Remarks before the
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The Eighties: The Outlook for Change

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Ever since Jim Murphy invited me to speak at this luncheon, I've been telling myself that I must avoid the obvious approach of talking about the past decade of the seventies and the new decade of the eighties. Despite all that talking to myself, I have decided to take the obvious path of looking backward and then forward.

The decade of the seventies was certainly a most unpredictable period for bankers—whether those bankers were commercial bankers or central bankers. From a personal standpoint, for most of the seventies I thought of myself first as the New York Fed discount officer and, second, a tired traveler.

Thinking back, the decade started for me with flying back from Rome, to be involved in the collapse of Penn Central and some very real problems in the commercial paper market. The decade ended, in a sense, with a flight back in October from London to attend an unusual Saturday meeting of the Federal Open Market Committee to vote on a significant tightening of monetary policy and a major change in the techniques of open market operations.

In between those two flights across the Atlantic—the first and the last years of the decade of the seventies—both commercial and central bankers, particularly those of us here in New York, coped with: the Lockheed loan guaranty, the Franklin failure; Herstatt; the deep recession of 1974-75, W. T. Grant; REITs; the oil embargo; a blackout and blizzards; the financial crises of UDC, New York City, and New York State; persistent turmoil in the foreign exchange markets, the policy measures of November 1, 1978 and October 6, 1979; the unprecedented high levels of interest rates and inflation; and, rounding it all out, the Iranian crisis, Afghanistan, and spectacular price movements in the gold and commodities markets.

I come from this experience of the seventies with one clear conclusion. Our banking system—commercial, as well as central—has shown its strength, resilience, and determination. These qualities are sure to be tested in the eighties and beyond In the midseventies, a number of New York banks were coping with serious problems Close attention to those problems by bank management, often with prodding by the regulators, has reduced those problems to dimensions that are not now of major concern I don't want to suggest that we are about to return to the golf-course banking of the fifties, but bank managements seem now to be more in a position to do careful strategic planning as opposed to scrambling from crisis to crisis With the high probability of major changes in banking in the eighties, that planning will be of major importance.

Although we are only three weeks into the eighties, it seems that the challenges of this decade will be even more varied and demanding than those of the seventies—and the crystal ball seems more clouded than usual as one tries to ponder the nature, dimensions, and timing of those events. The unusual and unexpected have become the norm.

Major international developments occur with a rapidity and immediacy that many of us are still not used to. Events like those in Iran and Afghanistan still seem to come as a surprise, despite some early warning signals that are read best by Monday morning quarterbacks Political coups and new governments—some elected, some otherwise, some quite close to our borders—have become the order of the day. New relationships and sharp breaks with other countries are rather frequent—one need only point to China and Russia.

These overseas developments have important effects, both direct and indirect, for our banks, not only the large multinational but even the small country bank: frozen accounts, setoffs and attachments, renegotiated loans, handling college students' checks, financing a farmer's crop or a small exporter's receivables, and advising on loan and investment decisions against the likelihood of a major increase in defense spending.

In the field of legislation and regulation, much looms before us. One need only mention McFadden, the Douglas Amendment, the Glass-Steagall Act, Regulation Q, the membership bills, and the proposed International Banking Act regulations to get an idea of the dimensions for possible change. Further attention is to be given to the Edge Act regulations, and the proposal for an international banking facility here in New York is receiving another look.

These laws and regulations serve a variety of interests, and proposed changes raise even more numerous issues It is my hope that the legislatures, the regulatory bodies, and the banking associations will perceive the interrelationships between these various laws and regulations so that changes in one area are carefully framed in terms of realities and anticipated changes in other areas. An isolated, piecemeal approach could pose real risks to individual institutions as well as industries We in the Federal Reserve will continue to look to the officers of your association and your member banks for thoughtful commentary as the legislative and regulatory proposals are being shaped.

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Then there will be the technological changes of the eighties. Equipment will be smaller, quicker, and relatively speaking less expensive, both for internal back-office purposes as well as external telecommunications. The technology of the eighties may give many banks capabilities that they do not have today and the challenge to manage that capability competently and securely. In short—change, once again, seems certain.

Our planners tell us that, when things are most uncertain, planning is even more important. At the New York Reserve Bank, as I am sure at all other banks, we have been and are deeply immersed in looking at the eighties to discern the potential major influences and forces, to prepare for the most likely course of events, and to mold these events to the extent possible.

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We have just completed our objective-setting process for 1980 and have set as our first objective the development of a strategic plan based on those forces most likely to have a significant effect on the Bank in the eighties. It is an effort to identify better the role of the Bank and the dimensions and directions of the Bank's policy efforts in the eighties. I hope it will be an important tool for Mr. Solomon as he assumes the Presidency.

Let me be more specific and speak to a few of the issues I know we will be facing. First, we will be studying the future structure of banking. The Administration has a mandate under the International Banking Act to provide the Congress with a report and recommendations on the McFadden Act and its restrictions on banking within state boundaries. While the report has been delayed, its day in the sun cannot be too far off.

For many of us, McFadden has been considered a major encumbrance to the achievement of a modern, efficient banking system meeting the banking needs of big business and small borrowers alike in a strong, competitive environment. The recent grandfathering of the interstate banking operations of foreign banks points to the inequities United States banks face and counsels changes in McFadden. From another standpoint, I lived through the Franklin failure and know all too well the difficulties of looking to a domestic bank as a merger partner in an emergency situation. How is one to find a domestic bank within the confines of a state, capable of taking over another large bank without major antitrust difficulties?

Somewhere in the eighties—my personal preference is earlier rather than later—there will be legislation permitting interstate branching. I don't picture that legislation as authorizing an overnight, free-for-all, coast-to-coast dash, as banks and street corners are gobbled up. I trust it will be a stage-by-stage process both geographically and in terms of time. I would trust too that, as a bank's proposed geographical span is broadened and the number of its offices increased, the bank regulators would continue to give careful consideration to the antitrust aspects as well as to management competence, the adequacy of the capital base, earnings performance over time, and the efficiency, security, and control of day-to-day operations.

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Permit me an aside. As the Federal regulators deal with the matter of changes in the banking structure, I hope they will review carefully their concepts of markets.

- There is the geographical marketplace, and it is difficult for me to comprehend that for some very large banks the marketplace stops at the state line.
- There are markets in terms of products It is again difficult for me to comprehend, particularly here in the Northeast as thrift institutions gain new powers, that a commercial bank's share of the market is measured strictly in terms of other commercial banks, excluding the savings banks, savings and loans, credit unions, and other financial entities. For example, a medium-sized commercial bank, by my standards, can look misleadingly large in its market when the competing thrift institutions across the street are excluded from the numbers.

Since I'm with the Federal Reserve, I feel an obligation to say some words about monetary policy As you all know, the October 6 package included the adoption of a new operating approach to monetary policy which focuses on the linkages between reserve paths and monetary aggregates. Levels of short-term interest rates are now de-emphasized. This new approach to open market operations has been tested over recent weeks and will be tested further and refined, as needed, over the months ahead.

Although it is too early for definitive conclusions, we think that the new approach is bringing about some desired results. These results include a reduction of the rate of growth of the monetary aggregates, and we've been seeing that. The new technique is probably contributing to that slowing, but the other tightening moves of October 6 probably also deserve some credit.

The domestic markets and the market analysts seem now to have a better grasp of our approach but that's not the case overseas. Our de-emphasis of short-term rates has occasionally led to a drop in the Federal funds rate, and foreigners view that as an easing of policy by the Fed even when they are told that is not the case We have a major educational challenge in this respect.

In the monetary policy area, too, we are reexamining the role of the discount window and of the discount rate in the current policy environment. We are also reviewing the appropriate extent of access to the discount window by member banks and all other depository institutions, especially as we see the potential number of borrowers growing rapidly While it is too early to tell what the reviews will lead to, my own sense is that the discount rate has had, and should not lose, its signal effect because it is an important, meaningful, and well-understood expression of the direction of monetary policy At the same time, the discount window, in its classical sense, must be available to assure that the banking system has a source of liquidity in times of occasional market strains, or adverse deposit flows, as well as the knowledge that there is a lender of last resort.

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I have also been thinking of the money markets. As a discount officer in the midsixties, my focus—and that of most money desk managers—was the Federal funds market, and now, only fifteen years later, we all talk of global funding, Eurodollar markets, foreign exchange markets, securities futures markets—and, of course, the perennial Federal funds market. In fifteen years, these markets have not only grown in dollar size, the volume of transactions has also increased dramatically, particularly in the New York foreign exchange market. In that market, we'll be doing another survey fairly soon to get a current fix on the numbers.

I often wonder as to the underlying economic justification of this ever-growing volume of transactions, and whether the economic justification outweighs the risks inherent in the sheer size and number of these transactions. I know that Herstatt and Franklin resulted in new internal controls, limits, and procedures. I hope that, with the passage of time, those new systems haven't become thought of as routine.

Additionally, I would share with you my concern as to the role rumors play in the foreign exchange and commodities markets, and with some growing spillover into the government bond market. I am reminded of the day shortly after the announcement of the Federal Reserve's October 6 package. It was a Friday and, first,

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the rumor was that Paul Volcker had resigned. Not satisfied with Paul Volcker's resignation, the next rumor was that he was dead. Whether the source of the rumor had a short or a long position, he was certainly trying to hedge his bet, and not in the most ethical of ways. Similarly, about a week ago there were rumors that the Russians had invaded Iran, and in no time at all the price of gold shot up through $800 an ounce. .

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My last comments are on technology and computers. For the Fed and for all banks, the decade of the eighties will be a period of important change. We will see the nationwide replacement of the Federal Reserve Communications System For the Federal Reserve, the change in technology is planned to accommodate the banking needs of the eighties, consistent with the Fed's bank service role. For example, we will see at the

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New York Fed, our old workhorse, the Sigma IX, replaced by a computer from the next generation. Throughout the banking system, there will be a move to real time accounting, with improvements in risk-management techniques but also with uncertain effects on financial markets, financial practices, and business relationships. At the New York Fed, we will continue to install new high-speed currency equipment as part of our efforts to improve the quality of currency in circulation.

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I've covered a number of topics this morning but feel I have left unmentioned others that will require our time and attention. It may well be that the developments of the eighties that we haven't even thought of will have the greatest impact on our lives as commercial or central bankers. At any rate, the decade of the eighties will test us all. I look forward to working with you as we analyze and master the challenges that face us.