

The U.S. domestic economy enjoyed solid growth and prosperity in 1997. Gross domestic product grew by almost 4 percent after inflation, the civilian unemployment rate remained well below 5 percent, inflation pressures eased further, and yields on long-term U.S. securities fell below 6 percent. The strong economy and stable financial conditions enabled Fifth District depository institutions to maintain high earnings and good asset quality. The Federal Reserve Bank of Richmond also enjoyed a successful year, meeting its objectives and making important contributions to Federal Reserve initiatives.

MONETARY POLICY AND PUBLIC AFFAIRS

In 1997 President Broaddus was a voting member of the Federal Open Market Committee. He was supported by the Bank's economists, who continued to produce high quality research on monetary policy.

The Bank strengthened its public information and community affairs programs through presentations and the development of new communication channels. Mr. Broaddus continued his community outreach through public speaking engagements and meetings with business, civic, and community development leaders across the region. The Bank also cosponsored a national conference in Richmond for high school teachers of advanced placement economics and hosted a regional conference in Baltimore on collaborative approaches to neighborhood economic revitalization.

The newly established Internet site made on-line information regarding the Bank, its publications, and the Fifth District economy readily accessible to educators, students, the business community, the media, and the general public.

Region Focus, a quarterly regional business magazine, made its debut at mid-year, and *Econ-Exchange*, a publication designed for economics teachers, was established in partnership with the E. Angus Powell Endowment for American Enterprise.

BANKING CHANGES AND CONTRIBUTIONS TO FEDERAL RESERVE SYSTEM ACTIVITIES

Consolidation in the banking industry accelerated this year as the stable economy encouraged each of the largest banking firms headquartered in the Fifth District to make sizable acquisitions. In no other area of the country was acquisition activity more intense, with Fifth District bank holding companies announcing the two largest and five of the ten largest bank acquisitions in the nation. With the implementation of nationwide branching, the District's largest banking organizations merged more than 60 bank affiliates across the country with their lead banks headquartered in North Carolina. This acquisition and merger activity stimulated the formation of numerous community-based depository institutions in the District.

Both the System and the Bank undertook major initiatives in 1997 to improve acquisition, interstate banking, and examination processes. Recent major revisions to the Federal Reserve's Regulation Y governing bank holding companies facilitated the timely processing of individual acquisition and merger applications. The Federal Reserve System established a new reserve and settlement account structure to meet the changing needs of interstate banking organizations. The System also made changes to several critical software systems to support the new account structure, and Bank staff provided depository institutions with information and training regarding these changes. Additionally, Reserve Banks issued the first uniform directives to govern the conditions under which they provide payment and account services to depository institutions nationwide. Finally, the System successfully implemented a new Statistics and Reserves (STAR) software application designed to process financial reports submitted by depository institutions and to calculate and provide reserve account information.

As the focus of Federal Reserve bank supervision shifted toward identifying risks faced by banking institutions more effectively, the Bank incorporated safety and soundness examinations aimed at reducing these risks. The new examination process requires a fundamental change in approach for System bank examiners, which necessitated major changes to training programs. During 1997, the Richmond Bank continued to play a leadership role in redesigning these Systemwide examiner training programs. The Bank also worked to enhance interagency coordination between the Federal Reserve and other federal and state banking supervisors to help minimize overlapping supervisory burdens.

PAYMENT SYSTEM AND SERVICES

Throughout the year, attention focused on the future of the Federal Reserve's role in the payment system. The System's Committee on the Federal Reserve in the Payments Mechanism (the Rivlin Committee) completed a fundamental review of the Federal Reserve's role in the provision of check collection and automated clearing house (ACH) services. Two major recommendations emerged from the Committee's report:

- The Federal Reserve should remain a provider of both check collection and ACH services, with the explicit goal of enhancing the efficiency, effectiveness, and convenience of both systems, while ensuring access for all depository institutions; and
- The Federal Reserve should play a more active role, working closely with providers and users of the payment system, both to enhance the efficiency of check and ACH services and to help evolve strategies for moving to the next generation of payment instruments. (See this *Report's* feature article for additional discussion.)

Against this background, the Bank was active in the payments arena throughout 1997. The Bank exceeded its financial objective of recovering the full cost (including a private sector adjustment factor) of providing priced financial services

to depository institutions; staff completed a comprehensive cost-benefit analysis on the future of the Bank's Charleston, West Virginia, check processing center and determined that it should remain open to serve West Virginia customers; and the Charlotte and Richmond Offices began offering new check-image capture services, while the Baltimore Office was the first office in the Federal Reserve System to introduce a new automated system for processing check adjustment cases. These new services will provide more automated interfaces and efficiencies for the Bank and its customers.

To promote the use of electronic payments, the Bank expanded its involvement in joint educational and marketing efforts with District ACH associations, which resulted in a significant increase in the use of ACH services for utility bill payments. The Bank also made major enhancements to its funds transfer and securities transfer services. By substantially increasing its consultative, systems development, and operational assistance to the U.S. Treasury, the Bank aided government efforts to enhance the efficiency and effectiveness of government payment and information systems.

SUPPORT SERVICES

A new building automation system was installed at the Richmond Office and the Bank strengthened its building security. A new integrated budget and financial planning system provided efficiencies and streamlined financial planning. The Bank also began implementing new purchasing, accounts payable, and inventory and asset management systems that will improve control and efficiency. Looking forward, a major project is underway to ensure that all automated support systems are ready for the century date change. The Bank will provide testing support for its customers by July 1998.