Federal Reserve Notes

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VOLCKER GIVES CONGRESS MONEY TARGETS FOR 1982

Federal Reserve Chairman Paul Volcker, in Congressional testimony this month, outlined the 1982 money-growth targets appropriate to maintaining progress against inflation. He noted that, by year-end 1981, virtually all major price indexes were advancing well below double-digit rates, for the first time since 1978.

Volcker argued, however, that the events of the past several years have demonstrated one important lesson—ending an inflation is not a simple and painless process, especially when the inflation has become deeply imbedded in business and household expectations. Also, the events of the past several months have demonstrated that these problems can be aggravated if too much of the burden rests on only one policy instrument—monetary policy. In this connection, he noted the skepticism in financial markets about policymakers' dedication, in view of their past inability to "carry through" with anti-inflationary policies, most notably in the boom of the late 1970s.

Volcker listed several necessary elements in a *sustained* recovery—such as speeding the transition to lower interest rates and healthier capital markets, and reducing the costly elements of anticipated inflation built into wage and price contracts. To accomplish this, however, he said that the Federal Reserve must maintain a sustained (and hence credible) anti-inflationary

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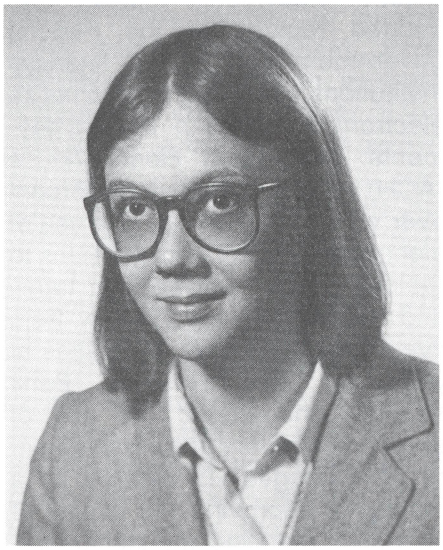
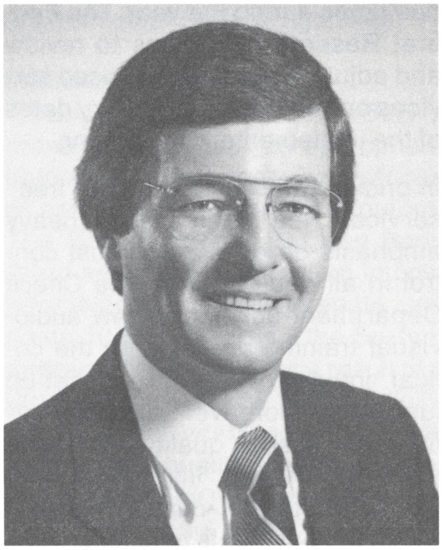


Sara Garrison



John Hoover

GARRISON, HOOVER NAMED FED VPs

Sara Garrison and John F. Hoover, two new Federal Reserve vice presidents, are playing key roles in implementation of the Monetary Control Act.

Hoover, with 20 years' professional banking experience, has joined the San Francisco Reserve Bank's Financial Services Group. Garrison, who joined the Bank in August 1977 to organize and develop its international-reports activities, has been promoted officer in charge of the Statistical and Data Services Department. She succeeds Matti von Turk, who resigned to accept a position with BankAmerica Investment Management Company.

Hoover reports to Richard T. Griffith, executive vice president of District Operations, and is responsible for product management and customer relations in Financial Services. The department was formed in mid-1981 to develop, price and market various operating services being offered to financial institutions by the Federal Reserve Bank of San Francisco.

A native of New York, Hoover served on the staff of the Fed's Board of Governors from 1973 to 1979. While there, he attained the position of assistant director of financial examinations. Prior to coming to the San Francisco Fed, he was senior vice president and cashier at the Republic Bank of Houston, Texas.

Hoover earned a bachelor of science degree in economics at Fordham University, and did graduate work at George Washington University in management and organizational development. His other banking experience included serving as a vice president and manager of administrative services at the First Interstate Bank of California in

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SAN FRANCISCO RESERVE BANK REPORTS ON EXPANDED SCOPE OF OPERATIONS IN 1981

The January issue of this publication summarized the major operating results of the Federal Reserve Bank of San Francisco in 1981. This issue completes the story with a review of payments services and other activities.

Payments Services

All payments departments became actively involved in the implementation of open access and pricing during 1981. As noted above, pricing schedules were phased-in at various times during the year. The Federal Reserve now plans to review and adjust fees for those priced services on the 1982 anniversary dates of the implementation of pricing.

In pricing what were formerly "free" services, the Bank placed heavy emphasis on quality and cost control in all departments. The Check Department developed new audio-visual training programs in the critical input-processing and set-up functions. Moreover, all Bank offices established quality-assurance units to develop, implement, and monitor internal quality controls within the payments functions.

In its first several months under check pricing, the Reserve Bank experienced a six-percent decline in check-processing volume. At the same time, it witnessed a dramatic surge in the handling of "fine sort" deposits—that is, in handling presorted bundles containing up to 250 checks payable at a single check-processing endpoint. Nationwide, the Federal Reserve lost an average of about eight percent of its total check volume to the private sector, which is in line with projections made before the commencement of pricing. In the preceding three years, in contrast, the Federal Reserve experienced check-processing growth of six to seven percent annually. Pricing probably was the major reason for the overall decline in volume, but other factors also contributed—such as an increase in overnight availability of check exchange among some of the nation's major commercial banks via chartered air-carrier. The Fed also provides overnight consolidated shipments among most of its 48 nationwide processing centers, but check-availability times can stretch to two days where more remote points are involved.

Electronic-payments activity expanded rapidly, as the Federal government and private financial institutions continued to emphasize electronic transfers for making payments. Automated clearinghouse (ACH) volume increased 35 percent over year-earlier levels. The use of electronic datalink transmissions to replace courier deliveries of tapes and reports expanded rapidly, from five sites at mid-year to 15 sites at year-end. The Reserve Bank strongly encouraged the use of electronic delivery and presentment of ACH images via datalink as a means of improving the quality of services, reducing manual operations, and encouraging greater use of ACH facilities. The Fed used long-run costs as a price basis for ACH operations. With electronic payments encouraged in this fashion, the System believes that the public will benefit in terms of efficiency and improved collection time.

Cash, Fiscal Activities

Despite all the activity in check and electronic payments, the Reserve Bank continued to handle substantial amounts of coin and currency in 1981. Altogether, it paid 4.6 billion coins and 1.7 billion pieces of currency into circulation during the year. Efficiency in the cash function improved with the installation of high-speed currency sorting machines, of which eight are now in operation at various District locations. Each machine has an optimum feed rate of 1,200 notes a minute, and is capable both of detecting counterfeits and of destroying on-line those notes which do not meet minimum fitness standards. These high-speed units also deliver a consistent quality of fit currency, which is needed to meet the requirements of the financial industry as it continues to expand its use of automated teller machines.

In its role as fiscal agent for the U.S. Government, the Reserve Bank handled substantial amounts of public-debt instruments in the form of savings bonds and marketable Treasury securities. Activity in marketable securities increased five percent in volume, reflecting continuing investor interest in the record high rates offered on such issues. But as a result of the installation in 1980 of an automated Treasury-bill processing system, the District's Fiscal Department was able to respond effectively to the heavy workload associated with Treasury-bill purchases. The Los Angeles office, which handles all savings-bond operations for the District, installed a minicomputer-based software system to improve the efficiency as well as the quality of customer services in this area. And as noted previously, the Reserve Bank completed development of the SHARE resource-sharing project, which automates safekeeping and transfer of book-entry and definitive securities in fiscal activities.

The Bank continued efforts to curb the cost of transportation activity—which is the District's third largest expense item, after personnel costs and new-currency costs. Rising fuel prices continued to boost costs of air transportation for the inter-district check-delivery system, but costs rose at a much slower pace than heretofore. Airline-industry deregulation and the air traffic-controllers' strike led to a declining number of scheduled commercial flights, but the District's contracted commercial-freight forwarder displayed a high level of performance during the year. This permitted the Bank to reduce transportation-related float (checks credited prior to receiving payment) for those cash letters delivered to other Reserve Banks throughout the System. In early 1981, the Bank redesigned its intra-district check-delivery network into a single service contract with all offices utilizing one carrier. This streamlined system affords greater management control and cost efficiency in comparison to the previous system, which utilized a half-dozen different carriers.

Supervisory Developments

In the supervisory area, the bank examinations and bank holding-company inspections conducted during 1981 confirmed the generally healthy condition of the institutions supervised by this Reserve Bank. However, examiners found many evidences of the effects of inflation—such as reduced liquidity, marginally lower capital ratios, pressure on earnings, and (in some instances) lesser asset quality. The Bank kept examination costs in line by adopting new policies regarding frequency of examinations. One new policy permits the use of an 18-month instead of a 12-month cycle of examinations for sound and well-managed state member banks. Similarly, the Reserve Bank entered into an agreement with the California State Banking Department, whereby each agency will examine well-managed state member banks in alternating years. The Bank continued to coordinate its holding-company examinations with the examinations of subsidiary banks made by other regulatory agencies, in line with the policy developed by the Federal Financial Institutions Examination Council, the coordinating body for Federal regulatory agencies. The policy promotes efficiency by pooling the knowledge and skills of different regulators when conducting examinations of the larger bank holding-company organizations.

The applications staff handled a workoad which doubled in size, largely because of the desire of District financial institutions to position themselves for anticipated legislation that could reduce existing limitations on geographic operations and types of services offered. Notable among the applications processed was Midland Bank Ltd.'s request for approval to acquire a controlling interest in Crocker National Corp.—the largest and most complex application ever submitted under the Bank Holding Company Act.

In discharging its responsibilities, the Bank's staff examined more than 100 international offices—such as agencies of foreign banks, overseas offices of U.S. banking organizations, and Edge Act corporations (firms involved in international trade and finance). Edge operations continued to increase substantially during the year, in line with earlier legislation which permitted banking organizations to consolidate their Edge operations into nationwide branch networks. There are now six head offices of Edge corporations in the District with 26 branches nationwide, reflecting the conversion of individually-capitalized corporations into branches of larger entities, as well as the establishment of new branches in cities not previously served. Conversely, most of the individually-capitalized corporations previously operating here converted to branches of other out-of-district entities, while eight new Edge branches opened for business in the District. Foreign agencies, Edge corporations, and banks conducting international business meanwhile established 50 International Banking Facilities (IBFs), as a result of legislation and regulations designed to encourage offshore activities to remain within domestic jurisdictions.

The consumer-affairs staff conducted examinations at all state member banks and also at about one-fifth of their branches, in line with a Federal Reserve program designed to achieve broad-based compliance with consumer-protection laws and regulations. The staff processed almost 1,000 individual complaints against commercial banks during 1981—about 35 percent more than in 1980—but none of the complaints required the Bank to resort to its enforcement powers to compel remedial action. In its educational role, the consumer-affairs staff published a consumer-education booklet designed to assist potential borrowers looking for a loan, as well as creditors who want to improve their customers' understanding of credit transactions. In addition, the unit co-hosted several seminars with Board of Governors staffers, to explain key material from the Truth in Lending Simplification and Reform Act both to lending-institution personnel and to examiners from other Federal agencies.

Improved Productivity

Throughout the year, the Bank's management struck an appropriate balance between cost effectiveness of operations and quality of output. The San Francisco Reserve Bank rated second in the System in cost effectiveness, with aggregate unit costs 10 percent below the System average. Meanwhile, as a result of a quality-improvement program initiated several years ago, the Bank improved its quality of performance, as measured by reductions in errors and processing times on various operational tasks. The Federal Reserve is now actively reviewing measures of quality because of the new emphasis on market-oriented services under the Monetary Control Act.

Lastly, as a means of assuring the effectiveness of future operations, the Bank continued construction work on a 12-story, 653,000-square-foot headquarters building on San Francisco's Market Street. The present headquarters building was built in the 1920s and is small and inefficient from the standpoint of 1981-style banking operations. Indeed, with recent increases in workload, the Bank's headquarters operation now has spread over five separate buildings. The new facilities are scheduled for occupancy in late 1982, ready to assist the Bank in providing many central-banking services to a large and diverse group of Western financial institutions.

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Los Angeles, and as international systems planning officer at Chase Manhattan Bank in New York.

Garrison, who holds a doctor's degree in psychology from Tulane University, began work at the Federal Reserve as a statistical analyst in 1977. She was promoted to Manager of International Reports in 1979 and to International Reports Officer in 1980.

The Statistical and Data Services Department handles the Bank's economic and financial statistics. This includes the reporting and reserve-maintenance requirements of more than 1,600 Western financial institutions, reflecting the sharp expansion of reporting under the Monetary Control Act.

Prior to joining the San Francisco Fed, Garrison held various academic positions, from research assistant to adjunct assistant professor, at Tulane, Hunter College and the University of Wisconsin.

Von Turk had joined the San Francisco Fed in 1971 as the senior statistician in the Bank's Research Department. She subsequently became the first officer in charge when Statistical and Data Services was established as a separate department in 1975.

1982 MONEY TARGETS

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monetary policy throughout the next several years.

In his Congressional testimony, Chairman Volcker quantified these broad goals of policy, as the Federal Open Market Committee is required to do under the terms of the Humphrey-Hawkins Act. For 1982, he announced monetary-growth ranges of 2½ to 5½ percent for the narrow M-1 aggregate; 6 to 9 percent for the broader M-2 measure, and 6½ to 9½ percent for M-3, the broadest measure. In general, M-1 (the former M-1B) includes currency and transaction (checkable) deposits at depository institutions, M-2 includes currency plus all types of deposits (except large time certificates) plus money-market funds, and M-3 primarily equals M-2 but with the inclusion of large time certificates.

The M-1 target for 1982 is lower than the range specified a year ago for M-1B (3½ to 6 percent after a NOW-account shift adjustment), but the M-2 and M-3 ranges were left unchanged. The 1982 M-1 range is consistent with somewhat larger actual growth than was experienced last year with the adjusted measure.

In the Chairman's words, "The lower end of the range would now appear appropriate only if the pace of financial innovation again picks up"—for instance, with a rapid spread of arrangements for "sweeping" temporarily excess check-account balances into money-market funds or other liquid assets not included in M-1. Given the present level of M-1 and last year's relatively slow growth, the Fed could find acceptable an outcome in the upper half of the range. That outcome would be roughly equivalent to a four-percent growth rate from the lower end of the range targeted in 1981.

Volcker continued, "These technicalities should not confuse a simple message: consolidating the progress we've already attained on the inflation front will require continued restraint on monetary growth." The growth ranges specified for 1982 are consistent with an economic recovery later this year, but not with the sharp type of recovery experienced in the past. He claimed that the most important objective is a *sustainable* non-inflationary recovery—something the nation has not been able to achieve in the last several decades.

Free copies of the Federal Reserve report, "Monetary Policy Objectives for 1982," are available on request from the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 544-2184.