

Houston Business

A Perspective on the Houston Economy

This article describes the role of the Federal Reserve in Southeast Texas, where the 265 employees of Houston's Federal Reserve Branch Bank are an integral part of the local banking community.

The Federal Reserve In Houston

The public image of the Federal Reserve is shaped mostly by monetary policy and changes in short-term interest rates. However, the Federal Reserve has many other responsibilities, less publicized but essential to the daily operation of the U.S. financial system.

For example, the Federal Reserve supervises bank holding companies, state member banks and the U.S. operations of foreign banking institutions to protect the integrity of the nation's banking system. It plays a major role in the U.S. payments system, providing vault cash to the banking system, processing and collecting 20 billion checks annually, and operating the nation's primary electronic funds transfer system. As fiscal agent for the U.S. government, it is the nation's banker, maintaining working funds for the Treasury Department, honoring Treasury checks, and issuing, servicing and redeeming Treasury securities.

Many of these financial services, such as bank examinations, check processing and delivery of vault cash, have a strong local element. This article describes the role of the Federal Reserve in Southeast Texas, where the 265 employees of Houston's Federal Reserve Branch Bank are an integral part of the local banking community.

PART OF A SYSTEM

The U.S. Constitution gives Congress the power to create money and set its value, a power Congress delegated in 1913 to the nation's new central bank—the Federal Reserve System. The Federal Reserve is a quasi-public institution; its decisions and daily operations are independent of the executive branch of government but subject to oversight by Congress. The Federal Reserve System

was launched in 1914 in a decentralized format. At the System's center is its Board of Governors in Washington, D.C., seven members appointed by the president and confirmed by the Senate for 14-year staggered terms of office. The Board of Governors has a key role in domestic and international economic policy, monetary policy, banking supervision and overseeing the operations of 12 Federal Reserve District Banks.

These 12 Federal Reserve Banks—located in major cities throughout the United States—operate the nationwide payments system, distribute currency and coin, conduct bank examinations and serve as banker to the U.S. Treasury. The District Banks also participate in formulating monetary policy. The boards of directors of District Banks recommend changes in the discount rate to the Board of Governors. The District Bank presidents, in turn, join the Board of Governors on the Federal Open Market Committee to change short-term interest rates.

Within the 12 Federal Reserve Districts, 25 Branch Banks also operate. The Eleventh Federal Reserve District consists of Texas, southern New Mexico and northern Louisiana, with headquarters at the Federal Reserve Bank of Dallas. Three Branch Banks operate within the Eleventh District: the El Paso Branch, which opened in 1918; the Houston Branch, which opened in 1919; and the San Antonio Branch, which opened in 1927. Other major U.S. cities served by Branch Banks include Los Angeles (in the San Francisco District), Miami (Atlanta District), New Orleans (Atlanta District) and Baltimore (Richmond District). The Houston Branch, located at 1701 San Jacinto St., serves banks and institutions in 41 counties in Southeast Texas.

CHECK PROCESSING

In Houston, as in most Federal Reserve Banks, the largest number of employees perform check processing duties. Check operations in Houston run 24 hours a day, six days a week, and provide about 42 percent of the Branch's jobs. Each day, customers of Houston-area banks deposit checks in their accounts, checks that are drawn on local banks or on banks located throughout the United States. These Houston banks, in turn, bring about 1 million checks each day to the Houston Branch, asking that the funds be col-

lected and placed into their account with the Federal Reserve. Once collected, Houston banks pass the funds to their Houston customers.

The first principles of check collection are simple. The Fed knows which bank wants the money, since each bank turns in a cash letter or deposit slip along with the checks it wants collected. The Fed knows where to collect the money, since a unique routing number is on the bottom of each check in magnetic ink, and the amount of the check will be encoded as well. Since the Fed has an account for every depository institution (called a reserve account), it becomes a matter of running the checks through high-speed processors and then having the totals moved from one bank's account to another under predetermined deadlines.

Beyond these first principles, matters complicate quickly. Generally, paper checks must be physically delivered to the banks they are drawn on before funds can be collected. If checks are drawn on banks outside the Houston area, the Fed ships each check from Houston back to the Federal Reserve District where it was originally drawn and by courier to the bank itself. Also, some checks are presented and then rejected because of insufficient funds, closed accounts and so on. These checks must be returned to the bank of first deposit—with all the original accounting entries reversed.

Federal Reserve check services compete for business with large private banks, clearinghouses and other check processors. To make sure the playing field is level between the Federal Reserve and private processors, the Fed is required by law to collect fees to cover all check processing costs, including adjustments for taxes and capital costs. Also, since the Fed's system of reserve accounts is unique, each Federal Reserve Bank or Branch opens its books daily to clearinghouses and other check processing associations for settlement among their members.

These rules give Federal Reserve check processing services the feel of a private-sector operation. A customer assistance center in Houston helps financial institutions with various requests, such as account information and assistance with electronic connections to the Fed; a local business development staff markets Fed check services to financial institutions; and competition keeps the Fed focused on

Houston Branch Federal Reserve Bank of Dallas

Essential facts

- Houston Branch opened for business on August 4, 1919.
- Houston Branch moved into its current building at 1701 San Jacinto in 1958.
- Operations serve local economic activity.
- The Branch serves financial institutions in a 41-county area in Southeast Texas.
- Check processing operations make up about 42 percent of the Houston Branch staff.
- Cash operations process approximately 1.5 million currency notes per day.

Whom to call

- Branch Manager, Robert Smith III (713) 652-1548
- Treasury Direct sales of securities (713) 652-1621
- Customer assistance (713) 652-1652
- Library and economic information (713) 652-9164
- To arrange public tours (713) 652-9138

technical changes as the market moves toward electronic products and check imaging.

CASH AND COIN

Picture every bank in Houston holding the exact amount of cash it wants on Friday morning, ready for customers to cash payroll and other checks and visit ATMs for weekend withdrawals. Customers withdraw money from their banks, spending it at stores and other area businesses. Those businesses deposit the cash back into their bank accounts on Monday morning—leaving some banks with too much cash on hand and others not enough. Throughout the week, banks come to the Houston Branch to withdraw cash for the coming week or deposit excess currency.

The Houston Branch accepts each deposit of cash from a local bank, verifies the deposit is generally correct by counting the number of bundles of cash received, marks each bundle of 100 notes for ownership, separates the deposit by denomination and moves the deposit into its vault. Each bank is then given credit for its initial deposit, subject to later verification and adjustment. Any adjustments take place after a piece-count of the deposit is performed by high-speed currency processors that each verify up to 90,000 notes per hour, totaling about 1.5 million currency notes per day.

These machines also check the denomination of each note, test for counterfeits and

verify each note is fit to be recirculated. Worn currency is automatically shredded and disposed of, and processed currency is stored at the Federal Reserve to be put into circulation again as needed by local banks. New currency from the Treasury's Bureau of Engraving and Printing is put into circulation if processed currency is not available.

MANY OTHER ROLES

As a fiscal agent for the U.S. government, the Houston Branch acts as a depository for federal taxes, both from individuals and from banks in Southeast Texas that are authorized to accept tax deposits from the public. As the government's banker, the Branch accepts government checks, postal money orders and redeemed savings bonds for payment. The Houston Branch also handles the local sales of original issues of government securities—bills, notes and bonds auctioned weekly—to assist the Treasury Department in financing the national debt.

Another important role for the Fed is the supervision of financial institutions to ensure they operate safely and in compliance with banking laws and regulations. In Houston, a staff of 19 bank examiners perform on-site examinations of 10 commercial banks, 85 bank holding companies and all operations of foreign banking institutions in the Eleventh District.

A small economics group in Houston works closely with the Dallas research staff, providing information on Houston and Gulf Coast economic and energy conditions as Federal Reserve monetary policy is formulated. Federal Reserve research is shared through a Houston newsletter, local speaking engagements and a Houston Branch library that contains Federal Reserve and other publications.

The organizational structure of a Federal Reserve Branch Office is similar to a commercial bank's, with a Branch manager, deputy Branch manager and bank officers who oversee Operations, Banking Supervision, Auditing, Research, Accounting, Personnel and other departments. Each Federal Reserve Branch Office has a board of directors made up of local business leaders who advise the Fed on regional economic and banking conditions.

— Robert W. Gilmer
Jennifer B. Tellepsen

Winter has left its mark on the Houston economy, with solid holiday sales and volatile oil and natural gas prices driven by cold weather. Employment data through November 1996 show Houston on a steady 2.4 percent growth path, and Beige Book responses point to continued moderate expansion. Oil and gas services and durable manufacturing continue to expand rapidly, while construction growth has moderated in recent months.

RETAIL SALES

Local retailers report a good holiday season, with results that were solid, if not spectacular. The timely cold weather that kicked off the holiday season returned in mid-December to keep sales going strong. In an effort to offset the short holiday season, many retailers stayed open long hours and lost some profits to higher operating costs.

ENERGY PRICES

Low inventories of major heating fuels have left energy prices at the mercy of the weather. Bitter cold in the United States and Europe sent fuel prices soaring in December, as light sweet crude steadily marched up from \$22 to \$26 per barrel. Crude prices briefly weakened after the United Nations approved Iraqi crude oil sales, but so far those sales have been a nonfactor in oil markets dominated by cold weather.

Natural gas prices also rose sharply with cold weather. Spot prices at Louisiana's Henry Hub were over \$4 per thousand cubic feet all of Christmas week. Warmer weather and higher inventory levels than those a year earlier saw prices quickly weaken in January.

REFINING

Refiners' margins improved in late November and early December, primarily as heating oil prices rose. Margins have weakened since then but remain better than earlier this winter. Inventories of heating oil and gasoline are extremely low, and European imports have been limited by cold weather there. Demand for heating oil has affected the normal turnaround

schedule for refiners, delaying production of gasoline for the summer, which signals higher gasoline prices this spring.

PETROCHEMICALS

Petrochemicals largely remain unchanged. Very strong demand and high levels of production continue, but high energy prices are squeezing profit margins. A slight softening of chemical prices, combined with the run-up in natural gas and gas liquid prices, has worsened a situation that was already difficult early this winter.

OIL SERVICES AND MACHINERY

The industry remains stretched to the limit and is doing everything possible to meet growing demand with limited capacity. Selected skilled workers, such as machinists, are in very short supply, as are some kinds of equipment—offshore rigs and measurement-while-drilling instruments, among others. A 15 percent increase in drilling budgets is forecast for 1997, but much of this will be absorbed by higher prices and rental rates.

REAL ESTATE

Real estate reports were generally upbeat, with the announcement of several new suburban office buildings in Fort Bend County making the biggest news: a major relocation and a new corporate headquarters, as well as proposed speculative projects. One survey respondent felt the office market as a whole has "finally stabilized and is ready to turn around, starting from the suburbs." Retail and industrial activity remain strong; apartment rents have recently performed better than expected.

November sales of existing homes were slightly above those of a year earlier, and sales of new homes were down slightly. However, single-family homes in Houston wrapped up a good year, with sales up 19 percent and starts up 17 percent on a year-to-date basis. Existing home inventories continue to tighten, and for the first time in many years, finding the right home in the right neighborhood in Houston can be difficult or entail a long wait.

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The views expressed are those of the author and do not necessarily reflect the positions of the Federal Reserve Bank of Dallas or the Federal Reserve System.