

# Research

## UPDATE

*from the Federal Reserve Bank of New York*

RESEARCH AND MARKET ANALYSIS GROUP

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### New Director of Research Named

In early September, Christine M. Cumming succeeded Stephen G. Cecchetti as director of research at the Federal Reserve Bank of New York.

Prior to being named research director, Ms. Cumming was senior vice president responsible for the Bank Analysis and Advisory and Technical Services areas of the Bank Supervision Group. From 1992 to 1994, she served as vice president in the Domestic Bank Examinations area of Bank Supervision. While in Bank Supervision, she was active in the Basle Committee on Banking Supervision,

participating in the development of the market risk amendment to the 1988 Basle Accord and co-chairing the committee's Risk Management Group. Ms. Cumming has also worked in the Bank's International Capital Markets area and managed Research areas specializing in industrial countries and international financial markets.

Mr. Cecchetti, who served as the Bank's director of research for two years, returns to Ohio State University, where he is a professor of economics.

### Fed Conference Examines How the Decline in Income among the Poor Has Affected Their Material Well-Being

Over the past few decades, the nation has experienced a sharp rise in income inequality. Although much discussion has centered on the decline in real incomes among the poor, relatively little attention has been given to an important consequence of income inequality: the impact on broad measures of material well-being.

In May, that topic was the focus of a conference that was sponsored by the Federal Reserve Bank of New York, "Unequal Incomes, Unequal Outcomes? Economic Inequality and Measures of Well-Being." The proceedings of the conference were published in the latest issue of the Bank's *Economic Policy Review* (vol. 5, no. 3).

Leading researchers, academics, and policy analysts from around the country participated in the conference. “We asked presenters if the deterioration in income experienced by the poor has led to a similar deterioration in outcomes—in such areas as health, housing, and crime victimization trends,” says James Orr, a research officer and one of the conference organizers. “The wide range of papers delivered rose to the challenge, addressing such timely issues as poverty’s impact on the health of children, housing affordability for young and poor families, and the relationship between income and the likelihood of being a crime victim.”

The conference participants agreed that there have been many improvements in the material well-being of the poor over the years—yet problems remain. For instance, despite advancements in health care, health problems still disproportionately affect low-income groups and minority groups. In addition, although housing affordability has improved across most income groups, the poorest Americans are the one group yet to benefit. Furthermore, the rates of crime victimization have fallen nationwide, but the mortality rates of the inner-city poor still are unacceptably high.

In a discussion of public policy responses, some participants observed that, contrary to expectations, school finance reform is not necessarily an effective way to reduce income inequality substantially. Others noted that economic and social changes have compelled large cities to scale back policies that promote income redistribution from the wealthy to the poor. In addition, new legislation that limits liability for preexisting environmental damage has made it easier for businesses to return to the central cities—bringing with them new industries, urban renewal, and jobs.

Looking ahead, the participants discussed the challenges still faced by those who study income inequality’s causes and effects. For example, the limitations of the current data sources remain an obstacle. However, efforts are under way to push beyond these limitations and define inequality in more concrete terms. Efforts such as these will also shed light on the effect that government policies have on income inequality’s magnitude and consequences.

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## Banks Continue to Be Critical Providers of Liquidity

As more corporations look to the securities markets to meet their funding needs, the role of banks as providers of credit to large businesses has steadily declined. Nevertheless, there is fresh evidence that banks continue to be a key source of liquidity for corporations at times of economic stress.

*Has the decline in the importance of banks in financing large firms been overstated?*

In “Are Banks Still Important for Financing Large Businesses?” (*Current Issues in Economics and Finance*, vol. 5, no. 12), Marc Saidenberg and Philip Strahan analyze the effects of last fall’s turmoil in the securities markets on the borrowing practices of large corporations. The authors explain that beginning in August 1998, when the Russian government announced its intention to default on its bonds, a wave of volatility overtook foreign financial markets and eventually spilled over into U.S. markets. Borrowing in the U.S.

commercial paper market—the primary source of short-term funding for large corporations—grew extremely expensive, with the yield spread between commercial paper rates and short-term Treasury rates doubling in the space of a month. In response, large numbers of firms, under pressure to refinance their commercial paper as it matured, turned to their backup lines of credit with banks.

The authors find evidence of these developments by tracking changes in the volume of commercial paper issued by nonfinancial firms and changes in the volume of banks’ commercial and industrial lending in the fall of 1998. They show that commercial paper outstanding dropped more than \$16 billion from mid-September to year-end. By contrast, from September to the beginning of November, commercial and industrial lending by large commercial banks rose more than \$20 billion—a growth rate twice that observed earlier in the year.

### Publications and Papers

The Research and Market Analysis Group produces a wide range of publications:

- ***The Economic Policy Review***—a policy-oriented research journal focusing on macroeconomic, banking, and financial market topics.
- ***Current Issues in Economics and Finance***—a newsletter-style publication offering concise and timely analyses of economic and financial topics.
- ***Second District Highlights***—a regional supplement to *Current Issues* covering financial and economic developments in the Federal Reserve System’s Second District.
- ***Staff Reports***—technical papers intended for publication in leading economic and finance journals. *Staff Reports* are available only in electronic form.
- ***Publications & Other Research***—an annual brochure spotlighting the Group’s research output.

The striking increase in firms' reliance on bank loans during this period—and the accompanying decline in firms' use of commercial paper—suggest that banks are still important players in corporate financing, particularly at times of economic difficulty. “By providing a backup source of liquidity,” Saidenberg and Strahan note, “banks helped insulate many large corporations from market shocks.”

The authors go on to examine why banks are so well equipped to provide this kind of liquidity insurance. An analysis of bank funding practices reveals that banks have an advantage over competing financial institutions because they tend to experience deposit inflows when liquidity elsewhere dries up.

## Web Site News

- Members of the Federal Reserve Bank of New York's Research and Market Analysis Group can be reached via e-mail at [firstname.lastname@ny.frb.org](mailto:firstname.lastname@ny.frb.org).
- Papers in our **Staff Reports** series are available only in electronic form. Earlier this year, we ceased distributing hard copies of individual papers and directed all readers to our web site, where you can download most new and back issues.
- Back issues of many of our publications and papers are available at our web site. There, you can also find links to other Federal Reserve System research offerings and to Federal Reserve Bank of New York information and announcements.
- The Regional Economy page of our web site offers important information on the Federal Reserve System's Second District. For example, you can find links to graphs profiling current regional and local economic trends, the Federal Reserve System's “Beige Book” (a periodic report on regional economic trends), the Bank's regional job-growth projections, and approximate release dates for major regional indicators.

The Regional Economy page also provides links to the New York State and New Jersey Departments of Labor, the Bureau of Labor Statistics, the Census Bureau, and other government sites.

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## New Titles in the *Staff Reports* Series

The following new *Staff Reports* are available electronically at the Research and Market Analysis Group's web site: [www.ny.frb.org/rmaghome](http://www.ny.frb.org/rmaghome).

### Macroeconomics and Growth

No. 83

#### What Was behind the M2 Breakdown?

*Cara S. Lown, Stavros Peristiani,  
and Kenneth J. Robinson*

The authors contend that capital constraints on depository institutions largely explain the unusual pattern of M2 growth in the early 1990s. Their work suggests that M2 may contain useful information about economic growth during periods when depository institutions experience no major disturbances.

No. 87

#### Nonlinear Time Series Modelling: An Introduction

*Simon M. Potter*

Potter reviews recent developments in three major types of nonlinear models: Markov Switching, Threshold Autoregression, and Smooth Transition Autoregression. In addition to describing Classical and Bayesian estimation techniques, he reviews parametric tests for nonlinearity in each model.

### Banking and Finance

No. 82

#### Heat Waves, Meteor Showers, and Trading Volume: An Analysis of Volatility Spillovers in the U.S. Treasury Market

*Michael J. Fleming and Jose A. Lopez*

Fleming and Lopez examine the U.S. Treasury securities market for volatility spillovers across the three main trading centers of Tokyo, London, and New York. They find that volatility spills over into Tokyo and London from New York but not into New York from Tokyo or London. In addition, they find that lagged trading volume significantly affects volatility in the London and Tokyo markets.

No. 84

#### A General Equilibrium Analysis of Check Float

*James McAndrews and William Roberds*

McAndrews and Roberds' analysis of check "float"—the time lag between the receipt and clearing of a check—supports the view that float is a significant factor behind the continued popularity of check payment. Their analysis confirms recent data indicating that the average value of float per check is small.

No. 85

#### Payment Intermediation and the Origins of Banking

*James McAndrews and William Roberds*

Like banks today, the medieval banks of continental Europe facilitated trade by serving as payment intermediaries. McAndrews and Roberds show that early banks—by standing between the buyer and seller on a centralized basis—could enforce future contracts and effectively internalize the offsetting nature of an economy's universe of trades.

No. 86

#### Settlement Risk under Gross and Net Settlement

*Charles M. Kahn, James McAndrews,  
and William Roberds*

By modeling how the trading economy generates demand for payment services, the authors discover advantages of net settlement that have not been widely explored. In particular, net settlement systems avert certain gridlock situations and can economize on collateral requirements and minimize trading delays.

## Papers Presented by Economists in the Research and Market Analysis Group

“The Mechanisms for Exchange Rate and Wage Interaction,” *Linda Goldberg and Joseph Tracy*. National Bureau of Economic Research Summer Institute (for the International Trade and Investment Group and the International Finance and Macro Group), Cambridge, Massachusetts, August 4.

The authors explore the sensitivity to dollar movements shown by the wages of workers in different industries and different categories of educational attainment, and document whether the measured wage responsiveness for workers who remain at their jobs differs from that for workers who change jobs.

“The Information in the High-Yield Bond Spread for the Business Cycle: Evidence and Some Implications,” *Cara Lown*. Oxford University Conference on Financial Instability, Oxford, England, July 9-10. With Mark Gertler.

The authors show that the interest-rate spread between high-yield and AAA-rated corporate bonds has significant explanatory power for the business cycle and outperforms other leading financial indicators; they interpret these findings as being symptomatic of financial factors at work in the business cycle.

**Stability, Asymmetry, and Discontinuity: The Outset of European Monetary Union,”** *Paolo Pesenti*. Brookings Panel on Economic Activity, Washington, D.C., September 2-3. With Giancarlo Corsetti.

European Monetary Union is performing well above expectations in terms of its impact on financial markets and the effectiveness of

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the new institutions in coping with cyclical contingencies, but persistent asymmetries may undermine further integration in Europe.

“Competition in Shifting Product and Geographic Markets,” *Lawrence Radecki*. 1999 Western Economics Association Meetings, San Diego, California, July 6-10.

The forces that have transformed the structure of the banking industry are also causing shifts in the nature and location of competition in banking services.

Individual copies of these papers can be obtained by e-mailing the Research and Market Analysis Group authors at [firstname.lastname@ny.frb.org](mailto:firstname.lastname@ny.frb.org).

## New York Fed to Hold Conference on Fiscal Policy

On December 3, the Federal Reserve Bank of New York will sponsor the conference “Fiscal Policy in an Era of Surpluses: Economic and Financial Implications.”

The conference will examine how the formation of fiscal policy has evolved over time and will address such issues as the measurement of the stance of fiscal policy. Presenters and discussants will also focus on the shrink-

ing supply of U.S. Treasury securities debt and its implications for financial markets.

More than 150 policymakers, market participants, and academics are expected to attend the conference, which is being organized by the Bank’s Business Conditions area. The conference proceedings will be published in an upcoming issue of the Bank’s ***Economic Policy Review***.

### Recently Published

Paul Bennett. 1999. “Portfolio Theory and Bank Lending: Avoiding Concentrations of Credit Risk through Strategic Diversification.” ***Journal of Lending and Credit Risk Management*** 81, no. 11: 64-7.

Michael J. Fleming and Eli M. Remolona. 1999. “What Moves Bond Prices?” ***Journal of Portfolio Management*** 25, no. 4: 28-38.

Sydney Ludvigson. 1999. “Consumption and Credit: A Model of Time-Varying Credit Constraints.” ***Review of Economics and Statistics*** 81, no. 3: 434-47.

James M. Mahoney. 1999. “The Performance of Investment Newsletters,” with Jeffrey F. Jaffe. ***Journal of Financial Economics*** 53, no. 2: 289-307.

Sangkyun Park. 1999. “Effects of Risk-Based Capital Requirements and Asymmetric Information on Banks’ Portfolio Decisions.” ***Journal of Regulatory Economics*** 16, no. 2: 135-50.

Paolo Pesenti. 1999. “What Caused the Asian Currency and Financial Crisis?” with Giancarlo Corsetti and Nouriel Roubini. ***Japan and the World Economy*** 11, no. 3: 305-73.

Simon Potter. 1999. “Dynamic Asymmetries in U.S. Unemployment,” with Gary Koop. ***Journal of Business and Economic Statistics*** 17, no. 3: 298-312.

Kevin Stiroh. 1999. “Is There a New Economy?” ***Challenge*** 42, no. 4: 82-101.

Joseph Tracy. 1999. “The Effect of Collective Bargaining Legislation on Strikes and Wages.” ***Review of Economics and Statistics*** 81, no. 3: 475-87.

# RESEARCH AND MARKET ANALYSIS GROUP PUBLICATIONS AND PAPERS: July–September 1999

## *Economic Policy Review,* Vol. 5, No. 3

“Unequal Incomes, Unequal Outcomes? Economic Inequality and Measures of Well-Being”  
*Proceedings of a Conference Held at the Federal Reserve Bank of New York*

Papers include:

Poverty, Children’s Health, and Health Care Utilization  
*Barbara L. Wolfe*

Economic Inequality and Social Differentials in Mortality  
*Arline T. Geronimus*

Public Health and the Public Agenda  
*Kevin Thurm*

Housing Outcomes: An Assessment of Long-Term Trends  
*James A. Orr and Richard W. Peach*

A Look at Real Housing Prices and Incomes: Some Implications for Housing Affordability and Quality  
*Joseph Gyourko and Joseph Tracy*

The Changing Relationship between Income and Crime Victimization  
*Steven D. Levitt*

Economic Inequality and the Provision of Schooling  
*Thomas A. Downes and David N. Figlio*

From John Lindsay to Rudy Giuliani: The Decline of the Local Safety Net?  
*Edward L. Glaeser and Matthew E. Kahn*

Earnings Inequality and Central-City Development  
*Edwin S. Mills*

Social Indicators and the Study of Inequality  
*Marcia K. Meyers and Irwin Garfinkel*

## *Current Issues in Economics and Finance,* Vol. 5

No. 11  
Can New York City Bank on Wall Street?  
*Jason Bram and James Orr*  
Second District Highlights series

No. 12  
Are Banks Still Important for Financing Large Businesses?  
*Marc R. Saidenberg and Philip E. Strahan*

No. 13  
A Decomposition of the Increased Stability of GDP Growth  
*Margaret M. McConnell, Patricia C. Mosser, and Gabriel Perez Quiros*

## *Staff Reports*

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*The views expressed in the publications and papers summarized in Research Update are those of the authors and do not necessarily reflect the position of the Federal Reserve Bank of New York or the Federal Reserve System.*