

President's Foreword

Few years reflect as much unity of purpose as did 1999. In the year just past, one objective stood out as the Federal Reserve's single most important: managing the century date change successfully. As we headed toward this unprecedented event, we knew that the integrity and trust we've gained through years of experience depended on our readiness.

The Federal Reserve Bank of Cleveland geared virtually all of its operations in 1999 around achieving this objective. The multi-year Y2K project, which culminated in 1999, involved preparing our own systems and operations and ensuring that our customers and the financial institutions we supervise were prepared as well. Considerable time and resources were dedicated to maintaining public confidence in our nation's banking system. And, throughout 1999, much energy was focused on finalizing our contingency plans and managing the transition period.

Thanks to the tireless efforts of our dedicated employees, the Year 2000 rollover was a complete success for our Bank, the Federal Reserve System, the banking industry, and our country. Because we were so well prepared for this unprecedented event, those minor problems that did arise were handled quickly and skillfully. All of our efforts in terms of testing and preparing our own services and systems meant there was no uncertainty about what to do when even a minor glitch occurred.

As we and the entire financial services industry geared up for the century date change, a related development was also in the limelight: the re-examination of our industry's very structure. Throughout 1999, we followed the progression of a major piece of banking legislation, the Gramm–Leach–Bliley Act, which Congress passed in November. This legislation, long in the making, overhauled the banking and financial services industries by removing the legal barriers that prevented mergers between such businesses as banking, securities underwriting, venture capital, insurance, and real estate. Depository and nondepository institutions alike can now reorganize and take advantage of new business areas, and thus new revenue streams, that were formerly off limits.

Financial modernization has many far-reaching implications that will contribute to the rapid pace of change that has characterized our industry for a number of years. Along with new privileges, banking organizations will find they have new challenges, too. The separation between banking and commerce will grow murkier, as financial institutions come to play an even greater role in our economy's development. These institutions must also come to terms with managing new and more complex risks.



The Gramm–Leach–Bliley Act also creates new responsibilities for the Federal Reserve. As the umbrella supervisor of the new financial holding companies created by the Act, we will provide the needed oversight to all financial organizations and their affiliates, and ensure that institutions are managing risk appropriately. We'll also develop new rules, in partnership with other federal agencies, to govern such issues as consumer privacy and community reinvestment practices.

As of this writing, many of the details required to implement the provisions of the Act have not been finalized, and the various agencies charged with implementing it, including the Federal Reserve, will need to cooperate to fill in the fine points. Based on our past successes, I am confident that we will find common ground in interpreting the issues that remain. While the law represents a broad compromise reached by several different entities, we believe it holds much promise for the industry. How the industry will evolve in light of these new opportunities remains to be seen.

The spirit of modernization, so evident this year in our dealings with the industry and the public at large, also pervaded many of our internal functions. As always, we remain committed to finding and providing new efficiencies in our nation's payments system. In 1999, the Federal Reserve Bank of Cleveland took a sizable step in this direction by leading efforts to revamp operations in our largest priced-service area: check processing.

The Check Modernization Project is a multi-faceted, Systemwide initiative designed to reduce the cost of Federal Reserve check services, speed the distribution of new products, further automate our check services, and improve overall service quality. The project will provide new efficiencies, not only in our paper-based check processing operation, but also in the workings of our various electronic check products and services. Under the largest component of the project, a standardized software platform will be established for all 45 of the System's check processing sites. This enhancement will serve as a natural launching pad for revamping such related services as check imaging, adjustments, and electronic delivery.

The lion's share of the planning and conceptualizing behind the Check Modernization Project took place in 1999 under the direction of the Cleveland-based Retail Product Office staff. In 2000 and beyond, we will continue our leadership role by managing the implementation of these state-of-the-art systems for the entire Federal Reserve System.

Another topic of discussion throughout 1999 has been our economy's unbridled growth, which has co-existed with record-low inflation and unemployment levels. The American economy is stronger than ever, and no one could have predicted that our growth would have lasted for nine years, or that it would have been characterized by a virtual lack of inflation. For 1999, unemployment, at 4.2 percent, and inflation, at just over 2 percent, were at their lowest levels in more than 30 years. Overall economic growth once again exceeded 4 percent. For many economists, the inability to predict such circumstances has been a humbling experience that has led to much debate and many questions. But it may well be that too much emphasis is placed on forecasting and "managing" economic growth.

This year's essay examines the historical evolution of the idea that monetary policy should be geared principally to control economic growth, and thereby, also control inflation. We think that this approach to monetary policy has led to several unfortunate consequences, not the least of which is bad rhetoric regarding what monetary policy can and cannot do. We urge a reconsideration of the issue and suggest an alternative to the traditional demand management framework.

We could not have accomplished all that we have in 1999 without the guidance provided by the directors of our Cincinnati, Cleveland, and Pittsburgh offices, and the members of our business and community bank advisory councils. We especially want to thank those directors who completed their terms of service on our Boards in 1999. For their oversight and valuable contributions we are truly grateful. On our Main Office Board of Directors, G. Watts Humphrey, Jr. (president of GWH Holdings, Inc.), completed his third year as chairman. Mr. Humphrey also served as the chairman of the System's Conference of Chairmen in 1999. Robert Y. Farrington (executive secretary-treasurer, emeritus, of the Ohio State Building and Construction Trades Council) completed his second term as a director in 1999. As chairman of our operations committee, Mr. Farrington also played a key role in overseeing the renovation and building project that took place in 1998.

We also thank Phillip R. Cox (president and chief executive officer of Cox Financial Corporation), who completed his second term as a director on our Cincinnati Board. We are pleased that Mr. Cox remains with us, albeit in a new capacity, as a director on the Main Office Board.

A special debt of gratitude goes to Robert W. Gillespie (chairman and chief executive officer of KeyCorp), who finished his third one-year term as our Federal Advisory Council Representative. During 1999, Mr. Gillespie also served as chairman of the Federal Advisory Council. His insight and expertise as well as the valuable contributions of all of our departing board members will be missed.

In addition, I would like to express my sincere appreciation to the officers and staff of the Federal Reserve Bank of Cleveland, for their extraordinary efforts throughout 1999. Preparing our Bank and depository institutions for the century date change was a challenging task, requiring countless hours of work and unparalleled dedication. Remarkably, we were able to handle this extraordinary responsibility and still accomplish many other significant objectives. The Bank is well positioned to fulfill its mission with distinction in the 21st century.



Jerry L. Jordan

President