THE FEDERAL RESERVE BANK of ST. LOUIS

CB
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News and Views
for
Eighth District Bankers

A Year In Review: Fed's Bank Relations Effort Turns One

The St. Louis Fed's bank relations effort, launched last year to improve communications between the Fed and Eighth District depository institutions, begins its second year this month. Among the highlights of 1991:

* Bank President Tom Melzer hosted five District Dialogue meetings with CEOs of financial institutions. This year marked the first time that meetings of this nature were held in Mt. Vernon, Ill., and Paducah, Ky.

* About 200 participants attended first-ever Regional Economic Forums in Greenville, Miss., El Dorado, Ark., Jackson, Tenn., and Columbia, Mo. Fed economists and a representative from Banking Supervision participated in a discussion of economic issues with bankers and business leaders.

* District bankers applauded the Fed's new visit program, affirming the need for Fed officers to continue meeting with them. Hottest topics of discussion included the regional economy and Fed services.

* The Central Banker, or *CB*, our quarterly newsletter, is now mailed to more than 2300 individuals and, in its first year, covered topics ranging from the credit crunch and the shrinking S&L industry to truncation and the importance of the public comment process. A subscriber survey in this issue (see enclosed postcard) will help us continue to get you the news you need most.

Plans for year two of the bank relations effort include meetings in additional cities and more contact with bankers. If you have any suggestions about our bank relations programs, please call Jackie Himmelberg at 1-800-333-0810, ext. 8311, or (314) 444-8311.

Trends in Home Mortgage Lending Similar in District and Nation

Lenders in the Eighth Federal Reserve District approved the majority of home-purchase loan applications—roughly 77.5 percent of conventional loans and 62.2 percent of government-backed loans. Nationwide, the approval rates were 72.3 percent for conventional loans and 71.7 percent for government-backed loans.

Based on data from the four largest metropolitan statistical areas in the District (St. Louis, Little Rock/North Little Rock, Louisville and Memphis), black applicants were denied conventional home-purchase loans 2.8 times more often than white applicants in 1990. White applicants were denied about 12.4 percent of the time, black applicants, 35 percent of the time. Denial rates for government-backed loans were similar.

The primary reason reported for denying loans was credit history, followed by debt-to-income ratio and collateral.

Lending records of individual institutions varied greatly, depending on their location, the types of applicants they serve, the types of loan products they offer and their credit standards.

For 1992, several changes have been made in the HMDA reporting requirements. The major change requires financial institutions to begin using 1990 census tract numbers instead of 1980 in identifying and reporting property locations.

Feditorial

Why Fed Presidents Should Be on the FOMC

Anatol B. Balbach

Throughout the Fed's 77-year history, its independence and accountability have been questioned.

With the introduction of the Monetary Policy Reform Act last summer (see story below), this issue has risen again. Though it has been said before, it bears repeating: the Fed's structure ensures accountability, and Fed presidents contribute significantly to monetary policy decisions. Here's how.

Members of the Fed's Board of Governors, who constitute a majority (seven) of the Federal Open Market Committee (FOMC), are appointed by the President and are confirmed by the Senate. In addition, the President nominates and the Senate confirms the Board's chairman and vice chairman.

The five remaining voting members of the FOMC are regional Reserve Bank presidents. The Board approves the appointment of each Reserve Bank president and is responsible for overseeing Reserve Bank activities.

The Board also appoints three of the nine directors on each Reserve Bank's board of directors, including the chair and vice chair.

Thus, the Board of Governors, who are direct appointees of the President and Congress, and Reserve Bank presidents, who are directly responsible to the Governors, are ultimately answerable to both the President and Congress.

The Monetary Policy Reform Act, which proposes to limit monetary policy decisions to the Governors, will ensure that Washington exerts more everyday influence on policy. Because the primary impact of monetary policy is on the long-run economy, responding to short-term pressures by attempting to fine-tune the economy could do serious damage to long-term economic stability.

Historically, the more responsive a central bank is to short-term political concerns, the higher the long-run inflation rate and the lower the standard of living. Regional Bank presidents, simply because of their distance from Washington, can help insulate monetary policy from short-term pressures. They stand as an important buffer between persistent pressures to devalue the currency and the maintenance of economic stability.

Anatol B. Balbach is a senior vice president and director of research at the Federal Reserve Bank of St. Louis.

Congress Introduces Bill to Limit Fed Presidents' Role

The first Senate hearings on a bill to remove Federal Reserve Bank presidents from voting on monetary policy decisions were held in November.

The Monetary Policy Reform Act of 1991, which was introduced into Congress last August by Sen. Paul Sarbanes, D-Md., proposes to make the Federal Reserve's Board of Governors in Washington, D.C. solely responsible for directing monetary policy actions. A companion bill was also introduced in the House.

Essentially, the bill would eliminate the Federal Open Market Committee (FOMC), which directs open market operations, the most powerful and flexible monetary policy tool.

The FOMC is made up of 12 members, each with one vote. The seven members of the Board of Governors are always voting members as is the president of the New York Fed. The remaining four votes are rotated annually among the 11 other Fed presidents.

Under the new bill's provisions, Fed presidents would serve as advisors to the Board of Governors on monetary policy, but would not vote on policy actions.

The bill proposes to make the Fed more accountable by limiting monetary policy decisionmaking to members of the Board of Governors.

Daniel L. Thornton

How To Tell What the Fed Is Doing

Most observers agree that monetary policy has been easing for over a year now. The Fed's move to an easier monetary policy began with the onset of recession in 1990 and continued even more strongly in the last half of 1991 as the economic recovery began to look anemic.

Many analysts and most of the press base their conclusions about monetary policy on the behavior of interest rates, which have dropped substantially over the period. Unfortunately, the Fed has only a short-term influence on interest rates—it does not control them directly and has little influence on them over the long haul. Thus, interest rates are not a reliable indicator of Fed policy.

The only thing Fed actions are reliably related to is money growth; thus, it makes sense to examine money growth to see what indications it gives about Fed policy. Unfortunately, the growth rates of two widely used monetary aggregates, M1 and M2, give confusing and disparate indications of Fed policy. So which is better?

M1 is the sum of currency and checkable deposits, both of which are controlled by the Fed. Analysts, however, typically pay more attention to M2 because the Fed sets specific targets for its growth. The problem with M2 is that, in addition to M1, it includes several savings-type deposits: passbook savings, small-denomination time deposits, money market deposits, some money market mutual funds, etc. Currently, such deposits account for about three-fourths of M2.

These savings-type deposits are not subject to the Fed's reserve requirements, so they can grow or shrink for reasons that are unrelated to Federal Reserve actions. Indeed, it is not unusual for M2 growth to move in a direction that is the opposite of Fed policy.

M1, on the other hand, is a direct reflection of Fed actions. The Fed supplies the currency portion of M1 directly. And it imposes reserve requirements on the checkable deposit portion, currently about 70 percent of M1.

Through its open market operations—the buying and selling of Treasury securities in the open market—the Fed increases or decreases the amount of reserves available to the banking system. Such actions directly influence the amount of checkable deposits and, consequently, M1.

If you look at the accompanying table, you'll see that both M1 and reserves started growing rapidly in late 1990, reflecting a significant easing in monetary policy. M2 grew somewhat more slowly, reflecting a sharp drop in the growth rate of savings-type deposits. Since September 1991, both M1 and reserves indicate a significant further easing, while M2 shows only a modest acceleration.

Because a large portion of savings-type deposits is made up of "managed liabilities" that depository institutions can increase or decrease with credit demand, their recent slow growth is due in part to the decline in credit demand during the recession. If the economy picks up, as most analysts are forecasting, the growth rate of these savings-type deposits should accelerate in 1992. Such deposits have also been affected increasingly by the restructuring of banks and thrifts and by what appears to be a trend away from credit market intermediation through depository institutions. This suggests that their growth in 1992 may be slow by historical standards.

Unfortunately, the growth rates of two widely used monetary aggregates, M1 and M2, give confusing and disparate indications of Fed policy. So which is better?

Regardless of what happens to these deposits, however, their inclusion in M2 renders it a poor indicator of Fed policy. If you want a monetary aggregate that gives the clearest indication of what the Fed is doing, watch M1.

Growth Rates of Selected Monetary and Reserve Aggregates

Period	M1	M2	Savings-type deposits	Total reserves
Dec. 1989 – Dec. 1990	4.0%	3.2%	3.0%	2.9%
Dec. 1990 – Dec. 1991	8.8%	2.7%	0.7%	9.6%
Dec. 1990 – Sept. 1991	7.3%	2.5%	0.9%	5.5%
Sept. 1991– Dec. 1991	13.4%	3.5%	−0.2%	22.9%

Daniel L. Thornton is an assistant vice president at the Federal Reserve Bank of St. Louis.

Regional Roundup

OUT FOR
COMMENT

The following are Federal Reserve System proposals currently out for comment:

Two proposed amendments to Reg Z (Truth in Lending) dealing with home equity disclosure rules. Comments due by Feb. 28. (Docket No. R-0743)

Direct all comments to William Wiles, Secretary of the Board, Board of Governors of the Federal Reserve System, 20th and Constitution Avenue, N.W., Washington, D.C. 20551. For copies of proposals out for public comment, contact Anne Guthrie at (314) 444-8810.

Fed Expands Louisville Territory

On February 3, the Fed officially expanded its Louisville Branch territory to include 10 counties in southwestern Indiana that had previously been assigned to the St. Louis territory. They are the counties of Daviess, Gibson, Green, Knox, Pike, Posey, Spencer, Sullivan, Vanderburgh and Warrick. Because the Louisville Branch already provided most Fed services to these counties, the change more realistically reflects operational boundaries.

The principal benefit of the enlarged territory is that residents of the Indiana counties can now be considered for appointment as a Louisville Branch director, while remaining eligible for head office director.

For more information, please call Louisville Branch Manager Howard Wells at 1-800-626-4507.

Double-dip Recession Unlikely, Say Experts

Are we headed for a double-dip recession? Probably not, though it might feel that way to a lot of people.

Despite positive growth in the nation's economy in third quarter 1991 (a 1.7 percent annual rate of increase), some recent economic indicators, particularly those measuring consumer confidence, are pointing downward. In addition, the index of coincident indicators, a gauge of the economy's current strength, remained flat or declined for each month between July and November 1991.

Most economists say, however, that even though the economy was weak in late 1991 and will probably remain sluggish in early 1992, declines in economic activity in consecutive quarters—that is, another recession—are unlikely.

Treasury Announces New Collateral Valuation for TT&L Deposits

To minimize risk, the Treasury announced that, effective March 30, the value of collateral securing TT&L deposits will be the same as that of securities pledged for borrowing at the Fed's discount window.

Here's an example: Currently, Federal National Mortgage Association bonds are valued at 100 percent of their par value as TT&L collateral. When used as credit discount collateral, however, these same securities are valued at 90 percent of par value. Under the new rules, Federal National Mortgage Association bonds will be valued at 90 percent of par value when used as TT&L collateral.

The Treasury plans to announce new collateral values for more than 100 types of securities, both definitive and book-entry, early in 1992.

The Fed will contact each institution with information about the effects of the changes on its collateral. For more information, call Harriet Siering at (314) 444-8502 or Judie Courtney at (314) 444-8630.

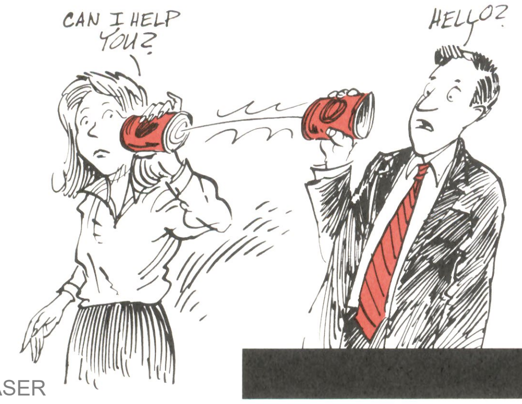
Automation Consolidation Sites Chosen

Richmond, Dallas and East Rutherford, New Jersey, have been selected to serve as the three automation consolidation sites for the Federal Reserve System.

The sites were screened early last summer by a Chicago consulting firm that specializes in location analysis.

In approximately two to three years, these sites will house all computer software applications currently handled by mainframe computers at each of the 12 districts. Better reliability is the primary benefit from consolidation; responsiveness to customer requirements, greater efficiency and reduced costs will also result.

Fed Gets Phone Mail



Callers to the St. Louis Fed have a new option: you can choose to leave a recorded message behind on a new phone mail system, beginning early 1992.

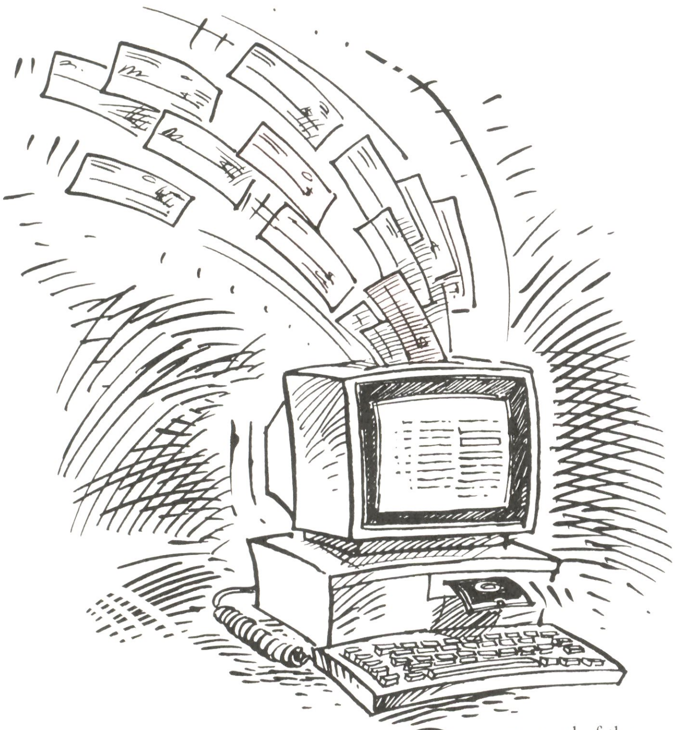
Phone mail is being installed as part of an effort to increase the capacity of the head office's telephone system and improve responsiveness to callers.

The new phone mail system works like this: when the person you are calling is unavailable, your call will be answered by someone else. This person will either direct you to someone that can help you, take your message themselves, or give you the opportunity to leave a detailed message behind on phone mail.

If you choose to leave a phone mail message, your call can be returned with the information you need.

Please let us know how the new system is working.

Taking the Paper Out of Check



One goal of the Federal Reserve System is to promote a more electronic payments mechanism. In support of this goal, the Eighth District took several steps in 1991 to encourage financial institutions to deposit and receive check data electronically. With the help of EDITH® (Eighth District Interactive Telephone Helpline), Fedline® and Bulkdata transmissions, the Fed has increased its base of electronic-check services and customers during 1991. Specifically:

In February.

Return item advices became available over EDITH, at no additional cost. For $20 per month, customers now have timely access to both forward collection and return item mixed advice and autocharge totals. Currently, 239 financial institutions Districtwide have signed up for this service.

These same services are available over Fedline and are included in the monthly access fees.

In March.

St. Louis zone institutions began depositing interdistrict point sheets for our Cash Letter Monitoring System (CLMS) electronically via bulk data. By depositing electronically, duplicate cash letters can be deposited as late as 9:00 a.m. This also eliminates the job of manually preparing duplicate cash letters, resulting in fewer clerical errors and adjustments. Currently, 75 percent of St. Louis' CLMS data is deposited electronically.

In April.

The St. Louis office began offering check truncation, making the service a Districtwide product. With truncation, a financial institution receives pertinent information from the MICR line electronically, while the Fed handles processing and provides safekeeping of the actual items. Overall, this service can reduce the costs associated with sorting, filing and mailing checks back to your customers.

In October.

Eighth District offices began offering Extended MICR. With Extended MICR, presentment is made electronically, with the physical items following at a later date.

In November.

The St. Louis office was selected as one of two System government check image pilots. Although this will not affect commercial check processing right now, the technology being tested could play a major role in the future services we are able to offer our commercial check customers.

In addition to these enhancements, several more are scheduled for 1992. Specifically:

In January.

The St. Louis office introduced an electronic fine sort deposit option, allowing institutions to deposit fine sort cash letter data electronically via bulk data or PC diskette. By depositing electronically, a depositor can realize a 25-cent-per-package price savings.

In second quarter 1992.

The St. Louis office will pilot one of two automated check adjustment systems with several local depository institutions. The results of the pilot will be used to develop a Systemwide application.

Also, a new Fedline application will allow CLMS depositors to deposit via Fedline.

Ongoing.

Payor bank account totals and MICR line information via Fedline or Bulkdata have become increasingly popular. As of December 31, the District's customer base for payor bank services had increased to 167, with 73 new customers added in 1991.

In the big picture, movements toward electronics like these are just beginning. The District plans to pursue electronic check services further in the coming years. If you would like any information on electronic check processing, please contact your local Fed office.

FedFacts

New Flexible Rate for Seasonal Credit Available by Phone

Changes in the new flexible rate on seasonal credit from the Fed's discount window are now available on a recorded interest rate message by dialing 1-800-333-0810, ext. 8728, or locally at (314) 444-8728.

Since January 9, the new seasonal rate has been a market-related rate, based on the moving average of the federal funds rate and the secondary market rate on 90-day large certificates of deposits.

The rate on seasonal credit for the Jan. 23–Feb. 5 period is 4.0%. No change was made in the basic discount rate, which is currently 3.5%.

Fedline® Offers Electronic Submission of FR2900

Beginning in March, Fedline customers will be able to submit their weekly FR2900 (Report of Transaction Accounts...) to the Fed electronically. Electronic submission will allow you to submit more accurate data faster, while eliminating the paper forms you usually send. In the future, we will begin to accept other reports electronically as well.

For more information about submitting your FR2900 report electronically, please contact Joan Boelter at (314) 444-8627.

Treasury Auction Rules Changed

The Treasury has changed its auction rules to broaden participation. The following changes became effective November 5:

* All registered government securities brokers and dealers may submit bids for customers in Treasury auctions.

* Any bidder may bid without a deposit or an explicit payment guarantee. In place of these, the Fed will accept an autocharge agreement developed by the Treasury and the Fed and signed by the bidder and a depository institution. Under such an arrangement, the securities purchased by the bidder will be delivered to the depository institution, and the institution's reserve account will be charged on the settlement date.

* The maximum award on non-competitive tenders was increased. For notes and bonds, the maximum award to any single bidder is now $5 million, up from $1 million. A maximum non-competitive award of $1 million remains for bills.

New Operating Letter for Electronic Access Customers

The St. Louis Fed recently adopted a comprehensive new operating letter—Operating Letter No. 22—that spells out in one place the terms of agreement for its electronic or automated services. The new operating letter eliminates the burden on both depository institutions and the Fed of maintaining numerous agreements for each electronic Fed service. Now, by simply using an electronic or automated method to access a service or provide data to the Fed, your institution will have agreed to the operating letter's terms.

Calendar

Upcoming Fed-sponsored Events for Eighth District Depository Institutions

February 25, 26, 27
Half-day seminars on "CRA: Compliance or Marketing?"
St. Louis, Missouri

March 11
Regional Economic Forum
Columbus, Mississippi

April 7
District Dialogue
Little Rock, Arkansas

April 8
District Dialogue
Jonesboro, Arkansas

For more information on these meetings, please call (314) 444-8320.

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