

Federal Reserve Bank of Dallas May 1985

## Where the Strong Dollar is Going

### Dallas Board Chairman Says the Long-Term Outlook is Good

The dollar's relative value will decline before the end of the year, but the drop will have beneficial effects in the long run to the U.S. and to its future economic well-being, according to Robert D. Rogers, President and Chief Executive Officer of Texas Industries Inc. and the Dallas Fed's chairman of the board.

Rogers made his prediction on the dollar's strength at a recent luncheon for business leaders in El Paso following the Board's April meeting in that city.

The strong dollar is responsible for increased unemployment and a decrease in the gross national product, he said. While the record trade deficit has kept inflation low, the deficit means the gross national product grew 2 percent less than it should have, and unemployment is about 2 percent higher than it should be, he said.

"It is estimated that our trade deficit has exported about two million jobs to foreign countries," Rogers noted. "The political and economic extravagances

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of a high trade deficit are acceptable as long as there is satisfactory GNP growth and a satisfactory unemployment rate. But what would happen if GNP growth were to disappear? Would we still be pleased to export 2 percent or more of annual GNP growth outside our borders? And what would happen if unemployment rates were to rise to 10 percent or more, would we still be willing to sustain 2 percent or more additional unemployment by exporting jobs?"

Rogers said he felt it was unrealistic, both politically and economically, to anticipate that the trade deficit can continue to grow. "The single most important factor affecting the trade deficit is the relative strong value of the dollar. Were it to fall, the trade deficit would fall correspondingly."



Robert D. Rogers

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The dollar's strength, which has increased 58 percent against other major currencies since 1980, won't continue much longer because of the difficulties the United States will have in financing its budget and trade deficit, he believes.

"The current national budget and trade deficits total \$300 billion and are rising," he noted. "These must and will be financed by savings, foreign and domestic." He cautioned, however, that the demand for dollars (and dollar assets) is not inexhaustible.

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# Capital Adequacy Guidelines Revised

The Federal Reserve Board has announced revisions to its capital adequacy guidelines for state member banks and bank holding companies to be effective May 15, 1985.

The amended guidelines require a minimum ratio of primary capital to total assets of 5.5 percent and a minimum ratio of total capital to total assets of 6.0 percent for all state member banks and bank holding companies. This requirement represents a decrease in the minimum primary capital ratio for community banking organizations (those with less than \$1 billion in total assets) and an increase in the minimum primary capital ratio for regional and multinational banking institutions. The minimum total capital ratio remains unchanged for community institutions and increases for larger banking institutions. (See table.)

Primary capital includes common stock, perpetual preferred stock, capital surplus, undivided profits, contingency and other capital reserves, instruments mandating conversion into common or perpetual preferred stock, allowance for loan and lease losses and the minority interest in the equity accounts of consolidated subsidiaries.

The Board has decided to deduct goodwill in computing primary and total capital ratios of state member banks. With respect to bank holding companies, the Board will continue to take the level and character of intangible assets into account in assessing capital adequacy, but will avoid any automatic deduction of goodwill or other intangible assets from primary or total capital.

The primary capital ratio for state member banks is computed as follows:

Primary capital components +  
 Goodwill/Average total assets +  
 Allowance for loan and lease  
 losses (exclusive of allocated  
 transfer risk reserves) -  
 Goodwill

For bank holding companies, the primary capital ratio is:

Primary capital components/  
 Total assets + Allowance for  
 loan and lease losses (exclusive

of allocated transfer risk  
 reserves)

The total capital ratio for state member banks is:

Primary capital components +  
 Secondary capital components\*  
 - Goodwill/Average total assets  
 + Allowance for loan and lease  
 losses (exclusive of allocated  
 transfer risk reserves) -  
 Goodwill

For bank holding companies, the total capital ratio is:

Primary capital components +  
 Secondary capital components/  
 Total assets + Allowance for  
 loan and lease losses (exclusive  
 of allocated transfer risk  
 reserves)

The new minimum ratios were established in the interest of achieving uniformity in the capital requirements of large and small banking organizations and maintaining consistency with other federal bank regulators. The amended guidelines, when considered in conjunction with the capital maintenance regulations of the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, establish uniform minimum capital levels for all federally supervised banking organizations, including bank holding companies, regardless of size, type of charter, primary supervisor or membership in the Federal Reserve System.

In general, banking organizations are expected to operate above the minimum primary and total capital levels.

The Board has decided, in accordance with its July 1984 proposal, to continue using its "zone" standards in assessing the adequacy of total capital. (See September 1984 *Roundup*.) Subject to consideration of other factors, institutions with capital equal to at least 7 percent of total assets fall in Zone 1 and would be considered adequately capitalized. Institutions in Zone 2, which includes organizations operating with total capital equal to 6 to 7 percent of total assets, would be considered marginally capitalized. Zone 3 states that banking organizations with total capital that is less than 6 percent of total assets may be considered undercapitalized, in absence of clear extenuating circumstances.

The Board made three changes in its existing capital guidelines for state member banks in order to define capital more consistently with the capital regulations of the OCC and FDIC. These changes, which do not apply to bank holding companies, require the automatic deduction of goodwill from primary and total capital; eliminate equity commitment notes from primary capital; and define the capital ratios in terms of average assets rather than period-end figures.

\*The components of secondary capital are: limited-life preferred stock (including related surplus); and bank subordinated notes and debentures and unsecured long-term debt of the parent company and its nonbank subsidiaries.

## MINIMUM CAPITAL RATIOS

	<u>Current Guidelines</u> (percent)	<u>Amended Guidelines</u> (percent)
<i>Minimum Primary Capital:</i>		
<i>Multinational and Regional Community (under \$1 billion in total assets)</i>	5.0	5.5
	6.0	5.5
<i>Minimum Total Capital:</i>		
<i>Multinational and Regional Community</i>	5.5	6.0
	6.0	6.0

# Fed Study Looks At Bank Fees

The majority of consumers, regardless of income, considers the level of service charges and fees to be a relatively unimportant factor in the selection of their primary financial institutions.

This is one of the observations in a study done by Federal Reserve Board staff on the impact of bank service charges and fees on customers. Commissioned last July by the Board's Consumer Advisory Council, the report draws on existing data sources, including three Federal Reserve-sponsored consumer surveys conducted in 1984, 1983 and 1977, and on Functional Cost Analysis information prepared by Federal Reserve Banks.

Consumers, regardless of their income level, generally rank convenience, availability of many services, and safety above low services charges or low minimum balance requirements when asked to cite the most important factors in their selection of a bank.

The data shows that in 1983, 79 percent of all families had checking accounts. The comparable percentages for low-income families and low-income minority families, who were of special concern to the Council in requesting the study, are 61 percent and 28 percent, respectively.

Families who do not have a checking or savings account are more likely to be poor, nonwhite home renters who have lower levels of education than families with accounts. Data shows, however, that those without accounts are generally satisfied with use of cash or money orders to pay their bills, the report states.

The study also looks at service charges and fees from the perspective of the commercial bank. It notes that while explicit pricing of consumer products and services is customary among businesses outside of banking, the recent evolution of commercial banking toward explicit pricing is often

viewed by the public with skepticism and distrust. The study suggests that to a large extent this skepticism may reflect the fact that over the years customers were accustomed to receiving many banking services and products without explicit charge. In fact, in many cases consumers expected to receive premiums for giving their business to a particular bank.

While commercial banks may have offered consumers products and services without charge, they were never free, the study notes. Rather, consumers paid for these services in other ways—primarily in the form of foregone interest on funds deposited in regulated accounts paying below market (although often the maximum authorized by law) interest rates.

The study suggests that some of the widespread consumer skepticism regarding the justification of increases in bank fees may be traced to poor communication between bankers and their customers. According to conclusions drawn by the Fed staff from all available data, banks generally did not profit from service charge increases.

A personal checking account analysis done as part of the study finds that, while minimum balance requirements and service charges have generally risen at banks since 1979, expenses incurred from providing these services also have risen. According to the report, service and handling fees increased by 42 percent at banks with less than \$50 million in deposits, by 103 percent at banks with deposits between \$50 million and \$200 million, and by 123 percent at the largest banks between 1979 and 1983.

However, the return to banks on the typical personal checking account in 1983 was found to be either essentially unchanged or somewhat smaller than in 1979, depending on the particular bank-deposit size category considered. This finding suggests, according to the report, that the increase in minimum balance requirements and service charge fee revenue over the 1979-1983 period was just sufficient to maintain a constant return on the average personal checking account.

## Reg AA Amended: New Rules for Loan Contracts

Regulation AA, Unfair or Deceptive Acts or Practices, has been amended by the Federal Reserve Board of Governors to eliminate some provisions which have previously existed in loan contracts. (The rule does not apply to credit extended for the purchase of real property.)

The new rules, which go into effect Jan. 1, 1986, will prohibit:

- repossession of household goods other than those for which the credit has been extended**
- “confession of judgment” clauses (when a borrower agrees in advance to permit legal judgment against himself upon default)**
- credit contracts requiring borrowers to agree to waive or limit state protections that shelter their homes**
- “pyramiding” of late charges (i.e.: penalizing those who are late on a single payment with extracted late charges after they have paid in full)**
- misrepresentation of a cosigner's liability**

The new rules will apply to all banks and their subsidiaries with the exception of savings banks that are members of the Federal Home Loan Bank System.

These rules have been amended to implement, as to banks, the Credit Practices Rule recently adopted by the Federal Trade Commission. The FTC's rules do not apply to commercial banks. However, the Federal Trade Commission Act requires that the Board adopt, subject to certain exceptions, substantially similar regulations.

The Board is not required to adopt a rule if it finds that such acts or practices of banks are not unfair or deceptive, or if adoption of similar regulations would seriously conflict with essential monetary and payment systems policies of the Board. The Board has concluded that neither statutory exception is applicable.

## Strong Dollar, continued

"The fundamentals of supply and demand will return, the political realities will be felt, and the relative value of the dollar will fall before the end of the year," he said.

Rogers added a postscript to his speech, saying his remarks were prepared before the dollar took a sudden and abrupt plunge because of the problems with certain thrifts in Ohio.

"While the drop is not unanticipated or unwelcome, as these remarks will attest, the form of this drop is unnerving." He said the significance of the drop is unavoidable and that faith in the dollar's value at today's relative price is fragile.



Rogers answered questions from the El Paso media after his speech.

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