



Central Banker

SPRING 2002

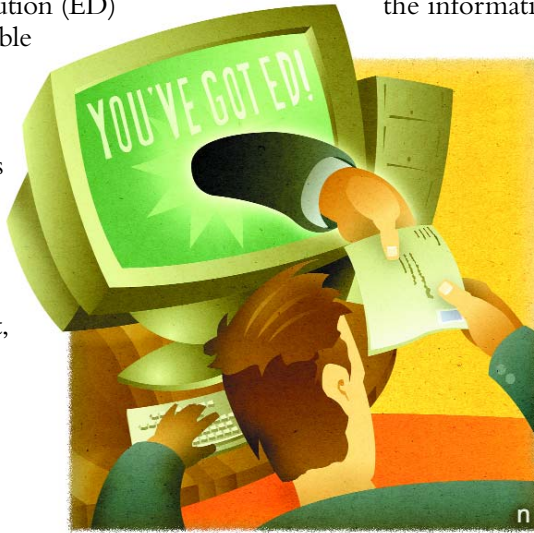
News and Views for Eighth District Bankers

Bankers Benefit from Electronic Distribution

More than 500 Eighth District customers have taken advantage of the St. Louis Fed's new Electronic Distribution (ED) service since it became available in early January. The following information now is available electronically:

- changes to the federal funds target and discount rates,
- regulatory information,
- operating circulars,
- cash and check services,
- Electronic Access Support,
- Electronic Payments,
- services directories and holiday schedules,
- supervisory bulletins,
- bank holding company (BHC) and bank application press releases, and
- weekly BHC and bank applications—public comment periods.

This new service will better serve District customers because it delivers information in real time.



ED subscribers receive an e-mail notification that contains a link, which allows them to view and print the information from their computer screens.

ED subscribers should be aware that account management information and messages sent via FedLine are separate services. In addition, the Bank will not distribute any confidential information, such as examination materials, via ED.

We encourage customers who do not have Internet access to set up an account with an Internet service provider soon. Paper mailings for ED materials will cease Oct. 1, 2002.

For more information, e-mail Tracie Mueller at emailalert@stls.frb.org or call her at (314) 444-8810, or 1-800-333-0810 ext. 44-8810. A list of frequently asked questions also can be found on our web site, www.stls.frb.org. ■

Fed Revises PSR Policy Statement

The Federal Reserve Board has revised its policy statement on Payments System Risk. Two key changes may interest Eighth District institutions: 1) Certain depository institutions now can pledge collateral to the Federal Reserve so that they may gain additional daylight overdraft capacity in excess of their net debit caps; 2) Starting April 2002, the posting time of

electronic check presentments (ECP) will move to later in the day, beginning at 1 p.m. local time. This change will minimize the disincentive posed by the earlier posting rules. It also will reduce or eliminate the daylight overdraft charge differential that was created when customers previously used ECP.

The press release that announced the policy revision is available under the "Press

Releases" section of the Federal Reserve Board's web site: www.federalreserve.gov/boarddocs/press/boardacts/2001/.

If you would like a paper copy of this release, contact Tracie Mueller at (314) 444-8810 or 1-800-333-0810, ext. 44-8810. If you have questions regarding the Payments System Risk Policy, contact Hillary Debenport at (314) 444-8488 or 1-800-333-0810, ext. 44-8488. ■



Feditorial

Economic Forecasts: *Is It Possible to Predict the Future?*

By William Poole, president and CEO, Federal Reserve Bank of St. Louis

Most economists have about as much confidence in economic forecasts as they do in forecasts about their local weather.

Since Jan. 3, 2001, the Federal Open Market Committee (FOMC) has cut the intended funds rate 11 times. During the January 2002 FOMC meeting, the committee voted to keep the intended funds rate the same. Although I cannot predict what our economic future will look like, I can offer my own perspective on where we are right now and how we got here.

At the end of 2000, the consensus among policy-makers was that our economy would slow down during the first part of 2001. We expected the slowdown would be a brief “V” shape—as plotted on a graph—that would not end a decade of economic expansion. As the year progressed, the slowdown did materialize, and it lasted longer than we anticipated. That “V” became a “U”; yet, as of late August 2001, forecasters continued to project near-term recovery without a recession.

All bets were off starting Sept. 11. That day’s tragedies were unprecedented, and forecasters had no historical basis from which they could base their projections about our economic future.

Failure to predict the economy’s turning point, or even realize for several months that a peak has occurred, is typical. Clearly, our economy was not performing well before the attacks. Many considerations were important factors. As the growth rate

slowed in 2000, businesses sharply reduced their investments, and inventories grew substantially. In 2001, businesses cut investment further and liquidated inventories. On the flip side, new car and home sales flourished. Therefore, it is impossible to know whether we would have had an official recession had the attacks never happened.

What does the future look like? I can’t offer a specific forecast. My personal conviction is that our current economy contains powerful forces that will promote growth and full employment. We have strong, resilient people, efficient markets and low inflation.

Most economists agree that if our central bank does not achieve price stability, no one else can. I define price stability as an environment in which the inflation rate, when properly measured and averaged over several years, is zero. Achieving price stability—as I define it—will yield a highly stable economy. I believe we cannot be so aggressive in our efforts to stabilize the economy that we run the risk of compromising the goal of price stability.

The long-run goals of the Fed are clear. When it is necessary, we are ready to cut or raise the intended funds rate. Likewise, when the available information does not indicate that a change is warranted, the Fed is prepared to wait patiently until the appropriate action becomes clear. ■

The Proposed Check Truncation Act

Every year, approximately 50 billion checks are written, and each night millions of checks are processed and transported for presentment to paying banks across the country. Financial institutions expend significant economic resources in collecting and returning these checks.

On Dec. 17, 2001, Federal Reserve Chairman Alan Greenspan forwarded a legislative proposal to senator Paul S. Sarbanes, the chairman of the Committee on

Banking, Housing and Urban Affairs. The proposed Check Truncation Act is designed to foster innovation and create greater efficiency in the payments system by reducing some of the legal impediments to check truncation that exist under current law.

At this time, the proposed act has not been introduced to Congress. If enacted, the act would enable banks to expand their use of electronic methods in collecting

and returning checks, which would reduce the industry’s reliance on transportation to move checks across the nation.

For more information on this important draft legislation—including a message from Greenspan and a section-by-section analysis of the proposed law—visit the Federal Reserve’s Board of Governor’s web site: www.federalreserve.gov/paymentsystems/truncation/default.htm. ■



The USA Patriot Act Creates New Duties

The USA Patriot Act was enacted some six weeks after the tragic terrorist attacks of Sept. 11. The Patriot Act places new or expanded responsibilities on financial institutions, especially those doing business with foreign financial institutions. One purpose of the act is to “prevent, detect, and prosecute international money laundering and the financing of terrorism.” The intent is to foster greater cooperation among the banking industry, regulators and law enforcement agencies.

The Patriot Act’s definition of financial institutions is broad. It includes securities and commodities dealers and brokers, money transmitters, loan and finance companies, and real estate settlement companies. Some of the act’s provisions apply to all financial institutions, while others are more limited in scope. Regardless, all financial institutions should anticipate extensive rulemaking. *Note: Some provisions will take effect on a given date even if no rules have been issued.*

Is This “Know Your Customer” Revisited?

Not necessarily. “Know Your Customer” was far more reaching because it would have required financial institutions to verify their customers’ identities and document specific details about their customers’ businesses. With the new Patriot Act, the secretary of the Treasury is required only to establish minimum documentation standards. Financial institutions must verify their customers’ identities, maintain records and consult government lists of terrorists and terrorist organizations. Those regulations are required to be in place by Oct. 26, 2002.

The Bank Secrecy Act Amendments and General Provisions

The Bank Secrecy Act is the core of U.S. money-laundering efforts. While its anti-laundering requirements are not new for banks, they may be new to other financial institutions.

Establish Programs: Because the Patriot Act mandates that all financial institutions establish anti-money laundering programs, some bank holding companies will need to export their bank secrecy programs to their subsidiaries. These programs must include formal policies and procedures, appointment of a compliance officer, ongoing employee training and independent audits. After consulting with appropriate regulators, the Treasury secretary may set minimum standards for the programs and exempt certain institutions. The section’s provisions will become effective this April.

Expanded Protection: If the government receives a voluntary report of a potential violation of the Bank Secrecy Act, financial institutions will be given expanded protection from civil liability to their customers. Additionally, an insured institution is protected, theoretically, if in good faith it discloses facts related to a Bank Secrecy Act violation in a written employment reference requested by another insured financial institution.

Acquisitions and Mergers: One new statutory requirement is that the primary federal regulator, when acting on an application to acquire or merge banks under the Bank Holding Company Act (BHCA) or the Federal Deposit Insurance Act (FDIA), is required to take into consideration a company’s effectiveness in combating money laundering.

Increased Penalties: A separate section increases civil and criminal penalties for certain money-laundering violations to at least twice the amount of the transaction, up to a limit of \$1 million.

How Will This Affect International Money Laundering?

Effective Dec. 25, 2001, U.S. financial institutions cannot have correspondent accounts for foreign shell banks. The Treasury’s implementing rules (published Dec. 28, 2001) define correspondent accounts very broadly to include every imaginable kind of account. The provision applies to securities brokers as well as to depository institutions. The Treasury is particularly interested in industry comments on its definition of these accounts.

Every U.S. financial institution that has correspondent accounts or private banking accounts maintained in the United States for non-U.S. customers must establish special due diligence procedures for opening and maintaining foreign accounts, and for detecting and reporting money laundering.

Minimum standards also are set for enhanced due diligence on the correspondent accounts of foreign banks operating under an offshore banking license or under a license issued by a country designated as “non-cooperative with international money laundering principles.” These standards become effective this July, even if the implementing regulations have not been issued.

The Patriot Act also includes a number of other provisions designed to prevent terrorist organizations from using the U.S. financial system without detection or punishment. While many of the financial institutions that the Federal Reserve supervises have robust compliance programs, the recent tragedy illustrates the importance of due diligence. ■

Regional Roundup

Louisville Gears Up for Check Standardization

In April, Louisville will be the first office in the Eighth District to move to Check Standardization, a project that will convert check processing platforms at each of the Federal Reserve's 45 sites to a standard, centrally managed platform. Conversions at the three remaining District offices will occur throughout the spring and summer.

Check Standardization is a Federal Reserve infrastructure change that will be largely transparent to financial institutions. However, bankers will notice a few changes—primarily on some printed outputs—after their local Fed office converts.

For a sneak preview of some post-conversion changes, visit www.stls.frb.org/banking/financial.html. Then select the "Check Standardization" link. ■

Eighth District Announces Changes to Boards of Directors

The Federal Reserve Bank of St. Louis has announced the following new board members:

- Lewis F. Mallory Jr., chairman and CEO of National Bank of Commerce in Starkville, Miss., elected to a three-year term at the St. Louis board.
- David H. Brooks, chairman and CEO of Stock Yards Bank & Trust Co., appointed to a three-year term at the Louisville Branch board.
- Cornelius A. Martin, president and CEO of Martin Management Group in Bowling Green, Ky., appointed to a three-year term at the Louisville Branch board.
- Thomas W. Smith, president and CEO of Ephraim McDowell Health in Danville, Ky., appointed to fill the unexpired

portion of a three-year term at the Louisville Branch board.

- Tom A. Wright, chairman, president and CEO of Enterprise National Bank in Memphis, Tenn., appointed to fill the unexpired portion of a three-year term at the Memphis Branch board. ■

OUT FOR COMMENT

The following is a Federal Reserve System proposal currently out for comment:

On Jan. 23, the Federal Reserve System's Board of Governors approved regulatory changes intended to improve the quality and consistency of Home Mortgage Disclosure Act (HMDA) data. The amendments take effect for data collection beginning Jan. 1, 2003.

The Board is requesting public comment on the proposal to set the thresholds for reporting the annual percentage rate on first-lien and subordinate-lien loans. The Board also seeks comment on requiring lenders to ask telephone applicants their race, ethnicity and sex. Also adopted were a number of clarifying and technical changes, in addition to reorganizing Regulation C to make it easier to use.

Federal Register notices are located at: www.federalreserve.gov/boarddocs/press/boardacts/2002

Direct all comments to: Jennifer Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th St. and Constitution Ave., N.W., Washington, D.C. 20551.

Seasonal Credit Is Available for Community Banks

The Federal Reserve offers seasonal credit to qualifying community banks to help them meet their local customers' seasonal needs. Community banks that experience yearly fluctuations in their deposits and loans—caused by construction or farming operations, college or resort activities, municipal financing and other types of seasonal business—frequently can qualify.

To qualify, a financial institution must:

- be under \$500 million in deposits and in sound financial condition,
- meet the general requirements for the program, and
- complete a brief application that includes monthly deposit and loan data.

There is no commitment fee or stock purchase required. Likewise, banks do not need to be Federal Reserve members to be eligible for the program.

Once approved, banks can use their credit lines as a primary seasonal funding source or as a market-based rate on all outstanding loans that are secured to our satisfaction. Credit may be drawn down incrementally, as needed, and partial and full prepayments are allowed without penalty.

The seasonal credit program is a safe, sound, flexible and affordable way to meet a community's peak seasonal funding requirements. If you have any questions or would like an application or program brochure, please contact anyone in the Credit Office. Those numbers are (314) 444-8316, 444-8769 and 444-8622 or 1-800-333-0810, extensions 44-8316, 44-8769 and 44-8622. ■



James B. Bullard is an assistant vice president and senior economist, and **Charles M. Hokayem** is a research analyst at the Federal Reserve Bank of St. Louis. Look for more information on this topic in an upcoming issue of *Review*.

Why the Fed Should Ignore the Stock Market

During the 1990s, stock price movements were extraordinary. At the beginning of 1994, the Dow Jones Industrial Average (DJIA) was about 3,800; as of this writing (February 2002), the DJIA hovers around 10,000 but is down about 1,000 points from the peaks that occurred during late 1999 and early 2000. These movements have sparked a great deal of discussion among policy-makers, academic economists and the financial press about the role the stock market should play in influencing monetary policy decisions. During the recent stock-market gyrations, there has been resurgent interest in rules that monetary policy-makers can follow when they adjust short-term nominal interest rates.

These rules, based on the work of Taylor (1993), typically call for the Fed to adjust the intended federal funds rate in response to two factors: (1) the deviation of inflation from a target rate of inflation, and (2) the performance of the real economy relative to a historical benchmark. Taylor argued that such a rule would best keep inflation low and stable, and simultaneously keep the economy on a steady growth path. All the recent attention on the

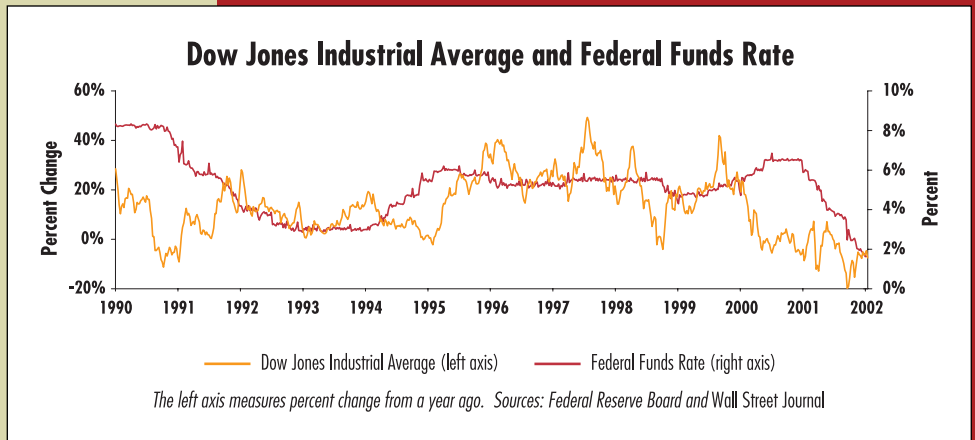
stock market and on monetary policy rules has inspired a natural question: Should the Fed also react to equity price movements when it makes monetary policy decisions? Some analysts have argued that such a reaction sometimes occurs. For example, the federal funds rate declined in 2001 as the returns on the DJIA fell. This episode along with some of the history can be seen in the chart, which plots the federal funds rate and the percentage change in the DJIA from 1990 to 2001.

We suggest that the Fed not react to equity price developments because it would be similar to looking in a mirror. Stock market prices already reflect the actions the Fed is taking to influence inflation and output. Here's why:

Let's begin with the idea that investors expect to get the same returns from bonds as they do from stocks—once one takes into account that stocks tend to be riskier. For our purposes, let's assume that the risk premium for stocks is unchanging over time. If expected bond returns change up or down, then investors will reallocate their portfolios between stocks and bonds until their expected returns—net of risk—are again equal.

Because bond prices are connected with short-term nominal interest rates, whenever the Fed changes short-term nominal interest rates, bond prices also change. Likewise, when bond prices change, so do stock prices. In other words, Fed policy changes cause a readjustment in all asset prices: short-term interest rates, bond prices and equity prices. Therefore, to turn around and argue that the Fed should react (again) to changing stock prices is somewhat circular.

One might ask, "What would happen if the level of equity prices were included in a Taylor-type monetary policy rule?" To keep equity prices relatively constant, the discussion given



above suggests that nominal interest rates should not move at all. But this conflicts with the basic idea behind the Taylor rule, which calls for movements in nominal interest rates to stabilize output and inflation.

In summary, if policy-makers include equity prices in the policy rule, it will only interfere with the Fed's job of stabilizing inflation and output. This is why we think the Fed should ignore the stock market when making decisions about monetary policy. ■

Reference

Taylor, John B. "Discretion vs. Policy Rules in Practice." *Carnegie-Rochester Conference Series on Public Policy*, 1993, 39, pp. 195-214.

Community Affairs Produces Two New Publications

The St. Louis Fed's Community Affairs Department has released its latest installment of "Perspectives on Credit Scoring and Fair Mortgage Lending." This brochure—the fourth of a five-part series—explores staff training and data accuracy. The first four installments, together with an introduction and folder for the series of credit scoring articles, are available now. The remaining installment, "Overrides and Second Review Process," is under development and should be distributed within the next few months.

Coming up with the money for affordable housing, job training, downtown revitalization and other community development projects is hard. To make it easier, our Community Affairs Department has produced a self-study guide, "Community Development Financing: Coming Up With the Money." The guide is designed for employees at banks, nonprofits and government agencies who are new to community development.

To order hard copies of these publications, contact Linda Aubuchon at (314) 444-8646 or toll-free at 1-800-333-0810, ext. 44-8646.

You may also access the credit-scoring brochures on line at www.stls.frb.org/caffairs/index.html.

Fed Introduces Two Accounting and Billing Applications

This spring, financial institutions will be able to access two web-based accounting applications nationwide. They are Account Management Information and Service Charge Information.

The Account Management Information system will allow customers to have real-time access to their accounting activity and let them "drill down" from summary totals to detail-level transactions. The Service Charge Information application—formerly referred to as Data Access System for Billing—will provide customers with online access to their monthly billing statement and allow them to download billing data for their internal use.

Prior to application rollout, customers will receive product information and a self-guided, computer-based training CD. Information sessions also will be offered to District customers following implementation. For more information on these two applications, contact Ranada Williams at (314) 444-8343 or 1-800-333-0869, ext. 44-8343. ■

Community Investments Roundtable

MAY 22—MEMPHIS

For more information, contact Ellen Eubank at (901) 579-2421

District Dialogues

The schedule through July 2002 is as follows:

APRIL 3—MEMPHIS, TENN.

APRIL 4—JACKSON, TENN.

JULY 16—BOWLING GREEN, KY.

JULY 17—LOUISVILLE, KY.

For more information, contact Jill Dorries at (314) 444-8818 or 1-800-333-0810, ext. 44-8818.



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