- 0.8	14.5	--	9.8
U.S. Treasury securities	-20.4	3.7	-19.6	5.1	-18.9	7.1	-21.3	1.0	-21.2	2.0
Other securities	- 8.4	16.8	-11.3	19.2	-14.3	21.2	- 5.2	15.6	- 4.4	13.7
Total loans	5.6	11.8	5.5	12.4	6.4	10.6	5.8	14.1	5.8	10.7
Business loans	9.7	11.4	9.4	12.0	9.9	10.6	7.8	16.4	10.6	9.8
Real estate loans	5.5	11.7	7.9	10.6	10.1	6.0	4.5	18.6	3.0	12.8
Consumer loans	8.4	14.2	3.8	14.3	5.4	8.6	2.4	20.8	12.4	14.1
Total deposits	- 7.6	7.5	- 9.4	6.1	-10.3	3.2	- 7.6	12.2	- 5.2	9.5
Demand deposits	--	5.3	1.5	3.9	3.0	1.8	- 1.3	8.3	- 2.0	7.2
Time and savings deposits	-14.7	9.6	-19.7	8.2	-22.8	4.7	-13.4	16.0	8.0	11.6
Large CD's	-53.2	16.0	-57.9	9.2	-60.1	1.3	-52.7	35.2	-42.9	34.3
Other	- 4.5	8.1	- 6.8	7.8	- 9.1	5.9	- 2.5	11.6	- 1.8	8.4
Total borrowings	-71.6	48.8	+72.0	60.6	-84.0	58.4	-59.7	66.4	54.0	21.0
Other liabilities	52.1	38.9	56.2	44.9	55.7	46.7	60.1	31.7	32.7	16.4
Eurodollars	109.4	63.0	100.0	64.0	100.0	63.0	--	--	600.0	--

^{1/} Changes for 1969 are from December 25, 1968, to December 24, 1969. Comparable dates were used to compute 1968 changes

^{2/} Exclusive of loans and Federal funds transactions with domestic commercial banks and net of valuation reserves.

^{3/} Less cash items in the process of collection.

^{4/} Negotiable time certificates of deposit in denomination of \$100,000 or more.

^{5/} Largely borrowing in the Federal funds market and from Federal Reserve Banks.

^{6/} Bank liabilities to foreign branches.

^{7/} Issued by a bank holding company or other bank affiliate.

^{8/} 19 major banks that account for approximately 90 per cent of borrowing from foreign banks.

^{9/} banks that do not borrow in Eurodollar market but whose affiliates or holding company sell commercial paper.

NOTE: Figures may not sum exactly due to rounding.

TABLE 5

ANNUAL CHANGES IN MAJOR BALANCE SHEET ITEMS, WEEKLY REPORTING BANKS

1969 and 1968^{1/}

(In billions, not seasonally adjusted)

Items	Total		20 Multi-Nat'l Banks ^{8/}		60 Major Regional Bks. ^{9/}		260 Large Local Banks	
	1969	1968	1969	1968	1969	1968	1969	1968
Total loans and investments ^{2/}	1.4	19.7	.5	11.6	-.1	5.9	1.0	2.2
U.S. Treasury securities	-5.9	1.0	-2.1	.9	-1.7	.1	-2.1	.1
Other securities	-2.9	5.6	-2.6	2.8	-.4	1.2	.1	1.6
Total loans ^{2/}	10.5	17.1	5.3	7.9	2.0	4.5	2.2	4.7
Business loans	7.5	7.5	4.4	4.2	1.6	1.6	1.1	1.6
Real estate loans	2.1	3.4	1.1	.9	.4	1.1	.6	1.4
Consumer loans	1.8	2.3	.3	.5	.4	.7	1.1	1.1
Total deposits ^{3/}	-15.5	15.1	-8.9	4.0	-4.5	4.6	-2.1	6.5
Demand deposits ^{3/}	.9	5.2	1.2	1.0	-.5	1.6	-.6	2.5
Time and savings deposits	-15.5	9.9	-10.0	3.0	-4.0	2.9	-1.5	4.0
Large CD's ^{4/}	-12.3	3.2	-7.2	.5	-3.4	1.4	-1.7	1.3
Other	-3.2	6.7	-2.9	2.5	-.6	1.5	.3	2.7
Total borrowings ^{5/}	10.1	3.7	5.0	2.2	3.0	1.3	2.0	.2
Other liabilities	9.3	5.0	7.4	4.1	1.2	.5	.7	.3
Euro-dollars ^{6/}	7.6	2.7	6.7	2.6	.6	.1	.3	--
MEMO:								
Commercial paper ^{7/}	4.3	n.a.	2.4	n.a.	1.3	n.a.	.6	n.a.

^{1/} Changes for 1969 are from December 25, 1968 to December 24, 1969. Comparable data were used to compute 1968 changes.

^{2/} Exclusive of loans and Federal funds transactions with domestic commercial banks and net of valuation reserves.

^{3/} Less cash items in the process of collection.

^{4/} Negotiable time certificates of deposit in denomination of \$100,000 or more.

^{5/} Largely borrowing in the Federal funds market and from Federal Reserve Banks.

^{6/} Bank liabilities to foreign branches.

^{7/} Issued by a bank holding company or other bank affiliate.

^{8/} These banks were selected on the basis of a number of criteria including size, volume of business loans, relative participation in Federal Funds market, Euro-dollar market and commercial paper market.

^{9/} The same criteria as those listed in footnote 8 were used to select these 60 banks. However, these banks, in general, are smaller and each region of the country was given representation.

NOTE: Figures may not sum exactly due to rounding.





Table 6

ANNUAL CHANGES IN MAJOR BALANCE SHEET ITEMS, WEEKLY REPORTING BANKS

1968 and 1969 ^{1/}

(In per cent, not seasonally adjusted)

Items	Total		20 Multi-Nat'l Banks ^{7/}		60 Major Regional Bks. ^{8/}		260 Large Local Banks	
	1969	1968	1969	1968	1969	1968	1969	1968
Total loans and investments ^{2/}	.6	9.5	.5	12.1	-0.2	11.9	1.3	3.8
U.S. Treasury securities	-20.4	3.7	-17.9	7.8	-24.1	1.3	-20.6	.8
Other securities	-8.4	16.8	-15.6	19.7	-4.6	14.8	-1.5	14.6
Total loans ^{2/}	5.6	11.8	6.7	11.2	5.2	13.4	4.1	11.5
Business loans	9.7	11.4	10.4	11.2	9.9	11.3	7.6	11.9
Real estate loans	5.5	11.7	9.0	8.3	5.4	17.1	2.0	12.2
Consumer loans	8.4	14.2	5.6	9.4	8.1	16.8	10.5	15.9
Total deposits ^{3/}	-7.6	7.5	-9.4	4.4	-8.2	9.2	-4.6	10.5
Demand deposits ^{3/}	--	5.3	2.6	2.4	-1.7	6.5	-1.9	8.3
Time and savings deposits	-14.7	9.6	-20.1	6.3	-14.7	12.1	-7.1	12.7
Large CD's ^{4/}	-53.2	16.0	-59.0	4.8	-53.1	27.3	-39.1	36.0
Other	-4.5	8.1						
Total borrowings ^{5/}	-71.6	48.8	68.0	6.8	76.0	8.1	95.0	9.7
Other liabilities	52.1	38.9	-75.1	52.5	-70.6	61.6	-59.7	16.9
Euro-dollars ^{6/}	109.4	63.0	98.0	45.9	600.0	--	--	--

^{1/} Changes for 1969 are from December 25, 1968, to December 24, 1969. Comparable dates were used to compute 1968 changes.

^{2/} Exclusive of loans and Federal funds transactions with domestic commercial banks and net of valuation reserves.

^{3/} Less cash items in the process of collection.

^{4/} Negotiable time certificates of deposit in denomination of \$100,000 or more.

^{5/} Largely borrowing in the Federal funds market and from Federal Reserve Banks.

^{6/} Bank liabilities to foreign branches.

^{7/} These banks were selected on the basis of a number of criteria including size, volume of business loans, relative participation in Federal Funds market, Euro-dollar market and commercial paper market.

^{8/} The same criteria as those listed in footnote 7 were used to select these 60 banks. However, these banks, in general, are smaller and each region of the country was given representation.

NOTE: Figures may not sum exactly due to rounding.



Table 7.

Selected Nondeposit Sources of Bank Funds
By Number of Banks and Amounts Outstanding
(Amounts in billions of dollars)

	Oct. 29, 1969		Jan. 7, 1970		Mar. 11, 1970		Change:		Change:	
	No. of Banks	Amount	No. of Banks	Amount	No. of Banks	Amount	Oct. 29, 1969 Mar. 11, 1970	Oct. 29, 1969 Jan. 7, 1970	Jan. 7, 1969 Mar. 11, 1970	
Commercial paper	58	3.7	62	4.4	65	5.6	2.4	.8	1.7	
Issued by subsidiaries	9	.4	10	.5	10	.15	.0	.0	.0	
Issued by other affiliates	49	3.3	52	4.0	55	5.4	2.4	.7	1.7	
Loans sold outright	143	5.7	145	6.0	151	7.8	2.3	.3	2.0	
To affiliates ^{1/}	72	4.7	73	4.7	74	6.3	1.8	0.0	1.8	
To nonbank public	71	1.1	72	1.4	77	1.5	.5	.3	.2	

^{1/} Most of the loans sold to subsidiaries and affiliates reflect acquisitions by those subsidiaries and affiliates out of the proceeds of their sales of commercial paper to the public or other methods of financing, but they also include some acquisitions by foreign branches of the bank out of the proceeds of Euro-dollar deposits.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date April 6, 1970.

To Chairman Burns.

Subject: Market Effects of Governor

From Chas. Molony. *cm*

Brimmer's San Francisco speech.

Press accounts give only mild support to the statement in our Government Securities Market Report for Thursday, April 2, that "The weaker tone (in Treasury note and bond prices) was attributed in part to Governor Brimmer's remarks yesterday (before the San Francisco Bond Club)."

The observation in our internal market report was, of course, based upon statements made by dealers in Government securities to the New York Federal Reserve Bank's trading desk in conversations April 2 and reported by the trading desk to our staff here during the daily call on Government bond market developments.

Two factors may have influenced the mildness of press references to the market impact of the Brimmer speech: 1. The market for corporate and tax-exempt bonds, and the stock market as well, moved UP a little, and the press gave more stress to that than the fact that, as our market report put it, "Treasury note and bond prices drifted lower in very quiet trading." 2. At the same time that Governor Brimmer was saying in San Francisco that "there is no basis for concluding that the battle against inflation has been won," Herbert Stein was predicting in a New York speech a "significant reduction" in inflation this year.

The New York Times' bond and stock market stories paired the Brimmer and Stein speeches, and the bond market story said outright: "The two talks seemed to offset each other (as market influences)."

In addition, the New York Times' April 2 story (by Ed Dale) on the Brimmer speech itself gave prime attention to the proposal for differential reserve requirements on loans in order to influence allocation of credit. The Brimmer comment relating to current monetary policy was not mentioned until the 8th paragraph, and then it was set out in this fashion: "On the immediate issue of monetary policy Mr. Brimmer gave no predictions. But he said, 'There is no basis for concluding that the battle against inflation has been won.'"

The Wall Street Journal's bond market story April 2 was much more pointed, when it got around to mentioning the Brimmer speech in paragraph 14. This story said:



"Apprehensions about inflation were fanned yesterday by a Federal Reserve Board member's statements that 'the policy of economic restraint so far has had little impact on the rate' of price increases, traders said. In addition, Andrew Brimmer, a Reserve Board Governor, suggested new credit-tightening moves might be imposed to better control bank-lending power.

"Mr. Brimmer's remarks had only a limited impact yesterday on bond prices, with some traders waiting for amplification before adjusting quotes. Corporate bond price levels generally remained firm, while Government issues slipped a token 1/8 to 1/16 lower, in response to Mr. Brimmer's comments." (underlining supplied)

Neither the speech comments nor the bond market movements on April 2 were memorable enough to be mentioned in the week-end reviews of the market over the preceding five days. Nor was either mentioned in the only (Goldsmith-Nagan) bond letter received today.

The pertinent New York Times and Wall Street Journal accounts are attached, with relevant parts marked for convenience should you wish further detail.

Attachments.



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By TMJ NARA, Date 4/18/22

~~CONFIDENTIAL (FR)~~

Board of Governors

Government Securities Market

Paul L. Kelty *PK*

Thursday, April 2, 1970

Highlights

Treasury bond market weaker. . . Bill yields slightly higher, with 3-month issue up 1 basis point to 6.35 per cent. . . Stock prices narrowly mixed. . . Federal funds trade mostly at around 8 per cent. . . System makes \$434 million of repurchase agreements.

Market Report

Treasury note and bond prices drifted lower today in very quiet trading activity. The weaker tone was attributed in part to Governor Brimmer's remarks yesterday. Very little demand was noted. At the close of trading, intermediate term issues were mostly 2 to 10/32 lower, while long-term bonds were 2/32 higher to 4/32 lower.

Activity was also very quiet in the Treasury bill market. Yields tended to back up, however, with dealers expressing concern over their very large financing needs today. Most issues closed 1 to 4 basis points higher in rate. The 6-month bill rose 2 basis points to 6.40 per cent bid, while the 1-year issue advanced 1 basis point to 6.31 per cent.

The corporate bond market was quiet and firm, while municipals were quiet and mostly unchanged. Today's \$40 million A-rated Columbia Gas financing, yielding 8.75 per cent with 5-year call protection, is around 80 per cent sold. The \$30 million Aa-rated Kentucky Utilities Co. bonds, yielding 8.60 per cent with 5-year call protection, are only around 35 per cent sold. Stock prices closed narrowly mixed. The Dow-Jones industrial average gained .33, while the Standard and Poor index lost .28 on a volume of 10.5 million shares.

Federal funds traded mainly in a 7-1/2 to 8-1/4 per cent range, with an 8 per cent effective rate anticipated. Nonbank dealers had new financing needs of nearly \$2.3 billion, partly reflecting the payment date for weekly bill awards as well as maturing Rp's with the System. They found some out-of-town money at around 8-1/4 to 8-1/2 per cent, while the major New York banks made loans to dealers in an 8-1/2 to 9 per cent range. None of the large New York banks borrowed from the System.

Desk Action

The Account Management made \$434 million of repurchase agreements for one day, comprising \$374 million against Governments and \$60 million against acceptances.

Lending of Securities:The System lent dealers \$17 million of Treasury securities, mostly for five days, including \$13.2 million of notes and bonds. Repayments totaled \$16 million, leaving a balance of \$36 million.

BIG BOARD STOCKS UP WITH VOLUME

New York Times

APR 2 1970

Dow Adds 6.47 to Close at
792.04 as Turnover
Rises to 9.81 Million

COPPER SHARES IN GAINS

Memorex Jumps by 6½ and
Telex Surges 9⅛—789
Issues Climb, 535 Off

By JOHN J. ABELE

The stock market picked up some speed and strength yesterday with prices at the close of trading near the highest levels of the day.

Copper stocks were a feature as shares of leading producers responded to news of an increase of 4 cents a pound in the price of the metal by the Phelps Dodge Corporation, the nation's second largest copper producer.

Some of the more volatile glamour issues also stood out in the advance. Actively traded Telex soared 9⅛, to 139⅞, while Memorex climbed 6½, to 126¾. Both stocks were weak on Tuesday following some adverse comment on their accounting practices.

The Dow-Jones industrial average, a popular barometer of blue-chip activity, finished

Price advances led declines by a comfortable margin throughout the session. At the close, there were 789 winners and 535 losers, slightly below the widest margin of the day.

Interest Is Reflected

Volume also rose, reaching 9.81 million shares, against 8.37 shares. The increase may have reflected renewed interest by some institutional interests following the close of the first quarter.

The economic background remained essentially the same but an encouraging note was sounded by Herbert Stein, a member of the President's Council of Economic Advisers, in a speech here. Mr. Stein said there was "a good probability that the rate of inflation will be significantly reduced" this year "without a large prolonged loss of total output."

While Mr. Stein was downgrading the prospects of a recession, however, Andrew F. Brimmer, a member of the Federal Reserve Board, was in San Francisco, where he warned that economic restraint had not had much impact on inflation so far and that anti-inflation measures would have to continue in effect.

The stock market's renewed buoyancy was reflected in the list of the 15 most-active issues. Nine of these closed with gains, including six that added a point or more; five active stocks declined by fractions and one finished unchanged.

Burlington Northern Off

Burlington Northern, formed recently by the merger of the Great Northern and Northern Pacific railroads, topped the active list with trades of 212,000 shares, most of which crossed the tape shortly before the close on a block of 191,700 shares at 39. The stock closed at 39¾, down ⅞.

Phelps Dodge was the volume leader among the resurgent copper issues with trades of 147,000 shares, compared with 5,000 shares on Tuesday. The stock closed at 55¾, up 1¾, after trading as high as 56½.

Trading activity in Phelps Dodge included a block of 98,000 shares at 55.

No other major copper producers had joined the move to increased prices by the time the market closed but traders clearly were hopeful that they would follow suit.

Kennecott, the 10th most-active stock, added 2⅛, to 52⅞, after trading as high as 53¾. Inspiration Copper jumped 5 points, to 68; Copper Range added 6 points, to 82½; American Smelting rose 1⅛, to 36, and Anaconda was up ⅞, at 30.

Stocks of aluminum companies, which compete with copper-makers in many markets, also shared in the flurry. Reynolds Metals added 1½, to 35¾, and Alcoa rose ½, to 71⅛. But Kaiser Aluminum, which had forecast increased aluminum prices, ended unchanged at 36½.

Increase in Blocks

Increased institutional activity was reflected in an increase in big-block trades to 54 from 44 on Tuesday. Among the larger blocks were 99,000 shares of Hart, Schaffner & Marx, which closed at 26, down ⅞; 84,500 shares of Quaker Oats, off ⅞, to 43¾; 80,000 shares of General Tire, down ⅞, to 19½, and 59,000 shares of Capital Cities Broadcasting up ⅞, to 35¼.

Benguet, which is planning a reorganization of activities in the Philippines and the Bahamas, scored the largest percentage gain. It rose a point, to 9¾, on trades of 95,300 shares.

Pollution control stocks came back into favor. Actively traded Diversified Industries rose 1¼, to 23¼; American Air Filter added 2 at 54, and Buffalo Forge was up 1¾, to 45½. Chromalloy rebounded from recent weakness, adding 1¼ at 25¾.

Market Summary

Wednesday, April 1, 1970	
N.Y. Times Railroads	109.89 +0.79
N.Y. Times Industrials	806.33 +5.32
N.Y. Times Combined	458.11 +3.06
N.Y.S.E. Composite	50.10 +0.23
Standard & Poor's Comp.	90.07 +0.44
Dow-Jones Industrials	792.04 +6.47

NEW YORK STOCK EXCHANGE		Wednesday		Tuesday	
(Volume 9,810,000 shares)					
Total Issues	1,593	1,590	789	619	
Advances	789	619	535	674	
Declines	535	674	269	297	
Unchanged	269	297	94	57	
New Highs	94	57	28	35	
New Lows	28	35			

ODD-LOT TRANSACTIONS		
Tuesday, March 31, 1970		
Purchases	Short Sales	Total Sales
317,694	4,010	372,345

at its highest level of the day with a gain of 6.47 points at 792.04.

The New York Times combined average rose 3.06 points, to 458.11, and the exchange's composite index rose 0.23 point, to 50.10.

Some of the strong points in the blue-chip list included du Pont, up 1½, to 98½; Procter & Gamble, up 1½, to 110½; Eastman Kodak, up 1¾, to 78¾, and United States Steel, up a point, to 38¾.



CREDIT MARKETS SHOW PRICE RISES

Lower Yields on Corporate
and Tax-Exempt Offerings
Broaden Week's Trend

By JOHN H. ALLAN

The credit markets moved nearly unanimously yesterday toward higher prices and lower interest rates, broadening a trend that had concentrated largely in corporate bonds earlier in the week.

In the most significant test of the tax-exempt bond market this week, Tennessee sold \$53-million of high-grade bonds, and the winning underwriters priced them to yield 1-10th of a point less than similar bonds marketed last week. Despite their lower yield, the bonds sold quickly and, by late afternoon, less than \$10-million were still unsold, according to the Morgan Guaranty Trust Company, the leading underwriter.

In the corporate bond market the Central Illinois Public Service Company sold \$25-million of high-quality bonds to a syndi-

New Bond Issues

STRAIGHT DEBT							
		Orig.	Asked	Price	Quote	Chng.	Yld.
Intl Paper	8.85s95	100.103	103			*	8.55
Crwn Zell	8 7/8s00	100.25	102 1/4			+ 1/4	8.67
Penn P&E	9s2000	101.041	102 1/2			+ 3/4	8.75
P S Ind	8 1/4s74	100.841	100 7/8				7.99
P S E&T	9 1/8s00	101.29	103			+ 1/4	8.83
T V A	9 1/2s95	101	103			+ 1/4	8.80
Alcan	9 1/2s95	101.25	103				9.18
Ches Pot	8 3/4s10	101.116	101 1/4			+ 1/2	8.66
Duc Lt	8 3/4s00	99.75	100 3/4			+ 1/4	8.69
Allegh Lud	9 1/2s95	100.50	102 1/4			+ 1/4	8.76
Chrysler	8 3/4s75	100	100 3/4			+ 1/4	8.57
Chrysler	8 7/8s77	100	98 3/4			+ 1/8	8.99
Pac G&E	8 3/4s02	100.816	100 1/4			+ 1/4	8.61
Nort Nat	8 3/4s90	100	99 1/2				8.79
Ashland	8.80s00	100	102 1/4			+ 1/2	8.60
Marathon	8 1/2s00	99.75	100 1/2			+ 1/4	8.46
St Il Oh	8 1/2s00	99.75	101 1/4				8.38
CONVERTIBLES							
		Quote	Chng.				
Mall'kdt	5 3/4s95	105 1/2-106 1/2					
Univ Comp	7 1/4s95	102 - 102 3/4	- 1/4				
Graph Sci	7s1985	96 - 98	+ 1				
Baxter	4 3/4s90	100 1/4-101 1/4					
Kirsch	6s1995	106 - 107	+ 1/2				
Hyatt	6s1995	99 1/4-100 1/4	+ 1/4				

cate managed by Kuhn, Loeb & Co. and the underwriters priced these securities to yield 8.63 per cent.

27 Basis Points Less

These bonds were priced to yield 27 basis points (hundredths of a percentage point) less than the 8.90 per cent yield on the similarly rated Pennsylvania Power and Light Company bonds marketed March 23 in the preceding financing involving Aa-rated

securities. The Pennsylvania Power bonds were quoted at a price to yield 8.75 per cent yesterday, and most investment bankers planned to offer the Central Illinois bonds at a yield not lower than 8.70 per cent.

Despite all these differences, the new utility issue sold faster than most investment bankers had suspected. By late afternoon, it was in the neighborhood of 50 per cent sold, according to Kuhn Loeb.

The \$150-million issue of Atlantic Richfield Company debentures, priced by a Smith, Barney & Co., Inc., group Tuesday to yield 8.625 per cent, sold out completely yesterday and rose to a premium in price. Originally offered at 100 per cent of their face value, the bonds were quoted in the late afternoon at 100 3/8 bid, 101 asked.

Yield of 9.53 Per cent

The \$50-million of Transcontinental Gas Pipe Line Corporation bonds, offered at a yield of 9.53 per cent, also sold swiftly. White, Weld & Co. and the Stone & Webster Securities Corporation headed the investment banking syndicate.

All these bonds attracted investors and prices for already

outstanding securities moved up as much as 3/4-point on no particular news that could be expected to affect the credit markets in a significant way. Herbert Stein, a member of President Nixon's Council of Economic Advisers, predicted a "significant reduction" in inflation this year, but Andrew Brimmer, a member of the Federal Reserve Board, told the San Francisco Bond Club that "there is no basis for concluding that the battle against inflation has been won." The two talks seemed to offset each other.

As one investment banker explained it, the bond market's stronger performance recently has been caused chiefly by "the general feeling that we're going to wade through all this volume and it won't be as bad as we once thought." During March and April, a record-setting \$5-billion of corporate bonds are scheduled for sale.

Furthermore, he said, the reduction on March 25 in the prime rate by major banks will exert a "positive" influence on the credit markets for some time to come. The move was basic enough and important enough to have a more lasting impact on interest rates, he asserted.

In the tax-exempt bond market, Tennessee awarded its \$53-million of Aa-rated bonds to the Morgan Guaranty group after it made a bid resulting in a net interest cost of 5.50 per cent. The underwriters then priced the bonds to yield from 3.90 per cent on those maturing later this year up to 6.10 per cent on those coming due in 1989.



NEW TOOL URGED IN MONEY POLICY

Federal Reserve's Brimmer
Wants Credit Channeled
to High-Priority Areas

CITES HOUSING PLIGHT

Says His Plan Would Avoid
Interference in Individual
Banks' Loan Decisions

By EDWIN L. DALE Jr.

WASHINGTON, April 1—A member of the Federal Reserve Board proposed today a sweeping change in the way the nation conducts its monetary policy.

Andrew F. Brimmer, the board member, said that the Federal Reserve policy of severe restraint on credit and money last year had almost completely failed in its aim of dampening the flow of loans to business while housing and state and local government borrowing were hurt.

Calling the 1969 results "far from comforting," he proposed that the Federal Reserve be empowered to impose higher or lower reserve requirements on banks according to different categories of loans. It would be the first time that reserve requirements were applied to banks' loans—their assets—as distinct from their deposits, and it would require an act of Congress.

Priority Pattern

Mr. Brimmer said unequivocally that he conceived of his idea as enabling the Federal Reserve to influence lending in the direction "of whatever set of priorities might be established from time to time"—something the central bank has traditionally resisted.

Mr. Brimmer made his proposal in a speech to the San Francisco Bond club. The text was made available here.

An alternative device for "channeling" credit to borrowers the Government wants to favor is a system of direct controls. Congress voted authority for such controls late last year, but both the Federal Reserve and the President have resisted their use. Mr. Brimmer by implication took the same view today.

He emphasized that his plan could "to re-direct the flow of credit without any direct interference by the Federal Reserve in lending decisions of individual banks." The new system would, in effect, make some loans less profitable to banks than others, but they could make any loans they chose.

On the immediate issue of monetary policy Mr. Brimmer gave no predictions. But he said, "There is no basis for concluding that the battle against inflation has been won."

He added, "Given the continued strength in business investment and the strong pent-up demand for housing, I think it is extremely important that national stabilization policies be conducted in a way that will avoid providing so much

stimulus that a new burst of inflation will be generated before we have succeeded in checking the inflationary pressures we still face."

Mr. Brimmer gave an example of his proposed system of differential reserve requirements, applied against bank assets:

"If the objective of public policy were to give priority to loans to meet the needs of state and local governments, it could be given effect through a reserve ratio against such loans smaller than the ratio for other loans.

Details Explained

"Loans to acquire homes could be exempted—if public policy calls for giving housing the highest priority—by setting the requirements at zero.

"In contrast, if policy called for substantial restraint on consumer credit or on loans to business, the reserve ratio applicable to such loans could be set quite high. In fact, any array of loan priorities could be adopted and the reserve requirement scaled accordingly—depending on the changing needs of public policy."

Mr. Brimmer said last year's experience "has convinced me that the time has come for a thorough re-examination of the main tools and techniques of monetary control in the United States." He recognized the traditional view that a central bank "should not concern itself with the composition of bank credit but only with its rate of growth."

But he added: "In my own view, a central bank should not be indifferent to the changing composition of bank credit. To adopt such a posture would mean that drastic variations in the availability of credit in im-

portant sectors could occur—and persist — with seriously adverse consequences for the economy as a whole.

"In my opinion, we need a better way to assure that the over-all objectives of monetary policy can be achieved without having a few sectors bear a disproportionate share of the burden of adjustment, while other sectors escape or significantly modify its impact."

Much of Mr. Brimmer's paper was devoted to what actually happened in bank lending last year, broken down by various categories of banks. He concluded that in the larger, weekly reporting banks the "total business credit extended was significantly higher in 1969 than 1968."



The Bond Markets

Pacific Telephone's Debentures Mopped Up, Quoted at Premium

Prices of Seasoned Industrials,
Utilities Also Benefit as
\$1.57 Billion Offer Awaited

By IVAN SILVERMAN
Staff Reporter of THE WALL STREET JOURNAL

NEW YORK—A \$150 million offering of Pacific Telephone & Telegraph Co. securities, about 90% sold after reaching the market Tuesday, was mopped up by purchasers early yesterday morning and pushed to a premium from the offering price.

Originally, the American Telephone & Telegraph Co. unit's issue was priced at 100 with an 8.65% coupon, setting a yield of 8.65% to maturity in 35 years. Late yesterday, however, some traders quoted the debentures at about 100¼ bid, 100½ asked, where an investor's yield was down to about 8.61% in 2005. As bond prices rise, yields decline.

Prices of seasoned utility and industrial issues rose in tune with Pacific Telephone's advances, with some securities gaining ½ point, observers said. The Bell unit's sale represented the last major test by the corporate bond market prior to a huge \$1.57 billion-plus AT&T financing, to begin in about two weeks.

"I'm looking for small, sustained price gains over the next few sessions, now that we've leapt the Pacific Telephone hurdle," one trader said.

In the municipal market yesterday, a \$53 million package of Tennessee bonds was almost all sold after award through competitive bidding. A significant portion of the buying, however, came from Wall Street bond houses, rather than from investors, sources said.

Some observers guessed that about 25% of Tennessee's bonds remained in the financial community. Both metropolitan and country banks placed orders for the state's securities, sources said.

Underwriters led by Morgan Guaranty Trust Co. and six other managers won Tennessee's issue on a bid of 100 with various coupons, offering the state a 5.5067% annual borrowing cost. A second team, narrowly edged out, submitted terms setting a 5.509% loan rate.

Prices of Older Issues Stabilized

The AA-rated bonds were offered to investors at prices scaled to yield from 3.90% for the 1970 maturities to 6.10% for bonds due in 1988-89. Three bank members within the winning

syndicate bought the \$15.6 million of securities due 1981-87, traders said.

The relatively good reception given Tennessee's issue, following the excellent sales results of \$25 million Washington bonds, sold earlier this week, helped to stabilize prices of older securities, observers said.

At the same time, dealers expressed fears about the heavy supply of long-term, tax-exempt securities remaining on Wall Street's shelves.

"We've seen good retail business in bonds due from one-to-10 years, but issues due in 15 years or more are posing marketing problems," one underwriting executive said. "These long bonds, picked up by dealers over the past two weeks, have been marked up but haven't been sold," he added.

Investors are said to be avoiding long-term commitments for a variety of reasons, including fears that inflation will severely erode the value of their purchases over the coming decades.

Apprehension on Inflation

"People continue wondering what \$1,000, plunked down today, will be worth in bread and eggs 20 years from now, when their bond matures" one trader said.

Apprehensions about inflation were fanned yesterday by a Federal Reserve Board member's statements that "the policy of economic restraint so far has had little impact on the rate" of price increases, traders said. In addition, Andrew Brimmer, a Reserve Board governor, suggested new credit-tightening moves might be imposed to better control bank-lending power.

Mr. Brimmer's remarks had only a limited impact yesterday on bond prices, with some traders waiting for amplification before adjusting quotes. Corporate-bond price levels generally remained firm, while Government issues slipped a token ¼ to 1-16 point lower, in response to Mr. Brimmer's comments.

The important 4¼% Treasury issue due 1987-92, for example, was about ¼ point higher early in the day, largely due to the good receptions accorded new corporate issues, traders said. By day's close, however, the 4¼s were quoted at 70 11-16 bid, 71¾ asked, a one-day gain of ½ point. An investor's yield at the latest asked price is 6.43%.

Treasury issue trading was said to be light.

In a late development, underwriters led by Blyth & Co. announced plans to bring Portland General Electric Co.'s dual public offering to market today. The package includes \$20 million of seven-year, first-mortgage bonds, priced at 100 and carrying an 8¼% coupon, plus 600,000 shares of common stock (\$12,525,000) priced at \$20.875 each.

The company's debt securities are rated Baa by Moody's and triple-B by Standard & Poor's. Currently, Portland General has about 7.9 million common shares outstanding. The



Abreast of the Market

By VICTOR J. HILLERY

The firming tendency evident in the stock market late Tuesday blossomed yesterday into a surprise rally on a broad front. Trading expanded but remained relatively light.

Some brokers had expected the lackluster drift generally characteristic of the action earlier this week to continue for a while, but prices moved up from the start yesterday. Analysts noted that the upturn accompanied the strength that came into the bond market after Pacific Telephone's \$150 million debenture offering Tuesday.

More yeast for the upswing was supplied by Herbert Stein, of President Nixon's Council of Economic Advisers, who said there's "a good probability that the rate of inflation will be significantly reduced" this year "without a large, prolonged loss of total output." He added it appears that "the duration of the slowdown will be limited and that output will be rising again in the second half of the year."

Among the latest signs of the economy's course was news yesterday that new factory orders rose 1.6% in February to \$54,749,000,000 and February construction spending ran at a seasonally adjusted annual rate of \$91.7 billion, up 1.2% from January.

After starting with a rise of about 3½ points, the Dow Jones industrial average continued to move up almost steadily. It ended at 792.04, up 6.47 points.

Advances Far in Front

Advances outstripped losers on the New York Stock Exchange 789 to 535. Stocks reaching highs for the year overshadowed lows 94 to 28, which compared with 57 and 35 respectively on Tuesday.

Particularly strong was the copper group, which benefited from Phelps Dodge's announcement late Tuesday that it raised its copper price to 60 cents a pound from 56 cents (see below). The move not only strengthened the copper issues but also stocks of producers of some competing metals such as aluminum.

On the inflation front, news came after the close that Andrew F. Brimmer, a Federal Reserve Board member, said the policy of economic restraint so far has had "little impact on the rate of increase in prices and there is no basis for concluding that the battle against inflation has been won."

Big Board volume expanded to 9,810,000 shares from 8,370,000 Tuesday, and trades of 10,000 shares or more to 54 from 44.

Gainers also held the upper hand on the American Stock Exchange, and its index was up 0.04 to 25.08. Turnover picked up to 3,610,000 shares from 2,560,000 Tuesday.

In over-the-counter bond trading, prime corporates and long-term U.S. Government issues climbed ½ point.

Most Groups Gain

Besides copper stocks, many other groups were up were ch-



April 7, 1970.

TO: Chairman Burns

FROM: Robert C. Holland

SUBJECT: Brimmer speech.

I have read carefully through Governor Brimmer's speech of April 1, 1970 in San Francisco, and am led to the following conclusions.

1. His comments on general monetary policy - clearly identified as his own views - are indicative of his general policy emphasis, but are not sufficiently explicit, argumentative or future-oriented to extend beyond acceptable bounds (pp. 30, 32-33).
2. His comments on the desirability of lifting Regulation Q ceilings at the first opportunity also do not exceed commonly accepted bounds (p. 21).
3. His comments on loan asset reserve requirements are introduced with an appropriately diffident wording:
". . .thought might. . .be given to the possibility. . ."
I think his subsequent presentation is subject to criticism only in two related respects, insofar as its propriety is concerned: (1) the proposal is presented in such great detail and with so many illustrations that it invites the judgment that Board consideration of it is far advanced; and (2) there is no explicit cautioning statement that the proposal



Chairman Burns

- 2 -

April 7, 1970.

is not being actively considered by the Board and is not
being put forward in its behalf.

Attachment



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Chairman Burns

Office Correspondence

Date April 15, 1970

To Board of Governors

Subject: Foreign investments

From Governor Brimmer

Attached are summary memoranda on certain proposed foreign investments that I mentioned at today's Board meeting. One involves applications of Northern Trust Company, Chicago, and Chemical International Banking Corporation, New York, to acquire, in combination, 50 per cent of the stock of a bank being formed in England. The other involves the application of Irving International Financing Corporation, New York, to acquire, in company with Crocker-Citizens International Corporation, San Francisco, 50 per cent of the stock of an international financing corporation to be formed in Australia. (The Crocker application is in the pipeline.)

Applicants contend that in neither case will majority control or management direction be furnished by the U.S. interests, either individually or in combination. Accordingly, the Board's staff recommends that the so-called standard conditions relating to cases where control is exercised not be included in these instances.

Pursuant to the understanding at the Board meeting, these files are being made available to the other members of the Board for review. Unless members indicate to me by Friday, April 17, a desire to have the applications placed on the Board agenda for consideration, I will act upon them under delegated authority. My inclination is to approve them.



APPLICATION FOR APPROVAL UNDER DELEGATED AUTHORITYDate March 27, 1970.Federal Reserve District 2.

By: Irving International Financing Corporation ("IIFC"), New York, New York,
a Section 25(a) Corporation.

For: Permission to acquire 25 per cent of the capital stock of a proposed
international financing corporation, Australian International Finance
Corporation ("AIFC"), Melbourne, Australia, at a cost of approximately
\$2,800,000.

Recommendations for Approval:Federal Reserve Bank 3-24-70Division of Supervision and Regulation *J.P. [Signature]*Clearances:State Department (informal) 3-18-70Comptroller of the Currency --Legal Division (Board)

AIFC is to be organized under Australian law by four founding shareholders: Australia and New Zealand Banking Group, Ltd., a merchant bank headquartered in London, England; Bank of Montreal, a commercial bank domiciled in Montreal, Canada; Crocker-Citizens International Corporation, San Francisco, California, an Edge Act subsidiary of Crocker-Citizens National Bank; and IIFC. Each of the foregoing shareholders will have a 25 per cent interest in AIFC and each will appoint two members to AIFC's board of directors and one representative, resident in Australia, to a management committee responsible for the daily operations of AIFC. In its letter of application, IIFC contends that, as no action may be taken at any meeting of shareholders, the board of directors, or of the management committee unless a quorum is present and unanimous consent is obtained, there is no possibility for IIFC, either alone or together with the other Edge Act Corporation shareholder, to control the actions or policies of AIFC. Consequently, it does not appear necessary that the letter of consent to IIFC contain the standard conditions. Additional details concerning the proposal appear in the attached memorandum from the Federal Reserve Bank of New York.

IIFC reports in combination with its parent, Irving Trust Company, and with its parent's other Edge Act subsidiary, Irving International Banking Corporation. FCRP: 1-31-70; Outstandings, \$316.6 million; Ceiling, \$319.6 million.

Attachments - Memorandum from the FRB of New York dated 3-23-70,
Proposed letter.



FEDERAL RESERVE BANK OF NEW YORK

TO: BEX Files March 23, 1970

FROM: Richard C. Penn, Analyst

SUBJECT: Proposed investment by Irving International Financing Corporation, New York, New York, in Australian International Finance Corporation, Melbourne, Australia.

PROPOSAL

Irving International Financing Corporation (IIFC), New York, New York, requests consent of the Board of Governors to invest up to approximately US\$2,800,000 in the purchase of 25 percent of the capital stock of Australian International Finance Corporation (AIFC), Melbourne, Australia.

The proposed investment would represent 140 percent of IIFC's capital (no surplus) of US\$2,000,000 as of December 31, 1969. Therefore, the Board's consent would be required for the purchase and holding of shares of AIFC by IIFC in excess of the applicable limitations set forth in the provisions of paragraph 5(c) of Section 25(a) of the Federal Reserve Act and Section 211.9(b) of Regulation K.

It should be noted that this Bank authorized IIFC (under delegated authority) on February 19, 1970 to increase its capital from US\$2,000,000 to US\$5,000,000. However, we have been informed that the additional capital will be paid in at the time the proposed investment in AIFC is consummated; such investment would then represent 56 percent of IIFC's increased capital.

AUSTRALIAN INTERNATIONAL FINANCE CORPORATION (AIFC)

Organization and Operations

IIFC states that the decision to establish AIFC is in response to the growing importance of the Pacific Area to world trade and the need for medium term financing in the growing Australian economy. AIFC is to be organized under Australian law by four founding shareholders: Australia and New Zealand Banking Group Ltd., a merchant bank headquartered in London, England; Bank of Montreal, a commercial bank domiciled in Montreal, Canada; Crocker-Citizens International Corporation (Crocker), San Francisco, California, an Edge Act subsidiary of Crocker-Citizens National Bank, also headquartered in San Francisco; and IIFC.



FEDERAL RESERVE BANK OF NEW YORK

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AIFC would engage in medium and long term lending, investments, underwriting and other related financial services, essentially operating in a merchant banking capacity. Initially, AIFC's activities would be concentrated in Australia in order to serve United States and other international corporations which are establishing manufacturing and extractive operations there. However, IIFC contemplates that AIFC will ultimately conduct a global operation with emphasis on the entire Pacific Area. We are informed by IIFC that AIFC would not engage in any business within the United States.

IIFC indicates that AIFC would rely on both the Euro-dollar and Euro-currency markets as well as on the Australian money market for the funds needed to conduct its lending activities, which would constitute the major portion of its business (AIFC's investment activities would consist largely of equity participations incidental to the company's lending activities). IIFC also indicates that, to the extent it is feasible, loans would be matched substantially by deposits or borrowings in the same currency and with matching maturities. However, IIFC anticipates that, at least in the initial period of its operations, the new corporation will not be able to obtain medium and long term deposits to match all of its loans. Consequently, it is planned that each of the shareholders of AIFC will arrange a "standby undertaking" to provide AIFC with additional funds as needed (as more fully described in the "Capitalization" section of this report) to the extent of ten times the respective shareholder's investment "to purchase loans from AIFC or to lend AIFC funds against its loan portfolio in the unlikely event that at some future time funds are not available to AIFC from the Australian or Euro-markets". AIFC would be allowed to make loans unmatched by deposits or borrowings only to the extent that such loans are covered by the proposed standby facilities.

Capitalization

AIFC would have an authorized capital of Australian (A)\$50,000,000 (approximately US\$56,000,000 at the exchange rate of A\$1 = US\$1.12), comprised of 50,000,000 shares having equal rights and having a par value of A\$1 (US\$1.12) per share, of which A\$5,000,000 (US\$5,600,000), or 5,000,000 shares, would be paid in initially.

Initially, IIFC intends to purchase and hold 1,250,000 shares of the outstanding capital stock (representing 25 percent ownership) of AIFC at a cost of approximately US\$1,400,000. However, we understand that, according to the purchase agreement,



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IIFC would make a further investment of like amount in common shares, and/or subordinated debt and/or other form to be determined. The remaining capital stock would be equally divided among Australia and New Zealand Banking Group Ltd., Bank of Montreal, and Crocker. (It should be noted that Crocker is submitting a similar application through the Federal Reserve Bank of San Francisco.) IIFC indicates that the four shareholders of AIFC intend to offer an equal participation in AIFC to at least one major bank headquartered in the Far East through the issuance of an additional 1,250,000 shares of AIFC, thereby reducing the proportionate interest of each founding shareholder (we understand that informal discussions have already been held in this regard). In addition, equity participations in AIFC may be offered to other Australian institutions.

IIFC's participation in the previously mentioned "standby undertaking" to provide AIFC with additional funds as needed will be arranged through IIFC's parent organization, Irving Trust Company (Irving Trust), New York, New York. Under the proposed arrangement, Irving Trust would be prepared to provide up to US\$14,000,000 initially (ten times IIFC's initial investment in AIFC) and up to US\$28,000,000 eventually (ten times IIFC's total proposed investment in AIFC), as additional capital is contributed by each shareholder.

Management

IIFC states that each of the founding shareholders will appoint two members to AIFC's board of directors and one representative, resident in Australia, to a management committee responsible for the daily operations of AIFC, with the representative of Australia and New Zealand Banking Group Ltd. acting as General Manager. At least five directors must be present at meetings of the board to constitute a quorum, including one appointee of each shareholder, and all resolutions passed at meetings of AIFC's board of directors and management committee must receive unanimous approval of the quorum present and voting. In addition, the presence of all shareholders is required for a quorum at any meeting of shareholders. A resolution may be passed at such a meeting only if it is proposed unanimously and receives unanimous approval.

In its letter of application, IIFC contends that, as no action may be taken at any meeting of shareholders, the board of directors, or the management committee unless a quorum is



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present and unanimous consent is obtained, there is no possibility for IIFC, either alone, or together with Crocker, to control the actions or policies of AIFC. IIFC further states that if the Board imposes its standard condition on the proposed investment, in all probability, it would not be acceptable to the other shareholders and "the project would either be abandoned or reorganized with non-U.S. shareholders".

OTHER APPROVALS

We understand that the approval of the Reserve Bank of Australia is necessary for IIFC to make the proposed investment in AIFC. However, IIFC does not contemplate any difficulty in obtaining such approval.

VOLUNTARY FOREIGN CREDIT RESTRAINT PROGRAM

IIFC states, in effect, that the proposed investment would be made within the guidelines set forth under the Administration's voluntary foreign credit restraint program. In this connection, the Foreign Department of this Bank has indicated that it has no objection to the proposed investment, either under the voluntary foreign credit restraint program, or otherwise.

COMMENTS AND RECOMMENDATION

The proposed investment appears to be consistent with the purposes of Section 25(a) of the Federal Reserve Act. Accordingly, I recommend that the Board of Governors grant its consent for Irving International Financing Corporation (IIFC), New York, New York, to invest up to approximately US\$2,800,000 in the purchase of 25 percent of the capital stock of Australian International Finance Corporation (AIFC), Melbourne, Australia, provided that at least US\$1,400,000 is invested within one year from the date of the Board's approval.

In this connection, I also recommend that the Board grant its consent to the purchase and holding of shares of AIFC by IIFC in excess of the applicable limitations set forth in the provisions of paragraph 5(c) of Section 25(a) of the Federal Reserve Act and Section 211.9(b) of Regulation K.



Richard C. Ross

APPLICATION FOR APPROVAL UNDER DELEGATED AUTHORITYDate April 1, 1970.Federal Reserve Districts 2&7.

By: The Northern Trust Company ("Northern"), Chicago, Illinois; and
Chemical International Banking Corporation ("CIBC"), New York, New York,
a Section 25(a) Corporation.

For: Permission to acquire 800,000 shares (20 per cent) and 1,200,000 shares
(30 per cent), respectively, of the capital stock of London International
Bank Limited ("LIB"), London, England, at a cost of approximately
\$1,920,000 and \$2,880,000, respectively.

Recommendations for Approval:Federal Reserve Banks Chicago - 3-16-70; New York - 3-24-70.Division of Supervision and Regulation ggp JRSClearances:State Department (informal) 3-18-70Comptroller of the Currency 1 --Legal Division (Board) JA

As described in the attached memoranda from the Federal Reserve Banks of Chicago and New York, LIB is being organized by two United States interests, namely, Northern and CIBC, and by two European interests, namely, Credit Suisse ("CS"), Zurich, Switzerland, the third largest Swiss commercial bank, and Baring Brothers and Co., Ltd. ("BBC"), London, England, a leading English merchant bank. Northern and BBC will each own 20 per cent of the capital stock of LIB, while CIBC and CS will each own 30 per cent. LIB will have a Board of Directors consisting of two representatives of each of the four founding shareholders, a Chairman who is at present the Senior Managing Director of BBC, and a tenth member, a British citizen reported to be highly experienced in international operations, who will function as Managing Director of the bank and be responsible for its daily affairs. Neither majority control nor management direction will be furnished by the United States interests, either individually or in combination.

LIB will be similar to other banks (such as Atlantic International Bank Limited) that have been formed in Europe by consortia of European and American interests. Initially, it will offer loans in Euro-currencies, will underwrite, syndicate, sell and distribute long-term debt and equity securities, and will deal in foreign exchange as required. It is anticipated that more sophisticated financial services will be subsequently developed.



FOREIGN CREDIT RESTRAINT PROGRAM

Northern reports in combination with its Edge Act subsidiary, Northern Trust International Banking Corporation. As of February 28, 1970, its General Ceiling was \$47,876,000 and outstandings charged against this Ceiling totaled \$43,809,000.

CIBC reports in combination with its parent, Chemical Bank, as well as with Chemical New York Corporation and Chemical International Finance, Ltd. As of February 28, 1970, its General Ceiling was \$610 million and outstandings charged against this ceiling totaled \$533 million.

In its application, CIBC reports that it has \$3,000,000 on deposit in the Euro-dollar market which will be used to make its proposed investment, thereby preventing a capital outflow from the United States.

Northern, in its application, states that its projections indicate that its proposed investment will be made within the foreign credit restraint guidelines.

Attachments - Memoranda from FRB of Chicago dated March 16, 1970, and from FRB of New York dated March 23, 1970.
Proposed letters.



GERALD R. FORD LIBRARY

This form marks the file location of item number 1a
as listed on the pink form (GSA Form 7122, Withdrawal Sheet)
at the front of the folder.

FEDERAL RESERVE BANK OF NEW YORK

TO: BEX Files

March 23, 1970

FROM: Cathy E. Jones, Analyst

SUBJECT: Proposed investment by Chemical
International Banking Corporation,
New York, New York, in London
International Bank Ltd., London,
England.

PROPOSAL

Chemical International Banking Corporation (CIBC), New York, New York, requests consent to purchase and hold, at a cost of approximately US\$2,880,000, 30 percent of the capital stock of London International Bank, Ltd. (LIB), to be incorporated under the laws of the United Kingdom and headquartered in London.

The proposed investment would represent 72 percent of CIBC's capital (no surplus) of US\$4,000,000 as of December 31, 1969. Therefore, the Board's consent would also be required for CIBC to purchase and hold shares of LIB in excess of the applicable limitations set forth in the provisions of paragraph 5(c) and Section 211.9(b) of Regulation K.

LONDON INTERNATIONAL BANK LIMITED (LIB)

Organization and Operations

LIB is being organized by CIBC in participation with Credit Suisse, Zurich, Switzerland, described as the third largest Swiss commercial bank; Baring Brothers and Co., Ltd., London, England, described as a leading English merchant bank; and The Northern Trust Co., Chicago, Illinois, a general commercial bank offering international as well as domestic and trust services. The proposed investment will operate as an independent institution capable of generating business with its own customers as well as handling referrals from its shareholders.

CIBC indicates that LIB will initially: (1) offer loans in Euro-currencies, primarily dollars, with tenors of three to seven years; (2) underwrite, syndicate, sell, and distribute long-term debt and equity securities; and (3) deal in foreign exchange as required. It is anticipated that more sophisticated financial services such as multi-national merger and acquisition work, international portfolio management and financial counselling will be subsequently developed.



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With the rapid rise in the significance and depth of the Euro-currency market, CIBC feels that specialized medium-term financing companies such as LIB are necessary to meet the longer-term financial requirements of major European corporate firms, particularly in the developed countries. We are informed that LIB will conduct no business either direct or indirect in the United States.

Copies of the Articles of Association and By-laws were forwarded to the Board by this bank on March 10, 1970.

CAPITALIZATION

It is expected that LIB will have a capital of pound sterling (£) 5,000,000 (approximately US\$12,000,000 at the exchange rate of £ 1 = US\$2.40), consisting of 5,000,000 shares of a par value of £ 1 per share. The initial issued capital is to be £ 4,000,000 (approximately US\$9,600,000), of which 50 percent will be paid in on the first call. Subsequent calls on the remainder will be at future dates as required by the Bank's growth.

As previously mentioned, CIBC proposes to purchase and hold 30 percent of the capital stock of LIB at a cost of approximately US\$2,880,000. Of the remaining capital stock, Credit Suisse will own 30 percent while Baring Brothers and Co. and The Northern Trust Co. will each own 20 percent.

Each of the shareholders would be expected to participate on a pro rata basis in the issuance of the equivalent of £ 5,000,000 of subordinated debt capital having a possible ultimate maturity of ten years. This subordinated debt is not expected to be needed immediately; however, it will probably be called down within a year, dictated by the growth of LIB. In this connection, CIBC's proportionate share (a maximum of approximately US\$3,600,000) will be advanced by its parent, Chemical Bank, New York, New York.

Management

The proposed bank is expected to have a Board of Directors consisting of two representatives of each of the four founding shareholders; a Chairman who is at present the Senior Managing Director of Baring Brothers and Co. (and who, we understand, is expected to continue in that capacity); and a tenth member, a British citizen reported to be highly experienced in international operations, who will function as Managing Director of the bank, responsible for its daily affairs.



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It is stated that neither majority control nor management direction will be furnished by CIBC or American interests in combination. Accordingly, CIBC feels that the Board of Governors should refrain from imposing the standard condition on this investment as such imposition would severely limit LIB's competitive aims.

OTHER APPROVALS

We are informed that the corporate name of LIB will have to be submitted to the Board of Trade of England for necessary formal approval. In addition, it is stated that the proposed Chairman of the Board is contacting the Governor of The Bank of England with respect to the views of the regulatory authorities in the United Kingdom.

VOLUNTARY FOREIGN CREDIT RESTRAINT PROGRAM

CIBC informs us that it currently has US\$3,000,000 on deposit in the Euro-dollar market which will be used to make the proposed investment thereby preventing a capital outflow from the United States. Accordingly, the Foreign Department of this Bank has indicated that it has no objection to the proposed investment, either under the revised voluntary foreign credit restraint program, or otherwise.

COMMENTS AND RECOMMENDATION

The proposed investment appears consistent with the purposes of Section 25(a) of the Federal Reserve Act. Accordingly, I recommend that the Board of Governors grant its consent for Chemical International Banking Corporation (CIBC), New York, New York, to purchase and hold, at a cost of approximately US\$2,880,000, 30 percent of the capital stock of London International Bank, Ltd., London, England. I further recommend that the Board of Governors grant consent for CIBC to purchase and hold the aforementioned capital stock in excess of the limitations set forth in the provisions of paragraph 5(c) of Section 25(a) of the Federal Reserve Act and Section 211.9(b) of Regulation K.

Cachy E. Jones

