President's Foreword

Last year, this Bank's annual report began with a reflection on the century date change, observing the lack of problems associated with that much-publicized event. We began, "The prospect of serious, unforeseen events had spurred people in our Bank and the Federal Reserve System to work together in pursuit of a common objective. In the aftermath of that project, we found that we had forged some new relationships—and deepened some old ones—among our customers, the institutions we supervise, the public, and even our colleagues inside the Federal Reserve System."

Little did we realize how true those words would ring today, in the aftermath of the September 11 terrorist attacks. Following the attacks, the Cleveland Bank and the Federal Reserve System were called upon to support this country's financial system in unprecedented proportions.

Central banks are poorly understood institutions among the public, and the Federal Reserve is no exception. To the extent that people grasp our purpose, they may think of our influence on interest rates and the economy, our efforts to promote sound banking practices, and our stockpiles of currency and coin. Even our customers may see us only for those services we directly provide to them, without considering the full scope of our involvement in the broader economy. Yet the genius of the Federal Reserve System is its ability to pool diverse resources in order to rapidly accommodate sudden shifts in the demand for dollar liquidity and, in so doing, to cushion our nation's banking, clearing, and settlement systems from severe shocks. The practical consequence of this capability is that financial transactions can continue even in the face of troubling national circumstances.

David H. Hoag, chairman; Robert W. Mahoney, deputy chairman; Sandra Pianalto, first vice president; and Jerry L. Jordan, president.

As the "Operational Highlights" section of this year's report makes clear, the Bank's ability to draw on the expertise of its financial services, credit risk, supervision, and research staff enabled it to quickly understand and respond to the many pressures that emerged in our financial system on September 11. In a very important sense, of course, it was not business as usual—but in many other ways, it was. The contingency planning we had done for the century date change proved invaluable during that crisis period. We understood clearly how our technical systems worked and how to resolve problems associated with them. But more important, we understood our *customers*' needs, their systems, and how to communicate with them. The culture we had developed in the Bank during the 1990s—one of customer service and cross-functional team work—demonstrated its effectiveness.

As a nation, we are still adjusting to the effects of the war against terrorism and a new, more vigilant security posture. Clearly, our economy was affected by these factors during the last months of 2001, a time when economic activity had already slowed from the brisk pace of prior years. In January, the Federal Open Market Committee already had begun a sequence of reductions in the discount and federal funds rates, recognizing reduced demand for credit and increased demand for liquid financial assets. The events of September 11 intensified these trends, just when it seemed that economic weakness might have bottomed out. As of this writing, the FOMC has reduced the federal funds rate 475 basis points, and, once again, this period of economic decline appears to be over.

Rhetoric—that is, our choice of language—has become a common theme in this Bank's annual reports. We continue this year with a discussion of the language used by economists, policymakers, market observers, and media analysts to describe changes in the federal funds rate over the business cycle. We suggest a different framework for thinking about and describing monetary policy actions than is commonly used. As we have argued in previous essays, we believe the goals of price stability and long-term economic growth are best served by replacing policy rhetoric that is built on a traditional activist framework with a rhetoric that better reflects what central banks truly can deliver.

We could not have accomplished all that we did in 2001 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 2001. For their oversight and valuable contributions we are truly grateful. On our Cincinnati Office board of directors, Jean R. Hale (president and chief executive officer, Community Trust Bancorp, Inc.) and Thomas Revely, III (president and chief executive officer, CBS Technologies, LLC) each completed a second term as a director. On our Pittsburgh Office board of directors, Gretchen R. Haggerty (senior vice president of accounting and finance, U.S. Steel Group) and Edward V. Randall, Jr. (management advisor and consultant, Babst, Calland, Clements & Zomnir, P.C.) also completed second terms as directors. The valuable contributions of all of our departing board members will be missed.

Finally, I would like to express my sincere appreciation to the officers and staff of the Federal Reserve Bank of Cleveland for their extraordinary efforts in responding to the tragic events of September 11, 2001. Because of your dedication, we were able to perform our role as the nation's central bank during this national crisis. Although our country faced a number of uncertainties, the American public — indeed, the world — saw that the Federal Reserve continued to provide the necessary support to the financial system.

The Federal Reserve Bank of Cleveland did not close on September 11, nor did we restrict our hours in the days that followed. I want to extend my heartfelt thanks to the officers and staff and their families for the personal sacrifices they made for the benefit of the Bank, its customers, and the nation.

Jerry L. Jordan

Jerry L. Jordan

President