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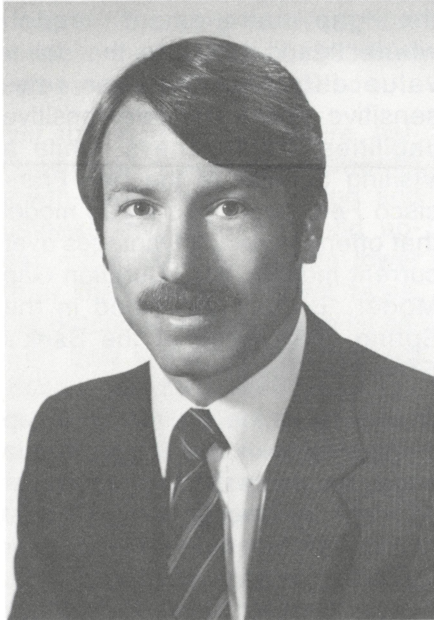
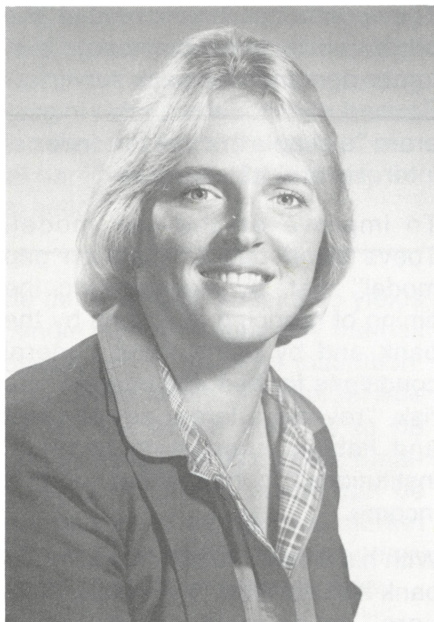


Michael Murray



Patricia Lang

ORGANIZATIONAL CHANGES AT S.F. FED

The San Francisco Fed recently completed a series of major organizational changes that included two senior management promotions and a new division of responsibilities among its executive management group.

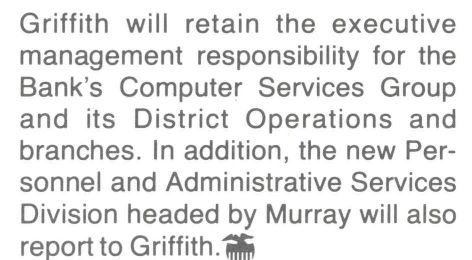
Michael J. Murray was promoted to senior vice president with responsibility for directing the newly formed Personnel and Administrative Services group. This Division consists of the Corporate Personnel Department, the Administrative Services Department and the Protection and Building Services Departments.

Patricia K. Lang was elevated to vice president and has succeeded Murray as officer in charge of the Corporate Personnel Department. Ms. Lang is responsible for directing all major personnel functions, including employment and training, compensation, benefits and employee relations for the District's 2200 employees.

One major change in executive management responsibilities involved the transfer of responsiblity for the Bank's financial planning, accounting and control functions to executive vice president Kent Sims, who has been named the Bank's chief financial officer. In a related move, John J. Carson, a senior vice president, was named controller. Another addition to Sims' responsibilities was the Bank's Facilities Planning Department, which oversees the Bank's new building projects in San Francisco and Los Angeles.

In announcing the Bank directors' approval of the reorganization, Bank president John J. Balles said it was undertaken to improve the balance in the work loads of individual members of executive management and to smooth the transition to a new first vice president. Effective upon his retirement August 1, John B. Williams, first vice president, was succeeded by executive vice president Richard T. Griffith.

Griffith will retain the executive management responsibility for the Bank's Computer Services Group and its District Operations and branches. In addition, the new Personnel and Administrative Services Division headed by Murray will also report to Griffith.



VOLCKER REPORTS POLICY TO CONGRESS

In testimony before Congress on July 20, 1983, Paul A. Volcker, newly reappointed Chairman of the Federal Reserve Board, gave his mid-year review of the course of monetary policy. He spoke at length on the economic recovery that seems to be progressing faster than anyone had expected, the continuing demands on the credit market of "growing structural deficits" that may crowd out the recovery, and the international dimension to the economic outlook in which the "extraordinary strength of the dollar" and the debt problems of the developing world figure prominently.

Excerpted below are Volcker's statements regarding monetary policy in 1983 and beyond. For copies of his complete testimony, please

(Continued on page 3)

ASILOMAR CONFERENCE PROCEEDINGS AVAILABLE

From November 28 through 30, 1982, the Federal Reserve Bank of San Francisco sponsored a conference on interest rate deregulation and monetary policy at Asilomar in Monterey, California. The proceedings of the Conference have been published by the Bank and copies are available from the Public Information Department at $5.00 a copy. Address requests to P.O. Box 7702, San Francisco, CA 94120 or call (415) 974-2246. Checks should be made payable to the Federal Reserve Bank of San Francisco. An outline of the contents of the published proceedings follows.

Contents of Proceedings

Opening Remarks	John J. Balles, President FRB San Francisco
Defining the Issues	Stephen Axilrod, Staff Director Monetary and Financial Policy Board of Governors Frank E. Morris, President FRB Boston
Monetary Targeting in a Zero Balance World (Author's Comments)	Richard G. Davis, Senior Economic Adviser FRB New York Discussants: William Poole, Council of Economic Advisers John Paulus, Morgan Stanley and Company
Financial Change and Monetary Targeting in the United States	John P. Judd, Research Officer John L. Scadding, Research Officer FRB San Francisco Discussants: Stephen Goldfeld, Princeton Univ. John H. Makin, Univ. of Washington and IMF
Roundtable	Thomas Mayer, Univ. of California, Davis V. Vance Roley, FRB Kansas City David Laidler, Univ. of Western Ontario
Financial Innovation, Deregulation, and Monetary Policy: The Foreign Experience	David H. Howard, Senior Economist Karen H. Johnson, Economist Board of Governors Discussants: Charles Freedman, Bank of Canada Michael Parkin, Univ. of Western Ontario Yoshio Suzuki, Inst. for Monetary and Economic Studies and Bank of Japan
Panel Presentation: Alternative Intermediate Instruments of Monetary Policy	James I. Pierce, Univ. of California, Berkeley Neil Wallace, Univ. of Minnesota Donald D. Hester, Univ. of Wisconsin, Madison Jerry L. Jordan, Univ. of New Mexico

IMPROVING THE GAP MANAGEMENT MODEL

Unpredictable events surround economic decisions and are often critical to their outcome. In recent years, unexpected fluctuations in interest rates have had a major impact on depository institutions' net interest income, prompting institutions to search for systematic methods of reducing their interest rate risk. One popular management tool has been the "gap management" model, where "gap" refers to the dollar value difference between rate-sensitive assets and rate-sensitive liabilities. Alden Toevs, while a Visiting Scholar at the San Francisco Fed, developed a gap model that offers several advantages over current models. His "Duration Gap Model" is fully described in the Spring 1983 issue of the Bank's *Economic Review*.

According to the conventional gap management model, a bank would hedge the interest rate risk of its net earnings by keeping the gap equal to zero in the time interval over which net earnings are to be hedged. Toevs, however, notes two serious shortcomings. First, he believes that the existing model "unnecessarily constrains a bank's choice of assets and liabilities" in creating a hedge. The constraints, in turn, reduce "the bank's ability to accommodate customer demands for bank services." Second, the model is unable to generate "a simple and reliable index of interest-rate risk exposure."

To improve on the gap model, Toevs developed a "duration gap model" that, by incorporating the timing of repricing decisions by the bank and by using more general conditions for hedging interest rate risk, "reveals a larger set of asset and liability choices to financial institutions" to hedge net interest income.

With his model, Toevs shows that a bank can develop "risk-return frontiers" to quantify opportunities available to it for positioning its balance sheet to profit from interest rate forecasts.

VOLCKER REPORTS

(Continued from page 1)

contact the Public Information Department at (415) 974-2246.

As you are well aware, interest rates dropped sharply during the second half of 1982 as the recession continued, and, with inflation subsiding, reserve pressures on the banking system were relaxed. Growth in money and credit has been, quite plainly, adequate to support growth in economic activity—indeed more growth in the first half of 1983 than had been generally anticipated...

Over the more distant future, balanced and sustained economic growth—with strong housing and business investment—would appear more likely to require lower rather than higher interest rates. That outcome, however, can be assured only if the progress against inflation can be consolidated and extended. In considering all these factors, the FOMC basically concluded that the prospects for sustained growth and for lower interest rates over time would be enhanced, rather than diminished, by modest and timely action to restrain excessive growth in money and liquidity, given its inflationary potential. But I must emphasize again that the best assurance we could have that monetary policy can in fact do its part by avoiding excessive monetary growth within a framework of a growing economy and reduced interest rates over time lies not in the tools of central banking alone, but in timely fiscal action.

Ranges for M2 and M3

Looking ahead, the Committee decided that the growth ranges established early in the year for M2 and M3 during 1983 (7-10 percent and 6½-9½ percent, respectively) are still appropriate. The most recent data, while showing somewhat larger increases in June, are still within (M2), or about at the upper end (M3), of those ranges...

The Committee also decided to continue the associated ranges for growth in total domestic non-financial credit of 8½ to 11½ percent...

Monitoring M1 and Debt

Decisions concerning appropriate targets for M1 were more difficult. As discussed further in an Appendix to this statement, the velocity of M1...has varied significantly from usual cyclical patterns, dropping more sharply and longer during the recession and failing to "snap back" as quickly. While a number of more temporary factors have contributed, a significant part of the reason appears to be related to the fact that a major portion of the narrow "money supply" now pays interest... For a time at least, uncertainty about the financial and economic outlook, and less fear about inflation, may also have bolstered the desire to hold money.

Growth in M1—in running well above our targets for nine months—has not, however, been confined to NOW accounts alone. Moreover, there are signs that the period of velocity decline may be ending. In looking ahead, with the economy expanding and with ample time for individuals and others to have adjusted to the rapid decline in interest rates last year, we must be alert to the possibility of a rebound in velocity along usual cyclical patterns, even though the longer-term trend may be changing.

In monitoring M1, the Committee felt that an appropriate approach would be to assess future growth from a base of the second quarter of 1983, looking toward growth close to, or below, nominal GNP. Specifically, the range was set at 5 to 9 percent for the remainder of this year, and at 1 percent lower—4 to 8 percent—for 1984. Thus, the Committee, in the light of recent developments, looks toward substantially slower, but not a reversal, of M1 growth in the future. Velocity is expected to increase, although not necessarily to the extent common in earlier recoveries.

...The targets, by themselves, do not necessarily imply either further interest rate pressures or the reverse in the period ahead—much will depend on other factors. In particular, progress in the budget and continued success in dealing with inflation should be powerful factors reducing the historically high level of interest rates over time, to the benefit of our private economy and the world at large.

"Targeting" Other Economic Variables

...I believe there are strong reasons why it would be unwise to cite "objectives" for nominal or real GNP rather than "projections" or "assumptions" in these Reports.

...The Federal Reserve alone cannot achieve within close limits a particular GNP objective—real or nominal—it or anyone else would choose. The fact of the matter is monetary policy is not the only force determining aggregate production and income. Large swings in the spending attitudes and behavior of businesses and consumers can affect overall income levels. Fiscal policy plays an important role in determining economic activity. Within the last decade, we also have seen the effects of supply-side shocks, such as from oil price increases, on aggregate levels of activity and prices. In the last six months, even without such shocks, the economy has deviated substantially from most forecasts, and from what might have been set as an objective for the year.

The duration gap model also yields a single number to quantify the risk position of the financial institution. This number is useful if interest rate risk for the entire bank is to be hedged in the futures market. Finally, the duration gap model can be generalized to hedge the market value of bank capital against unexpected changes in interest rates.

Copies of the Spring 1983 issue of the Bank's *Economic Review* are available through the Public Information Department at (415) 974-2246.

CHECK FLOAT RETURN ITEMS

Following its announcement of a one-day deferral of credit for interterritory returned items implemented on August 1, 1983, the Federal Reserve issued new procedures regarding intraterritory returned items on July 7, 1983.

Intraterritory returned items will continue to receive immediate availability, if deposited in *separately sorted* return item letters. This procedure will eliminate daily average interterritory return item float of $130 million nationally. Institutions may continue to deposit mixed return item cash letters if they choose but mixed cash letters will receive a one-day deferral of credit.

Intraterritory return items are those items that bear endorsements from depository institutions located in the same Reserve Office territory. Since the current procedures do not identify the type of return item cash letter, the Fed asks depository institutions to stamp "LOCAL" clearly on separately sorted intraterritory letters. This change became effective August 1, 1983.

Only return item cash letters marked in this manner will be given immediate availability. It is not necessary to identify interterritory or mixed return item cash letters.

For further information, please contact the Check Officer of the Federal Reserve Office serving your institution: Douglas Knudsen in San Francisco at (415) 974-2069, Sally Hackett in Los Angeles at (213) 683-8351, H. William Pennington in Portland at (503) 221-5903, Robert Richards in Salt Lake City at (801) 322-7887, and Kenneth Peterson in Seattle at (206) 442-5105.

SECURITIES SAFEKEEPING AND NONCASH COLLECTION FEES

The Federal Reserve Board requested comment on proposed revisions to the fee structures for its definitive securities safekeeping and noncash collection services by August 8, 1983.

The definitive securities safekeeping service consists of vault storage, primarily of municipal and corporate securities. (With the exception of arranging purchases and sales of Government and Agency securities, the Twelfth District offers definitive securities services only for collateral accounts.) Noncash collection provides a payments mechanism designed to collect items that cannot be processed through normal check collection channels. In accordance with the Monetary Control Act, the Federal Reserve began pricing these services in October 1981.

The proposed noncash collection fee structure would include fees per coupon envelope collected, as does the current structure. The fees for postage and insurance would continue to be based on the value of the coupons being collected. For bond redemptions, fees would be assessed for each redemption transaction, as opposed to the current fee for each item in a transaction. Actual charges for postage and insurance would continue to be charged for each bond redemption transaction.

The Board also requested that discussion of the future role of the Federal Reserve in the definitive securities safekeeping and noncash collection services be included in comments.

Copies of the Board's notice are available from our Corporate Services Department at (415) 974-2752. For further information, please contact the Securities Services Officer at your local Federal Reserve Office.

PROPOSED 1983 PRICES: TWELFTH DISTRICT

Definitive Safekeeping	
Purchases and Sales (per transaction)	$23.50
Noncash Collection	
Bond Collection (per transaction)	35.50
Local Collection (per envelope)	6.00
Per $1000 coupon value	1.00

Federal Reserve Bank of San Francisco
101 Market St., San Francisco, CA 94120

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