



Fall 1998



In This Edition



[Price Stability and Financial Stability: Competing or Compatible?](#)

[David C. Wheelock](#)

What the association of severe financial instability with fluctuations in the price level historically say.



[Successful Introduction of New \\$20 Note Deemed Critical](#)

Enhanced anti-counterfeit features will be seen for the first time.



[Feditorial: New Research Indicates Financial Institutions Are Key to ACH Growth](#)

[Hank Bourgaux](#)



[What Qualifies as a CRA Investment?](#)



[St. Louis Fed Gets New Face on the Web](#)



Regional Roundup



FedFacts



CENTRAL BANKER | FALL 1998

<https://www.stlouisfed.org/publications/central-banker/fall-1998/price-stability-and-financial-stability-competing-or-compatible>

Price Stability and Financial Stability: Competing or Compatible?

David C. Wheelock

Over the past decade, a number of countries have set explicit targets for inflation and mandated control of inflation as the paramount objective of monetary policy. Critics argue that such a narrow focus detracts from a monetary authority's responsibility to protect the stability of the financial system. These critics argue that a central bank with price stability as its sole objective might not respond to financial instability unless its inflation goal was threatened.

Others argue that a monetary policy directed at maintaining stability of the price level would lessen both the incidence and severity of financial instability. Anna Schwartz, for example, contends that a central bank "that was able to maintain price stability would also incidentally minimize the need for lender-of-last-resort intervention."^[1] Financial instability, according to Schwartz, often has been caused or made worse by fluctuations in the aggregate price level. A monetary policy that maintains price stability, thus, also would promote financial stability.

Michael Bordo, a professor of economics at Rutgers University, and I have examined whether the financial histories of the United States, the United Kingdom and Canada are consistent with Schwartz's claim.^[2] The most recent episode of significant financial distress in the United States occurred in the 1970s and 1980s and was reflected in widespread bank and S&L failures. Sharp declines in commodity and real estate markets after several years of price increases were the proximate causes of these failures. The financial distress, however, occurred in an era of aggregate price inflation followed by a sharp disinflation, which, according to Schwartz, worsened the resulting financial problems.

Sustained inflation, Schwartz argues, encourages speculative investment and borrowing on the expectation that prices will continue to rise. When inflation abruptly declines as it did in the early 1980s, however, borrower incomes may be insufficient to repay loans made on the expectation of continuing price increases. The resulting rise in defaults reduces the equity of lenders, possibly causing an increase in financial institution failures.^[3]

In the absence of inflation and disinflation, shocks like those affecting commodity markets in the 1970s and early 1980s might still cause significant financial problems. Schwartz argues, however, that if the aggregate price level is stable, or at least if its movements are predictable, then resources will be employed more efficiently and financial distress, regardless of its proximate cause, will be less severe.

Bordo and I find that many of the most severe episodes of financial distress in U.S. history coincided with sharp declines in the rate of inflation after sustained periods of rising prices. For example, the first serious banking panic and recession in U.S. history occurred in 1797, a year of deflation that followed three years of moderately high inflation averaging 8 percent per year. One historian described the inflation years as being prosperous, with "active internal trade; land speculation, many new companies formed," as well as "booming"

foreign trade, and a rapid increase in the number of banks. Deflation, however, brought "depression, panic and many failures."

Similar cycles of inflation and deflation, with increases in speculative activity and bank lending in the inflation phase, and bankruptcies and bank failures in the deflation phase, punctuated the 19th century. In the 20th century, the Great Depression also was associated with a major deflation and the failure of some 9,000 banks.

A definitive test of Schwartz's view would require information about the decisions of individual households, firms and financial institutions. The association of severe financial instability with fluctuations in the price level historically, however, would seem to support those who argue that price level stability and financial stability are very much compatible, and not competing, goals for monetary policy.

Endnotes

1. Anna J. Schwartz. "Financial Stability and the Federal Safety Net," in William S. Haraf and Rose Marie Kushneider, eds., *Restructuring Banking and Financial Services in America*. Washington, D.C.: American Enterprise Institute, 1988, p. 53. [back to text]
2. "Price Stability and Financial Stability: The Historical Record," *Federal Reserve Bank of St. Louis Review*, forthcoming. [back to text]
3. Willard Long Thorp. *Business Annals*. New York: National Bureau of Economic Research, 1926, pp. 113-14. [back to text]



CENTRAL BANKER | FALL 1998

[https://www.stlouisfed.org/publications/central-banker/fall-1998/successful-introduction-of-new-\\$20-note-deemed-critical](https://www.stlouisfed.org/publications/central-banker/fall-1998/successful-introduction-of-new-$20-note-deemed-critical)

Successful Introduction of New \$20 Note Deemed Critical

Although the redesigned \$50 note and \$100 note were introduced seamlessly over the past two years, public interest was mild because many financial institution customers don't see these larger denomination bills day to day. The latest currency to receive a face-lift, however, —the \$20 note—will have the greatest impact yet on the public.

The \$20 note is the most frequently used of the larger denomination notes and is commonly distributed through automated teller machines. In addition, it is the second most widely circulated bill in existence (after the \$1 bill). The new notes will be rolled out beginning Thursday, Sept. 24. Just as was the case with both the \$50 and \$100 notes, the Federal Reserve Banks gradually will replace old \$20 notes with the new ones as they wear out.

John Baumgartner, vice president of Wholesale and Cash Operations with the St. Louis Fed, said a successful phase-in of the new \$20 notes is important for security reasons.

"When we introduce these notes, much of the public will be seeing the anti-counterfeit features for the first time," he said.

These features will be familiar to bankers because they are the same ones included on both the \$50 and \$100 notes, with some slight variations. Like the other bills, the portrait on the \$20 note (President Andrew Jackson) is larger, moved off center and incorporates more detail. Other similar security aspects include a watermark, fine-line printing and color-shifting ink. Unlike the \$50 note, the thread position on the \$20 note is to the far left of the portrait instead of the right and glows green under ultraviolet light instead of the yellow color seen on the \$50 note. Also, the microprinting on the \$20 note is located in different places than on the other redesigned notes.

As the distributor of currency to financial institutions, the Federal Reserve has been working with the Secret Service to educate bankers, retailers and others on the redesigned note. Currently, Federal Reserve Banks and branches nationwide are holding seminars for bankers to explain the alterations to the currency. In May, the Fed mailed information packets on the redesigned notes to all financial institutions.

Baumgartner said it is critical that the public be well educated on the new currency so that a successful rollout of the \$20 note will have a domino effect when it is time for the rest of the currency to be redesigned.

"The ripple effect will be that the denominations to follow will be more widely accepted and understood," he said.

As for the introduction of those other redesigned denominations, the \$10 note is scheduled to be rolled out next year, and the \$5 note in 2000.



CENTRAL BANKER | FALL 1998

<https://www.stlouisfed.org/publications/central-banker/fall-1998/new-research-indicates-financial-institutions-are-key-to-ach-growth>

Feditorial: New Research Indicates Financial Institutions Are Key to ACH Growth

Hank Bourgaux

Electronic payments have been available to consumers and businesses for several years. The arguments for converting to these payments seem so convincing: They are faster, easier and cheaper. Why, then, are so many people still not convinced?

Earlier this year, the Federal Reserve System sought to answer this question by hiring two research firms to conduct an extensive survey of both consumers and businesses. At issue were two of the most popular electronic payment methods, direct deposit and direct payment (or automated bill payment). Some of the results surprised us; some didn't. But one important point emerged from the research—financial institutions are uniquely positioned to further the demand for these ACH services. The research showed that consumers and businesses are looking to their financial institutions, more than any other source, for information on direct deposit and direct payment. The message is clear: You have the power to influence your customers' attitudes about electronic payments.

Also apparent from the research is the public need for more education. Among consumers, direct deposit was a much more understandable concept than direct payment. Nearly all of the respondents said they are familiar with direct deposit. Meanwhile, a larger number of consumer respondents said they are not familiar with direct payment. Furthermore, research showed that adoption of direct deposit and direct payment was low among businesses. Only 13 percent of businesses surveyed offer direct payment to their customers, while just 32 percent make direct deposit available to their employees.

We also learned that opportunities abound for growth within each service, especially if incentives are offered to potential customers. For example, a majority of consumers who were offered free checking along with direct deposit of their payroll indicated their overwhelming willingness to accept direct deposit. If you as a financial institution are contemplating whether to expand your ACH service offerings, this research clearly demonstrates that demand for direct deposit and direct payment exists among a large segment of consumers and businesses.

The St. Louis Fed has summarized the results of the research in a booklet that we will send to each financial institution in the Eighth District later this fall. I ask that you take a few minutes to read this summary. Eventually, I hope that the results will propel financial institutions, as well as the Fed, into leveraging the efficiencies of the ACH system and generating more effective means of encouraging customers to use electronic payments.



CENTRAL BANKER | FALL 1998

<https://www.stlouisfed.org/publications/central-banker/fall-1998/what-qualifies-as-a-cra-investment>

What Qualifies as a CRA Investment?

For large financial institutions and even small institutions that choose to have their investments considered during a CRA examination, the issue of what qualifies as an investment for CRA purposes has become a hot topic. The revised CRA regulation defines qualified investments as an investment, deposit, membership share or grant that has community development as its primary purpose.

For CRA, community development is: affordable housing (including multifamily rental housing) for low- and moderate-income individuals; community services targeted to low- and moderate-income individuals; activities that promote economic development by financing small businesses or small farms (gross annual revenues of \$1 million or less); and activities that revitalize or stabilize low- and moderate-income geographies. The regulation provides examples of the types of investments that are considered under the CRA investment test. They include, among other things, support for organizations that help finance small businesses and support for financial intermediaries (such as community development corporations) that lend or facilitate lending to low- and moderate-income areas.

When examiners evaluate a bank's performance under the investment test, four criteria are considered: 1) the dollar amount of qualified investments; 2) the innovativeness and complexity of the investments; 3) the responsiveness to credit and community development needs; and 4) the degree to which qualified investments are not provided routinely by private investors.

For more information on CRA-qualified investments, call Glenda Wilson at (314) 444-8317.



CENTRAL BANKER | FALL 1998

<https://www.stlouisfed.org/publications/central-banker/fall-1998/st-louis-fed-gets-new-face-on-the-web>

St. Louis Fed Gets New Face on the Web

A visit to www.stlouisfed.org will reveal a fresh, improved web site for the Federal Reserve Bank of St. Louis. The St. Louis Fed rolled out the revamped, more user friendly site in August.

The new masthead shows images of the St. Louis Bank building, redesigned U.S. currency and a vault door, all surrounded by a black background. Smaller versions of the new masthead appear on every page of the site, allowing users to navigate more easily. Information on the site now is divided into six categories: general information, banking information, community affairs, economic research, education and publications.

"One of our main goals was to increase users' ability to find information quickly and easily," said Lora Holman, who manages the St. Louis Fed's site. "We feel that we have done that by utilizing newer web technology."

To help accomplish that goal, pull-down menus, which allow users to scroll down and instantly access subcategories instead of clicking to an index page, have been added. The new site also includes a "What's New" section, highlighting recent additions to the site.



CENTRAL BANKER | FALL 1998

<https://www.stlouisfed.org/publications/central-banker/fall-1998/regional-roundup>

Regional Roundup

Direct Deposit Week Coming in October

Plans are under way for the first-ever Direct Deposit Week, to be held Oct. 12-16. The week will focus attention on promoting direct deposit for both Social Security and employee payments, as well as on educating "cash consumers" (those without traditional bank accounts) about their options for receiving federal payments in preparation for EFT 99.

The Department of the Treasury, the Federal Reserve and the National Automated Clearing House Association are joining with ACH associations, financial institutions and community organizations in the effort. Financial institutions are encouraged to participate by hosting lobby promotions to spotlight the benefits of direct deposit to their individual customers and business customers.

Local community-based organizations also are helping organize activities, which will include distributing educational materials in the form of statement stuffers, posters and brochures and hosting local sign-up days. A national direct deposit sign-up day, featuring national and local events, is planned for Oct. 14.

For more information on how to participate, call Cheryl McCarthy at (314) 444-8459.

Fed to Offer New Net Settlement Service

By the end of 1998, the Federal Reserve will introduce a new, standardized net settlement service. The service will meet a number of key requirements, including: reducing settlement risks to participants in clearing arrangements by providing final settlement on the same day that settlement information is submitted; improving operational efficiency by not requiring the sending of individual Fedwire funds transfers to achieve settlement; and enhancing data security by including appropriate tools and procedures in a uniform, automated system.

The new service will be based on the submission of an electronic file by the settlement agent and will support multiple settlements in a day. The current service usually is based on a spreadsheet that is delivered to the Fed for entry into the Integrated Accounting System with finality generally deferred until 1 p.m. the next day.

For more information, call Jerry McGunnigle at (314) 444-8732.

Offline Activities Shifting to Boston Fed

As of Nov. 30, 1998, all Eighth District offline funds and book-entry security transfer services will be handled by the Offline Processing Center at the Boston Fed, as part of the Fed's nationwide consolidation. This means that all verifications, notifications and confirmations will be handled out of Boston. The procedures for offline transaction processing, however, will not change. For online customers, Boston will provide support in contingency situations in which they must revert to offline processing.

For more information on the conversion, call Jerry McGunnigle at (314) 444-8732.

Fed Updates Mississippi Delta Resource Directory

The St. Louis Fed's Community Affairs Department has revised portions of its profile on the Lower Mississippi Delta region. Included are updated descriptions of many organizations and programs in Arkansas, Illinois, Kentucky, Mississippi, Missouri and Tennessee. The revised directory is designed to help financial institutions meet the investment and development needs of their communities.

For a copy, or to request additional copies, call Diana Zahner at (314) 444-8761.



CENTRAL BANKER | FALL 1998

<https://www.stlouisfed.org/publications/central-banker/fall-1998/fedfacts>

FedFacts

New Savings Bond Offers Inflation Hedge

On Sept. 1, a new savings bond that pays a fixed return on top of the inflation rate was introduced to the public. The Series I savings bond offers a fixed return of 3 percent to 3.5 percent plus the average rate of inflation over a six-month period. Unlike current savings bonds, which are sold at half of their face value, Series I bonds are sold at face value in denominations of \$50, \$75, \$100, \$500, \$1,000 and \$5,000.

The Federal Reserve Bank of Kansas City processes savings bonds for the entire Eighth District. For more information, call 1-800-333-2919.

Two educational seminars on the new savings bonds will be held Wednesday, Sept. 30, at the St. Louis Fed. There will be a morning and an afternoon session. To register, call Bernie Berns at (314) 444-8321. Seminars in Louisville and Memphis are tentatively planned for next year.

1997 HMDA Data Available

Reports of 1997 mortgage lending activity are available now at central depositories throughout the nation. The reports include disclosure statements covering home purchase and home improvement loans, as well as loan originations, purchases and applications for the nearly 8,000 institutions covered by the Home Mortgage Disclosure Act (HMDA).

The 1997 data shows a total of 16.4 million loans and applications, an increase of 11 percent from 1996. This reflects a large degree of refinance activity during the year.

The Federal Financial Institutions Examination Council (FFIEC) has made the data available in various formats, including magnetic tape, PC diskette, CD-ROM and on its web site at www.ffiec.gov. To find out the location of the central depositories or for other questions, call the FFIEC at (202) 634-6526 or check the council's web site.