

# 2002 bank highlights

## Economic Research and Monetary Policy

*The Bank's Research function supports the President and Board of Directors of the Bank in their monetary policy-making roles. Economists conduct policy-oriented research aimed at achieving a better understanding of the links between monetary policy actions and economic activity; they also conduct applied microeconomic research that focuses on regional economic and fiscal issues. Much of the work of Research staff is made available to the public in print and on the web. Research staff also provide objective economic expertise to the public in a variety of government, academic, and business settings.*

The year 2002 provided numerous challenges for monetary policy economists. The economy continued its gradual, modest recovery, but the course of growth was unusually difficult to predict. A combination of car-happy consumers and increasingly efficient firms yielded strong consumer spending but mediocre investment spending and stagnant employment. While the long-run underpinnings of the economy remained sound, uncertainty about geopolitical events and concerns about the tepid recovery tempered consumers' and businesses' spending plans. The Federal Open Market Committee (FOMC) held the federal funds rate at 40-year lows through most of the year, and voted to reduce the policy rate by an additional 50 basis points at its November meeting.

The Bank's economists contributed to macroeconomic research on a variety of fronts: seeking to explain the widely noted decline in the volatility of GDP growth; estimating the extent to which consumers and businesses look ahead in making consumption and investment decisions; and determining the impact of joining a currency union on the volume of trade and the co-movement of prices and GDP between countries that share a common currency.

Work of the Bank's regional economists included a comprehensive study of the 50 states' need for revenues and ability to raise revenues; a study of the effect of the loss of a spouse, through death or divorce, on family income; and a study examining how widely shared across race and gender is the wage premium that accrues to those with higher education.

It was another successful year for the seminar series of the New England Study Group, organized to foster interactions between Bank economists and outside economists and development practitioners. There were ten NESG sessions on topics ranging from sprawl to Native American economic development.

With the sluggish recovery in the national economy, the insights of the Bank's regional economists were much in demand, and economists made presentations on economic and fiscal issues frequently throughout the First District.

The Bank's 47th economic conference, "Education in the 21st Century: Meeting the Challenges of a Changing World," held in June 2002, provided a forum for analyzing the effectiveness of recent efforts to reform elementary and secondary education. The 48th conference, scheduled for June 2003, will focus on behavioral economics: "How Humans Behave: Implications for Economics and Economic Policy."

The *Regional Review*, which takes a nontechnical approach to economics topics, included an article by former Fed Governor Alice Rivlin on the dilemmas facing capitalist economies in providing the fruits of rapid growth to more than just "the educated, the skilled, and the lucky." *New England Fiscal Facts* featured the last of three articles analyzing school funding concerns in New Hampshire.

## Supervision and Regulation

*The Bank's Supervision and Regulation function is responsible for periodic examinations of New England banking institutions, ongoing monitoring of banking conditions, and enforcement of regulatory measures. Supervision and Regulation staff also contribute to the development of supervisory and regulatory policy at the national and international levels and monitor major developments affecting nonbank financial institutions.*

New England's banks remained healthy in 2002, but strains were evident. Like their counterparts nationwide, New England's largest banking organizations saw their earnings adversely affected by soft loan demand, an increase in problem loans, especially in telecommunications and energy, and losses from international operations. New England's regional and community banks, while not experiencing significant credit quality problems, were challenged by a low interest rate environment and reduced loan demand that placed pressure on their earnings. The Bank's Supervision and Regulation staff closely monitored these emerging concerns, focusing resources on the effectiveness of banks' risk management activities in the affected areas.

Supervision and Regulation staff reallocated resources to meet the requirements of the USA Patriot Act, which places renewed emphasis on anti-money-laundering efforts of regulated institutions.

Working with staff from the Federal Reserve Board, the Bank's Supervision and Regulation staff played a prominent role in the development of the Basel Committee's approach to establishing bank capital requirements for operational risk. Staff conducted quantitative analyses in support of the Basel group's risk management subcommittee and worked to align

the current operational risk capital proposal with the "real world" experience of the banking community. The department also participated in a cross-institutional benchmarking project that will help finalize the credit risk aspect of the proposed Basel accord.

Supervision and Regulation staff held several regional conferences in 2002. A Regional and Community Bankers Conference in June featured topics ranging from regional economic conditions, credit trends, and emerging supervisory issues to a discussion of Federal Reserve supervisory approaches. In October, an Accounting Roundtable for Chief Financial Officers and Accountants discussed legislative responses to public accounting issues. In November, Supervision and Regulation's Insurance Knowledge Center hosted its second annual conference for state and federal bank and insurance regulatory agencies. The conference focused on the use of insurance products to manage the risks inherent in banking operations and the issues associated with the sale of insurance as a business line.

## Public and Community Affairs

*The Bank's Public and Community Affairs function serves the public by providing technical advice, consumer information, and educational resources directed toward promoting (1) economic and financial understanding, and (2) broader access to credit and economic development opportunities.*

In 2002, the Bank helped the New England Council establish a Creative Economy Council to highlight the economic contributions of creative industries, including the performing and visual arts; graphic design, architecture, and other applied arts; the media; and heritage and preservation organizations. The Creative Economy Council will serve as a forum for discussion and learning about these industries and will work collaboratively with other groups on development initiatives involving creative industries.

The Bank produced and distributed the publication, "Faith-Based Community Economic Development Principles and Practices," to assist faith-based organizations in fostering economic development in their communities. The publication proved popular, and the Bank undertook a second printing.

The Bank collaborated with the Federal Deposit Insurance Corporation, Action for Boston Community Development, and the Pioneer Institute in sponsoring conferences on ways to bring underserved communities and population groups into the economic mainstream.

*Communities and Banking*, the Bank's magazine on community development and credit issues, included articles on the expanding involvement of social investors in community economic development, sources of venture capital for small firms, manufactured housing, and mortgage scoring.

Late in 2002, the Bank introduced a brochure on identity theft to complement an existing video on this subject. The new brochure met with immediate success.

As part of the City of Boston's Earned Income Tax Credit Initiative, Bank staff provided free tax preparation services to Boston's low- and moderate-income populations.

"Classroom in the Workplace," a program initiated in 1999 to provide reading instruction to the Bank's summer interns, was expanded in 2002 to 20 companies and over 200 students. Math instruction was added to the program.

For the seventh consecutive year, the Bank operated the "Fed Challenge," an economic competition in which high school students simulate the roles of Federal Reserve monetary policy makers. The Bank also introduced with considerable success a noncompetitive, in-school version of Fed Challenge.

## Financial Services

*The Bank's Financial Services function serves the public by providing payments services, including check processing, cash, and electronic funds transfers, to New England banks and to the U.S. Treasury. In addition to serving New England, the Bank provides certain payments and support services to financial institutions in other sections of the country, and one of the Bank's major responsibilities is to lead the Federal Reserve System's payments policy-making arm, the Financial Services Policy Committee.*

In 2002, the Financial Services Policy Committee (FSPC) simultaneously made decisions to invest in its electronic payments services and to standardize, consolidate, and downsize its check-processing infrastructure. The decisions recognize that the retail payments system is in transition from a predominantly check-based system to electronic payments. The FSPC and the Boston Fed have promoted this move to electronic payments through a variety of initiatives for a number of years and fully support this market change.

A major System initiative, FedLine for the Web, became a reality for many Federal Reserve System customer banks in 2002. FedLine for the Web gives financial institutions web access to information and transactions services. Over the course of the year, the Bank held seminars throughout New England, and by the end of the year, a majority of Boston Fed customers had access to one or more of the check, ACH accounting, billing, and other services available through FedLine for the Web.

The System continued to develop its image-based services for check processing. FedImage Services, managed by the Boston Fed on behalf of the Federal Reserve System, implemented shared national image archives at two Reserve Bank sites, replaced older systems with a new standard check

image capture system at 24 Reserve offices, and provided services to more than 300 customers as of yearend.

In wholesale payments (Fedwire funds and securities transfers), the Bank successfully completed the consolidation of online support for customer banks in five additional Federal Reserve districts and joint custody collateral support for all banks nationwide. Following this consolidation, the Boston Fed became the primary wholesale services provider for banks in half the country, as well as the System's sole provider of joint custody collateral services.

Boston Fed responsibilities on behalf of the Federal Reserve System include services in support of U.S. Treasury payments. In 2002, the Bank assumed expanded responsibility for stored value card payments for military personnel; managed development of a web-based pilot system for vendor payments and intragovernmental payments; and provided technical support for the Federal Reserve System's Treasury Direct Call Center, located in three Federal Reserve Banks, including Boston. The Treasury Direct Call Center enables consumers to make direct purchases of U.S. government obligations.

Locally, in check services, the Bank began converting to the new standard automation platform for check processing. High levels of customer service were maintained throughout the con-

version process, which is expected to be completed in 2003. In cash services, the Bank led a Federal Reserve System work group that developed, tested, and implemented a more efficient method for processing \$1 notes. As a result of these

efforts, in 2003 and 2004 the Bank will introduce System-wide procedural efficiencies that will reduce cash processing costs for the System.

## 2002 Boston Fed Financial Services Activity

	Daily Dollar Value (in thousands)	Daily Average Volume	Volume Growth 2002 vs. 2001
<b>Commercial Check Processing</b>			
Processed Volume	\$3,900,000	4,100,000 checks	-6.4%
Fine Sort Volume	\$228,400	300,000 checks	-11.3%
Processed Returns	\$50,700	44,400 checks	-7.8%
Total Volume	\$4,200,000	4,400,000 checks	-6.8%
<b>Automated Clearing House</b>	\$1,770,000	1,072,254 items	8.5%
<b>Funds Transfers<sup>1</sup></b>	\$1,877,000	405,955 transfers	—
<b>Book Entry Securities Transfers<sup>1</sup></b>	\$1,366,800	99,557 transfers	—
<b>Cash Operations</b>			
Total Notes Paid	\$126,200	8,300,000 notes	-3.3%
Total Notes Received from Circulation	\$117,800	8,200,000 notes	-0.2%
High Speed Currency Processed	NA	8,600,000 notes	0.2%

<sup>1</sup> Boston provides operational support for funds and securities transfers for the depository institutions in six Federal Reserve Districts. Consolidation of these services took place over a period from September 2001 through May 2002; as a result, year-over-year growth comparisons are not meaningful.



*toys for tots*  
**community care day**  
homeless children's holiday party

Books and Kids Program

*Project ProTech*

**United Way**



*boston summer jobs program*

**BOSTON PRIVATE INDUSTRY COUNCIL**

dearborn middle school mentoring program

# classroom at the workplace

boston after school jobs program

job shadow day

school-to-career project  
*Workforce Development*  
south boston high school partnership



1,322 employees

# working together

with the public  
to make a difference

