Fed to Gauge Cost of Regulatory Compliance

The Resolution Trust Corporation (RTC) recently celebrated its third—and perhaps its last—birthday. Established in August 1989, the agency was charged with managing and disposing of bankrupt thrifts, as well as selling the repossessed real estate acquired by the defunct Federal Savings and Loan Insurance Corporation (FSLIC).

RTC officials have said publicly that their work is nearing completion. As of Oct. 1, 1992, no Eighth District thrifts were in RTC conservatorship (though some could be before the RTC’s authority expires next year).

The RTC estimates it will need an additional $45 billion—in addition to previous authorizations of $87 billion—to finish its job. (Resolutions have temporarily come to a halt because of a lack of funding.)

RTC officials indicate that this additional amount is sufficient to resolve all existing and new cases that it will likely take on by Sept. 30, 1993, when its authority expires. This makes the estimated price tag on the thrift cleanup $130 billion.

Since getting started, the RTC has closed 652 thrifts with a combined $216 billion in assets at closure. The majority of closed thrifts (384) were acquired by banks. Healthy thrifts acquired another 180. Of these bank and thrift acquisitions, about three-fourths were purchase and assumption deals—the acquiring institution received all of the deposits, some of the liabilities and a portion of the bankrupt thrift’s assets.
What the Fed Can Do To Stimulate Growth

During the past few months, many have found it difficult to distinguish the economic recovery from the recession that preceded it and are pressing the Fed to do more to stimulate economic growth.

Since the economy fell into recession, of course, the Fed has attempted to boost the pace of economic activity. The discount rate has been reduced seven times since December of 1990—four times since September 1991. Currently it is at 3 percent—its lowest level since 1963. Short-term interest rates are below their pre-recession levels and near 30-year lows. The growth of M1 and reserves has accelerated sharply. And reserve requirements have been lowered two times to stimulate lending.

As this list indicates, the Fed has used all the policy weapons in its arsenal to stimulate growth, yet the pace of economic recovery remains slow.

And the near-term outlook for rapid growth both here and abroad seems bleak.

What does this mean? It reminds us that the effects of monetary policy on the real economy are difficult to predict and short-lived. Monetary policy alone cannot increase the long-term growth potential of the economy. But, by establishing a stable price level—against which individuals and firms can make savings and investment decisions confidently—it can help ensure that this potential is realized.

As policymakers examine what can and should be done, we must remember the limits of monetary policy. We should be cautious about putting price stability and long-term growth at risk in an attempt to stimulate the economy in the short run.

Thomas C. Metzer is president of the Federal Reserve Bank of St. Louis.
Banks and Business Loans: Was There a Credit Crunch?

For more than two years, banks have been criticized for reducing the supply of business loans because of concern that this action either caused or contributed to the recent recession and the unusually slow recovery. Information on interest rates, bankers’ spreads, business loans and inventories, however, indicates that recent business loan performance was not uniquely different from its performance in earlier recessions when credit crunches also supposedly occurred. In reality, it is quite common for loans to decline during recessions and in the early stages of economic expansions.

A drop in loans can reflect either lenders’ reluctance to lend or borrowers’ reluctance to borrow. The critical difference is what happens to interest rates. During and temporarily after recessions, short-term interest rates typically decline, which indicates that loan demand, not loan supply, declines. The latest instance is no exception.

For example, the 90-day Treasury bill rate declined from a previous peak of 8.0 percent in early 1989 to 7.5 percent at the last business cycle peak (third quarter 1990) and continued to decline, reaching 3.11 percent in the past quarter. If there had been a credit crunch, interest rates would have risen to reflect bankers’ increased reluctance to lend.

Banks specialize in making business loans; however, because bank deposits are mainly short term, bank loans are also short term. As a result, firms rely on bank loans to finance short-term assets such as inventory and accounts receivable. In recessions, sales decline and firms reduce their demand for short-term assets, as well as their demand for short-term loans. This reduction in loan demand usually continues into the early stages of an economic expansion, as firms continue to sell excess inventory, rely on rebounding profits to finance limited asset expansion and switch to long-term financing such as equity and bonds.

During the recent recession, as in a typical recession, business loans have followed inventory movements quite closely. From early 1987 to early 1989, loans grew at a 5.9 percent annual rate, while inventory and sales grew at about a 7.9 percent rate. During the next year and one-half, sales growth slowed to a 5.9 percent rate, inventory growth slowed to a 4.3 percent rate and business loan growth slowed to a 3 percent rate.

During the subsequent recession (third quarter 1990 to second quarter 1991), sales growth slowed further to a 3.2 percent rate, inventory declined at a 3.3 percent rate ($27.6 billion), and business loans fell at a 2.5 percent rate ($11.9 billion). In the following year, sales rose 3.8 percent, inventory was essentially unchanged and business loans fell another $27.7 billion, or 4.4 percent. This pattern of slowing sales, inventory and business loan growth is typical of the eight recession and early-expansion periods since 1945.

During recessions, business failure and loan default rates rise. To compensate for this risk, interest rates on business loans typically rise relative to the rates that banks pay to fund their loans. This spread can be used to assess the recent experience. The spread between banks’ prime rate and the rate on 90-day CDs rose from about 1.8 percent in second quarter 1990 to a peak of about 2.7 percent in third quarter 1990. This spread was less than comparable spreads in the 1980 and 1981-82 recessions; in fact, the increase in the spread during the latest recession was smaller than increases during the previous four recessions. Thus the recent spread movement does not suggest an unusual reluctance of bankers to lend compared with earlier recessions.

Correctly assessing the reasons for a decline in loans presents policymakers from supporting unnecessary and potentially inflationary efforts to boost loans. History suggests that a rebound in business loans depends only on continued sales and inventory expansion.

John A. Tatom is an assistant vice president in the Research and Public Information Division of the Federal Reserve Bank of St. Louis. This discussion draws heavily on his recent article with Kevin L. Kliesen in the Bank’s September/October 1992 Review.
All-Electronic Deadlines for TT&L and ACH Near

It’s right around the corner: The Fed’s deadline for Treasury Tax and Loan (TT&L) depositories to convert to electronic connections is Dec. 31, 1992.

So far, 909 of the 1,246 District’s TT&L depositories—73 percent—have converted to Fedline®, a PC-based connection, or EDIT®, our telephone voice response system for advice-of-credit submission.

Meanwhile, commercial ACH receivers and originators are on pace for meeting the Fed’s July 1, 1993, all-electronic ACH initiative. Eighty-two percent of District ACH customers now receive their transactions electronically. The 100 institutions yet to convert to electronic connections can do so in four ways: through a bulk data link with the Fed, through our PC-based Fedline or FLASH-Light products, or through a third-party processor that has an electronic connection with the Fed.

District Bank Performance Continues Upward

Performance measures for the first half of 1992 indicate that District banks are positioned for a very good year. Key ratios of profitability and asset quality are significantly better than they were at this time in 1991. In addition, District banks continue to outperform their national peers.

Annualized Return on Average Assets (ROAA) for the first half of the year was 1.16 percent, an increase of more than 21 percent over the same period in 1991. The return on equity mirrored this increase in ROAA and now exceeds 14 percent on an annualized basis. A significant factor contributing to the higher earnings is the net interest margin, which has increased gradually over the past year to 4.4 percent. Nonperforming loans and loan losses have also decreased to their lowest levels in several years.

New Rule Reduces Publication Requirements

The Federal Reserve Board has issued a rule reducing the newspaper publication requirements for applications involving membership in the Federal Reserve System, establishment of branches of state member banks, bank mergers, bank holding company formations, and bank acquisitions by a bank holding company. Financial institutions are now required to have one notice, down from two, published prior to submitting applications to the Fed. This new rule, which took effect October 13, is part of a Systemwide effort to reduce regulatory burden.

St. Louis Fed Debuts Regional Quarterly

In mid-January, the St. Louis Fed will expand its coverage of regional economic developments in its seven-state area with the publication of a new quarterly magazine, The Regional Economist.

The Regional Economist will be geared to a non-economist audience and will address a broad range of economic topics. The first issue’s lead article looks at the health insurance industry, examining, among other things, some unique solutions at the state level to the problems of health insurance coverage.

Regular publication features will include an economic background piece—a primer on a current economic topic in the news—and an economic briefing—a state-by-state report on the latest business, banking, and agricultural developments in our District’s economy. The publication will also feature five pages of regional economic statistics.

The new 20-page quarterly replaces Pieces of Eight. In creating the new publication, all Pieces of Eight subscribers, as well as many individuals who have attended Fed-hosted meetings throughout the District, were surveyed about their specific interest in regional economic information.

The Regional Economist will be mailed to all Pieces of Eight subscribers. Others can reserve a subscription by calling Debbie Dawe at (314) 444-8809. The publication is free of charge.
Fed's Changes to Daylight Overdraft Policy Won't Hit District Hard

Though the Federal Reserve adopted a plan Sept. 30 to change banks that overdraw their Fed accounts during the business day, the penalties won't affect most Eighth District institutions.

The new charges, which will be phased in beginning April 14, 1994, will be imposed only on banks that incur excessive daylight overdrafts. Most District institutions are expected to be exempt from the rule because of the small number and value of their overdrafts; those that do incur charges will likely pay only a nominal fee.

Fees will be based on the size of the average daily overdraft. Nationally, only about 300 banks face potential fees; only 30 will pay more than $120,000 annually.

A secondary part of the Fed's plan—implementing new posting rules—will affect all Eighth District institutions that hold clearing accounts or reserve accounts with the Fed. The biggest change will occur Oct. 14, 1993, when banks will be required to post debits from check presentments within one hour, beginning at 11 a.m. EST. Banks will have two ways to credit their accounts for checks.

Both features of the Fed's plan attempt to reduce the Fed's risk from exposure to the overdrafts of large banks—those sending and receiving hundreds of millions of dollars a day—over Fedwire, the Fed's funds-transfer network.

Despite efforts to curb the practice, overdrafts now total about $180 billion at the peak of a typical business day.

Fed Streamlines Applications Procedures

As part of its program to reduce regulatory burden, the Federal Reserve recently revised several of its applications procedures that fall under the Bank Holding Company Act (Reg Y). At the same time, the Fed reaffirmed its current timetable for reviewing each application to ensure that its decisions are based on the complete record.

New measures include:

**Notice of Intent to File an Application**

Applicants may now submit a notice of intent to file an application. The notice, which will briefly describe the proposed transaction, helps the Fed identify, early on, issues unique to the proposal and clarify any information that the applicant must submit to ensure the proposal is adequately evaluated. The notice may be presented to the Fed by mail or in person.

**Limited Extensions to Pre-acceptance Period**

Extensions will now be granted only upon written request to the Fed, only for several days, and only in rare cases in which supplemental information requested by the Fed is necessary to complete the application.

**Elimination of Stock Redemption Notice for Certain Bank Holding Companies**

A stock redemption notice is no longer required from holding companies that will be "well capitalized" and in generally satisfactory condition following the redemption.
Since reducing the minimum daily fee for the MICRLine Capture service from $10 to $5 per day this spring, the St. Louis office has noted a 40 percent increase in the number of MICRLine customers. Currently, 68 St. Louis financial institutions are receiving MICR data electronically.

As a result of new customers, the monthly average of checks transmitted to St. Louis zone institutions via MICRline has increased by a half million, to about 2 million checks.

If you'd like more information on the Fed's MICRLine service, call 1-800-333-0869.

Amount Encoding Service Enhanced

On Sept. 12, the St. Louis office began accepting unencoded checks for deposit with the same availability as the regular deadline. To qualify, the unencoded checks must be received 90 minutes before any mixed or other Fed deadline. For example, our office must receive the unencoded checks by 7:30 p.m. to receive the same availability as our current 9 p.m. mixed deadline. The check encoding fee is $0.018 per item in addition to the normal deposit fees.

FCA Average Reports Now Available

The new Functional Cost and Profit Analysis (FCA) National Average Report contains 1991 income, expense and activity information gathered from more than 290 commercial banks across the country. This report also provides break-even, cost per-item and yield data on products for three deposit-size groupings, all in an easy-to-read format.

A new Credit Union Average report is also available. It contains 1991 FCA data from 53 credit unions nationwide. Each report costs $100. To order, send a check payable to Customer Support, Federal Reserve Bank of St. Louis, Post Office Box 442, St. Louis, MO, 63166. Please specify whether you want the commercial bank report or the credit union report.

Memphis Announces High-Dollar Group Sort Program

The Memphis Branch is now offering a group sort program that will allow customers to deposit checks drawn on three high-dollar Tennessee RCPC endpoints as late as 8 a.m. for same-day credit. There is a per-item fee of $0.66, in addition to a cash letter fee of $9.75 for in-zone depositors and $11.75 for out-of-zone depositors.

For more information, contact David Garavelli or Polly Hoskins at 1-800-238-5293 (Miss. and Ark.) or 1-800-552-5132 (Tenn.).

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