Fed to Maintain Money Supply Targets

The Federal Reserve will maintain the targets for growth in the nation's money supply it established at the beginning of the year but will allow growth "around the top of those ranges", according to testimony given before Congress by Paul A. Volcker, chairman of the Board of Governors of the Federal Reserve System. The report given by Volcker July 20 and 21 evaluated the performance of the economy in the first half of 1982 and discussed the outlook for the coming months.

Volcker told Congress that the Federal Open Market Committee, the monetary policy-making arm of the Fed, allowed growth toward the upper ends of the target ranges during the first half of 1982 because of an increased desire by individuals and businesses to hold assets in relatively liquid forms due to the uncertain state of the economy. The assets affected are part of the various definitions of the money supply, Volcker said.

The target growth ranges of 2.5 to 5.5 percent for the monetary aggregate M1; 6 to 9 percent for M2; 6.5 to 9.5 percent for M3; and 6 to 9 percent for commercial bank credit will be maintained throughout 1982 and will be tentatively retained for 1983. "Moreover—and I would emphasize this—growth somewhat above the targeted ranges would be tolerated for a time in circumstances in which it appeared that precautionary or liquidity motivations, during a period of economic uncertainty and turbulence, were leading to stronger than anticipated demands for money," Volcker stated.

Volcker's testimony reemphasized the Fed's firm stand on its fight against inflation. "I find it difficult to suggest when and how a credible attack could be renewed on inflation should we neglect completing the job now," he said. Volcker also stated that, while important, a new and more restrained fiscal policy does not justify greater growth in the monetary aggregates at this time and that such growth would only tend to undercut any benefits from the budgetary effort because of renewed inflationary expectations. "We believe fiscal restraint should be viewed more as an important complement to appropriately disciplined monetary policy than as a substitute," Volcker said.

A written report on the state of the economy and the course of monetary policy is required twice a year of the Federal Reserve Board by the Full Employment and Balanced Growth Act of 1978. Volcker's testimony was given in conjunction with the submission of this written report.
Direct Coin Wrapping Services Offered

Coin wrapping services will be available to financial institutions directly from the Dallas Fed beginning September 1. The new service will be offered in addition to the bulk coin services which continue to be available directly from the Fed.

Now financial institutions will have a choice as to how they receive coins from the Fed and may also be able to reduce costs. Previously, rolled coin service charges were debited from accounts one week before they were received by the ordering institutions. With the new wrapping service, institutions will have their accounts debited only one day before they receive the coins.

Specific information regarding the new coin wrapping service and its fees is available from the Cash Department.

Institutions now have the choice of receiving wrapped coin or coin in bulk.

DIDC Approves New Short-term Account

In its June 29 meeting, the Depository Institutions Deregulation Committee (DIDC) approved a new short-term deposit account as an initial step toward allowing banks and thrift institutions to compete more effectively with money market funds.

The DIDC approved an account with a term to maturity of seven to 31 days and with an interest rate ceiling tied to the 91-day Treasury bill rate. A minimum daily balance of $20,000 is required for the new account, which will be authorized beginning September 1.

Initially, thrifts are allowed to pay a rate equal to the current week's auction average of 91-day T-bills, while banks may pay up to 25 basis points less than the T-bill rate. This differential will be eliminated on May 1, 1983. During the interim, if the 91-day T-bill rate falls to or below 9 percent for four consecutive weeks, the differential will disappear until the rate rises above 9 percent again.

Withdrawals from the accounts are permissible by advance notice only, and no third-party drafts on the accounts are allowed. If the average balance in the account ever falls below $20,000, the interest rate must be reduced to the regular passbook savings rate, currently 5 1/4 percent at commercial banks and 5 1/2 percent at savings and loan associations. Compounding of interest will be allowed for the new accounts.

New Reserve Proposal Adopted

The Federal Reserve Board has adopted in principle a new system of accounting for bank reserves designed to give tighter control over the nation's money supply.

On June 28, the Board voted to require banks and savings and loan associations to institute a practice known as contemporaneous reserve accounting. Under the current method, known as lagged reserve accounting, financial institutions have two weeks after they close their books on Wednesday to establish reserves against the amounts in their accounts. The new system will shorten the lag involved in posting those reserves to two days.

The controversial issue of contemporaneous reserve accounting has been supported by the Reagan administration in hopes of establishing greater stability in long-term interest rates by decreasing the volatility in the supply of money and credit.

The new system will make it easier for the Fed to control total reserves and thus more effectively control the money supply.

The proposal has been adopted in principle only, and the effective date will be sometime during 1983 to allow financial institutions time to adjust their present systems.
Fed Launches New FRCS-80 Network

On June 28, the Federal Reserve System began operations of its new Federal Reserve Communications System for the Eighties, also known as FRCS-80. This system, which has been in the developmental stage for a number of years, replaces the Fedwire network which was used throughout the past decade.

A general purpose data communications network, the FRCS-80 consolidates the functions of previous separate communications networks into a single system capable of accommodating present and future needs. The system functions with a minimum capacity of three times the Fed's 1980 peak hour demand and can handle the Federal Reserve's internal communications requirements as well as its communication of statistical data to the Treasury and other government agencies.

In addition, the FRCS-80 will meet the Fed's requirements for providing services to on-line financial institutions, especially those services associated with the anticipated increased volume of electronic payments during the next decade. In 1981, for example, the Federal Reserve completed over 50 million funds transfers with a dollar value of almost $100 trillion. The FRCS-80 is also used to process other services, such as securities transfers and automated clearinghouse messages, and will improve the reliability and efficiency of these types of communications.

The FRCS-80 does not utilize a single central switching site such as the former switch in Culpeper, Virginia used for the previous network. Instead, the computer power of the FRCS-80 is distributed initially among 14 interconnected communications processors, or "nodes". These nodes are now located at the 12 Federal Reserve Bank head offices, the Treasury in Washington, and at Culpeper. Each node can read a message's destination and send it in the proper direction so that a message will travel through no more than two nodes in moving from one Fed to another. The Culpeper site has been transformed into the Network Management Center for the new system. Future expansion of the system and additional nodes are possible.

The FRCS-80 incorporates a new technology known as multipath packet-switching. Packet-switching describes the way in which messages are broken down into small sets of data, or packets, and are then combined with other message fragments in transit in order to maximize the efficiency of transmissions through communications lines. The messages are reassembled into their original form at the receiving point.

Institutions which were on-line with the former network are automatically connected with the new system and will not notice any operational changes resulting from the implementation. The Dallas Fed currently offers three levels of on-line service to financial institutions through its RESPONSE network, ranging from personal computers linked with the system through telephone communications lines to direct computer-to-computer links with the Fed's system.
Collection Service Enhanced

The Dallas Fed has announced several enhancements to its service of collecting corporate and municipal coupons which will provide increased flexibility and improved availability to the financial institutions using this service. The changes are effective with coupons payable in August 1982.

Immediate credit will be given on the maturity date for coupons classified as "future due", or those which are deposited prior to maturity. This represents a one-day improvement in credit availability for city items—those which are payable in the city of a Reserve Bank office—and a two-day improvement in availability for country items—those which are payable outside of Reserve Bank office cities. As in the past, city items must be deposited two banking days prior to maturity, and country items must be deposited six banking days prior to maturity.

For country items classified as "past due", or those which are deposited after maturity, credit will be given five banking days after receipt. This represents a three-day improvement in credit availability.

In addition to these changes, the Dallas Fed will no longer require presorting of coupon deposits according to city or country paying agent. Any mixed coupon cash letter the Fed receives will be handled according to country availability schedules. Institutions may continue to presort coupon deposits according to city or country paying agent and according to future or past due maturity date to receive the optimal credit availability, however.

Federal Reserve Bank offices act as the collecting agent for corporate and municipal coupons as part of the non-cash collection service. The Fed collects the funds and credits institutions' accounts for coupons deposited.

Loan Changes Announced

The basic discount rate at the Dallas Fed was reduced from 12 percent to 11.5 percent effective July 20. The lowering of the discount rate, which is the rate the Fed charges on loans to financial institutions, was approved by the Board of Governors and represents the first decline in the rate since December.

The Federal Reserve Board also announced July 6 that, in conjunction with the closing of the Penn Square Bank in Oklahoma City, "receiver's certificates" issued by the Deposit Insurance National Bank of Oklahoma City would be acceptable as collateral for discount window advances at the regular discount rate. The Deposit Insurance National Bank was formed by the FDIC to liquidate the assets of the Penn Square Bank.