FEDERAL RESERVE BANK
OF PHILADELPHIA

September 11, 1986

Mr. Robert M. Landis
Chairman of the Board
Federal Reserve Bank
of Philadelphia
Philadelphia, PA. 19106

Dear Bob:

I have never found a perfect time to change the discount rate, and a Wednesday is a bit unusual. But the particular explanation for August 21 is straightforward.

It was not "forced" by particular economic or financial circumstances. But it was reasonably clear to me the Board had been in a mood to act for some days. I thought it useful to review the matter and hear the views of the Reserve Bank Presidents during the FOMC meeting on Tuesday; otherwise we might have acted on Monday, a more "normal" day. A number of Board Members were traveling out of Washington on Thursday, and the market doesn't like us acting on Friday. I and others would be out of town the following week. Hence, by a process of exclusion, the Wednesday action, which, as I indicated, reflected to some extent the substance of discussion at the FOMC.

In a sense, I welcome your concern as a reflection of the seriousness with which you take your responsibilities. As you know, we get and review some Reserve Bank proposals every week, and there is no day that permits a fresh review by every Bank. But your letter does bring to our attention one clear disadvantage of a Wednesday, other things equal, which, by accident of scheduling, was not the case on the 21st.

Best regards,

PAV:ccm

FEDERAL
RESERVE BANK OF
PHILADELPHIA

Chairman of the Board

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
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OFFICE OF THE CHAIRMAN

August 21, 1986

Honorable Paul A. Volcker
Chairman
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

Dear Paul:

This morning the Philadelphia Federal Reserve Bank had its regular meeting and endorsed yesterday's action of the Board of Governors lowering the discount rate to 5 1/2 per cent. Our review of current economic and credit conditions in the region and our report to the Board seemed anticlimactic.

With New York, Boston, Chicago and Philadelphia having scheduled meetings for Thursday and Atlanta for tomorrow, it was hard to see the action of the Board yesterday, in the absence of any necessitous circumstance, as other than indifference to the views of a significant number of banks on this important action.

It comes in striking contrast with the letter I received from Governor Angell in early July in which he urged us to continue to make reporting to the Board on our rationale for discount rate actions "a high priority." He said, "An important role of Reserve Bank directors is to provide the Board of Governors with a current view of economic and credit conditions in their regions through their actions on the Reserve Bank's discount rates."

Dear Bob,
I have never found a perfect time to change the discount rate, and a Wednesday is a bit unusual. But the Friday explanation for August 21 is clearly not true. We were not "forced" by particular economic or financial circumstances. Neither was it exactly clear to me the Board had been in a mood to act for coverage. I thought it wasteful to receive the Reserve presidents' unanimous vote on Tuesday.

Ten Independence Mall, Philadelphia, PA 19106, (215) 574-6000

FEDERAL
RESERVE BANK OF
PHILADELPHIA

Chairman of the Board

Many of us are concerned with the independence of the Reserve Banks and their role in the functioning of the Federal Reserve System. We hope to preserve and enhance it.

With my best regards,

Sincerely,

Bob

Robert M. Landis

RML:dgk
cc: Wayne D. Angell

Ten Independence Mall, Philadelphia, PA 19106, (215) 574-6000

Federal Reserve Bank of Philadelphia
on Independence Mall

OFFICE OF THE
PRESIDENT

July 31, 1981

TO: ALL GOVERNORS AND PRESIDENTS

FROM: EDWARD G. BOEHNE

I found the attached memo dealing with the short-run impact on interest rates of the extended credit program for thrifts helpful in organizing my thoughts. Perhaps you'll find it helpful as well.

Attachment

cc: Stephen H. Axilrod
Peter D. Sternlight

Sixth and Arch Streets
Philadelphia, Pennsylvania 19106

FEDERAL RESERVE BANK OF PHILADELPHIA

July 30, 1981

TO: Mr. Boehne
Mr. Mullineaux

FROM: Mr. Lang

SUBJECT: Short-Run Impact of the Extended Credit Program on Interest Rates

Executive Summary

Borrowing from Federal Reserve Banks will increase under the extended credit program. In order to maintain the same total reserve path, the nonborrowed reserve path will be lowered by the amount of borrowing generated by the program. This offsetting change in the nonborrowed path is designed to prevent an expansion of money growth in excess of the FOMC's desired growth. The short-run impact of these reserve adjustments will be an increase in the Fed funds rate and other short-term interest rates. There are two reasons for this effect.

First, the change in the mix of borrowed and nonborrowed reserves will increase interest rates. Under lagged reserve accounting, the demand for total reserves in the current week is essentially fixed. A reduction in nonborrowed reserves will force more bank borrowing at the discount window. But since banks perceive that there are costs associated with borrowing from the Fed ("reluctance to borrow "), the Fed funds rate is bid up as banks attempt to avoid borrowing at the window. Thus, the change in the mix of reserves supplied will increase interest rates in the short run.

In addition, the new demand for borrowings by thrifts essentially represents an increase in the demand for total reserves. Under lagged reserve accounting, this demand by thrifts cannot be offset immediately by a reduction in demand for reserves by banks. Consequently, the Fed funds rate will rise even further in the short run.

The upward adjustment of interest rates will exacerbate thrift institutions' problems, possibly resulting in even greater demands on the discount window. A cumulative rise in extended credit from the Reserve Banks would be offset by further reductions in nonborrowed reserves, resulting in another upward adjustment of interest rates. Thus, it is possible that a more sustained rise in interest rates could develop. Whether the higher level of interest rates would result in slower money growth than the FOMC desired is open to debate at this point.

Short-Run Impact of the Extended Credit Program

Under the extended credit program, the Federal Reserve would lend to thrift institutions in order to allow them to avoid selling long-term assets at substantial losses. The Federal Reserve loans essentially will be replacing other funds that are being withdrawn by depositors.

In order to keep this lending from expanding total reserves above the desired path level, the Board proposes that the nonborrowed reserve path be reduced by the amount of thrift borrowing. The short-run impact of this approach will be to increase the Fed funds rate, as demonstrated below. Futhermore, if this type of lending expanded over time, the higher level of short-term interest rates could result in slower money growth than originally anticipated, at least for a time.

Supply and Demand for Total Reserves

Figure 1 depicts the supply (TR^s) and demand (TR^d) for total reserves as functions of the Fed funds rate (FFR). As the funds rate rises, the quantity of reserves demanded declines.

The supply curve of total reserves can be viewed as having three distinct parts. First, the supply curve is vertical at the policy-determined level of nonborrowed reserves (NBR_0). Reserves supplied in excess of nonborrowed reserves are borrowed reserves, where the amount borrowed rises as the spread between the funds rate and discount rate (DR) widens. The discount rate is assumed to be held constant for our purposes. There is some maximum amount of reserves which the Fed would lend; that is, some level of total reserves (TR_m) beyond which the Fed would refuse to lend at the window.

The Fed determines the initial level of nonborrowed reserves (NBR_0) and the intersection of the supply and demand curves determines the funds rate (FFR_0), total reserves (TR_0), and borrowing ($TR_0 - NBR_0$), as shown in Figure 1.

Before analyzing the extended credit program, it is useful to consider what happens to the funds rate if the Fed reduces nonborrowed reserves but does not alter the maximum amount of reserves it is willing to supply. In the very short-run of one week, the demand curve for total reserves is vertical under lagged reserve accounting (Figure 2). Nonborrowed reserves are reduced from NBR_0 to NBR_1, and the total reserve supply curve shifts from TR^s to TR^{s1}. Although total reserves remain the same (TR_0), borrowings increase ($TR_0 - NBR_1$) and the funds rate rises (FFR_1). Thus, a change in the mix of the reserves supplied in the current week will raise the funds rate.

The Extended Credit Program

The extended credit program will be triggered as the Fed offsets outflows of deposits or other liabilities from thrifts. Essentially, thrifts now will be demanding reserves, which will shift TR^d to the right (see TR^{d1} in Figure 3). In the current week, the increase in the demand for reserves is represented by $TR_1 - TR_0$. The Board proposes to supply these reserves to thrifts, but plans to offset them by an equal reduction in nonborrowed reserves. Nonborrowed reserves decline to NBR_1 (where $NBR_1 - NBR_0 = TR_1 - TR_0$). Unless banks are convinced that the terms of borrowing have been made easier—which could flatten the upward-sloping portion of the supply curve—the funds rate will rise to FFR_1.

Note that total reserves will rise above their target path in the current week even though the Desk lowers the nonborrowed path. Under lagged reserve accounting, the additional demand for reserves by thrifts cannot be instantaneously offset by a reduction in reserve demand by banks.

In the short run, upward adjustments in short-term interest rates could be quite large if the amount of thrift borrowing is large. This upward adjustment of interest rates will exacerbate the thrifts' problems, possibly resulting in even greater demands on the discount window.

How large could the extended credit program become? From April through June, thrift institutions experienced deposit outflows totalling $10 to $11 billion. If the Federal Reserve by itself had offset these deposit outflows with discount window lending, the nonborrowed reserve path by the end of June would have been lowered $10 to $11 billion. Since nonborrowed reserves in June were only $38 to $39 billion, the Board's proposed offset to extended credit lending would have reduced nonborrowed reserves by more than 25 percent.

At present it is expected that loans to thrifts would amount to from $1 to $2 billion. If one were concerned about the short-run effect of such lending on interest rates, one would want to keep the level of borrowing from rising much above that range. A reduction of nonborrowed reserves of $1 to $2 billion would have much smaller effects on financial markets than a reduction of $10 billion.

The initial increase in the funds rate as nonborrowed reserves are lowered will, with a lag, reduce the demand for reserves (and money). So over a longer time horizon, the funds rate and total reserves will return toward their original levels. But if lending to thrifts expanded over a period of time to higher and higher cumulative levels, the funds rate would continue to increase as the Desk successively

lowered nonborrowed reserves to offset the increased borrowing. Thus, it is possible that a more sustained rise in interest rates could develop. Whether the resulting short-run money growth would be significantly slower than the FOMC's desired short-run path is open to debate at this point. But there is some risk of this associated with the proposed adjustments to the nonborrrowed reserve paths.

FIGURE 1

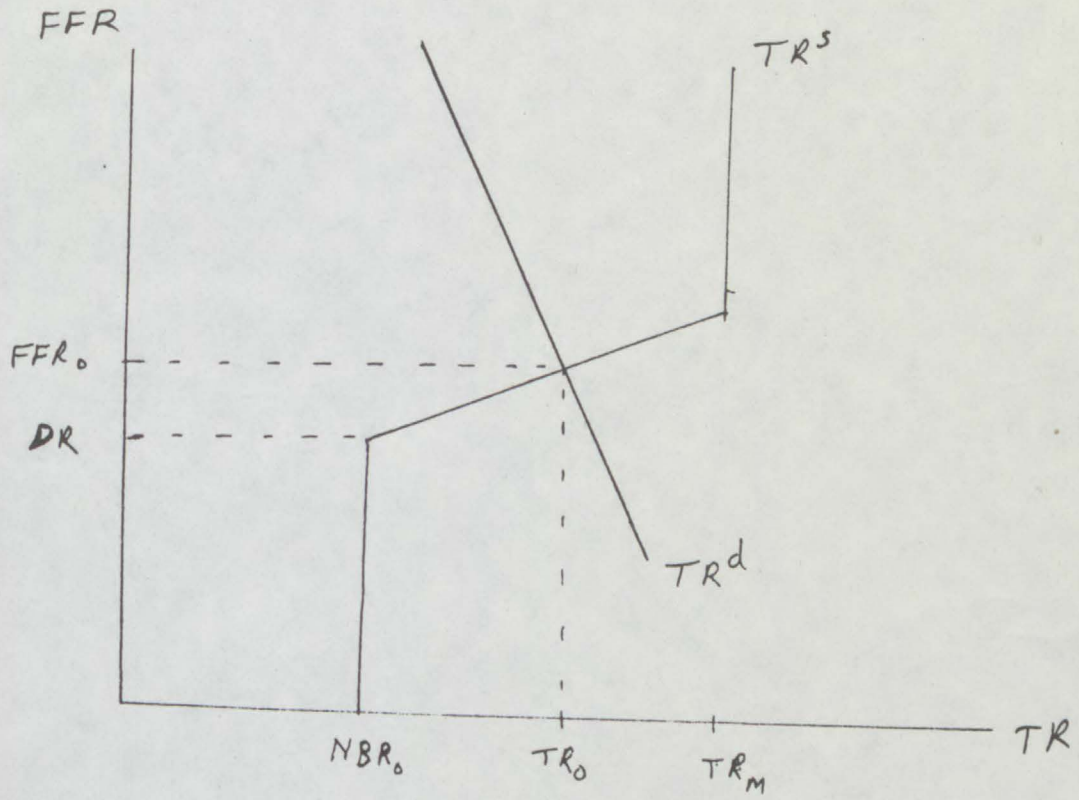


FIGURE 2

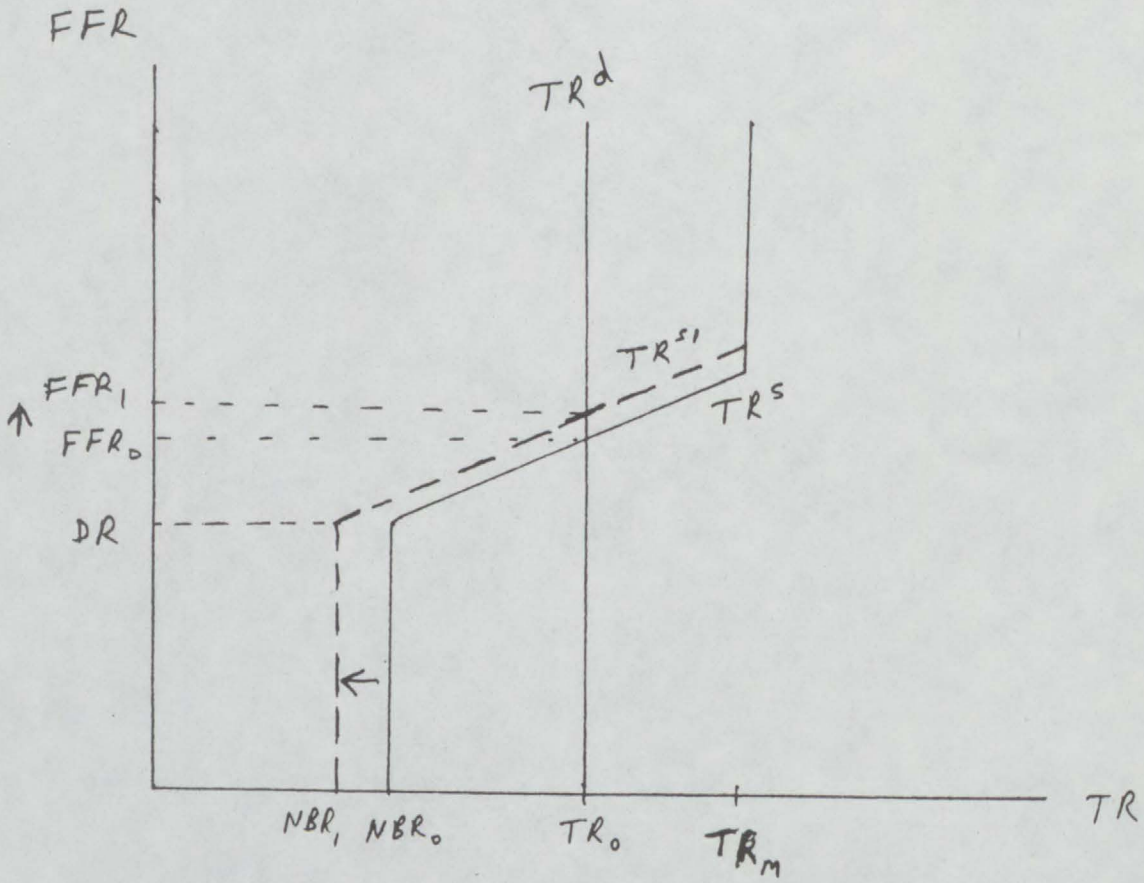
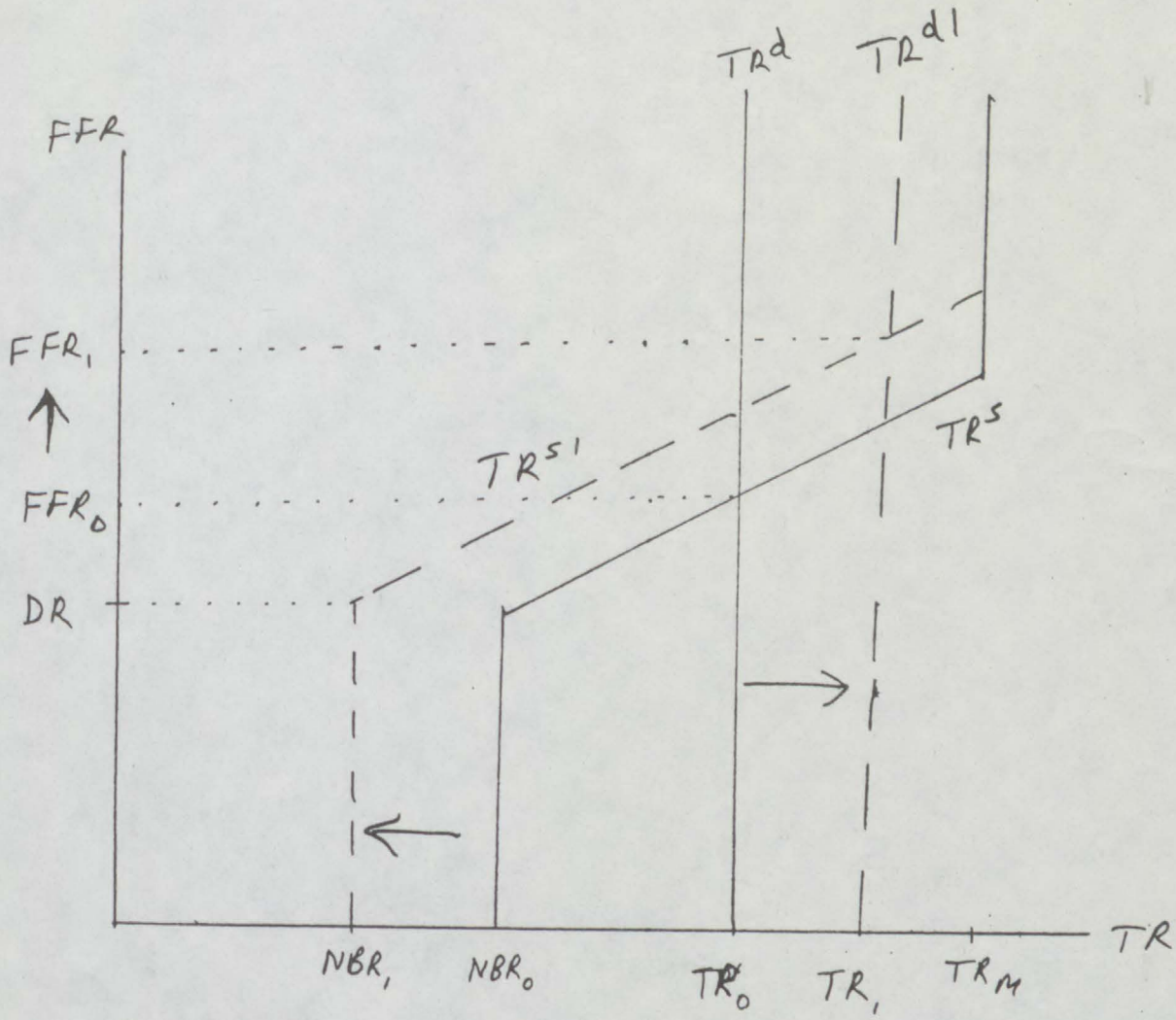


FIGURE 3



Ms Mallardi

January 5, 1981

David P. Eastburn, President
Federal Reserve Bank of Philadelphia
Philadelphia, Pennsylvania 19105

Dear Dave:

Thank you for your letter of November 26th concerning the impact of Regulation D on credit unions. In adopting the new reserve requirement provisions, the Board recognized that they would affect the current operations of many institutions and could require changes in the level of services being provided to customers. The restrictions on the use of telephone transfers were believed necessary in order to make reserve requirements on transactions accounts effective. If unlimited telephone transfers were permitted, a regular share account could be used to feed a share draft account, with a resulting loss of required reserves. If such a practice became widespread, the increase in monetary control, which was the fundamental purpose of the Monetary Control Act, could be hampered significantly. I believe that the ability of individuals to obtain an explicit return on their transactions balances should ameliorate the concerns expressed by many consumers. Of course, an unlimited number of telephone transfers are permitted from share draft and NOW accounts and, in addition, an unlimited number of mail withdrawals are permitted from any type of account.

You also indicated the concern expressed by many credit unions that the ability to make more than three transfers requires that the entire balance in the account be regarded as a transaction balance. Of course, the impact of this provision should be minimal because effective reserve requirements are low as a result of the eight-year phase-in of reserve requirements provided by the Act. If a credit union does not wish to restrict the ability of a member to withdraw by telephone in order to avoid reserve requirements, we recommend that it segregate the minimum balance requirement by placing it in a separate account, which is subject to the three telephone transfer per month limitation. While this may necessitate the use of two separate accounts, it has the effect of significantly reducing reserve requirements.

The Board has been concerned with the impact the Monetary Control Act would have upon depository institutions. We have attempted to implement the provisions of the Act in a fashion that minimizes the disruption of services being offered to the public yet facilitates achievement of the objectives of the Act. We believe that our efforts to date have struck a favorable balance.

Sincerely,

bcc: Ms. Mallardi (2)
Chairman's Log #3017

GTS:bbo
12/2/81

TO: Chairman Volcker

DATE: January 2, 1981

FROM: Messrs. Ettin and Schwartz

SUBJECT: Two issues dealing with reserve requirements.

Recently you asked that we investigate two matters dealing with reserve requirements.

I. New York banks and interest-bearing transaction accounts

According to a New York Federal Reserve Bank survey of officers in charge of the retail operations of eight large city banks (attached), there appears to be no avoidance of Regulation D, particularly on the three transfers per month provision. Indeed, several institutions, including Citibank, indicated that monitoring systems are already--or shortly will be--in place to assure the proper classification of deposits for reserve requirement purposes.

II. Letter to President Eastburn on request for relief by credit unions

In light of the New York survey results, we have drafted a response that encompasses your earlier comments. (See attached)

Attachments

MISC 3 4 (1/77)

FEDERAL RESERVE BANK
OF NEW YORK

OFFICE CORRESPONDENCE

DATE December 31, 1980

TO Mr. Juncker
J. Boss

FROM Bank Regulations Division

SUBJECT Survey on Transfers from Nontransaction Accounts

A survey was conducted by the Federal Reserve Bank of New York between December 24 and 31, 1980 concerning current bank practices in handling certain transfers from nontransaction accounts. Eight large money center banks were asked for responses to specific questions regarding nontransaction and transaction accounts.1/

The survey asked whether the banks widely offer telephone transfers, preauthorized transfers, automatic bill paying services, and debit cards through which third party payments can be made. The survey requested information regarding the banks' method of monitoring the monthly limit of three transfers when such transfers are from nontransaction savings accounts, whether customers are notified and/or charged a fee when the limit is persistently exceeded, and what procedures are in place to treat nontransaction accounts as transaction accounts for reserve requirement purposes when activity exceeds the three transaction limit for several periods.

The survey revealed that five of the eight banks, (Bankers, Irving, Manufacturers, Marine and Morgan) do not widely offer telephone transfer services or automatic bill paying services. Bankers, Irving and Manufacturers said they offer preauthorized transfers, but only on a very limited basis and only in connection with transaction accounts. Both Marine and Irving either have, or intend to have, pilot programs for such accounts, but only in connection with transaction accounts.

Chase and Chemical informed us that they widely offer telephone transfer services, preauthorized transfers and debit cards, all of which are handled through transaction accounts. Chemical intends to offer these services in the near future through nontransaction accounts subject to the monthly limit of three transfers. When these services are offered on nontransaction accounts, Chemical will activate an encoder system which identifies the fourth transaction and automatically and immediately shifts the account into a reservable transaction account. Chase's system for telephone transfers will not permit more than three transfers from savings to checking in any given month. The caller is advised upon his fourth call that he must come to a branch office to effect the transfer either at a teller window or at an ATM.

1/ The eight banks in the survey are: Bankers Trust Company (Bankers); Chase Manhattan Bank, N.A. (Chase); Chemical Bank (Chemical); Citibank, N.A. (Citi); Irving Trust Company (Irving); Manufacturers Hanover Trust Company (Manufacturers); Marine Midland Bank, N.A., (Marine) and Morgan Guaranty Trust Company (Morgan).

Citi says it does not generally offer telephone transfer services or bill paying services. It relies on its extensive network of 24 hour automated teller machines (ATMs) available at most branch sites and its "Citicard" which permits internal transfers between accounts. Payments on loans and bank credit cards are also permitted through the ATMs but a check is used to effect third party payments with the ATM serving as a lockbox. Citi also offers limited preauthorized transfers but only from transaction accounts. Telephone transfers are offered for the purchase of travelers checks from both transaction and nontransaction accounts, but this service is in the process of being restricted to transaction accounts. In the meantime, a monitoring system to prohibit more than three preauthorized transfers from nontransaction accounts is in place which prohibits a fourth transaction. It appears on the basis of information supplied, that Citi's systems provide a clear distinction between transaction and nontransaction accounts and adequate monitoring of activity.

JB:GRJ:LK/gr

Federal Reserve Bank of Philadelphia
on Independence Mall

OFFICE OF THE
PRESIDENT

#3017

November 26, 1980

The Honorable Paul A. Volcker
Chairman
Board of Governors of the
Federal Reserve System
Washington, DC 20551

Dear Paul:

As part of our general effort to meet our new constituents under the Monetary Control Act, we have had a number of meetings with credit union groups. We found credit unions to be quite upset about a couple of issues related to what constitutes a transaction account.

First, credit unions, because they have a relatively small and known customer base, do much of their business by telephone. Customers seldom, if ever, come to the credit union office to transact business. For this reason most share accounts with immediate withdrawal features can be accessed by telephone to move funds to other accounts. Unless the credit unions now go back to their customers and inform them that all such movement of funds between share accounts and other accounts will have a limit of three transfers per month, all these accounts will be classified as transactions accounts. Credit union executives feel these accounts are not really used for transactions purposes. They are not used for third party payments. They feel consumers just find it more convenient to use the telephone to transfer money from a share account to another account instead of getting into their car and driving to the credit union. They think it is ridiculous to now discourage telephone transactions.

Second, many credit unions that permit telephone transfers from share accounts have a minimum balance specified by the customer. The reason that the minimum exists is to qualify the customer for maximum life insurance benefits. At some credit unions this minimum balance is as high as $2,000. Under our current definitions the entire account, if it had no transfer restrictions, would be classified as a transactions account even though $2,000 of the balance is not eligible for transfer.

Sixth and Arch Streets
Philadelphia, Pennsylvania 19106

We promised credit union leaders in our district that we would pass these concerns on to you. Should the Board staff wish additional information, please have them contact Bill Stone, Vice President.

Sincerely,

David P. Eastburn

DPE/kb

Federal Reserve Bank of Philadelphia
on Independence Mall

Mr Schultz

October 28, 1980

The Honorable Frederick H. Schultz
Vice Chairman
Board of Governors of the
Federal Reserve System
Washington, DC 20551

Dear Fred:

I am enclosing an update of our master list of candidates of the Philadelphia Fed's presidency. If, after looking these names over, you have any additional comment, I'd appreciate hearing from you.

Our work goes well and we'll keep you posted from time to time on our progress.

Best regards,

Werner C. Brown

Werner C. Brown
Chairman, Search Committee

Enclosure

Sixth and Arch Streets
Philadelphia, Pennsylvania 19106

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Citation Information

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Citations: Recommendations for President, October 1980.

cc Mr. Axilrod

FEDERAL RESERVE BANK OF PHILADELPHIA
PHILADELPHIA, PENNSYLVANIA 19105

OFFICE OF THE
PRESIDENT

September 26, 1980

The Honorable Paul A. Volcker
Chairman
Federal Reserve Board of Governors
Washington, DC 20551

Dear Paul:

I have looked over the agenda of topics for the planned analysis of FOMC targeting issues which you forwarded in your letter of September 19. I think this effort is both necessary and timely and the outline of papers strikes me as quite comprehensive.

If I have any reservations about the project, they concern our apparent unwillingness to be rather open about it. It seems quite natural and appropriate for the Committee to be presently undertaking this endeavor. Indeed, I would be quite surprised if questions were not soon raised in Congress or the media about the need for such an evaluation.

I don't mean to suggest that we should publicly announce that we're carrying out such an analysis. That would imply that this is something more than a normal exercise designed to evaluate our policy. But I am concerned that too much effort may be devoted to keeping things under wraps, so to speak. This could be detrimental to the quality of the analysis as well as to relations with the public and the Congress.

I recognize your valid concern about public misinterpretation of such a study. But misinterpretation is also likely if we appear to be less than forthcoming, and this bothers me more.

Sincerely,

David P. Eastburn

cc: All Presidents and Governors
S. Axilrod