

Remarks of Cathy E. Minehan
First Vice President and Chief Operating Officer, Federal
Reserve Bank of Boston
Before the Credit Union League of Massachusetts
Metropolitan Chapter--Annual Meeting
March 22, 1994

Good evening. It's a pleasure to be with you tonight.

Massachusetts credit unions have been through some difficult times over the past several years, but this \$6 billion+ industry has turned the corner and now is in a strong financial position. We at the Federal Reserve Bank of Boston highly value our working relationship with you. Beginning in 1985, on the heels of the Ohio and Maryland deposit insurance problems, we at the bank have worked with you to obtain federal deposit insurance. This has been a very successful effort and over 98 percent of Massachusetts credit union deposits are now federally insured.

Moreover, credit unions in Massachusetts use the Federal Reserve's banking services extensively--most of you have account relationships with us and use our personal computer based fedline system for initiating and receiving ACH and fedwire transfers, receiving check related and account information, ordering cash, and other

services. As an industry, you have been a leader in using electronics, and I for one certainly wish you could convince your banking brethren to adopt check truncation as their standard mode of operation. We at the fed believe that electronic payments are much more efficient overall for the U.S. payment system, and one of our goals is to reduce, if not eliminate, the 21 tons of checks we transport around the country each night.

Another important, and overriding, goal of ours is economic and monetary stability. Tip O'Niell's saying about politics applies to economics as well--all economics is local. No matter how integrated our country's economy becomes, we still look for the ultimate sources of strength or weakness in our economy by studying our local regions. And by being sensitive to local conditions, we can sometimes force important national changes. This sensitivity to our region both informs our banking service offerings and is one of the reasons why it is important that the Federal Reserve have a role in bank regulation, subjects I will get to later.

Certainly this economic recovery is proof that all economics is

local. As one coast then the other continued in their worst downturns since the 30's, many other sections of the country enjoyed relative prosperity.

Well, we can at least say things are looking up in New England. Let me first cover some of the bright spots we've seen lately, and then some of our longer-term challenges.

Employment is the first relative bright spot. What would an economic presentation be without charts? Well, here's a handout, the first page of which is what's called a "spaghetti" chart (appropriate given the surroundings, don't you think), showing newly revised employment data for New England and the other census regions of the country. Note I said recently revised employment data. Each year the Bureau of Labor Statistics revises the payroll employment figures, which are based on a sample survey of establishments, to reflect more complete figures on the full universe of employers that are collected with a lag. Up until this new "benchmark" was done, we believed employment levels had begun to grow after the recession only in the fall of 1993. Now we see that the employment trough occurred more

than a year earlier in June 1992 and that jobs have grown since that time by about 2.5 Percent. Thus, the region is definitely recovering, a statement many observers have been hesitant to make.

Looking at the spaghetti chart, New England's recovery is quite obvious. In addition, data revisions elsewhere have also made the recovery evident in the middle atlantic states of New York, New Jersey and Pennsylvania. Moreover, New England's rate of growth is now roughly in line with national averages--so finally we don't have to comment on how far behind local conditions are from the rest of the economy.

Where is this employment strength? Well, one area where it isn't is the traditional base of New England manufacturing jobs. On the second chart in your handout you'll note the sharp decline in manufacturing employment since 1988; overall that decline has stabilized since 1992 but high tech manufacturing employment continues to plummet. To some extent this drop in manufacturing reflects a national trend, but here in New England the absolute decline has been steeper than the nation as a whole, largely reflecting

computer and defense related manufacturing. Employment growth of some magnitude is occurring in the nonmanufacturing area, particularly in the business services areas which can encompass both such high paying jobs as software developers, and low paying jobs like janitorial services.

February unemployment rates of 6.3% In New England were about equal to that of the whole country, and while initial unemployment claims and help-wanted advertising declined, both of these series were improved over a year ago. Finally, on a monthly basis, we at the bank make a series of personal contacts with retail, industrial, and other leaders around the first district. These contacts are published with similar reports in the Federal Reserve's so-called "beige book". The most recent beige book contacts in retailing and manufacturing were quite upbeat about 1994, and the business confidence index of the associated industries of massachusetts jumped to a record level in January and held that level in February.

Looking toward the future, what can we say about the forces and factors that determine New England's prospects? Overall most forecasters are predicting that the region's current slow growth will be

sustained. But by no stretch of the imagination can we expect a repeat of the 1980's, in the nation, or especially in New England. Our traditional economic drivers are in disarray, and the service and other industries that are now growing look less reliable.

Manufacturing, and insurance to a lesser degree, historically were seen as New England's economic drivers; they were also seen as providing "good" jobs with high benefits. These industries continue to shrink while others--eating and drinking places, social services, and temporary help agencies--grow but provide jobs that may not be as "good" in the traditional sense. Many people hope or believe that the software and securities industries will become New England's future economic drivers, but their potential role is more difficult to predict. They don't fit our traditional models of regional economic development, which see export sectors playing the role of regional engines of growth, and the rest of the economy following. We don't understand these new industries--or how their patterns of growth will work in the future. Unfortunately, the outlook for sectors we can see clearly--and for which the handwriting is already on the wall--do not bode well for New England. Two of these are obvious--defense and health care.

Defense is a clear minus on an ongoing basis. Connecticut and Massachusetts rank 1 & 2 among the states in the share of private sector employment related to defense. The continuing cuts in defense contracts will continue to be a drag on the region's economy at least through 1988--with Connecticut losing 2 percent of its jobs as a direct consequence of defense cutbacks, and the rest of New England experiencing direct losses of 1 percent. Recent data show defense related employment rising at r&d facilities but falling steeply in manufacturing.

Health care is another negative. It counts for about 1 in 10 jobs in New England and for Massachusetts was the only sector of continued job growth throughout the recession. Any serious restructuring of the health care delivery system in the U.S. Will have a heavier impact here as cost control is likely to be a major theme of reform. Moreover, the potential increase in employment that could arise from wider access to health care, may well be small given New England's already high proportion of the population covered by health insurance.

Finally, New England continues to be a high wage area. Even after the economy weakened here in early 1989, the rate of wage growth in the region failed to fall below the national pace, so the gap between New England and U.S. wage rates, while no longer growing, did not shrink appreciably. As firms look to growing out of the recession they have sought to trim costs and improve productivity with investments in technology. In this process of restructuring, many firms including those in manufacturing have relocated operations to lower wage areas, or if they stayed here, reduced work forces as much as possible. Thus, the potential for the increased job growth we might normally expect from the end of a recession--particularly one that seems to have been over for quite a while now--seems small. In general, we may have to be content with stability--an improvement over the last several years, but with no promise of the major engines of growth ready to race into action.

Turning to more mundane matters, the Federal Reserve itself is no stranger to the current business trends of restructuring and downsizing. One major effort we've begun will consolidate all of our mainframe data processing facilities into three sites, while at the same

time upgrading our nationwide communications network to be virtually seamless from one district to another. We believe these changes will allow the banks to respond more rapidly to the changing environment, provide higher levels of service nationwide, and reduce costs from what they might have been had we continued in our decentralized mode. Some of you may have already received new communications gear, and a new telephone number for your dial-in fedline service. These changes reflect the implementation of the new communications system that is more state-of-the-art nationwide, and the start-up of national centers to handle dial customers. Both the move to the consolidation sites and the implementation of the new network are progressing well, though completion once scheduled for 1995 may now not occur fully until 1996.

Now all of you are local institutions, and I know pride yourselves on the service you provide to your customers. I think it would be entirely understandable if you greeted the idea of reserve bank service consolidation with a healthy dose of skepticism--how will we remain focused on our customer needs with so much not controlled by the familiar staff over at 600 Atlantic Avenue? We've had similar

concerns and have focused considerable attention internally on developing a strategic agenda for the bank that tries to marry our traditional strengths and the needs and unique aspects of the first district. We see our relationships with you and the high quality of our services, as aspects of our traditional strength, and in some senses, part of the unique value-added of the Boston Reserve Bank. Thus, our strategic agenda looks to increase our contact with you, and to pursue an attitude of continuous improvement in all of our service offerings.

Maintaining our substantive involvement with depository institutions in our district is also critical to the Fed's ability to fulfill its mandate to maintain financial stability.

As most of you are aware, there has been some intense discussion in Washington over the past several months about consolidating federal bank regulation into a single new agency. Happily for those of you in this audience, credit unions are not affected by this proposal. But unhappily for those of us at the Federal Reserve, regulatory and supervisory responsibilities would be taken away from the fed under proposals put forward by the administration, the

chairman of the Senate Banking Committee, and the chairman of the House Banking Committee.

Regulatory consolidation has been on the legislative radar screen for many years in Washington, but it has taken on a much higher profile in the wake of Vice President Gore's report on "reinventing government" -- the national performance review report. Following on the heels of the vice president's report, which actually did not include any recommendations on consolidating bank regulators, the Treasury Department came forward last November 22 with a detailed proposal to combine the regulatory and supervisory responsibilities of the OCC, the OTS, the FDIC, and the Fed into a single regulatory agency called the Federal Banking Commission.

As you know, the Treasury and the Fed have been locked in a stand-off. The Treasury continues to call for a single regulator, and the Fed has mounted a highly unusual effort to persuade the public and the Congress to maintain a role for the Fed in regulation and supervision.

Basically, the Treasury and the Fed agree that the existing four

regulatory agencies represent an inefficient and unnecessary structure. Nobody argues in favor of the status quo. The question at this point in time really boils down to whether to have a single regulator -- the Federal Banking Commission-- or to have two federal bank regulators -- the Federal Banking Commission and the Federal Reserve.

The Federal Reserve has vigorously opposed the single regulator and argued that the Fed must maintain regulatory and supervisory authority for two reasons:

The first reason is that in order to fulfill its responsibilities as the nation's central bank, the Fed must be capable of anticipating and intervening in times of regional or national systemic financial crises. The Federal Reserve believes that an ongoing hands-on involvement in bank supervision is essential to its ability to deal with issues of systemic risk. Moreover, because of its broader perspective as a central bank, the Federal Reserve can bring a national policy focus to bank supervisory matters. The benefit of this was amply reflected, I think, in the work the Boston Fed did on recognizing the credit crunch and helping to formulate more responsive regulatory approaches to

cyclical downturns.

The second reason the Federal Reserve should remain a bank supervisor is that it is important to preserve the dual banking system which has been a cornerstone of the American banking system.

Let me say very briefly, as Chairman Greenspan has said, that consolidation is "likely to rob the choice of charter of any real significance". With only one federal regulator, the availability of a state charter will no longer carry with it the choice of a federal regulator. There will be little incentive for the single federal regulator to accommodate diverse state standards or to maintain the value of state charters. A key element of our current banking system will be lost.

These issues were brought out very clearly earlier this month during five days of hearings before the Senate Banking Committee. The concerns raised by the Federal Reserve have definitely caught the attention of some key members of the committee. Chairman Riegle has implored Secretary Bentsen and Chairman Greenspan to work

diligently to reach a compromise position.

Unfortunately, the rhetoric of the single regulator proposal has tended to harden the positions, and if any compromise is to emerge, that fundamental concept will have to be altered.

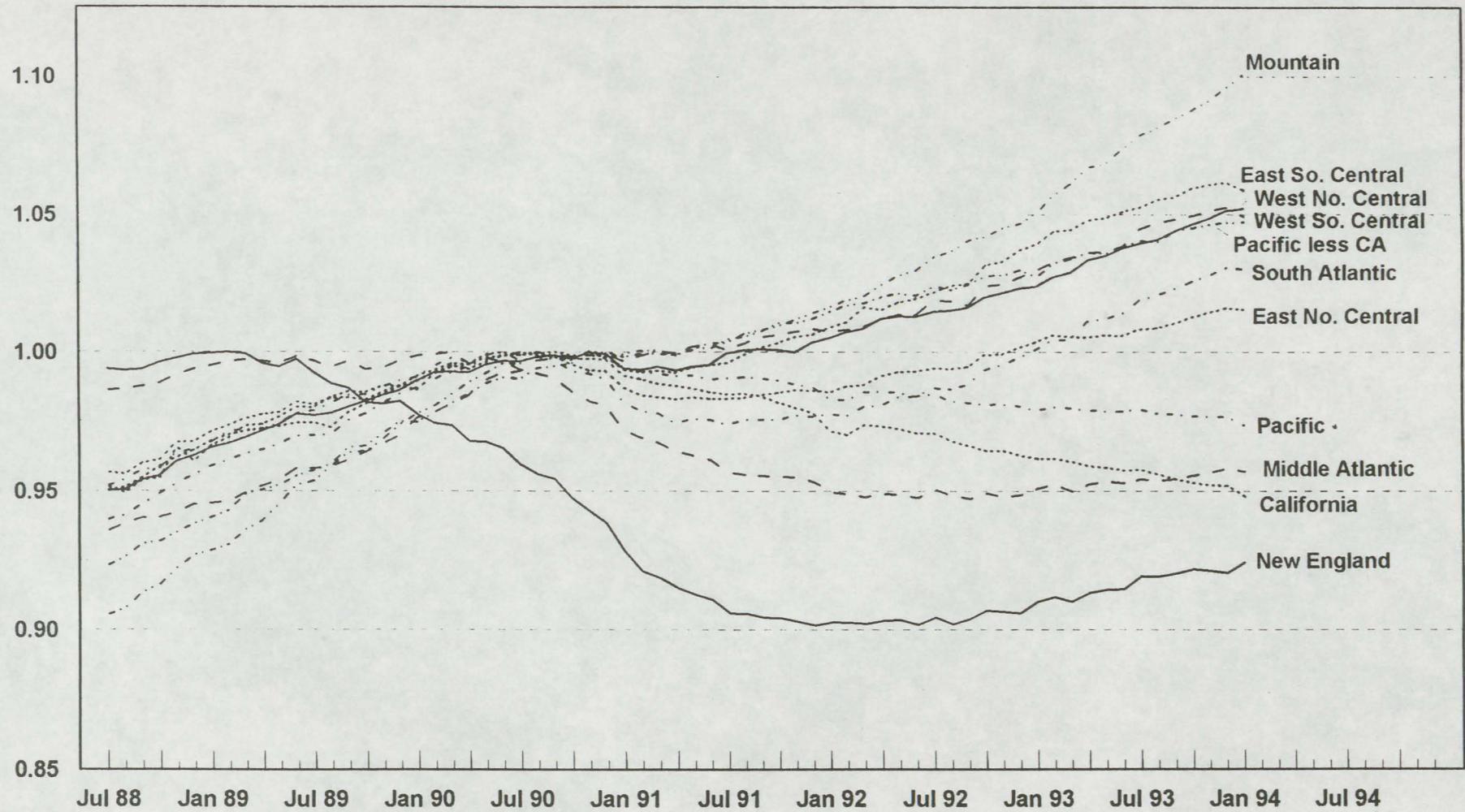
But we are optimistic that the overlap and duplication that has irritated so many people in the banking industry will be addressed through legislation, and at the same time the concerns of the nation's central bank will be incorporated.

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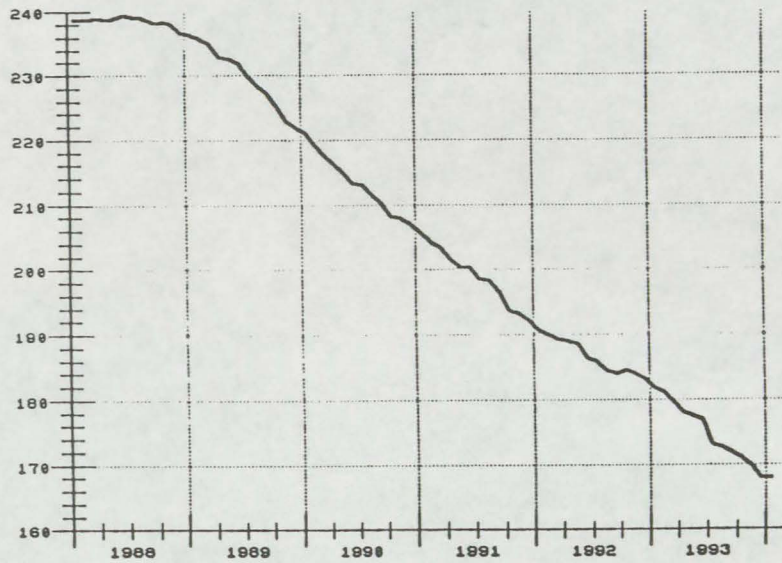
Nonfarm Payroll Employment by Census Region

Index, Each Region's Employment Peak = 1

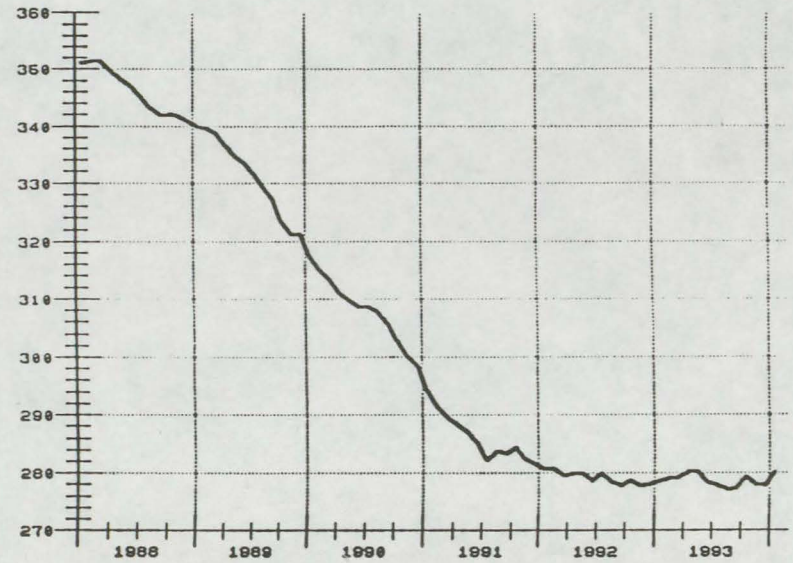


Source: U.S. Bureau of Labor Statistics.

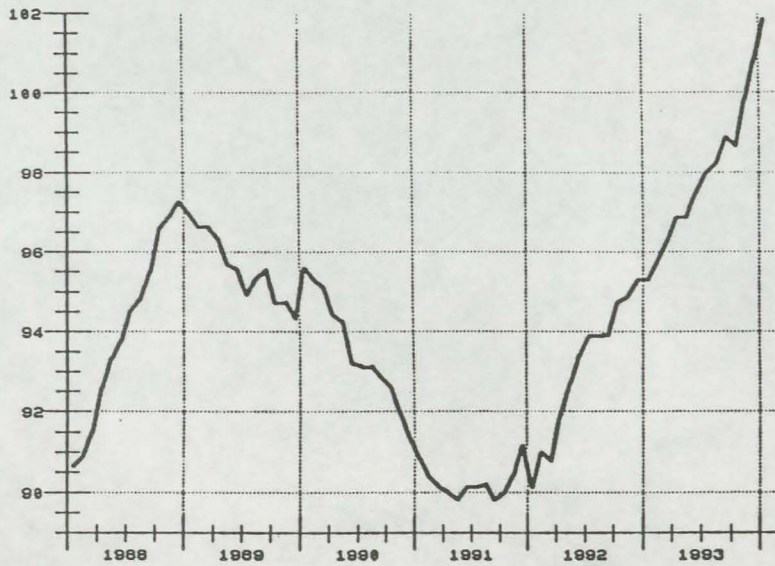
MANUFACTURING HIGH TECH EMPLOYMENT IN MASSACHUSETTS
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TOTAL NONMANUFACTURING EMPLOYMENT IN MASSACHUSETTS
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