
Report from the President

REPORT FROM THE PRESIDENT

I am pleased to have this opportunity to review the accomplishments of the Federal Reserve Bank of New York in 1996 and the challenges the Bank faces in the year ahead.

The Bank performed exceptionally well in 1996 in fulfilling its primary mission—implementing monetary policy and providing intelligence gathering, research, and analysis to support policy formulation. The economy's performance—with low inflation, declining unemployment, and steady job growth—was, arguably, its best in the 1990s.

I believe the Bank also performed well in advancing other key missions and objectives, many of which are directed toward ensuring the safety and soundness of banks and maintaining a smoothly functioning payments system.

I am particularly proud of the 4,000 dedicated men and women who work at the Bank and who are responsible for its superior performance in 1996. Their efforts in advancing the Bank's strategic vision—to exercise innovative leadership in carrying out the public policy agenda associated with the central bank's missions—made a major contribution to ensuring monetary, financial, and payments system stability and efficiency in 1996. The Bank's strong management team, supported by a highly skilled staff, made these accomplishments possible. I am grateful for their efforts and their support.

LEADERSHIP IN PUBLIC POLICY

One of my objectives as president of the Federal Reserve Bank of New York has been to use the research capabilities, analytical resources, and market insights of the Bank to increase public awareness of conditions that threaten the health of financial markets or the economy by addressing these issues in articles, public speeches, industry and academic conferences, and other public forums.

During 1996, we worked diligently to fulfill this mission, in part by producing a body of nationally and internationally recognized economic research. The Research Group's *Current Issues in Economics and Finance* and *Economic Policy Review* received considerable attention from policymakers, academicians, and the media. Reports and articles on the regional economy, stock market volatility, and the power of the yield curve to predict recessions generated especially strong interest.

In regional economics, we sharpened our focus on the tri-state economy by sponsoring a conference on the linkages between economic growth and technological development, by developing employment forecasts by state, and by speaking before a wide range of business and community groups on economic developments. Overall, the number of papers written by the Bank's economists and published in economic and finance journals, volumes of

The Bank performed exceptionally well in 1996 in fulfilling its primary mission—implementing monetary policy and providing intelligence gathering, research, and analysis to support policy formulation.

In 1996, the Bank undertook a number of strategic outreach initiatives on regional and urban issues.

conference proceedings, and scholarly books increased significantly compared with 1995.

Our effort to heighten the public's awareness of important public policy issues in 1996 also included an expansion of the Bank's speakers clearing house. The result of this effort was very positive. In 1996, the Bank's staff addressed more than 600 different groups—at the Bank, throughout the District, and all over the world.

During the year, I spoke on several occasions about what I believe is an essential condition to ensure the long-term growth of the U.S. economy—a monetary policy that promotes price stability as its primary goal. It is my view that an explicit national mandate establishing price stability as the central bank's primary objective would be beneficial in eliminating any remaining vestige of inflationary psychology in U.S. markets and would add to public confidence that balanced economic growth will continue.

I also believe that the long-term health of the U.S. economy generally, and the New York-area economy specifically, cannot be ensured in an environment with growing wage and income disparities among demographic groups. To narrow these disparities, the business community must pay greater attention to the education and skill-training needs of the work force. I have sought to direct public attention to this issue, and to challenge the business community in this District to join with the Bank and other organizations in programs that help train our future work force.

At the Bank, we have worked hard to develop and implement participatory programs that ease students' transition from school to

work and improve their understanding of business, economics, and finance. Several of these programs have been recognized by national educational organizations for their academic excellence and for helping students develop a positive work ethic. In addition, the Bank is strongly committed to training teachers and school administrators in various subjects in which we have expertise, from economics and finance to management and budgeting.

In 1996, the Bank undertook a number of strategic outreach initiatives on regional and urban issues. These initiatives included sponsoring a major conference in Syracuse on rural economic development, developing a Neighborhood Housing Services/Banker Consortium for mortgage lending and education in Buffalo, and establishing relationships with key banking and corporate sources of funds in support of community development corporations in New York State.

Our focus on regional and local needs has not diminished the Bank's attention to national and international issues. I am proud of our contributions in 1996 to the public debate over the management of risks posed by the growing use of derivatives by financial institutions. During the year, we worked with private sector participants to develop a set of "best practices" and principles to guide the market in its handling of derivatives and other wholesale market transactions. We also informed banks that the focus of our safety and soundness examinations will shift increasingly from balance sheet reviews of strengths and weaknesses to assessments of each bank's risk controls and overall risk management.

PURSUING CENTRAL BANKING MISSIONS

The Bank has day-to-day responsibility for implementing the decisions of the Federal Open Market Committee (FOMC) through the actions of the Domestic Open Market and Foreign Exchange Trading Desks. In 1996, the Domestic Open Market Desk made several adjustments in its operating procedures in order to add flexibility to open market operations. Among these adjustments was the more frequent use of term repurchase agreements (RPs) to meet the liquidity needs of the banking system. In addition, the Desk changed the customary hour of its operations from 11:30 a.m. to 10:30 a.m. in order to enter the market for repurchase agreements when that market is more liquid. These adjustments were well received by the primary dealers with whom the Bank does business and by other financial market participants.

In support of policy formulation, the Bank's research economists make presentations at FOMC briefings and provide commentary on the significance of newly released economic data. In 1996, these efforts improved policymakers' understanding of the relationship between inflation and unemployment, and helped the Domestic Open Market Desk adapt to changes in bank reserve positions caused by the growth in sweep accounts. Bank staff also gathered valuable information and perspectives on market conditions and developments from foreign governments and central banks that helped to guide policy decisions.

During the year, the Bank undertook to broaden its relationships with financial author-

ities in emerging countries, including those with the People's Republic of China and Hong Kong. It is critical to understand developments in China and Hong Kong as we near July 1, 1997, when Hong Kong returns to Chinese rule, and to communicate them fully to the financial markets. The smooth economic and financial transition of Hong Kong's sovereignty from the United Kingdom to China is important internationally.

A range of other international outreach initiatives were undertaken in 1996. For example, the Bank organized a conference on financial sector reform in Latin America attended by distinguished professionals from developing and industrialized countries. The conference, which explored what can and should be done to advance reform in emerging market economies, exemplifies the increasing role I envision for the Bank as an active promoter of discussion and action on critical issues confronting the global economy.

The Bank also provided technical assistance to countries in Latin America, Eastern Europe, the former Soviet Union, Africa, the Middle East, and the Far East. This assistance focused on various issues relating to open market operations, law and regulation, reserve management, and auditing. In addition, guidance on bank supervision figured importantly in our technical assistance efforts. Working with staff of the Board of Governors and other agencies, we successfully developed training programs for examinations personnel in various countries.

In 1996, the Domestic Open Market Desk made several adjustments in its operating procedures in order to add flexibility to open market operations.

On the international side, the Bank continued to monitor and analyze economic, financial, and political developments in emerging market countries and to measure their impact on the international economy and financial markets.

LEADERSHIP IN PROMOTING SAFETY AND SOUNDNESS

Another important mission of the Bank is to be a leader in promoting the safety and soundness of the domestic and international financial systems. This mission, while always challenging, took on new dimensions in 1996.

Domestic and global financial markets continued to experience profound structural and technological change in 1996; financial institution supervisors and regulators had to reassess and revise policies and programs continually to manage this change. I am pleased to report that the Bank remained in the forefront of this adaptive process. We used our operational experience, knowledge of market practices, and analytical capabilities to gain insight into the forces of change—both domestic and foreign—and their implications for financial and economic stability.

On the domestic side, we studied the ongoing restructuring of retail banking, the new ways banks deliver services to individuals and small businesses, and the substitution of electronic forms of payment for paper. These developments raise several regulatory and economic policy issues, including the impact on competition in local banking markets and the public's access to banking services. We will continue to monitor the performance of banks closely to be sure they serve the needs and convenience of their customers.

Further, we examined issues related to consolidation in banking, a trend that gained impetus from the removal of interstate branching restrictions by Congress, scheduled to take full effect in mid-1997. The Bank's researchers

also analyzed a range of other economic and financial topics, from the evaluation of value-at-risk models to various aspects of credit rating systems used by banks. Most of these studies were published in this Bank's economic reviews or in academic journals.

On the international side, the Bank continued to monitor and analyze economic, financial, and political developments in emerging market countries and to measure their impact on the international economy and financial markets. This work supports the Bank's diverse international responsibilities, including participation in the Interagency Country Exposure Review Committee and the Foreign Banking Organizations Supervision Program.

The Bank also sought ways to reduce risk in payment and settlement systems, working actively with the G-10 Central Bank Committee on Payment and Settlement Systems (CPSS), which I chair. This effort addressed issues in foreign exchange settlement risk, securities settlement systems, over-the-counter derivatives clearinghouses, and electronic money and emerging markets. Highlights included the introduction of a foreign exchange settlement risk reduction program and a successful effort of the Bank—in cosponsorship with the International Organization of Securities Commissions and the CPSS—to develop a public disclosure framework for securities settlement systems.

One of the Bank's strengths is its ability to bring unique, high-level expertise and analytical skill to complex financial supervision issues. We used this strength in 1996 to contribute to the

Federal Reserve's international supervisory efforts. We played a major role in reaching an agreement with offshore supervisors on how banking operations in their jurisdictions will be supervised in the future. This agreement represents the first step toward establishing an international framework for lowering bank secrecy barriers.

We also continued to provide leadership in implementing and refining market-risk capital standards and assessing bank strategies for managing specific risks. During the year, the Bank created a new capital markets training program for Federal Reserve bank examiners and developed examination procedures for reviewing banks' payments and settlement systems. These initiatives will support a Federal Reserve System effort in 1997 to assess liquidity and contingency planning at major banks.

In light of the significant changes taking place in the financial services industry, this Bank led a System-wide study of the Federal Reserve's bank examination process, with a view to enhancing its efficiency and effectiveness. The key finding of the study was that the System should move aggressively to a more risk-focused examination process, and we are working actively to this end.

Further, we have been heavily involved in the Federal Reserve's development and testing of an integrated laptop application for field examiners that will automate many aspects of the examination process. This product, Examiner Workstation, will allow for expanded electronic transfer of data from banks being examined to the Reserve Banks.

PROVIDING HIGH-QUALITY, COST-EFFECTIVE SERVICES

The Federal Reserve Bank of New York also seeks to provide high-quality, cost-effective payments and other banking services that are responsive to customer needs and consistent with the public interest. Our role in the payments system is unique. We are the nation's premier provider of electronic transfer and settlement services to banks and the Treasury; we also are the operating arm of the Federal Reserve System in the government securities and foreign exchange markets, and a supervisor of the banks to which we sell services.

This Bank has long held to a standard of zero tolerance for errors in providing secure and reliable payments services. In keeping with this standard, we continued to develop and implement automation systems and applications to facilitate the Federal Reserve's transition to mainframe consolidation and the provision of enhanced electronic payments services over a longer processing day.

Our major focus in the check, cash, fiscal, and electronic payments services areas during the year was the implementation of aggressive, multiyear strategies aimed at restructuring operations to improve efficiency and, in turn, reduce unit costs. These strategies resulted in substantial improvement in the Bank's operating performance. The most significant improvements were in check processing, where the first major elements of a broad-based plan were put in place. Actions taken in 1996 included the closing of the Jericho office in October and the consolidation of our downstate check-processing

Our major focus in the check, cash, fiscal, and electronic payments services areas during the year was the implementation of aggressive, multiyear strategies aimed at restructuring operations to improve efficiency and, in turn, reduce unit costs.

A number of changes were made in 1996 to improve the efficiency of operations not only at the Bank but also throughout the Federal Reserve System.

operations at our East Rutherford Operations Center and our District-wide check adjustment activities at the Utica office.

In 1996, for the first time since 1928, the United States issued a newly designed currency. The new \$100 banknote was issued in March; other denominations are scheduled for issuance during and after 1997. Given the widespread use of U.S. currency overseas—about two-thirds of the dollar value of all U.S. banknotes circulate abroad—there was a need to ensure a smooth transition to the new \$100 banknote internationally.

The Federal Reserve Bank of New York is the principal distribution point for depository institutions operating in the U.S. banknote market internationally. As such, the Bank, working with the private sector, developed a number of vehicles to ensure that the international market has ready supplies of the new notes. Our Cash and Public Information staffs worked closely with the Treasury Department in developing and implementing press and public awareness programs designed to promote acceptance of the new banknote.

In the electronic payments area, we continued to enhance Fedwire funds and securities transfer services for the Federal Reserve System. The Bank is responsible for the management of the Federal Reserve System's Wholesale Payments Product Office, which coordinates efforts throughout the System to maintain the Federal Reserve's funds transfer and book-entry systems as the nation's premier large-value payments systems. During the year, the Office, which is headed by the Bank's First Vice President, Ernest T. Patrikis, helped to formulate nationwide payments system policies. The

Office also worked with private sector payments systems to improve the coordination and consistency of message format standards, and with the Bank's electronic payments area in anticipation of electronic payments processing over an eighteen-hour day through an expanded funds transfer format.

In the fiscal services area, the Bank provided support to the Treasury in its plan to issue new inflation-indexed securities early in 1997.

STRENGTHENING OPERATING EFFICIENCY

A number of changes were made in 1996 to improve the efficiency of operations not only at the Bank but also throughout the Federal Reserve System. These initiatives were taken in response to heightened public scrutiny of the Federal Reserve and growing public interest in achieving maximum efficiency in all governmental organizations.

In 1996, the Federal Reserve System established a four-person special committee, of which I am a member, headed by vice chair of the Board of Governors, Alice Rivlin, to clarify the proper future operating role of the Federal Reserve in payments services. The committee's multimonth work will draw upon information and analyses gathered from within and outside the Federal Reserve System, including organizations and groups with a stake in payments system developments and issues. The Bank's participation in this committee puts us at the leading edge of payments system change.

In the Markets Group, significant resources were devoted during the year to designing a work floor environment that consolidates the

Domestic Open Market and Foreign Exchange Trading Desks, thereby creating an opportunity for staff synergies and speedier decision making. The construction of this new trading floor for both domestic open market and foreign exchange was substantially finished at year-end and the new “Desk” became operational in the first quarter of 1997.

In addition, the Markets Group introduced several technological and organizational innovations designed to improve the efficiency of trading operations. A new price quote system for traded U.S. government securities was inaugurated by the Domestic Open Market Desk to replace the famous “chalk board” in the trading room. The Desk also upgraded the Trading Room Automated Processing System used to communicate with the primary dealers. On the foreign exchange side, a new Electronic Brokering System was put in place. The Markets Group also completed a staff reorganization begun in 1995 by establishing a dozen small units, each with a well-defined set of core responsibilities.

The Emerging Markets and International Affairs Group was formed in 1996 by combining organizational units drawn from the Research, Bank Supervision, and Foreign divisions of the Bank. The Group is charged with preparing integrated and timely analyses of economic, financial, and political developments in emerging market countries. In fulfilling its mission, the Group has enabled the Bank to improve its understanding of such developments, strengthen regional expertise and contacts, foster strategic international relationships, and better align technical assistance activities with overall international objectives.

In another move to improve operating efficiency in 1996, the Bank merged Accounting Control and Credit Analysis with the Credit and Risk Management function. The new unit integrates the Bank’s risk management activities with the administration of payments system risk policies.

THE CHALLENGES AHEAD

The Bank operates in an environment of increasingly rapid change in banking and financial markets. The challenges facing us include determining how best to manage this change, how best to adapt technology to advance strategic goals, and how best to position the New York Fed for leadership as we approach the twenty-first century. To meet these challenges, the Bank is committed to maintaining the highest standards of integrity and excellence, furthering the public interest, and maintaining a supportive relationship with its staff. We also welcome the notion that change is a constant.

The nature of the Bank’s work is undergoing a profound transformation. Laptop computers, cellular phones and pagers, fax machines, and video conferencing technology are altering not only how we do our work, but where we do it. At the Bank, computer skills are becoming a virtual prerequisite for most jobs. A number of areas, most notably Cash and Bank Supervision, have instituted new workweek arrangements; other areas have introduced innovative flex-time and work-at-home options. The work force profile of the Bank also is changing—toward a more technical and analytical staff.

The Bank is committed to maintaining the highest standards of integrity and excellence, furthering the public interest, and maintaining a supportive relationship with its staff.

Looking ahead, management recognizes that the Bank will have to expand its efforts to build an internal culture based on continuous improvement in the quality and efficiency of Bank operations. To that end, we will continue to examine and reexamine all work processes throughout the Bank to reduce costs and better position the Bank to advance strategic objectives. We also will work to strengthen the Bank's position as an employer of choice in the region's financial community and will continue to introduce "benchmarking" and "best practice" standards into our performance measures. Increased attention will be placed on retaining high-quality staff.

The reputation of the Federal Reserve and, indeed, the economic well-being of the nation depend heavily on our success in promoting economic growth and price stability. As always, we will seek even better ways to meet this tremendous responsibility. In addition, I want this Bank to be the model for the System of how all central banking operations and activities can and should be performed. Finally, I firmly believe that this Bank also must contribute positively to meeting the social needs of our community. To achieve this goal, we will continue to work both independently and with community leaders to make the region a better place to live and work.