Federal Reserve Notes

FEDERAL RESERVE BANK OF SAN FRANCISCO • MAY 1977

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COLDWELL REPORTS RISING PRODUCTIVITY

Federal Reserve expenditures have risen far more slowly than government expenditures generally, according to a report made by Governor Phillip Coldwell last month to the Senate Banking Committee.

System expenditures increased at an 8.5-percent annual rate from 1974 to 1977, compared with a 15.9-percent rate for the Federal government. Coldwell said the Fed's favorable cost-control situation was achieved despite new regulatory responsibilities and the impact of inflation.

"Efforts to improve productivity and decrease costs are in the forefront in all of the budgeting and planning guidelines and procedures followed by the Board and Reserve Banks," Coldwell stated, "and we believe that these efforts have succeeded. As an indication of this improvement, actual output per manhour in our measurable output functions was estimated to have increased by almost 12 percent in 1976 following an increase of 6 percent in 1975."

The Fed provides central-banking services to the nation through a network of 50 offices employing 26,650 people. Its 1977 operating budget amounts to $753 million.

As an example of the upsurge in the Fed's workload, Coldwell cited supervisory activities arising in the holding-company area. In 1970 the Fed supervised 121 multi-bank holding companies and acted on an average of 32 applications a year. With the passage of the 1970 amendments to the Bank Holding Company Act, one-bank holding companies were brought under the System's jurisdiction. The Fed now supervises about 1,900 holding companies—which control about two-thirds of the nation's bank deposits—and processes an average of nearly 850 applications a year.

Coldwell said the same type of dramatic increase has occurred in other bank supervisory areas, such as international banking. The consumer-credit field also has grown substantially in recent years, beginning with passage of the Truth in Lending Act in 1968. Congress has passed nine other consumer-protection acts or amendments since that date.

Turning to central-banking operations, Coldwell noted the sharp increase in volume in recent years—especially wire transfers of funds, currency operations, and the processing of food stamps and checks. In particular, Reserve Banks handled a 182-percent increase in wire transfers between 1970 and 1976. Nearly 75,000 funds transfers are now negotiated each day, representing more than $150 billion in bank-to-bank transfers.

Reserve Bank processing of currency rose by a third during the 1970-76 period, and food-stamp processing rose by 58 percent. In 1976 alone, the Fed sorted and counted 7 billion pieces of currency and processed and destroyed 2 billion food stamps.

Coldwell noted that the System now handles about 50 million checks a day, or 85 percent more than in 1970. Checks processed in 1976 totalled 12.3 billion items. Over the past six years, the Fed has established 11

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BALLES NOTES INFLATION PROBLEM

Financial market participants are being forced to readjust their thinking to the possibility of a "six and six" year—that is, to a 1977 economy where prices and real output are both rising almost six percent, instead of the five-percent rates originally forecast by most economists. This readjustment has already caused trouble in the markets, according to John J. Balles, President of the Federal Reserve Bank of San Francisco, in a speech last month in Phoenix to a group of Arizona community leaders and Reserve Bank directors.

Balles referred especially to the "inflation jitters," which have recently dominated the financial markets because of the first quarter's price news. "The recent price statistics are indeed sobering, even allowing for the special circumstances which pushed up prices at a double-digit rate in early 1977," he said. "In contrast to the gradual deceleration of last year, we have recently experienced a worrisome speed-up in prices, reflecting such factors as weather problems, fiscal problems, and the importing of foreign inflation."

The Fed official explained, "Part of the problem is the weather-induced sharp rise in food costs, but the prices of other consumer goods have also accelerated, while the prices of services have continued to outstrip those of other consumer purchases. And households may expect further difficulties in coming months, since the wholesale prices of consumer goods have risen at an 8.2-percent annual rate since last fall, and those increases should soon be felt at retail."

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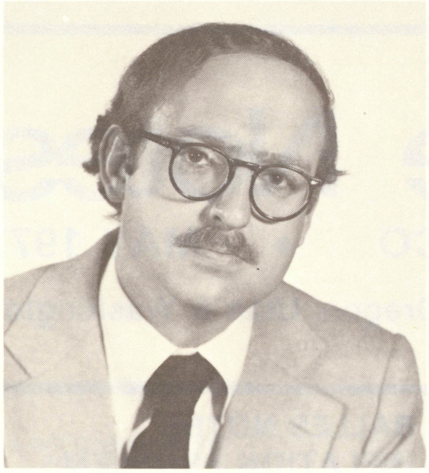


J.H. Makin

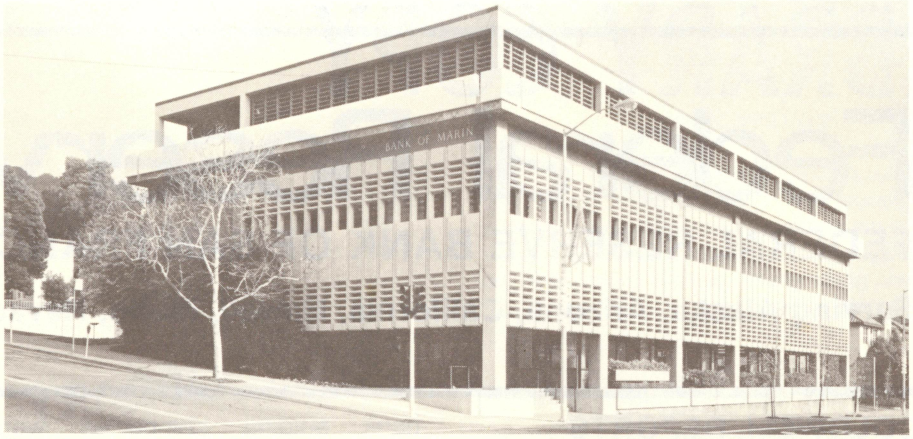
MAKIN NAMED VISITING SCHOLAR

John H. Makin, Associate Professor of Economics at the University of Washington, has been appointed to serve a six-month term as a Visiting Scholar at the Federal Reserve Bank of San Francisco.

The San Francisco Fed inaugurated the Visiting Scholar program to encourage creative research and the interchange of ideas by practicing economists. Scholars from Stanford, Ohio State, the University of Oregon, and the University of Chicago have recently held such appointments with the bank. The most recent Visiting Scholar was Milton Friedman, the 1976 Nobel Laureate in Economics.

In addition to his teaching position, Dr. Makin is a consultant to the U.S. Treasury Department's Office of International Affairs. He received his B.A. in Economics from Trinity College and an M.A. and Ph.D. from the University of Chicago. Dr. Makin has taught at the University of Wisconsin, the University of Virginia, and the University of British Columbia. He also served as Senior International Economist with the Treasury Department.

As an author and editor, he has produced nearly 40 articles and books in the areas of international monetary economics and macroeconomics. His books include *Elements of Money, Theory of Money, Theory of Macroeconomics, Theory of Economic Policy* and *Macroeconomics.* He was co-editor of *Eurocurrencies and National Financial Policies.*



The Bank of Marin Building in downtown San Rafael (California) serves as headquarters office for Independent Bankers Trust Company.

Welcome To The District
INDEPENDENT BANKERS TRUST COMPANY

Independent Bankers Trust Company capped what it termed "its most successful year of operations ever" by becoming a member of the Federal Reserve Bank of San Francisco last month.

During 1976, trust assets for Independent Bankers Trust Company increased 32 percent to over $35 million. The trust enjoyed an increase in fiduciary business in virtually all major categories, and it expects to increase its staff in 1977 as it gears up for continued growth.

Independent Bankers Trust Company is part of northern California-based Independent Bankshares Corporation. This multi-bank holding company was formed in 1973 by three previously unaffiliated banks—the Bank of Marin, the Bank of Sonoma County, and the First National Bank of Cloverdale—and in 1974 acquired the Bank of Lake County.

Today the four subsidiary banks operate through 23 offices in Marin, Sonoma, Mendocino and Lake counties. In 1976, the corporation's resources grew over 15 percent, approaching $300 million. Through Independent Bankers Trust Company, the corporation provides trust services to customers of its subsidiary banks.

Donald F. Murray, a vice president and Director of Independent Bankshares, serves as President and Chairman of the Board of Independent Bankers Trust. He replaced Richard O. Kwapil, who retired this March. Murray is also a Senior Vice President and Director of Bank of Marin and a Director of Bank of Lake County.

Directing the day-to-day operations of the trust company is Executive Vice President Hale M. Knight, who joined the trust early in 1975 with over 20 years of experience in the field. He is supported by six other officers at the trust's two offices in San Rafael and Santa Rosa.

COLDWELL REPORTS
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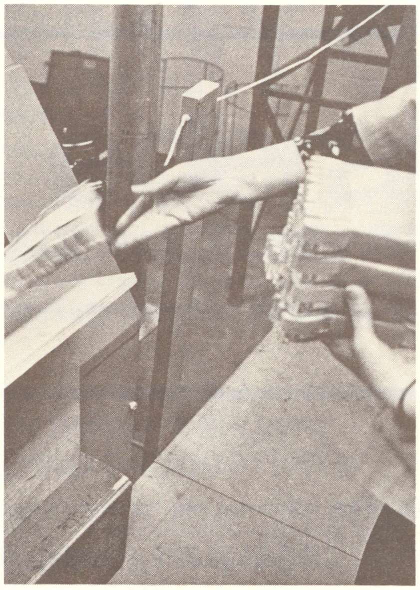
new regional check-processing centers to clear checks more rapidly and reduce float.

The System also, by establishing a program of direct deposit of Federal payments, has cut government disbursement costs by about $7 million annually. The Fed's data-processing and communications facilities now handle about 5½ million government payments monthly in this way. Again, through its automated clearinghouse arrangements, the Fed capitalizes on electronic transfers as an alternative to making commercial payments by check.

Coldwell noted that the increased workload has been managed despite a 5-percent reduction in Reserve Bank employment since 1974. "The Board believes that its review and budget processes have created a cost-consciousness throughout the System and that this has resulted in better productivity, cost efficiency and service to the public," he concluded.



Money to burn

FED UTILIZES NEW DESTRUCTION EQUIPMENT

Most people spend a great deal of their waking hours trying to accumulate money. The Federal Reserve Bank of San Francisco has the unique responsibility of getting rid of it— and in an environmentally acceptable manner.

In the last two years, the Bank has installed equipment that incorporates the latest state-of-the-art technology for this purpose. In 1976, the Bank verified and then destroyed over $2.2 billion in unfit currency and $1.1 billion more in food stamps.

To handle this task, the San Francisco Branch installed a high temperature incinerator in 1975, and other branches began operating even newer equipment during the past several months. Later this year, Los Angeles will install the largest destructor in this District.

All the equipment installed in recent months shreds currency instead of burning it. In a disintegrator, three rotating blades create a scissors-like action against two fixed blades that are set at close tolerances. The pieces of currency or food coupons are agitated between the sets of blades until the material is cut small enough to pass through a quarter-inch-diameter screen. After compacting, the residue is hauled away with normal building waste to serve as landfill. The machinery can handle as much as 600 pounds an hour.

The disintegrator is automatically fed, permitting currency to be destroyed without any people being present. Through a series of timers and microswitches, the currency and food coupons are fed to the disintegrator one bundle at a time. The whole unit is enclosed in a specially constructed lead-lined, walled room—the enclosure being for security and the lead lining for sound deadening.

FED AMENDS DISCLOSURE RULES

The Federal Reserve Board of Governors amended its Regulation Z (Truth in Lending) last month to require advance disclosure when there is a variable-rate clause in a contract that may increase the cost of credit to a customer. The amendment goes into effect on October 10.

Under the new rule, creditors must disclose that the annual percentage rate is subject to increase. This simplifies an earlier proposal on the subject made last fall.

Creditors using variable-rate clauses also will have to spell out the conditions under which the rate may increase, including identification of any index to which the rate is tied and any limit on the increase. Moreover, the advance disclosure must include the way an increase can be carried out—such as by an increase in payment amounts, a change in the number of scheduled payments, or an increase in the amount due at maturity.

In the case of home-mortgage transactions only, creditors must give numerical examples to show how the variable rate operates. The examples are to be based on a hypothetical increase of one-quarter percentage point in the annual percentage rate, made either through a change in the number of scheduled payments or an increase in the amount of those payments.

BURNS DISCUSSES ACCOUNTING STANDARDS

The decision of the Financial Accounting Standards Board (FASB) to favor historical-cost accounting in the restructuring of debt should provide a framework within which lenders can work effectively, Federal Reserve Chairman Arthur F. Burns said last month.

In commenting on an earlier FASB memorandum last July, the Chairman expressed concern that some variant of present-value accounting—rather than accounting based on historical experience—might be applied to banks and other financial intermediaries. At that time, he argued that the widespread imposition of such accounting standards for debt restructuring could threaten the viability of financial institutions and impede the potential performance of the economy. FASB subsequently issued another draft last December confining the new standards to troubled loan situations.

In a recent letter to Marshall S. Armstrong, Chairman of FASB, Burns said the latest proposal would avoid the major sources of the Board's earlier concerns. While pointing out some technical difficulties in the draft, he said the proposed standards would enable banks to operate effectively in adjusting loan contracts to the changing credit needs and financial circumstances of their customers.

Nevertheless, Burns added a cautionary note concerning the application of present-value accounting. "While the proposed statement is largely devoid of present-value accounting requirements, the Board wants to express its concern that, in the discussion of the basis for its conclusions, FASB appears to have accepted a rationale that could lend support to an expanded application of present-value accounting standards to troubled debt restructuring situations." He concluded, "The Board continues to feel that the application of such accounting standards to commercial banks and other financial intermediaries would be contrary to the public interest and therefore should be rejected."

FED ISSUES MONEY ORDER RULES

The Federal Reserve Board of Governors last month approved applications made by two bank holding companies for the issuance of money orders and similar consumer-type payment instruments.

In granting authority, however, the Board made it clear that this activity would not be added to the list of activities generally permitted for bank holding companies under its Regulation Y. Instead, the Board said it would process such applications on a case-by-case basis.

The Board noted that the wholesale money-order business in this country is dominated by a few nonfinancial companies that are not subject to the Federal Reserve System's reserve requirements. Unless a degree of competitive equity can be established under the present statutory framework, it argued, new competition in this business would not develop on a national scale.

"Such equity cannot be achieved if some competitors are subject to reserve requirements while others are not," the Board ruled. "In such unique circumstances, the Board finds that there are public benefits associated with enabling bank holding companies to compete with the dominant organizations in this business on an equal basis, by permitting what is essentially a consumer-oriented demand deposit business to be conducted by nonbank affiliates of member banks."

In addition to increased competition, the Board said the public could benefit from reduced costs and increased convenience to purchasers. It noted that money orders have proved to be particularly useful to persons of limited resources who do not or cannot practically maintain checking accounts.

BALLES NOTES

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Balles noted a more favorable outlook in the production sector, with real GNP rising at close to six percent this year. "The severe winter interrupted and postponed a strong expansion that was evident around the turn of the year, and so it practically guaranteed a sharp rebound right about now." He said that the recovery from the first-quarter shortfall, plus the continued growth of consumer and business demand, should generate a temporarily high rate of growth during the current quarter and set the stage for a healthy advance in late 1977 and early 1978.

The Fed official noted that the unemployment rate could fall below 7 percent sometime this year, but he suggested to his listeners that they "should keep their eyes on the doughnut instead of the hole"—on total employment rather than unemployment. Already, in the past two years, an expanding economy has created more than five million new jobs. And in 1977, he suggested, basic expansionary forces could boost total employment about three percent for the second straight year—a very strong increase in historical terms.

"But the one fly in the ointment is inflation," Balles continued. In this connection he noted the long-term inflationary threat created by the proliferation of Federal spending programs—and consequent substantial deficits—over the past decade. "The $112-billion combined deficits of the 1975-76 fiscal years might be explained in terms of the need to overcome recession, but how can we defend a deficit of like size in the expansionary 1977-78 period?"

Because of this fiscal situation, Federal demands on credit markets could be roughly the same this year as in calendar 1976, in contrast to the usual cyclical decline in such borrowing during a recovery period. "That projected demand comes just at the time when private credit demands are rising, and thus generates significant upward pressure on interest rates when coupled with the demands generated elsewhere."

Federal Reserve Notes is produced by William Burke, Ronald Getz and Karen Rusk. The publication is distributed to commercial banks by the Research Information Center, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco, California, 94120.

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