Federal Reserve Notes

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WESTERN BANKS LAG U.S. EARNINGS PACE

Western banks participating in the annual functional-cost analysis program achieved somewhat smaller net earnings than their national counterparts in 1976, reflecting a relatively higher level of expenses in this District. However, their performance roughly matched the national average in terms of net return on loans and investments. The survey results might not be completely representative—only 24 of the 144 member banks in the San Francisco Reserve District participated—but comparisons were similar in each of the three size categories in the survey (see table).

Participating banks are grouped each year in one of three deposit-size categories—up to $50 million, $50-200 million, and over $200 million. Participants furnish Federal Reserve analysts with deposit-structure and other characteristics, and this permits grouping of institutions of like size to facilitate comparisons.

The results of each survey, published in an annual *Average Banks* report, include cost ratios which help participants to compare their own results with those of other District member banks as well as member banks nationwide. These ratios provide an important management tool for banks to use in making policy decisions and in implementing cost controls.

In 1976, Western banks' net earnings as a percentage of available funds—that is, as a percentage of total liabilities minus bank premises and fixed and other assets—reached 1.75 percent for small banks, 1.62 percent for medium-sized banks, and 1.32 percent for large banks. In each case, the ratio was

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COMPUTER LINKS BANKS TO FED WIRE

A new service now available to member banks will enable them to connect their computers directly to the nationwide network known as Fed Wire. "The new computer-interface facility is faster, more accurate, and more secure than the linkup that was previously used," said Senior Vice President Richard T. Griffith, who is in charge of the Computer Services Group at the Federal Reserve Bank of San Francisco.

The Fed Wire is operated by the Federal Reserve System to transfer an average of $120 billion in funds each business day. With the new system, a commercial bank can transmit on-line transactions to its own computer, which in turn relays them to the Federal Reserve Bank. A data-entry operator enters information on a terminal keyboard and it is displayed on a CRT (cathode ray tube) screen. After verification by the bank's computer, data are transmitted to the San Francisco Fed's computer for relay through the nationwide Fed Wire. The Fed Wire allows commercial banks to transmit messages across the country in seconds.

A direct link to the Fed Wire enables commercial banks to implement increasingly sophisticated cash-management systems for themselves and their customers. In most cases, banks establish similar links to other funds-transfer services (including the commercially operated Bankwire) and their own internal systems, permitting further efficiencies in cash management.

The first link in the system was made with Wells Fargo Bank, and a number of other banks are now developing computer links to the Fed Wire or are exploring the new service. They include Crocker National Bank, Bank of America, Security Pacific National Bank, Union Bank, Valley National Bank of Arizona, First National Bank of Arizona, and Seattle First National Bank.

COMPUTER TO COMPUTER TIE-IN—Computers talking to computers? That's what's happening here. As Aric Clark, project leader of Wells Fargo Bank's Financial Institution System looks on, Data Control Clerk Grace Turner activates the new computer-to-computer interface system. Data are loaded into the Wells Fargo computer through the terminal above, and are then transferred to the San Francisco Fed computer. The system enables Wells Fargo to transfer funds throughout the nation via the Fed Wire much more quickly and efficiently.

"Since the implementation of this new interface, we have experienced no application program problems," said Aric Clark, Project Leader of Wells Fargo Bank's Financial Institution System.

"We have been working on this system for quite a long time," said Ben Conophy, Assistant Vice President at Crocker National. "So far we feel the results are well worth the time and effort that we put into getting it started."

From the Federal Reserve's point of view, the new system allows greater se-

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somewhat smaller for Western banks than for their national counterparts, the difference ranging between 17 basis points for small banks to 31 basis points for medium-sized banks. (One hundred basis points equal one percentage point.)

The earnings difference could be explained in terms of the much larger expense ratios in the Western banking community, which averaged about a full percentage point higher than elsewhere. Total expenses amounted to 7.44 percent of available funds at small Western banks, and the comparable ratios for medium-sized and large banks were 7.34 percent and 6.91 percent, respectively.

The higher expense ratios in the West are somewhat puzzling, especially since cost-of-money ratios were roughly comparable with the national figures. The higher expense ratios may be explained, however, by certain diseconomies of scale encountered by the large branch-banking systems found throughout the West. The number of branches per bank were at least two to three times the national average in each size category in this District, and Western banks' expense ratios were higher in each category.

Western banks' net portfolio yields, calculated as a percentage of invested funds, roughly matched the national averages in each size category in 1976. The regional ratios were 7.43 percent for small banks, 7.66 percent for medium-sized banks, and 7.06 percent for large banks. These yields were calculated as the return on assets minus departmental expenses. FCA uses a full-absorption costing method, which means that all expenses (including overhead) are allocated by function.

Western banks uniformly obtained much higher yields on real-estate loans, but fell behind their national counterparts in other loan categories, mainly in instalment lending. Yields on business loans and on securities portfolios were roughly similar, regionally and nationally.

Member banks participating in the functional-cost program provide detailed cost data each year to their District Reserve Banks. After the data are checked and processed, each participating bank receives a detailed report containing historical and current-year comparisons with a group of banks of similar size and characteristics. FCA participation thus enables each bank to evaluate the actual prices of its services.

The functional-cost program is a free service available to all Federal Reserve member banks. For further information, contact the Functional Cost Analyst in San Francisco—(415) 544-2351—or call the Bank and Public Services Department at the nearest Fed office.

FED NOTES CURRENCY SHIFTS

No one knows the exact whereabouts of the $85 billion in coin and currency now in circulation. But analysts speculate that much of it—billions in fact—is being held by individuals in private hoards consisting increasingly of hundred-dollar bills. Altogether, there is about $1,000 in circulation for every family in America—considerably more than might be expected in view of the widespread use of checks and credit cards for most large purchases.

Over the past three fiscal years (1975-77) the Federal Reserve Bank of San Francisco paid out $32.8 billion in currency for use by the 33 million people in the nine westernmost states. During this same period, about $31.9 billion was returned from the commercial banking system. Consequently, $914 million was added to the total supply of currency in this District—but the increase in hundred-dollar bills amounted to $1.4 billion.

According to a study by Paul S. Anderson of the Boston Federal Reserve Bank, only about a third of the nation's currency is being actively used. "Most families do not hold anywhere near the $1,000 per family in circulation, so a minority of individuals must have very large holdings, perhaps of $5,000, $10,000 or even more," he says. "Only a minute percentage of the currency outstanding is lost or destroyed."

FUNCTIONAL COST COMPARISONS—1976

	Under $50 Million		$50 to $200 Million		Over $200 Million	
	U.S.	West	U.S.	West	U.S.	West
As Percent of Available Funds						
Net earnings	1.916	1.748	1.930	1.622	1.589	1.322
Total expenses	6.475	7.435	6.124	7.336	6.162	6.907
Cost of money	4.921	4.927	4.804	5.272	4.592	4.712
As Percent of Invested Funds						
Net portfolio yield	7.528	7.432	7.501	7.658	7.111	7.058
Securities	7.770	7.360	7.751	7.410	7.608	7.346
Business loans	6.912	6.728	6.922	7.660	6.388	6.221
Real-estate loans	7.576	8.716	7.562	8.859	7.437	8.407
Instalment loans	7.843	6.922	7.728	6.000	6.906	5.659
Credit cards	3.384	2.602	5.986	7.329	7.580	9.449

Note: Number of participants included 443 U.S. banks and 9 Western banks under $50 million; 317 U.S. banks and 6 Western banks between $50 million and $200 million; and 109 U.S. banks and 9 Western banks over $200 million in deposits.

Officers of Pioneer National Bank include (from left) President and Chief Executive Officer M.C. Deitrick; Assistant Vice President Doris Poole; Cashier Tom Oliva; and Vice President Bill Wickham. Photo Courtesy of Yakima Valley Sun.

Welcome to the District PIONEER NATIONAL BANK

"We felt Pioneer National Bank was the best possible name to sum up our operation," says President M.C. Deitrick. "The name distinguished us from other local institutions, while at the same time it captured our image of a bank that blends individualism with newness."

Pioneer National Bank is the first bank to open in Yakima since 1958, and the first new national bank in that Washington community in over 40 years. Since opening in July, this latest member of the Federal Reserve System has been offering residents a full line of services—commercial and consumer loans, checking accounts, savings accounts, certificates of deposit, and easy accessibility and convenient banking hours.

When it comes to banking, however, Deitrick is no newcomer. For the last 15 years he was associated with the American Bankers Association, serving as Director of its Bank Management Department and then comptroller. Previously, he helped organize the Mid-Columbia Bank in Pasco, which subsequently merged with Peoples National Bank of Washington.

Planning for Pioneer National began about two years ago, under the leadership of a group including current directors Dr. Donald Ballew, Robert Lynch, Robert Lewis, Dr. Patrick Lynch, Robert Strausz, and Deitrick. The group concluded that the area's strong economic growth justified the launching of another financial institution, and began raising the capital for an initial stock offering of $1½ million.

"Almost 18 months elapsed from the time a go-ahead decision was made until our grand opening," Deitrick recalls. "But the arduous process was well worth it. Pioneer is a financial institution owned by shareholders who live here in the Yakima Valley. Our primary concern is for the people we serve—our neighbors and fellow business associates."

COMPUTER LINKS
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curity on the Fed Wire network, provides the potential for back-up link-ups to other Fed sites in cases of emergency, and permits increased control over message flow.

Keith Davis, Assistant Vice President (Support Services) of the San Francisco Fed's Computer Services Group, said that costs should be further reduced in the future as a result of new communications services available from common carriers. Davis added, "We are now transferring tens of billions of dollars per day over this network. Anything that increases security or control—such as the computer-interface system—is a real plus for the entire communications network."

FOCUS ON CENTRAL BANKING—Discussing the Short Course on Central Banking are (from left) Bob Easter, Mid-Cal National Bank; Senior Vice President Wes DeVries; Connie Woodcox, The Bank of California; Vice President Robert Dietz; and Larry Blair, Crocker National Bank.

FED HOSTS COURSE ON CENTRAL BANKING

Fourteen Northern California banks participated last month in the first annual Short Course in Central Banking sponsored by the San Francisco Branch of the Federal Reserve Bank of San Francisco.

This seminar was developed to provide management trainees and junior officers at commercial banks with an overview of Federal Reserve policies and operations.

During the two-day meeting, officers, economists and operations specialists of the San Francisco Fed covered such topics as monetary policy, the discount window, consumer affairs, equal credit opportunity, supervisory activities, check and cash operations, electronic funds transfer, fiscal operations and reserve accounting. Senior Vice President Kent Sims, in closing the sessions, discussed future trends in System policy and commercial banking.

Assessing the first Short Course, Senior Vice President Wesley G. DeVries, who is in charge of the San Francisco Branch, said that critiques by participants indicated that the program filled a need for closer communication between the central bank and commercial bankers. DeVries added that the Short Course was an excellent opportunity for staff members from the San Francisco Branch to meet commercial bankers face to face. "From the standpoint of commercial banks, the Short Course is also a means of supplementing their own development programs for officers and trainees who will be assuming key management positions in the future."

BALLES URGES INFLATION CURBS

The best hope for prolonging the recovery and lowering the unemployment rate is to reduce the underlying rate of inflation, John J. Balles told the Georgetown University Bankers Forum in Washington, D.C. last month.

The San Francisco Fed President said this policy prescription flows from the important research finding that the goals of reduced unemployment and lower inflation are mutually reinforcing, not conflicting. Under some circumstances, inflation may tend to increase rather than to decrease joblessness, according to a study by the Bank's research staff. The recent experience of Great Britain, Canada and Italy suggests the same results.

According to Balles, the perverse impact of rising prices on unemployment can be explained by the reactions of both consumers and producers, who associate inflation with increased uncertainty about the future.

"Households, more uncertain about the future value of their real incomes, tend to cut back on their spending plans. Businesses, more uncertain about the rate of return on new capital, tend to reduce investment in plant and equipment. The actions of both groups lower aggregate demand and thereby tend to raise the jobless rate."

Balles noted that many economists believe that an unexpected increase in the inflation rate will lead to a short-run reduction in unemployment—reflecting a positive supply response, with businessmen hiring more workers to increase output because of the better prices they receive for their products. But he argued that this positive response will soon be undone by negative reactions on the demand side, as households and businesses reduce spending because of increased uncertainty about the effects of inflation.

"What does this research finding imply for monetary policy?" he asked. "Quite simply, that we should pursue a gradual reduction in the growth rates of the monetary aggregates, to a level consistent with long-run price stability. This would follow the course initiated two years ago, when the Fed began the practice of making quarterly reports to Congress regarding our monetary-growth targets."

The Fed official said that there was no need for a more expansive monetary policy despite recent signs of a slower rate of growth in the economy. "For one reason, monetary policy has already been very expansive in 1977. Money-growth rates are not only high by historical standards, but are also above the upper bounds of the current targets which the Fed has set for long-term monetary growth."

He added that easing actions would not be called for even if there were stronger evidence of business sluggishness. Citing the case of the late-1976 "pause," he argued that if the Fed had responded to that episode with a more expansive policy, the effects would have been felt in the first half of this year, when the economy was booming and inflation reaccelerating.

Balles noted that the "pause" was really a mini-inventory cycle. "I don't believe that monetary policy should try to offset quarterly variations in economic growth caused by such mini-inventory cycles. Instead, I believe that it must aim at establishing a stable environment conducive to sustained economic expansion over the long haul."

The Fed official said that the achievement of fiscal restraint is the greatest policy challenge in the years ahead. He explained, "When fiscal policy results in chronic, massive budget deficits, the Fed comes under tremendous pressure to provide more reserves to the banking system to help finance such deficits. This reserve expansion increases the rate of monetary growth and ultimately leads to more inflation."

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Phone (415) 544-2184

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