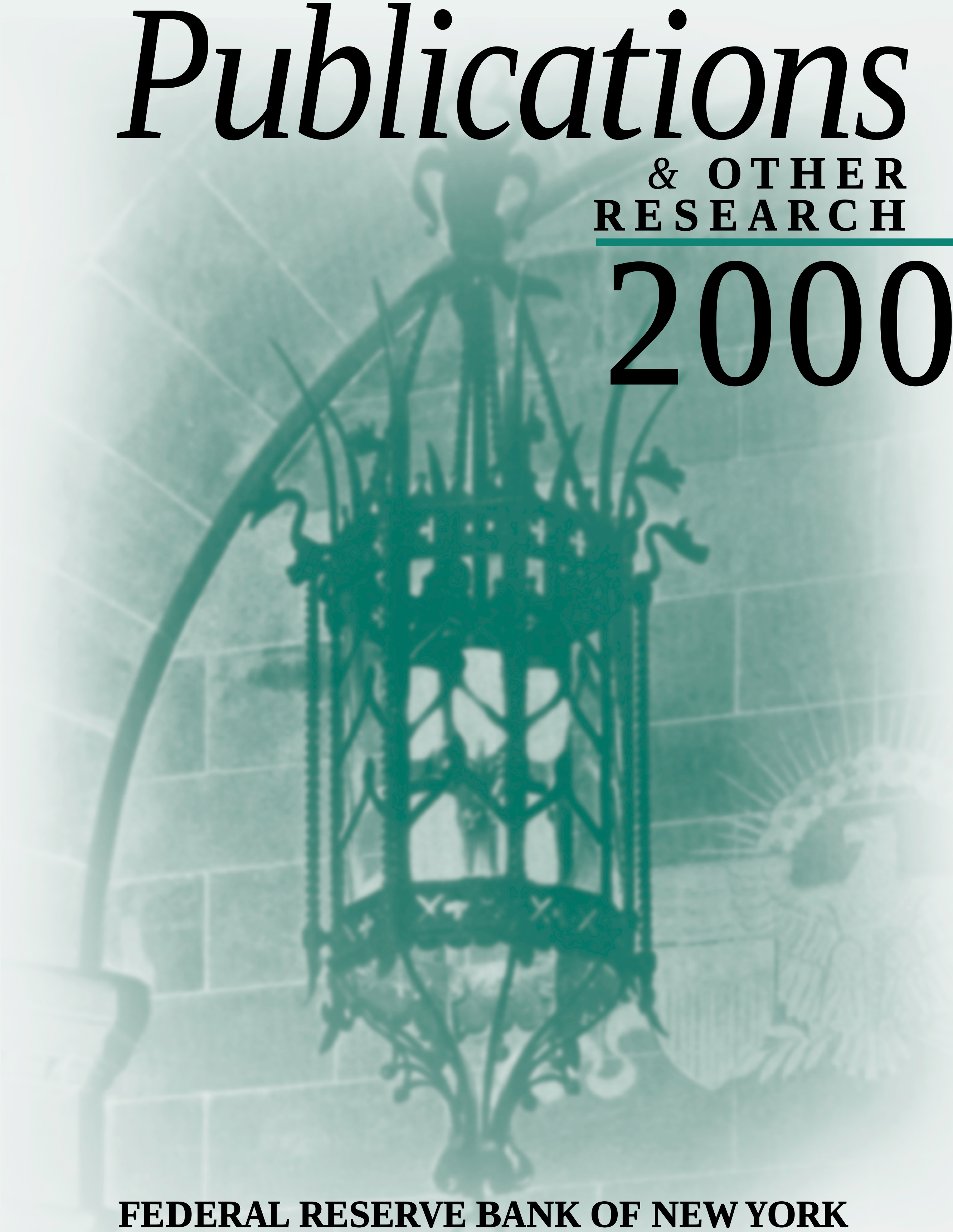
Publications

& OTHER RESEARCH

2000



FEDERAL RESERVE BANK OF NEW YORK

RESEARCH AND MARKET ANALYSIS GROUP

www.ny.frb.org/rmaghome

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FEDERAL RESERVE BANK OF NEW YORK

RESEARCH AND MARKET ANALYSIS GROUP

FEBRUARY 2001

INTRODUCTION

The Federal Reserve Bank of New York's Research and Market Analysis Group produces a wide variety of publications and discussion papers of interest to business and banking professionals, policymakers, academics, and the general public.

This catalogue lists recent issues in each of our research series:

- the ***Economic Policy Review***
  our policy-oriented flagship publication
- ***Current Issues in Economics and Finance***
  a newsletter-style publication focusing on economic and financial topics
- ***Second District Highlights***
  a regional supplement to ***Current Issues*** covering financial and economic developments in the Federal Reserve System's Second District
- ***Staff Reports***
  technical papers presenting research findings.

In addition, the Research and Market Analysis Group produces ***Research Update***, a quarterly newsletter complementing this catalogue. ***Research Update*** offers summaries of selected studies and listings of recent publications in our research series. It also provides other news and information about the Research Group.

Members of the Group also publish papers in many economic and finance journals, conference volumes, and scholarly books. A list of these publications begins on page 13.

ECONOMIC POLICY REVIEW

Volume 6

The *Economic Policy Review* is a policy-oriented research journal that focuses on macroeconomic, banking, and financial market topics.

EPR articles are available at www.ny.frb.org/rmaghome/econ_pol/index.html.

Number 1

In December 1999, the Federal Reserve Bank of New York sponsored the conference "Fiscal Policy in an Era of Surpluses: Economic and Financial Implications." This special issue is dedicated to the conference proceedings.

Papers include:

Opening Remarks
William J. McDonough

Formation of Fiscal Policy: The Experience of the Past Twenty-Five Years
Alan J. Auerbach

The Automatic Fiscal Stabilizers: Quietly Doing Their Thing
Darrel Cohen and Glenn Follette

The Near-Term Outlook for Fiscal Policy
Rudolph G. Penner

Fiscal Policy in an Era of Surpluses
Gary Gensler

Enhancing the Liquidity of U.S. Treasury Securities in an Era of Surpluses
Paul Bennett, Kenneth Garbade, and John Kambhu

The Benchmark U.S. Treasury Market: Recent Performance and Possible Alternatives
Michael J. Fleming

Number 2

Listening to Loan Officers: The Impact of Commercial Credit Standards on Lending and Output
Cara S. Lown, Donald P. Morgan, and Sonali Rohatgi

Over most of the last thirty-three years, the Federal Reserve has polled a small number of bank loan officers about their moves to tighten or ease commercial credit standards. Although the Senior Loan Officer Opinion Survey uses a small sample and gathers only qualitative information, it proves to be a useful tool in predicting changes in commercial lending and output. The authors find a strong correlation between tighter credit standards and slower loan growth and output, even after controlling for credit demand and other predictors of lending and output. The analysis also shows that the loan officer reports can help predict narrower measures of business activity, including inventory investment and industrial production.

The Timing and Funding of Fedwire Funds Transfers
James McAndrews and Samira Rajan

An examination of the Federal Reserve's Fedwire Funds Transfer service reveals that the highest concentration of funds-transfer value occurs in the late afternoon. The authors attribute this activity peak to attempts by banks (and their customers) to coordinate payment timing more closely. By synchronizing payments, banks can take advantage of incoming funds to make outgoing payments—especially during periods of heavy payment traffic. Conversely, during off-peak times, banks must rely more on account balances or overdrafts to fund payments, which increases the cost of making payments. For this reason, banks time their payments to coincide with an activity peak, thereby reinforcing the peak.

Capital Ratios as Predictors of Bank Failure
Arturo Estrella, Sangkyun Park, and Stavros Peristiani

The current review of the 1988 Basel Capital Accord has put the spotlight on the ratios used to assess banks' capital adequacy. This article examines the effectiveness of three capital ratios—the first based on leverage, the second on gross revenues, and the third on risk-weighted assets—in forecasting bank failure over different time frames. Using 1988-93 data on U.S. banks, the authors find that the simple leverage and gross revenue ratios perform as well as the more complex risk-weighted ratio over one- or two-year horizons. Although the risk-weighted measures prove more accurate in predicting bank failure over longer horizons, the simple ratios are less costly to implement and could function as useful supplementary indicators of capital adequacy.

Support for Resistance: Technical Analysis and Intraday Exchange Rates
Carol Osler

"Support" and "resistance" levels—points at which an exchange rate trend may be interrupted and reversed—are widely used for short-term exchange rate forecasting. Nevertheless, the levels' ability to predict intraday trend interruptions has never been rigorously evaluated. This article undertakes such an analysis, using support and resistance levels provided to customers by six firms active in the foreign exchange market. The author offers strong evidence that the levels help to predict intraday trend interruptions. However, the levels' predictive power is found to vary across the exchange rates and firms examined.

Number 3

Special Issue: Lessons from Recent Crises in Asian and Other Emerging Markets

The Economics of Currency Crises and Contagion: An Introduction
Paolo Pesenti and Cédric Tille

Two theories of the causes of currency crises prevail in the economic literature. The first traces currency instability to countries' structural imbalances and weak policies; the second identifies arbitrary shifts in market expectations as the principal source of instability. The authors of this article contend that only a synthesis of these theories can capture the complexity of the 1997-98 Asian currency crisis. In their view, the crisis resulted from the interaction of structural weaknesses and volatile international capital markets. The authors also cite two other factors that contributed to the severity of the Asia crisis: inadequate supervision of the banking and financial sectors and the rapid transmission of the crisis across countries linked by trade and common credit sources.

Foreign and Domestic Bank Participation in Emerging Markets: Lessons from Mexico and Argentina
B. Gerard Dages, Linda Goldberg, and Daniel Kinney

It is generally agreed that strong domestic financial systems play an important role in attaining overall economic development and stabilization. The role played by foreign banks in achieving this goal, however, is still controversial. This article brings new evidence to the debate over foreign participation by examining the lending patterns of domestic and foreign banks in Argentina and Mexico during the 1990s. The authors conclude that foreign banks in both countries typically have stronger and less volatile loan growth than their domestic counterparts. The corollary to this finding, however, is that bank health—not ownership per se—is the critical element in the growth, volatility, and cyclicality of bank credit. Still, diversity of ownership is found to contribute to greater credit stability in times of financial system turmoil and weakness.

Asia's Trade Performance after the Currency Crisis
Matthew Higgins and Thomas Klitgaard

The Asian countries hit by the 1997-98 currency crisis experienced a sharp reversal of capital flows that forced their current account balances to move from deficit to surplus. This study of the trade flows of Indonesia, Malaysia, South Korea, and Thailand finds that steep declines in imports, measured in dollar terms, accounted for almost all of the improvements in current account balances. However, a fuller picture emerges when the authors analyze the trade flows according to the volume of goods being shipped and the prices of these goods. The analysis shows that several factors contributed to the current account adjustment: higher export volumes in response to increased foreign demand outside of Asia, lower dollar import prices in line with declining world export prices, and the collapse in import volumes due to sharp declines in domestic economic activity.

Asia Crisis Postmortem: Where Did the Money Go and Did the United States Benefit?
Eric van Wincoop and Kei-Mu Yi

The Asia crisis was originally expected to affect the U.S. economy adversely, mainly through reduced exports to, and increased imports from, the crisis countries. However, U.S. GDP growth in 1998, at 4.3 percent, was surprisingly strong. This article examines the effect of the crisis on the U.S. economy, using a quantitative approach that focuses on capital outflows from Asia. It finds that banks were the primary mechanism by which the funds left Asia, and that these funds did not flow directly to the United States. Rather, they went first to offshore banking centers and then to European banks. In addition, the article uses an equilibrium framework to calculate the Asian capital outflows' impact on U.S. GDP. It finds that the overall impact was positive but small.

The Impact of the Asia Crisis on U.S. Industry: An Almost-Free Lunch?
James Harrigan

Despite predictions to the contrary, the Asia crisis had only modest overall effects on the United States. The expected surge in import volumes did not materialize and the drop in demand for U.S. exports was not enough to slow the nation's robust economy. Nevertheless, these overall effects could have masked other, larger effects in particularly vulnerable U.S. industries. To examine this possibility, the author conducts a sector-level analysis of the turmoil's impact. He concludes that, with the exception of the steel industry, imports from Asia do not compete directly with U.S. products. Accordingly, an appreciation in the dollar with respect to Asian currencies leads to consumption gains with little or no domestic pain.

Number 4

In June 2000, the Federal Reserve Bank of New York sponsored the conference "Specialization, Diversification, and the Structure of the Financial System: The Impact of Technological Change and Regulatory Reform." This special issue is dedicated to the conference proceedings.

Papers include:

Opening Remarks
Jamie B. Stewart, Jr.

The Determinants of Success in the New Financial Services Environment: Now That Firms Can Do Everything, What Should They Do and Why Should Regulators Care?
Anthony M. Santomero and David L. Eckles

The Economics and Politics of Financial Modernization
Randall S. Kroszner

The Changing Landscape of the Financial Services Industry: What Lies Ahead?
Cara S. Lown, Carol L. Osler, Philip E. Strahan, and Amir Sufi

All the Answers Are Different
Denis O'Leary

The Changing Role of Banking Supervision
Tom de Swaan

Forthcoming

These articles are available at www.ny.frb.org/rmaghome/econ_pol/2001.

Actual Federal Reserve Policy Behavior and Interest Rate Rules
Ray C. Fair

A popular way to approximate Federal Reserve policy is through the use of estimated interest rate equations, or policy "rules." In these rules, the dependent variable is the interest rate that the Federal Reserve is assumed to control and the explanatory variables are those factors assumed to affect Federal Reserve behavior. This article presents estimates of such a rule, using data from 1954:1-1999:3 but omitting the 1979:4-1982:3 period, when monetary targets were emphasized. Although the estimated coefficient on inflation is found to be larger in the post-1982 period, the difference is not statistically significant, and statistical tests fail to reject the hypothesis that the interest rate rule is stable across these two periods.

What Drives Productivity Growth?
Kevin J. Stiroh

Economists have long debated the best way to explain the sources of productivity growth. Neoclassical theory and "new growth" theory both regard investment—broadly defined to include purchases of tangible assets, human capital expenditures, and research and development efforts—as a critical source of productivity growth, but they differ in fundamental ways. Most notably, the neoclassical framework focuses on diminishing and internal returns to aggregate capital, while new growth models emphasize constant returns to capital that may yield external benefits. This article finds that despite their differences, both theories help explain productivity growth. The methodological tools of the neoclassical economists allow one to measure the rate of technical change, and the models of the new growth theorists provide an internal explanation for technical progress.

CURRENT ISSUES IN ECONOMICS AND FINANCE

Volume 6

Current Issues in Economics and Finance is a newsletter-style publication offering concise and timely analyses of economic and financial topics.

Second District Highlights—a regional supplement to *Current Issues*—covers important financial and economic developments in the Federal Reserve System's Second District.

Both series are available at www.ny.frb.org/rmaghome/curr_iss/index.html.

No. 1
Are High-Quality Firms Also High-Quality Investments?
Peter Antunovich, David Laster, and Scott Mitnick

The relationship between corporate reputation and investment results is the subject of ongoing debate. Some argue that high-quality firms ultimately provide superior stock price performance; others counter that stock prices already reflect these firms' prospects for growth and profitability. This study advances the debate by providing fresh evidence that investing in high-quality firms yields above-average returns and that these superior returns continue for up to five years.

No. 2
Health Insurance Trends Point to an Increase in Uninsured Children in New York and New Jersey
Carol Rapaport and Reagan Murray

Between 1988 and 1997, the percentage of children in New York and New Jersey receiving public health insurance increased modestly, while the percentage of children with private insurance showed a sharp decline. The net effect of these changes has been a marked rise in the share of Second District children without any health insurance.
Second District Highlights series

No. 3
The Emerging Role of Banks in E-Commerce
John Wenninger

How is the banking industry responding to the rapid development of on-line commerce? Evidence suggests that many banks are beginning to deliver credit and deposit products electronically. In addition, some large banks are developing products designed exclusively for e-commerce. As banks venture into the electronic arena, however, they are finding that new opportunities bring new operational and strategic risks.

No. 4
The Unreliability of Inflation Indicators
Stephen G. Cecchetti, Rita S. Chu, and Charles Steindel

Analysts seeking evidence of rising inflation often focus on the movements of a single indicator—an increase in the price of gold, for example, or a decline in the unemployment rate. But simple statistical tests reveal that such indicators, used in isolation, have very limited predictive power.

No. 5
New York–New Jersey Job Expansion to Continue in 2000
James Orr and Rae D. Rosen

Employment growth in the New York–New Jersey region in 2000 is expected to reach 1.8 percent, or 290,000 new jobs—continuing a seven-year expansion trend. However, some moderation in the growth in the national economy over the second half of 2000 may slow the region's job growth and prevent it from matching last year's rate.
Second District Highlights series

No. 6

Explaining the Gap between New Home Sales and Inventories

James A. Kahn

For much of the last four decades, the stock of unsold new homes has tracked sales very closely. Since 1995, however, inventories have fallen far behind rapidly advancing sales. What accounts for the change? Market trends have both reduced the need for inventories and slowed the response of inventories to shifts in demand. At the same time, the long current expansion has strained the resources of the building industry, creating supply shortages and raising costs.

No. 7

Rapidly Rising Corporate Debt: Are Firms Now Vulnerable to an Economic Slowdown?

Carol Osler and Gijoon Hong

The buildup of debt in the late 1990s has raised concerns about the U.S. nonfinancial corporate sector's health and its vulnerability to economic downturns. An analysis of the sector suggests that while small firms are experiencing some weakness, corporations as a group are in good financial shape.

No. 8

Understanding the Recent Behavior of U.S. Inflation

Robert W. Rich and Donald Rissmiller

One of the most surprising features of the long current expansion has been the decline in price inflation through the late 1990s. Some observers interpret the decline as evidence of a permanent change in the relationship between inflation and economic growth. But an analysis based on a standard forecasting model suggests that conventional economic factors—most notably, a decrease in import prices—can account for the low inflation rates in recent years.

No. 9

Explaining the Rising Concentration of Banking Assets in the 1990s

Kevin J. Stiroh and Jennifer P. Poole

In recent years, the nation's largest bank holding companies have sharply increased their market share of assets. Have these institutions achieved their dominance by expanding their existing subsidiaries or by merging with other bank holding companies? A study of industry data for 1990-99 suggests that the increased market share of the largest companies is attributable almost entirely to external growth through mergers and acquisitions.

No. 10

A Nation of Spendthrifts? An Analysis of Trends in Personal and Gross Saving

Richard Peach and Charles Steindel

The steep drop in the U.S. personal saving rate over the last decade has fueled speculation that Americans are spending recklessly. But alternative measures of personal saving show that households are actually setting aside a larger share of their resources than the official figures suggest. In addition, government saving has risen markedly, leading to an increase in overall domestic saving that has helped finance a surge in U.S. investment.

No. 11

Changing Technology and the Payment System

Jamie B. Stewart, Jr.

On September 11, 2000, Jamie B. Stewart, Jr., First Vice President and Chief Operating Officer of the Federal Reserve Bank of New York, delivered these remarks at Sibos 2000, the international banking operations seminar sponsored by the payment network SWIFT (Society for Worldwide Interbank Financial Telecommunications).

No. 12

The Emergence of Electronic Communications Networks in the U.S. Equity Markets

James McAndrews and Chris Stefanadis

Recent regulatory and technological changes have spurred the development of automated trading systems known as ECNs, or electronic communications networks. Proponents of the networks contend that ECNs can cut transaction costs, accelerate trade execution, and expand the price information available to investors. While some critics have questioned the effects of the ECNs on market integration, it is clear that the networks are poised to play an increasingly important role in the new electronic environment.

No. 13

Financial Crises in the Emerging Markets: The Roles of the Public and Private Sectors

Terrence J. Checki and Ernest Stern

In the wake of the emerging market turmoil of recent years, a broad consensus has developed on ways of strengthening the institutional framework to create more robust, and thus more crisis-resistant, economies. But there is no comparable consensus on how best to handle crises once they do erupt, or the respective roles of public institutions and the private sector in containing and resolving such crises. This article examines some of the key issues and outlines a flexible, managed-market approach to crisis resolution that allows for different forms of participation by the public and private sectors.

No. 14

Lowering Electricity Prices through Deregulation

Thomas Klitgaard and Rekha Reddy

A wave of regulatory reform is now transforming the U.S. electricity industry. As state and federal authorities allow independent power producers to compete with utilities in supplying electricity, consumers are paying close attention to the effects of this change on their energy bills. Although deregulation poses significant structural challenges, the introduction of competitive pressures should ultimately lead to efficiency gains for the industry and cost savings for households and businesses.

No. 15

The Federal Reserve's Contingency Financing Plan for the Century Date Change

Evangeline Sophia Drossos and Spence Hilton

With the approach of the new millennium last year, many market participants resolved to limit their exposure to Y2K-related risks by cutting back normal trading activities. The Federal Reserve foresaw that the widespread adoption of such a strategy could lead to serious liquidity problems in key financing markets. Consequently, the Fed undertook to create a Standby Financing Facility that would provide securities dealers with a form of backup funding and ease market anxieties about year-end credit conditions.

RESEARCH UPDATE

Research Update is a quarterly newsletter designed to keep you informed about the Research Group's current work. The newsletter—which complements this catalogue—offers summaries of selected studies and listings of recent articles and papers in our research series.

Research Update also reports on other news within the Group, including:

- staff publication in outside journals,
- upcoming conferences at the Federal Reserve Bank of New York,
- calls for papers, and
- new publications and services.

You can subscribe to *Research Update* or obtain copies at www.ny.frb.org/rmaghome/update/index.html.

STAFF REPORTS

The *Staff Reports* series features technical research papers designed to stimulate discussion and elicit comments. These papers are intended for eventual publication in leading economic and finance journals.

The series is available only at www.ny.frb.org/rmaghome/staff_rp/index.html.

Macroeconomics and Growth

No. 101
Microeconomic Inventory Adjustment: Evidence from U.S. Firm-Level Data
Jonathan McCarthy and Egon Zakrajšek

The authors examine inventory adjustment in the U.S. manufacturing sector using quarterly firm-level data over the 1978-97 period. Their evidence indicates that the inventory investment process is nonlinear and asymmetric, results consistent with a nonconvex adjustment cost structure.

No. 102
Finite Horizons, Political Economy, and Growth
James A. Kahn and Jong-Soo Lim

This study analyzes the political economy of growth when economic agents and the government have finite horizons and equilibrium growth is inefficient. A representative government with only the ability to tax and transfer can improve somewhat on the market allocation. However, it cannot achieve optimum growth because it lacks the ability to bind future governments. The authors argue that this ability is linked to political stability, and show that stability and growth policies are meaningfully related.

No. 106
Uncertainty and Labor Contract Durations
Robert Rich and Joe Tracy

The authors investigate the relationship between ex ante U.S. labor contract durations and uncertainty over the 1970-95 period. They construct measures of inflation uncertainty as well as aggregate nominal and real uncertainty. Their results not only corroborate findings of an inverse relationship between contract durations and inflation uncertainty, but also show that this relationship extends to both measures of aggregate uncertainty.

No. 111
Pass-Through of Exchange Rates and Import Prices to Domestic Inflation in Some Industrialized Economies
Jonathan McCarthy

This study examines the impact of exchange rates and import prices on the domestic producer price index and consumer price index in selected industrialized economies. When the empirical model is estimated over the post–Bretton Woods era, exchange rates are found to have a modest effect on domestic price inflation while import prices have a stronger effect. Pass-through is greater in countries with a larger import share and more persistent exchange rates and import prices.

No. 113
How Stable Is the Predictive Power of the Yield Curve? Evidence from Germany and the United States
Arturo Estrella, Anthony P. Rodrigues, and Sebastian Schich

Earlier studies have shown that the slope of the yield curve can have significant predictive power for real activity and inflation. The theoretical motivations of the models used in past studies, however, suggest that those relationships may not be stable over time. Using recent econometric techniques for break testing, the authors examine whether these relationships are in fact stable. They find that models that predict real activity are more stable than those that predict inflation, and binary models are more stable than continuous ones. The model that predicts recessions is stable over the full sample period in both Germany and the United States.

International

No. 96
Can Vertical Specialization Explain the Growth of World Trade?
Kei-Mu Yi

This paper demonstrates that the enormous growth in the trade share of output can be reconciled with the relatively small declines in tariffs worldwide once vertical specialization is included in international trade models. Vertical specialization magnifies the trade growth effects of trade barrier reduction. The author simulates a dynamic model of trade with vertical specialization and finds that it can explain about 70 percent of the growth of trade.

No. 100
Towards New Open Economy Macroeconometrics
Fabio Ghironi

This study develops a model that lends itself more directly to empirical investigation than other recent open economy models. The author proposes a plausible strategy for parameter estimation using data from Canada and the United States. He then proceeds to illustrate a practical application of the model, showing how a shock to the U.S. economy is transmitted to Canada under an inflation-targeting monetary regime.

No. 103
Excess Volatility of Exchange Rates with Unobservable Fundamentals
Leonardo Bartolini and Lorenzo Giorgianni

The authors conduct tests of excess exchange rate volatility that impose minimal structure on the data and do not commit to a choice of exchange rate "fundamentals." By examining data for three major exchange rates going back to 1984, the authors find broad evidence of excess volatility with respect to the predictions of the canonical asset-pricing model of the exchange rate with rational expectations.

No. 107
Factor Supplies and Specialization in the World Economy
James Harrigan and Egon Zakrajšek

A core prediction of the Heckscher-Ohlin theory is that countries specialize in goods in which they have a comparative advantage, and that the source of the advantage is differences in relative factor supplies. To examine this theory, the authors document the pattern of industrial specialization and factor endowment differences in a broad sample of countries over the 1970-92 period. Their results show the importance of factor endowments on specialization: relative endowments do matter.

No. 112
"Beggar-Thy-Neighbor" or "Beggar-Thyself"? The Income Effect of Exchange Rate Fluctuations
Cédric Tille

This paper analyzes the impact of exchange rate fluctuations when they are only partially passed through to consumer prices. It shows that an exchange rate depreciation does not necessarily have a beggar-thy-neighbor effect and may in fact have an opposite, or beggar-thyself, effect. The direction of the welfare effect depends on who owns the firms importing goods from producers and selling them to consumers—an issue that has not been explored in the previous literature.

No. 114
Is the Integration of World Asset Markets Necessarily Beneficial in the Presence of Monetary Shocks?
Cédric Tille

The author evaluates the consequences of the integration of international asset markets when goods markets are characterized by price rigidities. Using an open economy general equilibrium model with volatility in the money markets, he shows that such integration is not universally beneficial. The country with the more volatile shocks will benefit, whereas the country with moderate volatility will suffer. The welfare effects reflect changes in the terms of trade that occur because forward-looking price setters adjust to the changes in exchange rate volatility brought about by the integration of global asset markets.

Microeconomics

No. 97
What Do We Really Know about Trends in Outpatient Medical Expenditures for Children, 1977 to 1987?
Carol Rapaport and Christopher A. Trenholm

The authors examine patterns in medical expenditures for children in the 1977-87 period. They find that expenditures declined for Hispanic children and children in poor families relative to other children but remained stable for black children and children on Medicaid. These results suggest that the recent Medicaid expansions may not help all children attain good health.

No. 104
Public Infrastructure Investments, Productivity, and Welfare in Fixed Geographic Areas
Andrew F. Haughwout

Measures of the value of public investments are critical inputs into the policy process, and aggregate production and cost functions have become the dominant methods of evaluating these benefits. This paper examines the limitations of these approaches in light of applied production and spatial equilibrium theories. Its findings suggest that although public capital provides significant productivity and consumption benefits, an ambitious program of locally funded infrastructure provision would generate negative net benefits for the cities studied.

Banking and Finance

No. 98
Compositional Dynamics and the Performance of the U.S. Banking Industry
Kevin J. Stiroh

The author presents a decomposition framework for commercial banks and shows that both firm-level changes and dynamic reallocation effects have made substantial contributions to the changes in the profitability and capitalization of the U.S. banking industry from 1976 to 1998. His results provide a new perspective for understanding the impact of changes in competition on the performance of the U.S. banking industry.

No. 99
Monetary Policy Surprises and Interest Rates: Evidence from the Fed Funds Futures Markets
Kenneth N. Kuttner

The author estimates the impact of monetary policy actions on bill, note, and bond yields, using data from the futures market for federal funds to separate changes in the target funds rate into anticipated and unanticipated components. The response of bond rates to anticipated changes is found to be essentially zero, while the response to unanticipated movements is large and highly significant.

No. 105
Rating Banks: Risk and Uncertainty in an Opaque Industry
Donald P. Morgan

This study argues that bond raters' frequent and sharp disagreement over banks and insurance companies indicates that these firms are inherently more opaque than others. It finds that ratings agencies' uncertainty over banks stems from bank assets, loans and, in particular, trading assets—the risks of which are hard to observe and easy to change. Banks' high leverage, which invites agency problems, is also found to compound the uncertainty over bank assets.

No. 108
Bank Commitment Relationships, Cash Flow Constraints, and Liquidity Management
Donald P. Morgan

This study suggests that a close banking relationship—a loan commitment in particular—relaxes firms' cash flow and cash management constraints. The investment–cash flow correlation is found to be substantially lower when firms have a bank loan commitment. The difference in cash flow sensitivity reflects differences in firms' cash management practices in the face of cash flow shocks. Firms with a commitment run down their cash when their cash flow falls but investment prospects remain strong.

No. 109

Banks' Reserve Management, Transaction Costs, and the Timing of Federal Reserve Intervention

Leonardo Bartolini, Giuseppe Bertola, and Alessandro Prati

The authors use bank reserve and interest rate data to document a pattern in the federal funds market: banks tend to hold more reserves during the last few days of each reserve maintenance period, when the opportunity cost of holding reserves typically is highest. The authors then present a model in which transaction costs and the central bank's policy of smoothing interest rates cause a large amount of liquid funds to be associated with high interest rates around reserve settlement days.

No. 110

Day-to-Day Monetary Policy and the Volatility of the Federal Funds Interest Rate

Leonardo Bartolini, Giuseppe Bertola, and Alessandro Prati

The authors propose a model of the interbank money market with an explicit role for central bank intervention and periodic reserve requirements, and study the interaction of profit-maximizing banks with a central bank targeting interest rates at high frequency. The model predicts biweekly patterns of the federal funds rate's volatility and its response to changes in target rates and intervention procedures. The results are consistent with interest rate volatility patterns in the federal funds market.

OUTSIDE JOURNALS

Members of the Research and Market Analysis Group publish in a wide range of economic and finance journals, conference volumes, and scholarly books.

Published in 2000

Paul Bennett

"A Teoria das Carteiras e os Empréstimos Bancários" (Portfolio theory and bank lending). *Tecnologia de Crédito* 3, no. 19 (July): 63-72.

Paul Bennett, Richard Peach, and Stavros Peristiani

"Implied Mortgage Refinancing Thresholds." *Real Estate Economics* 28, no. 3: 405-34.

Sandra Black

"The Rise of Female Professionals: Are Women Responding to Skill Demand?" with Chinhui Juhn. *American Economic Review* 90, no. 2 (May): 450-5. Papers and Proceedings of the 112th Annual Meeting of the American Economic Association.

Michael Fleming

"Financial Market Implications of the Federal Debt Paydown." *Brookings Papers on Economic Activity*, no. 2: 221-51.

"U.S. Treasury and Agency Securities," with Frank J. Fabozzi. In Frank J. Fabozzi, ed., *The Handbook of Fixed Income Securities*, 175-96. 6th ed. New York: McGraw-Hill.

Linda Goldberg and Joseph Tracy

"Exchange Rates and Local Labor Markets." In Robert C. Feenstra, ed., *The Impact of International Trade on Wages*, 269-308. NBER conference volume. Chicago: University of Chicago Press.

James Harrigan

"International Trade and American Wages in General Equilibrium, 1967-1995." In Robert C. Feenstra, ed., *The Impact of International Trade on Wages*, 171-96. NBER conference volume. Chicago: University of Chicago Press.

Andrew Haughwout

"The Paradox of Infrastructure Investment: Can a Productive Good Reduce Productivity?" *Brookings Review* 18, no. 3 (summer): 40-3.

James Kahn

"The Design of Bank Loan Contracts," with Gary Gorton. *Review of Financial Studies* 13, no. 2 (summer): 331-64.

"What Inventory Behavior Tells Us about Business Cycles," with Mark Bils. *American Economic Review* 90, no. 3 (June): 458-81.

Comment on "An Empirical Model of Inventory Investment by Durable Commodity Intermediaries," by George Hall and John Rust. *Carnegie-Rochester Conference Series on Public Policy* 52 (June): 215-20.

Kenneth Kuttner

Comment on "Inflation Targeting and Output Stabilisation," by Guy Debelle, and "Monetary Policy Rules in an Inflation-Targeting Framework: Lessons from Canada," by Tiff Macklem and Gabriel Srour. In Charles Joseph and Anton H. Gunawan, eds., *Monetary Policy and Inflation Targeting in Emerging Economies*, 108-18. Proceedings of a conference sponsored by Bank Indonesia and the International Monetary Fund. Jakarta, Indonesia. July.

Martin Lettau

"Can Habit Formation Be Reconciled with Business Cycle Facts?" with Harald Uhlig. *Review of Economic Dynamics* 3, no. 1 (January): 79-99.

"Cross-Variable Restrictions in Euler Equations and Risk Premia." *Applied Economics* 3, no. 2 (February): 99-102.

Cara Lown and Stavros Peristiani

"Capital Regulation and Depository Institutions," with Kenneth Robinson. In James R. Barth, R. Dan Brumbaugh, Jr., and Glenn Yago, eds., *Restructuring Regulation and Financial Institutions*, 41-72. Santa Monica, Calif.: Milken Institute Press.

James McAndrews

"Opening the 'Black Box' of Network Externalities in Network Adoption," with Robert Kauffman and Yu-Ming Wang. *Information Systems Research* 11, no. 1 (March): 61-82.

Margaret McConnell

"Output Fluctuations in the United States: What Has Changed since the Early 1980s?" with Gabriel Perez Quiros. *American Economic Review* 90, no. 5 (December): 1464-76.

Donald Morgan

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Donald Morgan and Kevin Stiroh

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