'92 Annual Report

FEDERAL RESERVE BANK OF ATLANTA

Contents

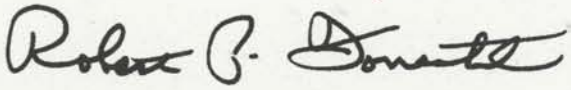
Message from the President

■ February 12, 1993

The 1992 annual report of the Federal Reserve Bank of Atlanta features some of our accomplishments for the year along with the consolidated financial statements of the Atlanta, Birmingham, Jacksonville, Miami, Nashville, and New Orleans offices. The names of all directors and officers who served the Sixth District during the past year are listed as well.

■ In addition to the review of the year's developments, this report includes a discussion of inflation. In particular, the essay presents my personal views about how aggressively the Fed can pursue the goal of price stability, given certain limitations on our ability to measure inflation precisely and the preferences of American society regarding the acceptable costs of achieving lower inflation. With inflation at its lowest rate in more than two decades, it is an appropriate time to consider this vital issue from a very practical standpoint.

■ I would like to express my appreciation to all of the Sixth District's directors for their valuable counsel throughout the year. In particular, I want to acknowledge those directors whose service ended in 1992—Saundra H. Gray, who served as a head office director and was previously on the Jacksonville branch board; Robert M. Barrett and Nelda P. Stephenson, of the Birmingham board; A. Gordon Oliver, of the Miami board; and Joel B. Bullard, Jr., Earl W. Lundy, and A. Hartie Spence, of the New Orleans board.



Robert P. Forrestal

President and Chief Executive Officer

Price Stability — What Does It Mean in Practice?

Over the last several years the United States has witnessed a lively debate over the appropriateness of price stability as a goal of economic policy. With inflation at its lowest levels since the late 1960s and the economy entering a new expansion phase, I believe the time is ripe for considering the goal of price stability and what it means from a practical standpoint.

BY ROBERT P. FORRESTAL

We are not presently experiencing the problem of accelerating price pressures. Last year the increase in the consumer price index (CPI) averaged 3 percent, and the moderate improvement expected in economic growth in 1993 and 1994 suggests that overall price pressures are not likely to worsen over that period.

■ These developments suggest that Federal Reserve policymakers such as myself should take stock of the progress that has been made toward the goal of price stability and provide financial markets, consumers, and businesspeople some sense of the direction that the inflation debate will take in the years to come. This essay does so by considering two issues. First, as a way to show the difficulty of precisely gauging progress toward the goal of price stability, some of the problems surrounding our ability to measure inflation are noted. Second, even if these technical problems could be satisfactorily resolved, the case can be made that the rate of measured inflation consistent with socially desired output growth is not necessarily zero. I would like to emphasize that the discussion that follows, covering both the significance of measurement problems and the limitations on the Fed's anti-inflationary posture that arise from preferences of American society, represents my personal views on the subject and not necessarily those of the Federal Reserve System. However, I regard these views as grounded in the social compact between policy institutions like the Federal Reserve and the political processes that created them.

■ There are, to be sure, many broader unresolved issues regarding inflation. Some are technical; others are policy choices. Does the availability of sophisticated financial innovations reduce inflation's distortions? Are the redistributional effects of inflation always a net cost

to society? How much worse is a highly volatile but low average inflation rate than a constant low rate? These are only a few examples.

■ Notwithstanding such questions, past experiences with high and volatile inflation in the United States and lessons from other countries have produced a general recognition of the importance of limits to inflation. When policymakers acknowledge and commit to keeping inflation within these limits, the cost of achieving and maintaining them can be minimized. A long-term commitment of this sort does not imply that inflation may not rise above or fall below these bounds over a short horizon as long as we ensure that policy will act to return inflation to a rate within them.

■ In addition to this broad consensus on the benefits of price stability, there is agreement on the profound role of monetary policy in this process. It is generally accepted that over the short run—say, during a business cycle—monetary policy can affect both output and prices but that over longer periods the effects of monetary policy on nonfinancial economic activity are neutral and only the price effects persist. Given this observation, clearly there are some limits on the extent to which monetary policy can offset or smooth over short-term disruptions or shocks without subverting a long-term commitment to price stability. Acknowledging these limitations, however, does not constrain monetary policy to follow narrowly defined rules.

■ Thus, even though the benefits of price stability are well understood and there is widespread consensus about the role of monetary policy in achieving it, there is still considerable room for debate about how aggressively this goal should be pursued. That subject is the focus of the statement that follows. The essay uses the current juncture of low inflation and an economy at the start of an expansion to highlight how an understanding of what we can achieve does not always tell us what we should do.

THE FED'S RENEWED COMMITMENT TO PRICE STABILITY

Although price stability, along with full employment, has been an explicit economic policy goal for several generations, the reduction of inflation to 3 percent is largely the result of a decision made several years ago by the Fed to reemphasize its determination to achieve price stability. After dropping from double-digit levels in the late 1970s and early 1980s to the 4 percent to 4 1/2 percent range by 1984, the CPI seemed stalled at that rate for the rest of the decade except for occasional fluctuations. The most noticeable deceleration in the inflation rate occurred in 1986, when a sharp decline in oil prices

offset increases in other consumer goods, resulting in an annual average CPI increase of only 1.9 percent. Still, core inflation—that is, the rate of price increases in goods and services exclusive of volatile items like food and energy—did not appear to budge.

■ Then in the late 1980s price pressures began to mount. The CPI rate jumped from 3.7 percent in 1987 to 4.1 percent in 1988 and to 4.8 percent in 1989. While the Fed began moving to counter these forces, a broader discussion initiated at that time focused on the U.S. central bank's goal of price stability and what it meant. While no formal definition was officially adopted by the Fed, an informal consensus developed around the "working definition" of price stability as a reduction in price pressures to a point where inflation is not a factor in economic decision making. Over the next several years inflation was brought down from a 5.4 percent annual average increase in 1990 to 3 percent in 1992. With the exception of 1986, last year's inflation rate was the lowest since 1967.

■ Thus, even though the connection between this working definition of inflation and the price indexes available to measure that concept is imperfect, we are at a critical juncture. It is time to ask if the goal of price stability has, in effect, been achieved. If so, where do we go from here? I believe that a brief review of technical problems surrounding the measurement of inflation provides convincing evidence that the U.S. economy is indeed close to price stability. Beyond these issues, however, social preferences in the United States may constrain monetary policymakers from immediately and completely resisting price pressures that might arise in the future. In other words, the lower bound to the measured rate of inflation consistent with price stability is greater than zero.

DIFFICULTIES IN MEASURING INFLATION

In seeking to attain most goals, organizations determine an appropriate set of measures that gauge progress as well as ultimate success or failure. Central banks can use various measures of price changes, ranging from price indexes of crude commodities and finished producer goods to a broad measure based on output—the GDP deflator. The following discussion focuses on the most widely used measure of inflation in this country, the consumer price index. However, the arguments also apply to the other price measures because no index is free from problems.

■ The CPI represents a "basket of goods"—more than 360 categories of products and services purchased by consumers, ranging from food and shelter to more discretionary items like cars and entertainment. Each category is given a fixed weight according to its estimated

share of consumer expenditures in the base period. One problem with the CPI is that these weights vary between periods as consumers shift from relatively more expensive products to less costly substitutes. For example, if oil prices jump sharply, consumers will gradually use fewer products that are energy-intensive and instead buy more fuel-efficient cars and homes. Shifts can occur more quickly, of course, among goods with many close substitutes.

■ Unfortunately, these shifts cannot be measured continuously. Instead, weights are adjusted only at an interval of many years. In the interim, a price index may still assign an old weight to, say, gasoline prices even though many people have switched to public transportation or smaller cars. The result may be a biased estimate, and the bias may work in the direction of overstating inflation.

■ Another significant problem with the CPI is that it only imperfectly captures improvements in quality that take place over time. Technological progress effectively creates new health care products and procedures under old names as the pace of technical change quickens. For instance, our intuition regarding the way prescription drug prices are measured would be to expect largely the same set of drugs to be surveyed over time. If they were, the prices of certain antibiotics, which have been declining, would work to pull down the CPI. However, the CPI methodology is to use, for example, pharmacies' prices for the last ten prescriptions purchased on a particular day of the month and to compare prescription drug expenses over time, not individual drug prices. This methodology more truly reflects actual spending, which encompasses purchases of new, more expensive drugs like AZT and beta-blockers. However, this practice represents a compromise in the sense that the basket of drugs is not held constant and thus the index does not provide a pure gauge of price changes. The result of this very reasonable effort to incorporate quality improvements is a probable upward bias in the CPI for this component. There are similar challenges for measuring other components as well.

■ There are also problems associated with the need to use indirect or imputed measures. In a world of scarce resources, including scarce resources for statistical collection by the federal government, not every product or service can be directly observed and measured in an ideal way. Statisticians must develop proxy measures, which inevitably have a certain degree of arbitrariness about them. For example, the portion of income devoted to shelter costs is imputed in a complex way that attempts to gauge the cost of owner-occupied housing by calculating an equivalent rental rate. While the current approach is theoretically pure, actual calculations are far less intuitive than an earlier method that used mortgage payments and other direct costs. Reasonable people may agree that one approach makes more sense, but neither is unambiguously the "right" method.

■ This brief review of measurement problems associated with the CPI illustrates the difficulty of specifying the CPI rate that is equivalent to price stability. Estimates vary as to the extent that inflation may be mismeasured as a result. However, there is some recognition that the net effect is to overstate it, and these biases become proportionately more distorting as the inflation rate declines. Thus, achieving "zero inflation" could represent deflation, a condition that certainly would, contrary to the Fed's price stability goal, play a role in economic decision making. The corollary of this observation is that achieving the goal of price stability implies a lower level for CPI inflation that is greater than zero.

SOCIAL PREFERENCES AND INFLATION

Even if all of these measurement problems could be satisfactorily resolved, I believe there is another, even more important reason that the optimal inflation rate is not necessarily the minimal inflation rate. This reason involves the concept of a social compact—between U.S. society and its policy-making institutions—and the costs and benefits of reaching price stability.

■ In an economy with stable prices, resources are allocated to their most efficient uses. In turn, long-run growth tends to be higher because funds are directed toward investments that raise the economy's productive capacity. The situation is quite different when prices are rising and these pressures are not expected to be restrained. Resources tend to be directed toward inflation hedges like gold, real estate, or other fixed assets or toward the costs entailed in constant portfolio shifts that are necessary to minimize inflation's effects on other assets. While price stability is clearly preferable, at the same time achieving price stability is not without costs, especially in the short run. If monetary policy is used to lower inflation but the policy is not anticipated or perceived as credible by economic decisionmakers, then the short-term resource cost of fighting inflation can be very high. Output may fall or not grow as rapidly as otherwise, and unemployment may rise considerably. I believe these costs are significant and that policy should take into consideration the situation in which a large number of people are thrown out of work and many businesses are disrupted.

■ In most advanced economies, policy institutions were created over the last century to mitigate the transition costs of necessary economic corrections. In the nineteenth century, business cycle fluctuations were much sharper than they are today. Imbalances were corrected by sharp implosions in financial markets, severe contractions in output, and costly dislocations of resources. Prices also tended to fall across the board, sometimes quite dramatically. Then economic growth began afresh.

■ While such swift and clean adjustments have a certain theoretical attractiveness, these abrupt changes were unnecessarily costly for those adversely affected. Sometimes, in the rush of a collapse, sound businesses, banks, and households were financially ruined because their assets were not liquid and they lacked the time to find sources to liquidate them. Over time, a variety of economic policy institutions and measures were established to mitigate and attenuate this process.

■ This broadly ameliorative aspect of macroeconomic policy has been reaffirmed formally as recently as 1978, when Congress began requiring the Fed to report to the legislature twice a year in regard to its goals for economic growth, employment, and inflation. Thus, I believe the Fed, like other policy institutions that act on behalf of society, must keep public preferences in mind when pursuing social goals. As a practical matter, this social obligation may mean that none of the transitions should be excessively traumatic.

Cyclical Price Pressures

The way this social compact operates in today's setting can be seen more clearly if we consider two situations in which inflation might begin to mount—first, as a result of cyclical dynamics and, second, in response to an external and totally unexpected event that jolts the economy, such as an oil price shock. In the former case, where bottlenecks begin to develop in response to growth at a rate faster than the economy's potential to expand, the textbook approach calls for the central bank to restrain money and credit growth by raising short-term interest rates. While I agree in principle, I nonetheless see certain limitations on the monetary authority, given the situation with the other hand of macroeconomic policy making—fiscal policy.

■ Fiscal policy has become handicapped by the large federal budget deficits that were built up during the 1980s and continue in the 1990s. As a result, we saw in the recent recession that fiscal policy was essentially unavailable as a countercyclical tool. In turn, all of society's attention was focused on the Fed to counter rising unemployment and shrinking output.

■ From my perspective, unless a sound deficit reduction plan is implemented, monetary policy is likely to be the only countercyclical policy available for a number of years. This situation, as I see it, makes it impossible for the Fed to focus solely on price stability as the goal of monetary policy. It would simply be too costly in terms of output and unemployment, in my opinion, to implement immediately the full policy restraint necessary to bring inflation back within the accepted bounds in the shortest period possible. The social cost in the short run

would be too high. In such circumstances, I believe that the Fed must take a more gradual path toward the goal of price stability.

■ Taking a detour from the course toward noninflationary growth in such circumstances should not be interpreted to mean that the Fed has become more tolerant of inflation; rather, the success we have had in lowering inflation during the past few years should give economic decisionmakers confidence that the Fed would quickly return to a posture of minimizing price pressures.

An External Shock and Inflation

In the second scenario in which inflation might rise, consider what should happen if a shock like the oil price increases of the 1970s were to recur. There are those who would say that maintaining the course toward price stability should remain the paramount goal of the Fed in such circumstances. They believe that the long-term benefits of price stability overwhelmingly outweigh any short-run costs of resisting inflation. In particular, they would be willing for society to incur a drop in output and a rise in joblessness while prices of other goods adjusted to the new higher price of energy. Some prices would fall; some might rise, and the mix of output would shift. Such a radical reallocation of resources would lead to temporarily higher unemployment and lower output as part of the adjustment process.

■ Those who would countenance such social costs in order to resist inflation argue that resources would be reallocated efficiently. They point out that if the impact of higher energy prices were only partly resisted, the price level would rise generally (and perhaps permanently) during the adjustment. As a result, they note, resources would likely be allocated to inflation hedges rather than to investments that add to productivity but may take longer to reach fruition. In their calculus, the Fed should not stray from the path toward price stability because long-term growth will suffer.

■ Others, I among them, believe that in the case of such a shock the central bank should not completely resist the ensuing price pressures. Rather, some of these might be accepted in the form of a temporarily higher CPI growth rate in order to make the short-run drop in output and employment less severe.

■ The role of monetary policy as the sole available tool of macroeconomic policy is a factor here just as it was in the hypothetical case of a cyclically induced run-up in prices. Through targeted taxation and spending measures, fiscal policy would be quite capable of

addressing the imbalances between particular sectors of the economy that might arise in the wake of a shock. Taxes could be raised on certain activities that may be receiving what is deemed an undeserved windfall; sectors that are disproportionately harmed could be subsidized through special programs. In contrast, monetary policy can be exercised only bluntly, via the Fed's influence on short-term interest rates and on money held in the form of bank reserves. Without fiscal policy as an offsetting force, monetary policymakers have only one way to mitigate the uneven impacts of a shock: by choosing to accept part of the pass-through to higher prices during the transition while making it clear that this course is merely a temporary detour from a noninflationary growth path.

■ As in the case of a cyclical acceleration of prices and a constrained response by the central bank, partial accommodation of a shock should not be interpreted as vacillation by the Fed vis-à-vis its stated goal. It seems to me that the credibility the Fed has achieved in the past few years in reducing inflation gives the central bank more flexibility under such circumstances to meet its complex social mandate.

Society's Inflationary Bias

The foregoing discussion explains why there is a lower bound on price stability that is above zero inflation. However, technical problems and social preferences do not necessarily set an upper limit on inflation. What happens if society underestimates the long-term costs of inflation or if society seeks to use inflation to solve its debt problem? This issue is not at all a hypothetical one, in view of the large federal budget deficits. Several attempts to address the deficit problem have failed, reflecting the fact that Americans have so far been unable to agree on an equitable distribution of the burden associated with cutting programs or raising taxes.

■ The social deadlock suggests that there is an underlying, almost unconscious, bias that favors greater inflation because it is much easier to pay back what has been borrowed yesterday or today in less valuable, inflated dollars of tomorrow. No formal decisions would need to be made, no votes cast, but a de facto tax would be levied, in effect reducing the debt outstanding. I strongly prefer an outright decision on the deficit through the political process. However, if such an agreement cannot be reached and inflation were to begin to rise sharply, the Fed itself would need to act as the stalwart upper bound by refusing to monetize the federal debt. Again, the credibility that we have achieved over the past several years in carefully wringing price pressures out of the economy should lend credence to our assertion that we will do so. Of course, historical experience suggests that the best way to maintain this credibility over

time is by having a central bank that has some degree of independence from those who are responsible for making fiscal policy.

Conclusion

The Federal Reserve System has succeeded in lowering inflation to a significantly slower rate than that of the 1970s and 1980s. Because of measurement biases in gauges like the consumer price index, I believe that the current actual rate of inflation is not far from price stability. As the economic expansion proceeds and resource use increases, price pressures could begin to mount. I firmly believe that the Federal Reserve System should gently but steadfastly resist such an acceleration in the inflation rate, bearing in mind the absence of fiscal policy as a countercyclical tool. If an adverse shock were to occur, price pressures could be accommodated and measured inflation would rise for a while. In neither case should such policy responses be interpreted as signaling an eventual return to the high inflation of the 1970s or even a wavering by the Fed from its commitment to achieving price stability. Instead, economic decisionmakers should recognize the Fed's proven determination to keep the economy on a noninflationary growth path. Ebbs and flows in the degree of anti-inflationary pressure coming from Fed policymakers reflect an appropriate flexibility in meeting the central bank's goals, goals that embody the preferences of American society as a whole.

Sixth District Highlights

FINANCIAL SERVICES

Volumes and Prices. During 1992 the volume of check collection and electronic payments services provided by the Sixth Federal Reserve District's six offices—in Atlanta, Birmingham, Jacksonville, Miami, Nashville, and New Orleans—continued to expand. These offices processed 3 billion checks, about 4 percent more than 1991's volume and 1.1 billion more than any other Federal Reserve District. Basic wire transfer volume increased 5 percent, and ACH commercial volume rose about 25 percent over 1991.

■ For each of the securities services—bookentry transfers, definitive safekeeping, and noncash collection—volume declined in 1992 from 1991 levels. The number of bookentry transfers originated on-line fell about 9 percent, reflecting volume losses caused by regional consolidations and mergers in the Southeast. Noncash collection volume was down approximately 27 percent, and definitive safekeeping volume dropped about 33 percent. The volume of these services continued to decline because fewer physical securities were eligible to be maintained or collected through these services.

■ The District fully recovered the $91.6 million total cost (plus a private sector adjustment factor) of providing priced services in 1992, and many of its prices remain among the lowest in the Federal Reserve System.

■ **Check Collection**. In October the first phase of a new system for the on-line settlement of forward collection items and return items (OSCAR) was implemented in the Birmingham office. The system, to begin operating in other District offices in 1993, streamlines check processing by automating the associated settlement and accounting functions. During 1992 the District participated in developing an automated adjustment system (known as FASTRAC) and rewriting the Federal Reserve System's Unisys-based check processing software. The District also served as the development site of the System's new software for the delivery of payor bank services such as truncation, MICR (magnetic ink character recognition) capture, and key account totals. Payor bank services volume grew approximately 25 percent as the customer base increased 44 percent, reflecting the District's commitment to encourage the use of electronic services in check collection.

■ **Electronic Payments**. In 1992 the District became a leader in Systemwide efforts toward achieving an all-electronic automated clearinghouse (ACH) by mid-1993. Fewer than ten Sixth District ACH endpoints remain to be converted to electronic delivery, with 1,251 converted through 1992. To further improve the level of service to customers, the District implemented an on-line user "help desk" that allows all Fed offices to log and track customer assistance requests and also initiated a voice response system for ACH return items and notifications of change.

■ **Noncash Collection and Definitive Safekeeping Consolidation**. As one of the Federal Reserve's four regional noncash collection processing sites, the Atlanta Fed's Jacksonville Branch continued its consolidation of System coupon and bond processing, adding Richmond District noncash items in September. Jacksonville also began processing for paying agents in the Atlanta, Miami, and Nashville zones. The District's definitive safekeeping services were further consolidated in a single office, Birmingham, to reduce costs and increase efficiency as the System pursues its planned withdrawal from providing these services by year-end 1993.

■ **Fiscal Services**. The Jacksonville office successfully implemented the PC Original Issue application (PCOI), a new Treasury Direct subsystem that provides servicing sites an alternative means of entering Treasury tender data during Treasury Direct mainframe downtime. Jacksonville was one of six Federal Reserve pilot sites for this system, which is the first Treasury Direct program to use personal computers.

■ **Cash Services**. With support from automation staff in the corporate services division, all District branches completed conversion to a new minicomputer-based system that facilitates automated logging, tracking, and reporting for cash shipments. Developed by the Sixth District, the new cash automation software is scheduled to be implemented in two other Federal Reserve Districts in 1993 and has engaged the interest of several other Districts.

■ **Hurricane Andrew**. A major challenge the Sixth District faced in 1992 was maintaining service levels when Hurricane Andrew hit southern Florida on August 24 and Louisiana two days later. Damage in Louisiana bypassed New Orleans, but the catastrophic destruction in Miami created extreme operational difficulties for the Fed branch there. Nevertheless, the Miami office, powered by an emergency generator and staffed by a corps of employees, remained open. Using contingency plans, electronic funds transfers were maintained via computer linkages to the Atlanta office, and branch staff handled a high volume of cash distribution to meet the increased local need. Check clearing was delayed until the branch had regained full power, but by August 26 the branch had restored all operations and functions.

SUPERVISION AND REGULATION

Supervision and Regulation. With the conversion of twenty nonmember bank subsidiaries of a major institution to Federal Reserve membership effective July 1, 1992, the number of Sixth District state member banks grew 20 percent (to 120) and aggregate assets increased about 56 percent (to $42.8 billion). This larger constituency called for a significant increase in commercial and consumer affairs examination staff. Staff additions were also required to handle new responsibilities mandated by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). This act sets forth an array of regulatory responsibilities, from savings disclosures and an enhanced Fed role in foreign bank supervision to a course of "prompt corrective action" whereby specific supervisory actions are prescribed dependent on an institution's capital level. For

example, the international examination staff grew approximately 85 percent to meet the act's requirement that all foreign agencies and representative offices be examined annually for safety and soundness. To address the automation needs of the larger staff and a broader set of responsibilities, the department investigated a number of automation alternatives and identified an appropriate computer system for purchase in 1993.

■ The number of new staff in the department has intensified already-demanding training requirements. Atlanta staff, who were involved in developing and implementing a rigorous curriculum for examiner training and certification adopted by the Board of Governors in 1991, have taken a similar role in a program to integrate Federal Reserve examiner training with the FDIC's. The District also continued its support for various System initiatives by contributing substantial resources to special examinations and criminal investigations, task forces, and the annual Shared National Credit review, the coordinated review of large national credits by federal regulatory agencies.

■ **Consumer and Community Affairs**. The community affairs staff have conducted research on barriers to lending in low- and moderate-income and rural areas that has contributed to the debate on the soundness and effectiveness of loan programs targeted to these areas. Sharing this information through a newsletter, speeches, and conferences significantly boosted community development activity throughout the District. The staff provided technical assistance to help create four new loan pools—with total committed resources of almost $150 million—for community development lending. In addition, staff members assisted three District financial organizations in setting up community development corporations. These initiatives will help finance affordable single- and multifamily housing and small business development throughout the District.

■ During 1992, the second year of collection and analysis of expanded 1990 Home Mortgage Disclosure Act (HMDA) data, increased attention was focused on fair-lending issues, particularly on apparent disparities in the treatment of minority loan applicants. Atlanta Fed consumer affairs examiners have expanded the scope of their fair-lending reviews, using HMDA data to target specific loan applications as a way of probing potential unequal treatment. The department has devoted additional resources to thorough assessments of state member banks' performance under the Community Reinvestment Act. Consumer affairs staff have also been greatly affected by FDICIA provisions, including Truth in Savings and the required examination of foreign branches located in the Sixth District for compliance with consumer protection regulations.

■ **Discount and Credit**. Like other areas of the supervision and regulation division, the discount function was also affected by the passage of FDICIA. One of the law's provisions, designed to help ensure the least costly resolution of problem institutions and thus avoid excessive drain on the deposit insurance fund, involves raising the Fed's potential liability in lending to failing institutions. Through providing chairmanship of the Federal Reserve System's Subcommittee on Discounts and Credits, the Sixth District positively influenced System lending

policy regarding these provisions of FDICIA as well as other discount practices. In addition, the discount function staff assumed responsibility for coordinating the District's risk management and monitoring program for accountholders. Institutions are monitored to determine whether excess credit exposure exists, whether daylight overdraft credit limits are suitable, and whether a "high-risk" designation should be assigned, and the findings are communicated to appropriate parties within the Reserve Bank.

■ The discount rate was lowered once in 1992, from 3.5 percent to 3.0 percent on July 2.

RESEARCH

Research. Issues related to the Federal Reserve's monetary and financial policy responsibilities occupied the research department in 1992, a year of continued slow economic growth and financial uncertainty. Reacting to recent difficulties in setting monetary policy goals and evaluating the economy's near-term path involved work on several issues. Staff examined the problems involved in separating the results of changes in monetary policy from the impacts of economic shocks, charted the effect of monetary policy on the Treasury yield curve, and developed a finance-based model of foreign exchange rate determination. The foreign sector also received attention in a study that indicates some adverse effects of exchange rate variability on international trade flows and in work on formalizing structures necessary for international policy coordination. Research on the information content of consumer confidence surveys as well as the role of survey and employment information in forecasting industrial production assesses the usefulness of data often relied on to monitor the domestic economy. As an additional aid to tracking regional economic conditions, the staff developed a publicly available survey of activity at manufacturing plants in the Southeast.

■ In research on long-term trends in economic activity, two studies address the contribution of capital, both human and physical, to economic growth while a third provides a history and critique questioning the usefulness of the economic base model of regional economic development, a model that often underlies long-term local and regional economic planning.

■ The staff also considered issues arising from the rapid changes in the nation's financial institutions and markets and their regulation. One study culminated in a proposal for avoiding financial distress through coordinating bank closing and discount window lending policy. Another study went beyond banking to compare and contrast the nation's pension insurance system with its insurance system for depository intermediaries.

■ In research related to bank consolidation, staff members called into question claims of cost savings from bank mergers as well as widely held explanations of variations in bank profitability among banking markets. Financial economists also studied banks' merger motivations and their choice of capital instruments. This work, which extended the department's inquiries into the structure of production in the financial services industries, led to a conference for experts on efficiency in financial institutions.

■ Staff continued to explore developments in financial markets and instruments and their

policy implications. A conference held early in the year brought together experts in financial markets and new derivative financial instruments with policymakers in an attempt to raise interest in public policy issues among academic economists who specialize in finance. The staff also developed, tested, and outlined the implications of models for securities pricing, path-dependent options, and mortgage-backed securities.

■ Research staff also assisted cash services in developing a currency inventory model that may help cash services target the amount of currency to order from the U.S. Treasury.

■ **Public Affairs**. Conferences and seminars on international trade, financial regulation, and regional development were a major part of the department's educational programs in 1992. A conference titled "Economic Development in the Southeast—Taking a Giant Step Forward" brought specialists and practitioners together to discuss development issues ranging from housing and the environment to exports and financing. A regional roundtable, cosponsored with the National Association of Business Economists, focused on near-term prospects for the Southeast's economy and the financial services industry. In conjunction with a series of educational activities to commemorate the New York Stock Exchange's 200th anniversary, staff organized a seminar on regulatory issues in banking and securities markets.

■ As part of its outreach to economic educators, the department, along with the Louisiana Council on Economic Education and the Dallas Fed, taught an international economics course for high school teachers at the University of New Orleans. Staff members also developed a curriculum guide to accompany an article in *Regional Update* on understanding the unemployment rate.

■ In addition, the Bank cosponsored the Fifth Special Financial Conference of the American Committee on Asian Economic Studies, a consortium of academics and policymakers involved in the economies of Asia and the Pacific Rim. Much of the discussion concerned European monetary union, and participants included central bankers from Germany and France as well as a number of Asian countries.

■ The department updated and redesigned two of its most popular pamphlets—one on recognizing counterfeit currency and another on the structure and functions of the Federal Reserve System. It also coordinated and produced a new newsletter reporting research division activities.

■ **Statistical Reports**. Department staff developed special mechanisms for monitoring changes resulting from numerous revisions to Regulation D during the year, including a reduction in reserve requirements, closing of loopholes, reducing the lag in counting vault cash as a component of required reserves, and doubling the amount of carryover permitted between reserve maintenance periods. The department also provided staff at the Board of Governors and the New York Federal Reserve Bank with early information about the effects of these changes on reserve holdings at depository institutions.

■ Data in the National Information Center data base were further refined as staff gathered and entered more precise information for commercial banks' branches and the representative offices of foreign institutions in the Sixth District. The

department assumed responsibility for gathering and processing Home Mortgage Disclosure Act reports.

■ Within the department a research and analysis group and a training advisory group were formed to help build on the analytical content of the department's work. Atlanta staff trained personnel at the Miami Branch in report preparation for Edge Act corporations and foreign bank agencies.

Automation Initiatives. The District focused significant resources toward preparing for transferring its IBM mainframe computer processing to three Federal Reserve consolidated processing sites in 1993. The consolidation, announced in late 1991, is intended to make the Federal Reserve's electronic payment services even more reliable and to provide a more uniform level of customer service nationwide. Atlanta computer staff have installed and have begun extensive testing of much of the software that will run in the consolidated environment, an important step for minimizing the risk of the move. As part of a Systemwide conversion, the Sixth District has also begun replacing its data communication system. The project, which will extend through 1995, involves installing a high-speed, high-reliability network to support the consolidated processing of data and the growth in electronic payment services.

Corporate Services

■ **Payments System Risk Initiatives**. The Bank prepared for further payments system risk policy changes approved by the Board of Governors. During 1992 software releases for accounting, securities, funds, and Treasury Tax and Loan (TT&L) were implemented to support these changes, which include revisions (effective in October 1993) to procedures for measuring the amount of overdrafts in reserve and clearing accounts during the day. In addition, Reserve Bank staff used interfacing software to test new daylight overdraft monitoring software and began preparations to host seminars in 1993 to help institutions review the policy changes.

■ **Software Development Projects**. Programming staff in Atlanta completed the detailed design and began to develop new software for the Federal Reserve's expense accounting system, known as PACS (Planning and Control System). The new system will be the Federal Reserve's first major application to operate on multiple (PC and mainframe) platforms. Software development is scheduled to be completed by August 1993, with implementation in Atlanta beginning in January 1994; at least six Reserve Banks will eventually use the new system.

■ The Atlanta Fed also completed the design in July for a new centralized billing (accounts receivable) system that will process all twelve Reserve Banks' billing operations at one of the System's new consolidated data processing sites.

■ The District continues to be involved in the development, maintenance, and support of Fedline, a PC-based software product through which financial institutions nationwide access Federal Reserve services such as electronic payments, account information, and cash ordering and deposits.

■ The Bank continued its leadership in a System project to enhance payments data security using a message authentication

code (MAC), a form of digital signature that indicates whether an electronic message has been modified during transit. Software and hardware components for the MAC system were tested using the ACH system, which verified the soundness of the technical specifications, but the project is still in the developmental stages.

■ **Interim Facilities Direction**. In 1992 the Bank leased office space to accommodate Atlanta staff during the period required to study, plan, design, and construct facilities that will meet long-term facilities needs of the head office. An additional 28,500 square feet leased at the 55 Park Place office tower allowed relocation of the statistical reports department from the Marietta Street building and expansion of space occupied by the supervision and regulation department at Park Place. In addition, a seven-year lease was signed for 96,800 square feet in the Equitable Building, adequate space to house several departments that will relocate to these offices during 1993.

■ **Human Resources**. To support the Federal Reserve System's automation consolidation initiatives, policies and programs were approved to encourage key staff members to remain with the Bank during the transition and to facilitate start-up operations at the consolidated sites. So far, seven individuals from the Atlanta Bank have accepted jobs at the consolidation sites. The Bank is also assisting staff members who may not be retained once consolidation is complete. Several meetings held with outside professionals were designed to help individuals prepare for the change.

■ To ensure compliance with the Americans with Disabilities Act implemented in 1992, all hiring and employment practices were reviewed, resulting in modifications to the Bank's employment application form and other appropriate changes. In addition, extensive training sessions were held at each of the District's six offices to inform supervisory and management staff of the act's implications, and special procedures were established to help departments identify essential job functions in order to comply with specific provisions of the new law.

■ In October department staff completed an upgrade, begun in 1991, of the Bank's comprehensive, automated human resource information system. The data base provides considerable support to Bank management in setting personnel policies and objectives, particularly affirmative action goals; maintains information critical to managing the Bank's compensation and benefits programs; and enhances the Bank's automated payroll system.

■ In 1992 the Bank's management approved a new managed care approach for administering health benefits. The new plan, in effect as of January 1, 1993, will replace the indemnity plan. It is designed to help contain cost increases in health benefits while providing employees improved benefits at discounted prices. Annual savings for the Bank are expected to range from $500,000 to $800,000 or more. Existing HMO options will continue to be offered at each branch office.

AUDITING

The District's audit management implemented a number of organizational changes in 1992 that better prepare the department for working

effectively in an environment of increasingly consolidated District and System operations. The structure of audits was also changed somewhat to improve their quality, effectiveness, and efficiency.

■ Audit emphasis was added in a number of areas of automation including environmental software products, data security, microcomputer applications, and the IBM AS/400. The department continued to provide audit coverage and monitoring for both System and District software development projects.

■ The District continued to serve as the site for the System Center for Auditor Development (SCAD), a training unit that develops Fed-specific auditing programs and negotiates contracts for external training services on behalf of the System's audit community. In collaboration with SCAD, auditing coordinated and conducted the first SCAD Symposium on Local Area Networks and Personal Computers.

Secretary's Office

The Bank's 1992 Distinguished Speakers Series featured a variety of prominent individuals including former U.S. Senator and Presidential Chief of Staff Howard Baker, Secretary of Health and Human Services Louis Sullivan, the late FDIC Chairman William Taylor, financial advisor John G. Heimann, Conference Board President Preston Townley, Federal Reserve Chairman Alan Greenspan, Federal Reserve Governors Susan Phillips and Lawrence Lindsey, and economist Norman Robertson. All discussed domestic and international financial industry and economic concerns. Ryder System Chairman Anthony Burns spoke to a joint meeting of the Sixth District's head office and branch directors. Three distinguished international figures—Andrés Rozental, Deputy Foreign Minister of Mexico; Carlos Rojo, Under Secretary of the Ministry of Economy for Argentina; and Jaakko Honko, Chancellor of the Helsinki School of Economics—spoke to audiences of Atlanta business, academic, and community leaders.

■ Members of the Advisory Council on Small Business, Agriculture, and Labor held two meetings to exchange views with President Forrestal and Atlanta Fed staff on business and credit conditions in the region. President Forrestal also met twice with the Financial Institutions Advisory Committee, which represents commercial banks, thrifts, and credit unions, to discuss some provisions of FDICIA such as prompt corrective action and new real estate lending standards.

■ In conjunction with his monetary policy responsibilities, President Forrestal also met periodically with leaders representing business, academic, financial, consumer, labor, and other community interests throughout the District to discuss current economic and policy-related issues.

Board of Directors

Edwin A. Huston
Chairman
Senior Executive Vice President–Finance
Ryder System, Inc.
Miami, Florida

Leo Benatar
Deputy Chairman
Chairman and President
Engraph, Inc.
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Atlanta, Georgia

Federal Advisory Council Member

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Deposit Guaranty National Bank
Jackson, Mississippi

Branch Directors

Birmingham

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President
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Jacksonville

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Chairman
President
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Venice, Florida

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Banking and Finance
College of Business Administration
University of Florida
Gainesville, Florida

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Miami, Florida

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Island National Bank
Palm Beach, Florida

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Intercap Investments, Inc.
Coral Gables, Florida

Nashville

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Chairman
First American Bank Distinguished
Professor and Head
Department of Finance
College of Business Administration
University of Tennessee
Knoxville, Tennessee

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President and Chief Executive Officer
First National Bank of Knoxville
Knoxville, Tennessee

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President and Chief Executive Officer
Brentwood National Bank
Brentwood, Tennessee

Victoria B. Jackson (resigned)
President and Chief Executive Officer
DSS/ProDiesel, Inc.
Nashville, Tennessee

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Knoxville, Tennessee

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Management Services
Nashville, Tennessee

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American General Life and Accident
Insurance Company
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President
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New Orleans, Louisiana

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Chairman and Chief Executive Officer
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Vicksburg, Mississippi

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Managing Director
Nelson Capital Corporation
New Orleans, Louisiana

Lucimarian T. Roberts
President
Mississippi Coast Coliseum Commission
Pass Christian, Mississippi

Jo Ann Slaydon
President
Slaydon Consultants and
Insight Productions and Advertising
Baton Rouge, Louisiana

A. Hartie Spence (resigned)
President
Calcasieu Marine National Bank
Lake Charles, Louisiana

Corporate Officers

Head Office

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President and Chief Executive Officer

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First Vice President and
Chief Operating Officer

W. Ronnie Caldwell*
Executive Vice President

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Senior Vice President

H. Terry Smith*
Senior Vice President

Sheila L. Tschinkel*
Senior Vice President and
Director of Research

John M. Wallace**
Senior Vice President and
General Auditor

Edmund Willingham
Senior Vice President and
General Counsel

*Management Committee
**Advisor to Management Committee

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Vice President

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Vice President

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Vice President and
Director of Human Resources

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Vice President

William C. Hunter
Vice President

Zane R. Kelley
Vice President

John R. Kerr
Vice President

B. Frank King
Vice President and
Associate Director of Research

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Vice President and
Public Affairs Officer

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Vice President

John D. Pelick
Vice President

Mary S. Rosenbaum
Vice President

Ronald N. Zimmerman
Vice President

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Assistant Vice President

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Assistant Vice President

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Assistant Vice President

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Research Officer

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Assistant Vice President

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Assistant Vice President

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Assistant Vice President and
Corporate Secretary

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Assistant General Counsel

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Assistant General Counsel

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Assistant Vice President

Alvin L. Pilkinton, Jr.
Assistant General Auditor

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Assistant Vice President

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Research Officer

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Assistant Vice President

Melinda J. Rushing
Assistant Vice President

Larry J. Schulz
Assistant Vice President

Robert T. Sexton
Assistant Vice President

Larry D. Wall
Research Officer

Jessie T. Watson
Assistant Vice President

Adrienne M. Wells
Assistant Vice President

Kian Kian Wong
Assistant Vice President

ATLANTA

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Senior Vice President and
Branch Manager

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Vice President and
Assistant Branch Manager

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Assistant Vice President

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Assistant Vice President

ROBERT I. MCKENZIE
Assistant Vice President

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Assistant Vice President

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Coordinating Branch Manager

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Assistant Branch Manager

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Assistant Vice President

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Assistant Vice President

CHARLES W. PRIME
Assistant Vice President

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Coordinating Branch Manager

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Assistant Branch Manager

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Assistant Vice President

JEFFREY L. WELTZIEN
Assistant Vice President

KIMBERLY K. WINSTEL
Assistant Vice President

MIAMI

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Vice President and Branch Manager

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Assistant Vice President and
Assistant Branch Manager

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Assistant Vice President

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Assistant Vice President

RAUL DOMINGUEZ
Assistant Vice President

ROBERT DE ZAYAS
Assistant Vice President

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Assistant Branch Manager

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Assistant Vice President

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Assistant Vice President

E. CHANNING WORKMAN, JR.
Assistant Vice President

NEW ORLEANS

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Vice President and Branch Manager

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Assistant Vice President and
Assistant Branch Manager

AMY S. GOODMAN
Assistant Vice President

WILLIAM E. THOMPSON III
Assistant Vice President

PATRICIA D. VAN DE GRAAF
Assistant Vice President

STATEMENT OF CONDITION

ASSETS	DECEMBER 31, 1991	DECEMBER 31, 1992
Gold Certificate Account	$ 479,000,000	$ 503,000,000
Special Drawing Rights Certificate Account	303,000,000	318,000,000
Coin	46,309,635	38,246,964
Loans and Securities	9,115,275,522	10,228,575,482
Items in Process of Collection	895,199,642	1,304,767,107
Bank Premises	56,962,197	57,015,133
Other Assets	3,003,780,411	2,296,550,712
Interdistrict Settlement Account	1,987,388,156	3,833,067,333
Total Assets	$15,886,915,563	$18,579,222,731
LIABILITIES		
Federal Reserve Notes	$11,425,796,490	$13,231,945,372
Deposits*	3,101,919,515	4,100,864,625
Deferred Credit Items	792,359,948	600,199,151
Other Liabilities	81,241,610	66,933,183
Total Liabilities	$15,401,317,563	$17,999,942,331
CAPITAL ACCOUNTS		
Capital Paid In	$ 242,799,000	$ 289,640,200
Surplus	242,799,000	289,640,200
Total Capital Accounts	$ 485,598,000	$ 579,280,400
Total Liabilities and Capital Accounts	$15,886,915,563	$18,579,222,731

*Includes depository institution accounts, collected funds due to other Federal Reserve Banks, U.S. Treasurer-General account, other and miscellaneous deposits

STATEMENT OF EARNINGS AND EXPENSES

EARNINGS AND EXPENSES	DECEMBER 31, 1991	DECEMBER 31, 1992
Current Income	$997,067,482	$873,609,356
Current Expenses	129,128,941	138,361,845
Cost of Earnings Credits	13,482,866	13,536,275
Current Net Income	$854,455,675	$721,711,236
Net Additions (Deductions)*	38,592,616	(94,804,216)
Assessment for Expenses of Board of Governors	10,430,300	11,888,400
Federal Reserve Currency Cost	11,484,999	15,152,205
Cost of Unreimbursed Treasury Services	6,844,689	3,010,027
Net Income before Payment to U.S. Treasury	$864,288,303	$596,856,388
DISTRIBUTION OF NET EARNINGS		
Dividends Paid	$ 14,806,390	$ 16,384,793
Payments to U.S. Treasury (Interest on Federal Reserve Notes)	852,190,013	533,630,395
Transferred to Surplus	(2,708,100)	46,841,200
Total Income Distributed	$864,288,303	$596,856,388
SURPLUS ACCOUNT		
Surplus January 1	$245,507,100	$242,799,000
Surplus December 31	$242,799,000	$289,640,200

* Includes gains/losses on sales of U.S. government securities and foreign exchange transactions

SUMMARY OF OPERATIONS

SERVICES TO DEPOSITORY INSTITUTIONS	1991 ITEMS (THOUSANDS)	1991 PERCENT CHANGE FROM ONE YEAR AGO	1992 ITEMS (THOUSANDS)	1992 PERCENT CHANGE FROM ONE YEAR AGO
Check Clearing				
U.S. Government Checks Processed	69,034	−6.8	68,069	−1.4
Commercial Checks Processed	2,890,085	2.6	3,000,989	3.8
Electronic Payments				
ACH Commercial and Government Payments Processed	261,681	10.7	307,455	17.5
Wire Transfers of Funds	9,522	4.9	9,949	4.5
Cash Services				
Currency Orders Processed	98	−14.0	98	0
Coin Orders Processed	48	−2.0	50	4.2
Loans to Depository Institutions				
Loans Processed*	1,878	16.9	1,187	−36.8
Securities Services				
On-Line Bookentry Transfers	61	−13.6	56	−9.0
Noncash Items Processed	628	−21.1	460	−26.8
Definitive Safekeeping Receipts	95	−27.5	64	−32.6
SERVICES TO U.S. TREASURY				
U.S. Savings Bonds Issued	6,954	2.5	5,875	−15.5
U.S. Savings Bonds Redeemed	251	−23.5	79	−68.5
Other Treasury Issues				
Issued	68	−23.6	49	−27.9
Redeemed	3	−40.0	3	0
Deposits to Treasury Tax and Loan Accounts	747	−9.9	738	−1.2
Food Coupons Destroyed	628,244	36.5	748,576	19.2

* Numbers shown are actual, not thousands.

This annual report was prepared by the Public Affairs Department of the Federal Reserve Bank of Atlanta. Design: Carole L. Starkey.

FEDERAL RESERVE BANK OF ATLANTA

Head Office and Atlanta Branch
104 Marietta Street, N.W.
Atlanta, Georgia 30303-2713

Birmingham Branch
1801 Fifth Avenue, North
Birmingham, Alabama 35203-2104

Jacksonville Branch
800 Water Street
Jacksonville, Florida 32204-1616

Miami Branch
9100 N.W. 36th Street
Miami, Florida 33178-2425

Nashville Branch
301 Eighth Avenue, North
Nashville, Tennessee 37203-4407

New Orleans Branch
525 St. Charles Avenue
New Orleans, Louisiana 70130-3480

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