FEDERAL RESERVE BANK OF ST. LOUIS

Central Banker

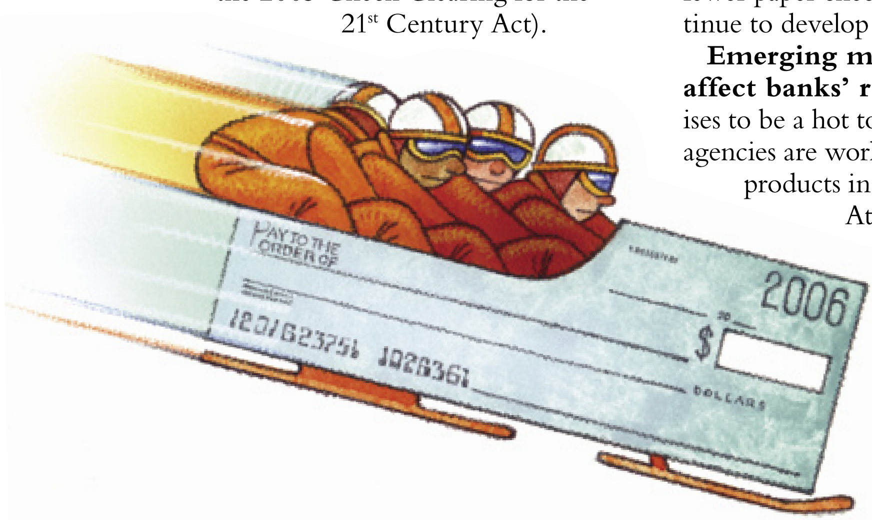
SPRING 2006

News and Views for Eighth District Bankers

Banking Industry To Face Familiar Challenges in 2006

Check 21, the search for new revenues, fraud prevention and credit risk are among the major challenges—and opportunities—facing the Federal Reserve and financial institutions in 2006.

Check image exchange will continue to pick up speed. Momentum in the adoption of electronic check processing promises to be one of the most significant developments in the payment industry, as many more community and large banks are expected to begin using Check 21 (under the 2003 Check Clearing for the 21st Century Act).



New revenue-growth opportunities will be explored. Thanks to Check 21, "remote capture" is intriguing many financial institutions with its possibilities. Check images could be captured at far-flung locations for electronic processing—potentially eliminating the need to transport paper checks to a processing center and enabling banks to appeal to customers previously beyond their physical reach.

Security and risk mitigation will remain a top priority. With more electronic banking and fewer paper checks, financial institutions must continue to develop ways to prevent electronic fraud.

Emerging macroeconomic trends will also affect banks' risk exposure. Credit risk promises to be a hot topic in 2006. Federal regulatory agencies are working on guidance for the very latest products in the residential mortgage market. At the same time, lending institutions are urged to create their own policies and procedures to best protect themselves.

For more information, read the full story, "What to Expect in 2006," in the January issue of *FedFocus* under Publications/Press Releases at www.frbservices.org. ■

Fed Making Free Animated DVD of *In Plain English*

The St. Louis Fed will soon release a new tool for educating the public about the structure and responsibilities of the Federal Reserve.

An animated DVD version of the popular publication *In Plain English—Making Sense of the Federal Reserve* takes viewers on a tour from the Fed's Board of Governors in Washington, D.C., to the boardroom of the FOMC and across the country to a Reserve bank. Buck, the narrator, discusses the Fed's roles in providing financial services, conducting monetary policy, and regulating and supervising banks.

The 20-minute free DVD will be available this summer to bankers, schools and any other organization interested in providing training on the basics of the Federal Reserve. More information will be available in the next issue of *Central Banker*. Additional economic education resources—as well as the web-based version of *In Plain English*—are also available on the Fed's public education web site at www.federalreserveeducation.org. ■

Feditorial

A Top Priority: Strengthening Our Roots Throughout the District

By David A. Sapenaro, first vice president of the Federal Reserve Bank of St. Louis

Ever notice when you prune a healthy bush in the fall, that the same bush grows back in the spring stronger, livelier than ever, bearing even more fruit or flowers? We were reminded of that very lesson last year as the St. Louis Bank was forced to prune back the check and cash operations at the Louisville and Little Rock branch offices, only to sow new and stronger growth in other areas.

I am referring to a Fed program we call Branching Out, which is the St. Louis Bank's effort to boost our presence and value throughout the Eighth District and its numerous communities. To borrow from a cliché, we are working hard to widen the door of open communications between the Fed and the constituents we serve.

In a nutshell, our new—or in some cases improved—activities fall under three longstanding Bank initiatives: to serve as a catalyst in promoting community development activities; to conduct regional economic research that can be used by policymakers and decision-makers throughout the District; and to provide and support economic education and information-sharing.

Since the effort began more than a year ago, we've held a number of public and community programs, including regional conferences on such topics as predatory lending and entrepreneurship. We've launched the Business and Economic Research Group (BERG), the Center for Regional Economics—8th District (CRE8) and a new regional research publication, *Regional Economic Development,* which debuted this past fall. At the same time, existing programs, like our former District Dialogues, have gotten a facelift (see article on Page 3) and improved the way we give information to, and glean information from, District bankers and other business leaders. Over the next several years, bankers will continue to see our District-wide presence flourish.

As for other priorities for the District—and me, personally—I am a strong believer in providing services that are the benchmark for quality and customer service and doing so in a manner that is cost-effective. You expect nothing less, and we expect nothing less of ourselves. Whether you interact with the Federal Reserve Bank of St. Louis through our public programs, our financial services or our bank examiners, you can count on receiving exceptional service from this organization. When you do, we'd like to hear from you. And if you don't, we definitely want to know about it so that we can try to fix it.

I'm eager to dig into the assignments ahead of me and personally can't wait to hit the road to attend a number of public programs. When we land in your neck of the woods, I hope you'll take some time to stop by, offer a handshake and let me know what you think. I'd really like to hear from you.

David Sapenaro, who became first vice president Jan. 3, can be reached at (314) 444-8721. ■

Federal Reserve Introduces "Check *into* AMI" Conversion

The Fed will eliminate by the end of 2006 check supplemental statements sent to customers. The statements include delivery of check advices, advices of auto charge, and basic and premium check activity. Once these statements are terminated, financial institutions in the Eighth District need to use accounting tools such as the Fed's web-based Account Management Information (AMI) system to view check information.

AMI offers customers real-time access to view intra-day account activity, download statements and search for specific transactions. The transition to AMI will provide financial institutions with a standard and more efficient method for obtaining check supplemental information.

In coming months, each Eighth District financial institution will receive an announcement letter, additional communication and training materials to help it select which AMI services will best suit its account management and reconcilement process. The institution will then have 90 days from the receipt of its announcement letter to convert to AMI or other online accounting tools. All conversion materials will be sent to the institution's check operations officer. Whereas cutoff dates vary for each customer, the sunset date for all check activity statements is Dec. 31, 2006.

Financial institutions that have access to AMI and wish to terminate their check supplemental statement prior to their scheduled conversion date should send a request to stlsaccountingservices@stls.frb.org.

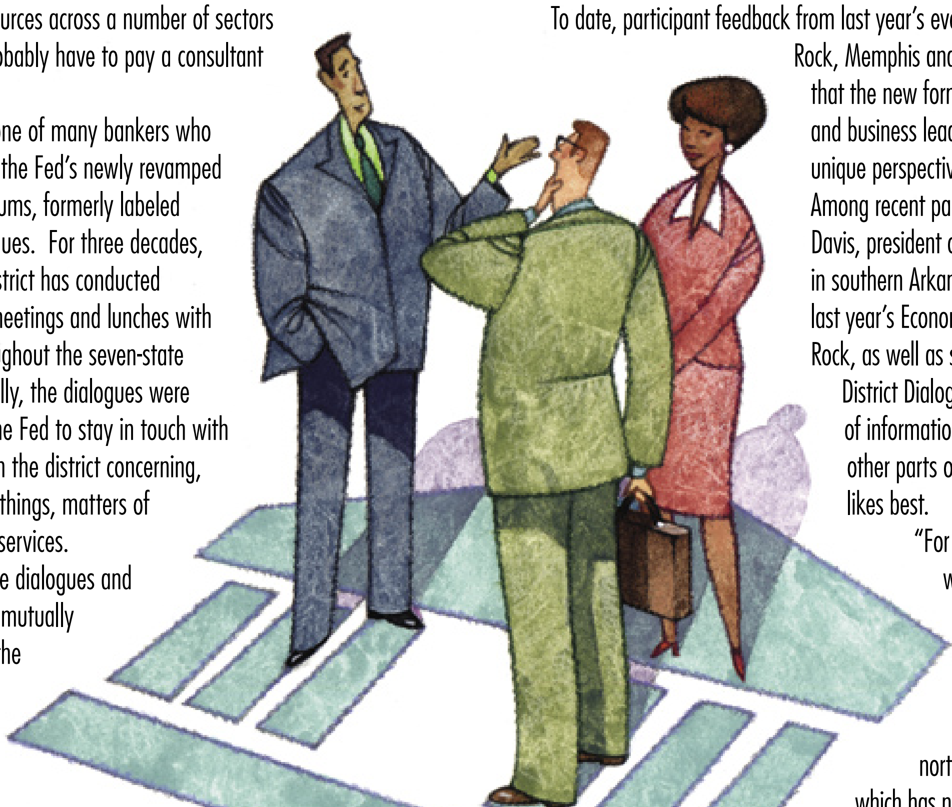
For more information on the "Check *into* AMI" conversion process or helpful AMI training tips, visit www.frbservices.org or call Ranada Williams at (314) 444-8343 or 1-800-333-0810, ext. 44-8343. ■

Revamped Economic Forums Provide Even More Perspectives

The more you know, the better off you—and your bank—are. McCall Wilson, president of the Bank of Fayette County in Moscow, Tenn., practically lives by those words. An avid bookworm, the CPA-turned-banker takes every opportunity he can to learn—especially from the Federal Reserve.

"When I attended last year's Fed Economic Forum in Memphis, I sat and talked with people I normally would never come into contact with," he says. "The forum was packed; we heard valuable information from very smart sources across a number of sectors that you'd probably have to pay a consultant to get."

Wilson is one of many bankers who participate in the Fed's newly revamped Economic Forums, formerly labeled District Dialogues. For three decades, the Eighth District has conducted forum-style meetings and lunches with bankers throughout the seven-state area. Originally, the dialogues were vehicles for the Fed to stay in touch with bankers out in the district concerning, among other things, matters of Fed financial services.



While those dialogues and lunches were mutually beneficial to the Fed and bankers alike, the Fed decided to revamp the program by changing the format, adding business and community leaders and academics to the mix, giving it a new name—the Economic Forum—and altering the focus.

"Our primary goal continues to be gleaning as much anecdotal information as possible to form a more complete picture of the District's economy," says Joel James, Banking Relations officer at the St. Louis Fed.

"The anecdotal information is valuable and helps us, including St. Louis Fed President Bill Poole, deepen our understanding of what's going on throughout the District. The forums also help us create and maintain relationships between the Fed and its branches and our customers." (See the *Feditorial* on Page 2 for First Vice President Dave Sapenaro's thoughts on the Economic Forums' role in the Fed's Branching Out efforts.)

New features include:

- pre-forum survey on each participant's views on regional economic conditions and opinions;
- roundtable discussions at each table during dinner, by a Fed employee or a volunteer;
- compilation of each table's discussions; and
- a meeting summary by Bill Poole.

To date, participant feedback from last year's events in Louisville, Little Rock, Memphis and Quincy, Ill., indicates that the new format is giving bankers and business leaders a helpful and unique perspective of their regions. Among recent participants is Carlton Davis, president of Warren Bank & Trust in southern Arkansas, who attended last year's Economic Forum in Little Rock, as well as several of the old District Dialogues. The exchange of information with his peers from other parts of the state is what he likes best.

"For example, last year we got to hear from bankers and businesspersons about the condition of the housing market in northwest Arkansas—which has no resemblance to our market in the southern part of the state, but it was useful to see how they were dealing with commercial loans, something we're wanting to do more of," he says.

"We'd have to go upstate and talk to them ourselves, where they understandably might not be willing to share such information with their competitors," Davis says. "But when you're talking to the Fed in that setting, you have a tendency to open up more."

James explains that the forums are a "safe" place to talk. "Because they aren't public or media events, the forums are conducive to more open discussion, and participants aren't so fearful that they're giving away valuable information to their competition."

The first 2006 Economic Forum is scheduled for March 14 in Bowling Green, Ky. Contact James at (314) 444-8963, or 1-800-333-0810, ext. 44-8963 for more information on this and future forums. ■

Regional Roundup

Resources for Displaced Hurricane Victims

Last summer's hurricanes displaced thousands of people from the Gulf Coast; some of them settled temporarily or permanently in the Eighth District. If hurricane refugees are among your new customers, you can help them with their financial difficulties during the coming tax season by directing them to several resources such as Operation HOPE and the Internal Revenue Service. They have set up hot lines to assist those with questions about financial matters or federal taxes. Trained volunteers from the banking, insurance, mortgage, finance and accounting industries provide free, one-on-one counseling through two call centers run by Operation HOPE at 1-888-388-HOPE (4673). Callers can get information on emergency credit management, deferring loan payments, filing insurance claims, locating lost documents and applying for federal or private assistance. Hurricane victims can also find a wealth of tax-related information at www.irs.gov and can call a special IRS disaster hot line at 1-866-562-5227.

Meanwhile, the Board of Governors of the Federal Reserve System, several federal agencies and state financial regulators are encouraging banks, thrifts and credit unions to continue to work with borrowers affected by the hurricanes. Assistance may include waiving fees, lowering interest rates, extending repayment schedules, or deferring principal or interest for an additional period, where appropriate. For these options to be considered, however, it is essential that the borrower contact his or her lender. Additional guidance is available at the Federal Financial Institution Examination Council's web site, www.ffiec.gov.

Learn How To Spot New $10 Bill

When the new $10 bill comes out, will your institution be ready to tell the fakes from the real deal? Eighth District commercial banks will be among the first to receive the new bills, starting March 2.

The new $10 note—like the previously redesigned $20 and $50 notes—incorporates state-of-the-art security features to combat counterfeiting, including three that are easy to use by cash handlers and consumers alike:

- **Color-shifting ink:** Tilt the bill to check that the numeral "10" in the lower right-hand corner on the face of the note changes color from copper to green.
- **Watermark:** Hold the note up to the light to see if a faint image of Treasury Secretary Alexander Hamilton appears to the right of his large portrait. It should be visible from both sides of the note. On the redesigned $10 note, it is easier than ever to locate the watermark: A blank oval has been incorporated into the design to highlight the watermark's location.
- **Security thread:** Hold the note up to the light and make sure there's a small strip that repeats "USA TEN" in tiny print. It should run vertically to the right of the portrait.

Learn more from the Treasury at www.moneyfactory.gov/newmoney/.

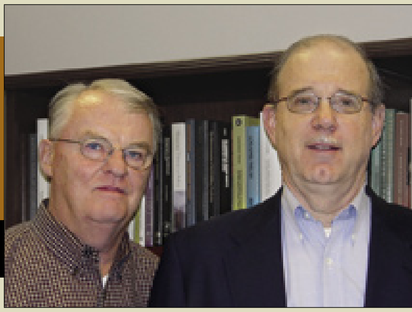
Seasonal Credit Is Available for Banks

At this time of year, the Federal Reserve reminds institutions that qualifying community banks may receive seasonal credit to help them meet the seasonal needs of their customers. Community banks that experience yearly fluctuations in their deposits and loans—caused by construction, farming, college or resort activities, municipal financing and other seasonal businesses—frequently qualify.

Banks can use their seasonal credit line either as a primary seasonal funding source or as backstop credit. Once established, credit may be drawn down incrementally as needed, and partial and full prepayments are allowed without penalty.

There is no expense involved in setting up or maintaining the seasonal line; however, all Federal Reserve loans must be secured to the Fed's satisfaction, and a flexible, market-based rate is applied to all outstanding loans.

To learn more, call the St. Louis Fed's Credit office at 1-866-666-8316 or send an e-mail to creditoffice@stls.frb.org. For an application and a brochure, visit our web site, www.stlouisfed.org/banking/credit/credit.html. ■



Greenspan's Unconventional View of the Long-Run Inflation/Output Tradeoff

By Robert H. Rasche and Daniel L. Thornton

Robert Rasche (right) is the director of Research and Daniel Thornton is vice president of Research at the Federal Reserve Bank of St. Louis.

From the time he became chairman of the Federal Reserve in 1987, Alan Greenspan steadfastly held to the view that low and stable inflation is a prerequisite for maximum sustainable economic growth.

Greenspan's focus on low and stable inflation helped keep interest rates low by reducing the inflation expectations and inflation uncertainty components of nominal rates. A commitment to price stability protects bankers (and others who borrowed short and lend long) who are hurt by unanticipated inflation.

Greenspan reiterated his belief in low and stable inflation many times during his nearly two decades as Fed chairman. In his first congressional testimony, in February 1988, Greenspan stated that "the strategy for monetary policy needs to be centered on making further progress toward and ultimately reaching stable prices," which he defined as, "a situation in which households and businesses in making their saving and investment decisions can safely ignore the possibility of sustained, generalized price increases or decreases."[1]

In February 1989, Greenspan explicitly noted that the Fed's ultimate objective is "maximum sustainable economic growth over time" and that "the primary role of monetary policy in the pursuit of this goal is to foster price stability."[2] When asked at the July 1996 FOMC meeting about the level of inflation that no longer alters decision-making, Greenspan responded, "I would say the number is zero, if inflation is properly measured."[3] In so doing, he confirmed that the rate of inflation that results in maximum sustainable growth rate of output is zero.

Greenspan's view of a long-run negative relationship between inflation and output growth is unconventional. Starting with the Phillips curve in the late 1950s, economists came to believe that lower rates of inflation could be obtained only by reducing output. In the late 1960s Milton Friedman and Edmond Phelps demonstrated that, if economic agents are rational, the tradeoff could not be maintained indefinitely, i.e., the steady-state level of output is independent of the rate of inflation, so that the long-run Phillips curve is vertical.

Most economists believe that, beyond some rate, inflation does reduce output. However, many believe that moderate inflation has no effect on economic growth, and some believe that moderate is good for growth.

One implication of Greenspan's view is that, should policymakers decide to adopt a specific numerical inflation target, the target inflation rate should be zero, appropriately measured. A second implication is that the idea that policymakers should tolerate some moderate inflation rather than to bear the economic costs of reducing the inflation rate to zero is significantly weakened, if not eliminated, if zero is the inflation rate consistent with maximizing economic growth.[4]

The Greenspan principle—maximum sustainable economic growth is achieved at zero inflation—is not yet reflected in modern monetary policy analyses. Nearly all theoretical analyses incorporate some variant of an "expectations-augmented Phillips curve," where inflation is influenced by the gap between actual and potential output in the short run. Most of these models assume the economy's long-run growth rate is driven by exogenous factors (e.g., technology and the growth rate of the labor force) that are independent of monetary policy.

Therefore, the Greenspan principle is not reflected in conventional models. Given Greenspan's success over the past two decades, it would seem desirable that conventional models be modified to allow for the unconventional Greenspan principle. One possibility is to incorporate Greenspan's observation that "as the inflation rate falls, it becomes increasingly difficult for producers to raise prices. They, therefore, tend to try to reduce costs in order to maintain margins."[5] ■

ENDNOTES:

1 Testimony before the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, Feb. 13, 1988.
2 Testimony before the Committee on Banking, Finance and Urban Affairs, U.S. Senate, Feb. 21, 1989.
3 Transcript of the FOMC meeting held on July 2-3, 1996, p. 51.
4 See Daniel L. Thornton, "The Costs and Benefits of Price Stability: An Assessment of Howitt's Rule," Federal Reserve Bank of St. Louis *Review,* March/April 1995, 78(2), pp. 23-38.
5 Transcript of the FOMC meeting held on July 2-3, 1996, p. 46.

Out*for*Comment

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

The federal bank and thrift regulatory agencies are requesting comment on proposed guidance on sound risk management practices for concentrations in commercial real estate lending.

The proposed guidance reinforces existing guidelines for real estate lending and safety and soundness and provides criteria for identifying institutions with commercial real estate loan concentrations that may warrant greater supervisory scrutiny.

Comments are due by March 14, 2006. 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, or go to www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

For more information about this proposal, visit www.federalreserve.gov/boarddocs/press/bcreg/2006/20060110/default.htm. ■

FedFacts

New State Quarters Scheduled for 2006 Release

The state commemorative quarter program, which started in 1999 and continues through 2008, will introduce five new designs in 2006. The commemorative quarters are being released in the order of each state's entry into the Union: Nevada, Nebraska, Colorado, North Dakota and South Dakota. The Nevada quarter starts circulating March 13. More information is available at www.usmint.gov/mint_programs/.

U.S. Mint Issuing "Return to Monticello" Nickel

The U.S. Mint in 2006 will release a nickel featuring Thomas Jefferson's visage modeled after a portrait painted in 1800 when he was elected president. The reverse will feature the familiar scene of Jefferson's Virginia home, Monticello, but crisper and cleaner than the image has been in recent years.

The front will also include the cursive "Liberty" inscription that debuted on the 2005 nickels, which is again presented in Jefferson's own handwriting.

The 2006 nickel is part of the Mint's Westward Journey Nickel Series. Last year's designs included the return of the buffalo nickel. See the designs at www.usmint.gov/mint_programs/. ■

CalendarEvents

UPCOMING FED-SPONSORED EVENTS FOR EIGHTH DISTRICT DEPOSITORY INSTITUTIONS

Greatness: Making It Happen

MEMPHIS—MARCH 7

Leadership Memphis and the Federal Reserve Bank of St. Louis invite bankers to a Breakfast with Paul Grogan, author of *Comeback Cities: A Blueprint for Urban Neighborhood Revival* and founder of CEOs for Cities. For information, call Leadership Memphis at (901) 278-0016.

Local Laws, Predatory Lending and Credit Flow

ST. LOUIS—MARCH 16

Starting with North Carolina in 1999, states and local governments have enacted laws to curb predatory lending in the subprime mortgage market. A new report from the Federal Reserve Bank of St. Louis takes a look at these laws and how they affect the flow of credit in the subprime mortgage market. The author will present his findings at this meeting and a panel of experts will lead a discussion on the topic. For information, call Cynthia Davis in Community Affairs at (314) 444-8761 or 1-800-333-0810, ext. 44-8761. ■

FEDERAL RESERVE BANK OF ST. LOUIS

P.O. Box 442
St. Louis, Mo. 63166-0442

Editor
Scott Kelly
(314) 444-8593
scott.b.kelly@stls.frb.org

Central Banker *is published quarterly by the Public Affairs department of the Federal Reserve Bank of St. Louis. Views expressed are not necessarily official opinions of the Federal Reserve System or the Federal Reserve Bank of St. Louis.*