

The Year in Review

The Federal Reserve Bank of Dallas embarked upon the 21st century with renewed optimism and enthusiasm for the future of America. Although 2001 brought unprecedented challenges, the nation's citizens, institutions and economy showed remarkable strength and determination in the face of adversity. The Eleventh Federal Reserve District's economy is resilient and rebounding, and its financial institutions are strong. The Dallas Fed looks forward to a second century of providing efficient services and ensuring sound banking principles in a thriving New Economy, while remaining prepared for any challenge.

Economic Overview

Ten years of economic expansion came to an end in 2001. Economic activity in the Eleventh District slowed throughout 2000 and turned negative in spring 2001, dragged down by the national and Mexican recessions and by the shock of September 11. However, the region's diverse economy shows signs of rebounding in 2002.



Had it not been for the attacks on 9/11, the U.S. and Eleventh District economies would likely have avoided recession. However, the resiliency we have seen since the attacks demonstrates that America's economic system cannot be derailed by terrorists.

Harvey Rosenblum
Senior Vice President and
Director of Research,
who was at the World Trade
Center on the morning of
September 11

Recent sources of economic strength—high tech, trade with Mexico, energy and construction—became sources of weakness in 2001. The high-tech sector began to slow after Y2K and started shedding jobs in early 2001. The Mexican economy contracted, weakening export opportunities for Texas. The energy industry suffered as prices fell.

The region was hard hit by the economic impact of September 11. As the hub for several major airlines, Texas was particularly exposed to the downturn in the transportation sector. Tourism contracted. Oil prices shifted down in response to sharply lower world demand. Increased security provisions made trade with Mexico more costly by increasing border delays.

As the various props were knocked out from under the regional economy, measures of aggregate economic activity soured. By year's end, the seasonally adjusted Texas unemployment rate had climbed to 5.7 percent, up from 3.7 percent in December 2000. All the jobs gained in the subpar growth of the first quarter were lost by midyear. December over December, job losses in the Eleventh District were comparable with those in the nation as a whole.

However, despite the downturn, the region's long-term advantages remain in place. Diverse industries, central access to trade corridors, natural resources, affordable housing, proximity to Mexico, limited government and a favorable regulatory environment will continue to attract residents and firms alike. As the nation recovers from recession, the region should grow in 2002.

Financial Services

The Bank's responsiveness allowed the Dallas Fed to provide uninterrupted services to customers following September 11. The Bank rose to the challenge, ensuring delivery of checks, access to cash and continued support of Fedwire operations.

To overcome the interruption of air service across the United States, the Dallas Fed immediately secured ground transportation to deliver checks. In a few cases, when ground transportation was unavailable, Bank employees used their own vehicles to ensure delivery.

The Bank experienced a higher than usual number of calls as customers became increasingly concerned about currency orders and the availability of armored carriers. Personnel were on 24-hour call and prepared to fill any emergency order. In the end, however, the September 11 attacks did not prompt an unusual increase in demand for cash.

As a result of disrupted communications, the main clearing bank for securities transfers experienced difficulty sending and receiving wires. Since the Fedwire system is critical to the liquidity of banks and other institutions, its hours were extended to meet the industry's needs.

Dedication to customer service did not begin September 11. It was in place throughout 2001.

The Federal Reserve System continued its effort to streamline the way it processes and delivers check services to financial institutions. The check modernization initiative is the largest automation project the System has ever undertaken. The efforts include a standard check-processing environment for all Reserve Banks, an enterprisewide system for check adjustments, redesign of the current image-processing infrastructure based on a single platform, and remote electronic access and delivery of check services over the Internet. As part of the national effort, the Dallas Fed coordinated the development and implementation of a suite of software programs that allows banks to access check services via the Internet.

In addition to checks, the Fed is making the transition to other web-based services. Using FedLine® for the Web, the Dallas Fed began offering cash and savings bond ordering to District banks. Expanded services will be available in 2002. With FedLine for the Web, products and services will be more readily available and accessible to customers nationally.

The Dallas Fed provided leadership for the Federal Reserve System in the implementation of standard software for cash services. This software will be used by Federal Reserve Banks across the nation to serve their customers.

The Bank processed record volumes of currency. Receipts of notes from financial institutions were up 5 percent from 2000, and deliveries rose 12 percent. As a result, the Bank added currency processing capacity. The Dallas Fed and its Houston Branch completed auxiliary coin vault areas to store large volumes of coin.

Additionally, the Bank began serving as the telephone-based help desk for the U.S. Treasury's Pay.gov web site, which allows businesses and individuals to make payments to federal agencies via the Internet.

The Dallas Fed continued to provide other services to the Treasury Department. The Bank is one of three Reserve Banks that administer the *TreasuryDirect* program, which allows the public to purchase securities at auction and hold them directly with the Treasury. The Bank also manages the



We did what we had to do to maintain stability in the nation's payments system.

René Gonzales
Vice President
Payments Services
Houston Branch



During a time of extraordinary national confusion, fear and financial quandary, our team held fast, stayed focused and did what we do best—serve our country through our customers.

Bill Morse
Assistant Vice President
Cash Department

Electronic Transfer Account (ETASM) program, which provides a low-cost bank account for federal payment receipts.

To ensure continued quality service, the Dallas Fed enhanced communication with customers. For example, the Bank conducted information sessions for customers on check modernization initiatives. The Dallas Fed also used focus groups to better understand how customers use Bank products and services.

In an ongoing effort to reduce customers' costs, automated clearinghouse operations in Dallas were centralized to the Federal Reserve Bank of Minneapolis. As a result of restructuring across the Federal Reserve System, the price for ACH services has been lowered. Dallas Fed food coupon operations were consolidated to the Federal Reserve Bank of St. Louis' Memphis Branch.

Banking Supervision; Discount and Credit

September 11, a slowing economy and rapidly declining interest rates created a challenging environment for Eleventh District banks. Yet through it all, they remain financially sound and well capitalized.

The Dallas Fed's role as a bank supervisor is to promote a sound financial system through fair and competent supervision of state member banks, bank holding companies and foreign agencies operating within the Eleventh District. The Bank also fosters consumer confidence in the banking sys-

tem by enforcing consumer compliance laws and reviewing the performance of state member banks in meeting their communities' credit needs.

Throughout the year, the Bank continued to refine the examination process, improving the timeliness of providing feedback to management and boards of directors. Bank examiners completed 125 on-site reviews and processed reports in an average of 26 days, a 20 percent reduction from the previous year.

Additionally, the Dallas Fed continued to inform the banking community on supervisory issues by providing speakers and panel participants to banking schools and trade associations. The Bank also conducted sessions on the roles and responsibilities of board members for District financial institutions.

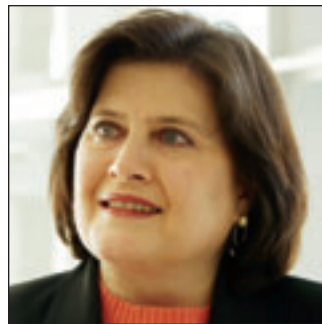
The Bank's contributions to supervision activities were not limited to the Eleventh District. Dallas Fed staff contributed greatly to System initiatives, educational efforts, work groups and task forces. The Bank also hosted major conferences for the System's regional and community bank and compliance examiners.

Dallas Fed staff worked closely with depository institutions following the September attacks to meet funding needs. During the crisis period, the Bank maintained communication with institutions to understand the effect events were having on their operations and to assist them in accessing the discount window if necessary.



Events such as 9/11 highlight the importance of being abreast of local banking conditions to support Federal Reserve System efforts in maintaining financial stability.

Earl Anderson
Vice President
Banking Supervision



Our main objective was to let financial institutions know that we were fully operational and would do what was necessary to provide needed liquidity.

Ann Worthy
Assistant Vice President
Discount and Credit

Throughout 2001, the Dallas Fed sought to educate District financial institutions on the use of the discount window, particularly the merits of the Bank's seasonal lending program. Discount window activity was down from 2000 levels, a reflection of the liquidity of District institutions during much of 2001.

The Dallas Fed played a key role in various System groups in the discount and risk areas. For example, the Bank converted the loan system used by Reserve Banks to a central system run and administered out of Dallas.

The Bank also implemented a new system to provide financial institutions a quicker and more efficient method to obtain account information, utilizing daily e-mails and faxes. Implementing this system reduced the number of mailings by about 600 per day.

The Dallas Fed worked with financial institutions and other Reserve Banks to reduce payments system risk.

Research and Public Affairs

The border economy, economic education and economic analysis of key areas, including high tech and biotechnology, were among the many noteworthy public policy issues the Dallas Fed explored in 2001 through research, public information, publications and conferences.

Substantial resources also were directed to understanding the economic impact of the September 11 events and to discussing important topics such as e-commerce, energy deregulation, 2001 tax cuts and economic conditions in Argentina.

Bank publications during 2001 provided professional insight and free-market perspective on a wide range of public policy issues and economic trends. Articles in *Economic and Financial Review* focused on the changing nature of domestic capital markets and economic issues relating to Mexico. *Southwest Economy* included articles on energy deregulation, e-commerce and banking competition in the New Economy.

The Bank's 2000 Annual Report included the ninth in a series of essays discussing linkages between free enterprise, technological change and economic growth. Titled "Have a Nice Day! The American Journey to Better Working Conditions," the essay generated many speech requests from business and community groups.

The Dallas Fed published a special monograph, *The Border Economy*, highlighting the unique and dynamic Texas-Mexico border region. The publication, available on the Bank's web

site, contains compelling articles on such topics as the impact of education on border income, the outlook for affordable housing along the Rio Grande and the link between NAFTA and maquiladora growth.

The Bank made a particular effort in 2001 to post to its external web site timely essays on important economic topics and updates on current economic conditions. The web site includes analyses of regional and national conditions updated every six weeks and charts on the U.S. economy updated weekly.

The Dallas Fed's Center for Latin American Economics presented a roundtable on U.S.–Mexican issues for the news media. Bank economists offered information on their latest areas of research, including Mexico's fiscal reform, synchronization of the U.S.–Mexican business cycles, and immigration and trade issues.

The Dallas Fed also organized a San Antonio conference on Texas border trade in which experts addressed transportation challenges created by NAFTA. The conference brought together experts to discuss the importance of transportation infrastructure, methods to improve border efficiency and optimal investment levels for Texas' trade corridors.



Immediately following September 11, we directed resources to discovering how the attacks affected the region's economy. We are now encouraged that the Texas economy is bouncing back and see signs that high tech is on the mend.

Mine Yücel
Assistant Vice President
and Senior Economist
Research Department



Our immediate response provided highly visible reassurance to both employees and customers that the Bank was secure as it remained open for business.

Domingo Castillo
Captain
Protection Department

The Community Affairs office provided information on prevailing community development topics, such as strategies for developing affordable housing, financial literacy and access to credit for small businesses. The Bank cosponsored a national research conference on how changing financial markets have affected community development, as well as a regional conference on how technological innovations have made financial services more accessible to low- and moderate-income people.

The Dallas Fed continued its traditional efforts to reach teachers and students through its popular economic education programs. The Bank sponsored a summer conference at the San Antonio Branch on financial literacy, targeting high school educators.

Additionally, the Bank hosted a conference for high school advanced placement economics teachers. This "A.P. Summit" focused on the New Economy as well as immigration, energy and high-tech issues. "Trade, Growth and the New Economy" was the subject of another conference for university and community college faculty.

The Dallas Fed worked with other Reserve Banks to develop and test an interactive Federal Reserve education web site (federalreserveeducation.org). This innovative new site equips educators with teaching activities, curriculum material, quizzes—and much more.

Partnering with other organizations, the Bank cohosted a speaker series with the National Center for Policy Analysis, featuring thought-provoking presenters. These policy forums are continuing joint projects between the Bank and the NCPA.

Security

Protection of operations, personnel, assets and facilities remains a top priority at all Federal Reserve facilities. The terrorist attacks clearly demonstrated the need to continue emphasizing security. In addition to strengthening protection strategy, the Dallas Fed's security professionals have remained in contact with local, state and federal authorities to ensure the Bank is well-informed and prepared to respond quickly to any threat. The Bank is committed to taking all necessary steps to ensure continuous and uninterrupted operations and service.