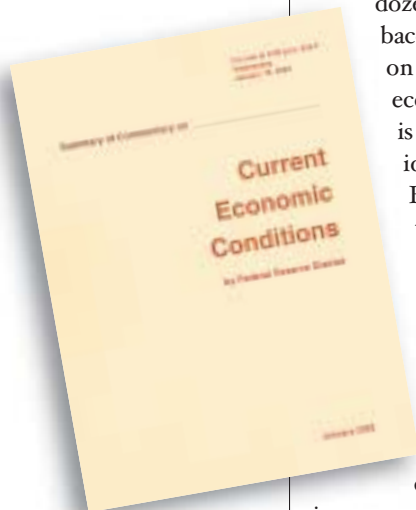


They're All Ears

The Richmond Fed's Regional Economics Team Listens Carefully to the District's Economic Heartbeat

BY BETTY JOYCE NASH



The "Beige Book" is published two weeks before each Federal Open Market Committee meeting.

An old woman who was getting up in years went to the doctor. After running a battery of tests, the doctor came back and told her that, unfortunately, she had perhaps six months to live. Naturally, she was distraught. After thinking about it a few moments, she asked her doctor what she should do. 'I suggest you marry an economist and move to North Dakota,' the doctor said. The woman was a bit baffled ... She asked, 'How will that make me better?' 'It won't, but it'll make your remaining time seem like an eternity.' "

Hoots of laughter fill a meeting room, proving that even at this early hour — 7:30 a.m. — the members of the Construction Financial Management Association are wide awake. Several dozen people have gathered over bacon and eggs to hear the latest on the regional and national economy. The featured speaker is Raymond Owens, a vice president of the Federal Reserve Bank of Richmond, who told the above joke to disarm the crowd and poke gentle fun at his own profession.

Keeping a good joke at the ready is a big part of Owens' job. He travels throughout the Fifth District to discuss economic conditions at various gatherings, as many as 60 in a year. Those economics gigs run two ways, though, Owens says. He gets as good as he gives.

"Not only do you show up and talk about the national economic condition, but you also meet and greet and talk to people," he says. "You learn about the local economy. You get more insight

than you ever could by sitting here reading reports."

True. Before the talk even starts, the group launches a roundtable discussion about the difficulty of finding construction workers and various incentives to lure them. That's information Owens stores and ponders later in the office. "Why 90 days?" he wonders aloud at the set time a new employee must stay for a referral to be rewarded. It could be a question he'll use in personal interviews to collect anecdotal information about the Fifth District economy.

Owens and six colleagues in the regional economics group of the Richmond Fed analyze plenty of data. In 2002, they put out 128 separate verbal and written reports and articles. The researchers also produce massive reports on the Richmond Fed's Web site, including a new monthly publication, "5E Economic Indicators," that tracks the District's most recent activity.

Regional group members Robert Lacy and Andrea Holland also contribute a regular section on the District economy to *Region Focus*.

Some of the timeliest information the regional group gathers, though, isn't online or on paper — it flows from the people they meet and talk to on the telephone. These snapshots of the Fifth Federal Reserve District are ultimately folded into the "Summary of Commentary on Current Economic Conditions," more commonly known as the "Beige Book." It's published two weeks before each Federal Open Market Committee (FOMC) meeting. The regional group uses the District information gathered for the book to prepare briefings for the Bank president as part of the FOMC cycle (see

the Summer 2002 issue of *Region Focus* for more on the FOMC). Owens and his group also contribute additional research on topics requested by the Board of Governors.

“When there are issues thought to be important to the national economy, we are asked to provide special reports to the FOMC,” he says. “Let’s say there’s a big natural disaster — a hurricane or 9/11 — we’ll often compile information on the impact on businesses and households.”

The Fifth District section of the Beige Book is a current overview of retail, services, manufacturing, finance, real estate, tourism, temporary employment agencies, and agriculture.

Each Federal Reserve Bank contributes summaries noting anecdotal information about its region’s economic sectors. Have orders expanded for manufacturers? What is the residential and commercial real estate market like? Are firms planning to hire or fire? How about inventories? The book in its entirety, then, becomes an instant picture of the national economy. “To understand the Beige Book, you have to understand what you hope to get out of it,” Owens says. “There’s this idea that regional economic information is important. It [the Beige Book] captures information that isn’t captured in a timely fashion [by traditional numerical measures]. The theory is that those numbers are missing important information that can be useful. The economy is dynamic, fluid. You don’t want to diminish the value of those economic numbers, but they don’t tell the whole story. One way to fill in those missing parts is with timely, detailed information at the regional level.”

Interviews with sources in each sector contribute to insights about the economy. The monthly manufacturing and retail/services surveys, nearly 10 years old in their present form, offer a wealth of data, especially when fleshed out with personal interviews, say Judy Cox and Aileen Watson, assistant economists in the regional unit. The surveys, intended for up-to-the-minute



LARRY GAIN/FED OF RICHMOND

Raymond Owens, a vice president at the Richmond Fed, travels throughout the Fifth District to discuss economic conditions. Talking and listening to the people he meets on these trips provide valuable insights into the local economy.

internal briefings for Richmond Fed economists, are released on the second Tuesday of each month. Cox and Watson often follow up survey responses with telephone calls or e-mails to glean more information. The personal interviews, Owens observes, add depth to the data.

“Government enumerators have a set of questions,” Owens says. “Those might be important, but they might not [be the right questions]. If you’re having a personal conversation with someone, they’ll tell you what’s on their mind.” In working the Fifth District over the past 20 years, Owens has picked up tidbits that inform his analysis of economic conditions. For instance, in a conversation with a fellow from Wilmington, N.C., he found out that two chemical companies had an arrangement to share production at certain times. “It gives you a better sense of how the capacity in an industry might be stretched,” he explains.

Lacy, who collects information for the Beige Book and also drafts the Fifth District’s summary before Owens edits the final document, interviews bankers and others working in the financial services industry. He typically calls the same people he has nurtured in his eight years

with the Bank. “We try to talk with people who are working directly with customers,” Lacy says. “We try also to have a mixture of small banks and big banks and banks in different states, so it’s fairly representative.”

Keeping an open mind, as well as asking the standard sets of questions, can inspire colorful comments, remarks Faye Ball, who calls residential real estate contacts and temporary employment agencies. Here are a few examples from a recent Beige Book:

- A banker reports that borrowing is sluggish, except among beer and wine retailers. “People drink more in a bad economy,” guesses a source.
- There appear to be some bright signs in manufacturing. A respondent notes that his industry has “cleansed itself of weaker companies,” enabling it to “put up the sail and go with the wind.”

It’s hard to know exactly what these bits and pieces of information say about the economy. Yet the comments can often point to a trend in the making. Owens cites an example.

“Some years ago, the general impression was that inflation in the United States was at a moderate rate and perhaps price pressures were likely to accelerate,” he recalls, adding that Fifth District respondents had reported little change in prices even though significant forecasts were reporting the opposite. “By the time we looked back, their reports were correct. I thought at first they were perhaps misinterpreting the question. But their responses were accurate.”

Speaking of accuracy, does the Beige Book actually get it right? Nathan Balke and D’Ann Petersen, economists at Southern Methodist University and AMRESO Commercial Finance Inc., respectively, evaluated how well the book reflects economic activity.

“My co-author and I read all the Beige Books, over about a three-month period,” Balke says, adding that they focused on books from 1983 through 1996. They tried to infer what the descriptions were saying about



Surveys of the manufacturing and retail/services sectors are released on the second Tuesday of each month.

economic growth and then attached a numerical score to the description. “We shuffled the Beige Books so we didn’t know what time period they were referring to. We tried to guard against using our knowledge of what actually happened.”

The two found that the Beige Books “do have significant predictive content for current and next quarter real GDP growth. Furthermore, the Beige Book has information about current quarter real GDP growth not present in other indicators such as the

Blue Chip Consensus Forecast or time series models that use real-time data.”

Economists in research departments throughout the Federal Reserve System filter anecdotal information, says Balke, transforming it into keen insights. “They use that information and use their own judgment about what that information is saying about the economy. It’s hard to sort it out, whether it’s the information from the contacts or the judgment of the staff that’s providing most of the information. My sense is that probably both are important.”

Each District’s Beige Book contribution reflects its unique regional economy. For example, the Federal Reserve Bank of Dallas calls on energy companies—including refineries, chemical companies, and oil and gas extraction industries—which continue to play an important role in the area’s economy.

“It’s [energy] still pretty big here, it’s about 6 percent to 7 percent of output right now,” says Mine Yücel, senior economist and vice president of the Dallas Fed.

The people who provide information to the Federal Reserve Banks for the Beige Book become valuable contacts who may be called on for quick facts. For example, after 9/11, the regional group hit the telephones to find out from real estate agents whether deals in progress would go through, among other investigations. “We get this very rich information,” Owens notes. “We can quickly and efficiently get accurate, on-the-ground assessments of what’s going on.”

The ability to interview is as handy as a head for figures, Owens notes. But many economists haven’t honed this skill.

“You’re taught in school the econometric techniques, to pound on the numbers,” he says. “What you’re never taught in school is to go out and talk to people and listen to people. That’s the lesson the whole regional section has taken to heart.”

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An Update on Check Services

The Winter 2003 issue of *Region Focus* included an article on the Federal Reserve’s role in the check clearing process. (See “The Check Business,” pp. 2-4.) Since publication, the Federal Reserve System has announced a major restructuring of its check services.

All Reserve Banks, including the Federal Reserve Bank of Richmond, will reduce the operating costs of their check services by taking such measures as streamlining the check management structure, reducing staff, decreasing the number of processing locations, and increasing processing capacity at remaining locations. These changes are in response to nationwide declines in check volume as consumers and businesses increasingly use electronic methods of payment.

Currently, 45 locations in the Federal Reserve System process checks and 43 locations perform check adjustments. By the end of 2004, 13 processing sites and 31 adjustment sites will close. As many as 1,300 positions at these locations may be eliminated, but approximately

900 jobs will be created at the remaining sites to handle the extra volume transferred to them.

In the Fifth District, check services are provided in Baltimore, Md.; Charleston, W.Va.; Charlotte, N.C.; Columbia, S.C.; and Richmond, Va. The restructuring plan calls for the Charleston office to transfer its processing and adjustment operations to Cincinnati and Cleveland, respectively, while the Columbia office will move both operations to Charlotte. Since the Charleston and Columbia offices provide only check services, they will be closed. In addition, Richmond’s check processing will move to Baltimore and its check adjustments will relocate to Charlotte.

All told, about 225 check services positions in the Fifth District will be eliminated. However, the Richmond Fed expects to add about 100 positions in Baltimore and Charlotte to handle their increased processing and adjustment workloads.

The restructuring plan is expected to reduce annual systemwide operating costs for check services by about \$60 million starting in 2005.

The goal is to help the Federal Reserve System recover the cost of providing payment services to financial institutions, a requirement of the federal Monetary Control Act of 1980. While the Fed earned an average annual after-tax return on equity (ROE) of 12.2 percent for its payment services from 1992 to 2001, declining check volumes and other factors reduced its after-tax ROE to 4.2 percent in 2002.

“Nationwide, consumers and businesses have made a significant shift in how they make payments, substituting electronic payments for checks. This development is good news for the nation’s payments system,” says Cathy Minehan, president and CEO of the Federal Reserve Bank of Boston and chair of the Federal Reserve System’s Financial Services Policy Committee. “But declining check volumes are requiring the Reserve Banks to make changes in their check operations to address the challenges posed by the changing market. [The restructuring plan] will help us meet these challenges.”

—CHARLES GERENA