Appendix II

Glossary of Terms

advance report on durable goods shipments, new orders, and unfilled orders—Data on shipments, new orders, and unfilled orders, expressed in current dollars, including such things as primary metals, information processing equipment, and transportation equipment.

assets—For an individual assets might include real assets, like a house or a car, or financial assets, like stocks or bonds. A bank's assets would include the loans it has made, the securities it holds, and other assets.

automated clearinghouse (ACH)—The Fed's electronic clearing and settlement system for exchanging electronic transactions among participating banks. These transactions are usually substitutes for recurring payments, such as payroll or loan payments.

Bank Holiday of 1933—A bank holiday was declared by President Franklin D. Roosevelt. All banks in the United States were closed following a series of bank panics that occurred during the Great Depression.

bank examination—A periodic review where regulators visit a bank to check its compliance with regulations and review the safety and soundness of the bank.

bank regulation—Actions to make, issue, and enforce specific rules and regulations governing the structure and conduct of banking under the authority of legislation.

bank supervision—Oversight of individual banks to ensure that they are operated prudently and in accordance with applicable statutes

barter—The direct exchange of goods and services for other goods and services without money.

Board of Governors of the Federal Reserve—Central, governmental agency of the Federal Reserve System, located in Washington, D.C., and composed of seven members, who are appointed by the President and confirmed by the Senate.

Bureau of Engraving and Printing (BEP)—The BEP produces Federal Reserve Notes and other security documents for the United States Treasury. It is an agency of the Treasury Department.

business sales and inventories—Total current-dollar sales and inventories for the manufacturing, wholesale, and retail sectors of the economy.

CAMELS—A rating system used by bank examiners to determine a bank's financial condition. Each letter stands for one of the six components of a bank's condition, including capital, assets, management, earnings, liquidity, and sensitivity to risk.

capacity—Measurement of the borrower's ability to pay, including the borrower's payment source, such as a job, or profits from a business, and amount of income relative to amount of debt.

capital—For banks and savings and loans, the funds that are invested in the bank by stockholders (as opposed to funds deposited by depositors).

central bank—Principal monetary authority of a nation, which performs several key functions, including issuing currency and regulating the supply of credit in the economy. The Federal Reserve is the central bank of the United States.

character—Character measures the borrower's willingness to pay. This is gauged by reviewing the borrower's payment history, credit report, and information from other lenders.

check clearing—The movement of a check from the institution at which it was deposited back to the institution on which it was written, and the corresponding credit and debit to the accounts involved.

collateral—Collateral helps determine a bank's options if the loan is not repaid. What asset is pledged as collateral? What is its market value? Can it be sold easily? A valuable asset could include a house or a car.

commercial paper—Short-term, unsecured promissory note issued by a commercial firm, a financial company, or a foreign government.

condition—Condition refers to the borrower's circumstances. For example, if a storeowner asked for a loan, the banker would be interested in expected sales over the period of the loan.

Consumer Price Index (CPI)—An indicator used to calculate the price level for consumer goods purchased by a typical urban family. The CPI is used to calculate the percentage changes in the average level of prices for a basket of goods and services.

Continental Currency—The currency authorized by the Continental Congress to help finance the American Revolution against England.

Core Consumer Price Index (core CPI)—A version of the CPI that excludes the volatile food and energy components of the CPI.

corporate bond—A long-term obligation of a corporation.

credit—The promise to pay in the future in order to buy or borrow in the present. The right to defer payment of debt.

currency devaluation—A deliberate downward adjustment in the official exchange rate established, or pegged, by a government against a specified standard, such as another currency or gold.

debit card—A card that resembles a credit card but which debits a transaction account (checking account) with the transfers occurring at the same time as the customer's purchases. A debit card may be machine readable, allowing for the activation of an automated teller machine or other automated payments equipment.

default—Failure of a borrower to meet the terms of a loan or credit agreement.

demand deposit—A deposit that may be withdrawn at any time without prior written notice to the depository institution.

depository institution—Financial institution that obtains its funds mainly through deposits from the public; this includes commercial banks, savings and loan associations, savings banks, and credit unions.

devaluation—See *currency devaluation*.

discount rate—Interest rate at which an eligible depository institution may borrow funds, typically for a short period, directly from a Federal Reserve Bank. The law requires that the board of directors of each Reserve Bank establish the discount rate every fourteen days subject to the approval of the Board of Governors of the Federal Reserve.

disinflation—A fall in the price level; the opposite of inflation.

earnings—Net income.

economic forecast—A prediction of future economic trends of key economic indicators.

economic growth—A measure of the annual change in the amount of goods and services produced (output), usually defined as the annual percentage change in real Gross Domestic Product (GDP).

electronic payments—Payments completed by the transfer of funds electronically rather than by check or cash.

excess reserves—Amount of reserves held by an institution in excess of its reserve requirement and required clearing balance.

federal deficit—A condition that occurs when the federal government spends more than it receives in revenues.

federal funds rate— Rate charged by a bank on an overnight sale of federal funds to another bank.

Federal Open Market Committee (FOMC)—Twelve-member committee made up of the seven members of the Board of Governors; the president of the Federal Reserve Bank of New York; and, on a rotating basis, the presidents of four other Reserve Banks. The FOMC meets eight times a year to set Federal Reserve guidelines regarding the purchase and sale of government securities in the open market as a means of influencing the volume of bank credit and money in the economy.

Federal Reserve Act of 1913—Federal legislation that established the Federal Reserve System.

Federal Reserve Bank—One of the 12 operating arms of the Federal Reserve System, located throughout the nation, that together with their 25 Branches carry out various System functions, including operating a nationwide payments system, distributing the nation's currency and coin, supervising and regulating banks, analyzing economic conditions, and serving as banker for the U.S. Treasury.

Federal Reserve Banks' Boards of Directors—Groups of nine directors—chosen from outside each Reserve Bank—who provide the Federal Reserve System with a wealth of information on economic conditions in key industries and regions.

Federal Reserve Note—Currency issued by the Federal Reserve, but printed by the Bureau of Engraving and Printing. Federal Reserve Notes account for nearly all the nation's circulating currency.

Federal Reserve System—The central bank of the United States, created by Congress and made up of a seven-member Board of Governors in Washington, D.C.,12 regional Federal Reserve Banks,and their 25 Branches.

Fedwire—Electronic funds transfer network operated by the Federal Reserve. Fedwire is usually used to transfer large amounts of funds and U.S. government securities from one bank's account at the Federal Reserve to another bank's account.

fee income—Income earned from selling services for a fee.

fiat money—Money that has little or no intrinsic value as a commodity; it is costless to produce, usually taking the form of tokens or pieces of paper, and is not redeemable for any commodity.

financial shock—Events in financial markets that impact the economy. Shocks are unexpected and unpredictable (e.g.,1987 Stock Market Crash, 1997 Asian Financial Crisis).

First Bank of the United States—Created by Congress in 1791 and headquartered in Philadelphia,it had branches in other major cities and it performed the basic banking function of accepting deposits and issuing bank notes,of making loans,and of purchasing securities. It was the largest corporation in the country and was dominated by big banking and money interests.By 1811 when the bank's 20-year charter expired, Congress refused, by one vote, to renew it.

fiscal agent—The Federal Reserve Banks act as the fiscal agent for the U.S.Treasury, providing services that include maintaining deposit accounts for the Treasury Department, paying U.S. government checks drawn on the Treasury, and issuing and redeeming savings bonds and other government securities.

fiscal policy—The federal government's decisions about the amount of money it spends and collects in taxes to achieve a full employment and non-inflationary economy.

five-Cs—A tool used by bank examiners to evaluate and grade a loan. See also *character, capacity, condition, collateral, and capital*.

foreign exchange rate—Price of the currency of one nation in terms of the currency of another nation.

Free Banking Era—A period from 1836 to 1863 when the American banking system consisted primarily of state-chartered banks with no federal regulation. State bank and privately issued paper money varied tremendously in shape and design.

full employment—The lowest level of unemployment of the civilian labor force.

Full Employment and Balanced Growth Act of 1978 (Humphrey-Hawkins Act)—Federal legislation that, among other things,specifies the primary objectives of U.S. economic policy—maximum employment,stable prices, and moderate long-term interest rates.

GDP deflator—A measure of the rate of inflation based on GDP statistics. This index measures the average price level based on GDP.

Glass-Steagall Act of 1933—The law that called for the separation of commercial and investment banking.

gold standard—A monetary system in which currencies are defined in terms of a given weight of gold.

government securities—Securities, such as bills,notes, and bonds issued by the U.S.Treasury or federal agencies.

Gramm-Leach-Bliley Act of 1999—The Financial Services Modernization Act permits affiliation of commercial banking with other financial services firms, including securities firms and insurance companies through a new financial holding company (FHC) structure.

gross domestic product (GDP)—Total value of goods and services (output) produced in the United States during a specific period. See also *nominal GDP, real GDP, and GDP deflator.*

housing starts—An estimate of the number of housing units on which construction was started.

industrial production/capacity utilization—An index designed to measure changes in the level of output in the industrial sector of the economy.

inflation—A rise in the general level of prices over a sustained period of time. (This should not be confused with increases in the prices of specific goods relative to the prices of other goods.)

inflation expectations—The rate of increase in the general price level anticipated by the public in the period ahead.

interest—The money a borrower pays (a lender charges) for the use of money over a period of time.

interest rates—Rates of interest paid on deposits and other investments,determined by the interaction of the supply of and demand for funds in the money market.

interest sensitivity—The sensitivity of interest income earned on a portfolio of securities or loans to changes in interest rates.

International Monetary Fund (IMF)—International organization established for lending funds to member nations, usually to finance temporary balance-of-payments deficits.

inventories—Goods that are being held for future sale.

investment—Financial investments refer to purchases of stocks or bonds. Economic investment refers to purchases of real capital goods used to produce other goods or services.

leading economic indicators—A composite index of ten economic indicators that tends to lead upturns and downturns in the overall economy.

lightweight vehicle sales—Total unit sales and leases of domestic and imported new automobiles and lightweight trucks (includes vans and SUVs).

liquidity—The ability of a bank or business to meet its current obligations or the quality that makes an asset quickly and readily convertible into cash.

long-term interest rates or bond rates—Interest rates on loan contracts—or debt instruments such as Treasury bonds, agency securities, municipal bonds—having maturities greater than one year. Often called capital market rates.

low-income areas—Median family income is less than 50 percent of an area's median income.

M2—One measure of the nation's supply of money, defined as M1 (currency in circulation,demand deposits, travelers'checks, and other checkable deposits) plus noninstitutional money market funds, small-denomination time deposits (under $100,000),and savings deposits.

management—Those who direct or manage a firm.

medium of exchange—Something that is willingly accepted as payment for goods or services. See also *store of value* and *unit of measure*.

member bank—Depository institution that is a member of the Federal Reserve System.All federally chartered banks are automatically members of the System; state-chartered banks may elect to join the System.

moderate-income areas—Median family income is at least 50 percent and less than 80 percent of the area median income.

monetary aggregates—Three standard measures of the money stock are M1 (currency in circulation, demand deposits,travelers' checks, and other checkable deposits), M2 (M1 plus noninstitutional money market funds,small-denomination time deposits (under $100,000), and savings deposits) and M3 (M2 plus large-denomination time deposits ($100,000 or more), balances in institutional money market mutual funds,and repurchase agreements and Eurodollars held by U.S. residents at foreign branches of U.S. banks).

Monetary Control Act of 1980 (MCA)—Requires depository institutions to hold required reserves on deposits.In addition, beginning in September 1981, the Fed charged banks for a range of services that it had previously provided free, including check clearing,wire transfer of funds, and the use of automated clearinghouse facilities.

monetary policy—A central bank's actions to influence the availability and cost of money and credit, as a means of helping to promote national economic goals. Tools of monetary policy include open market operations, discount policy, and reserve requirements.

money—Anything that serves as a generally accepted medium of exchange, unit of measure, and store of value.

mortgage interest rates—The interest rate charged on mortgages.

National Bank Act of 1863—Created a system of national banks that issued currency backed by U.S. government securities,allowing banks to issue the first uniform currency for the nation.

new orders—An economic indicator that measures new orders for durable goods.

nonfarm payroll employment—An estimate of the number of payroll jobs at all nonfarm business establishments and government agencies.

nominal GDP—GDP measured in current prices.See *gross domestic product*.

open market operations—Purchases and sales of government and certain other securities in the open market through the Domestic Trading Desk at the Federal Reserve Bank of New York, with the purpose of influencing the volume of money and credit in the economy.

payments system—Collective term for mechanisms (both paper-backed and electronic) for moving funds,payments,and money among banks throughout the nation.The Federal Reserve plays a major role in the nation's payments system through distribution of currency and coin, processing of checks, and the electronic transfer of funds.

personal consumption expenditures—Spending by consumers on goods and services during a time period.

producers' price index—An inflation index that measures prices for several thousand inputs producers use in producing goods and services.

productivity—The amount of physical output for each unit of productive input.

purchasing power—The amount of income you have available to purchase goods and services during a time period.

real GDP—GDP (gross domestic product) that has been adjusted to exclude inflation. Real GDP provides the value of GDP in constant dollars,which is used as an indicator of the volume of the nation's output during a time period.

retail sales—An estimate of the total sales of goods by all retail establishments in the U.S.

reserve requirements—Percentage of deposits that depository institutions must keep on reserve in their cash vaults or on deposit at a Federal Reserve Bank.

Second Bank of the United States—In 1816 Congress agreed to charter the Second Bank of the United States. However, the political climate at the time was volatile, and when Andrew Jackson, a central bank foe, was elected president in 1828, he attacked the central bank's banker-controlled power.When the Second Bank's charter expired in 1836,it was not renewed.

short-term interest rates—Interest rates on loan contracts—or debt instruments such as Treasury bills, bank certificates of deposit,or commercial paper—with maturities of less than one year. Often called money market rates.

specie—Coins that were valued for their metalic (gold,silver) content.

Standard & Poor's 500 (S & P 500) stock index—One of several indices designed to measure changes in price of a broad array of stocks.

state-chartered member banks—A bank that is chartered by a state and has elected to join the Federal Reserve System.

stock—Ownership share of a corporation.

stock market—A market where stocks are traded (i.e.,New York Stock Exchange, American Stock Exchange, or NASDAQ).

store of value—A function of money that allows for the transfer of purchasing power from the present to a future time period. See also *medium of exchange* and *unit of measure*.

trading partners—The U.S. exports and imports goods and services to nations that are its trading partners.

unemployment rate—Percentage of the labor force that is unemployed and actively seeking a job.

unit of measure— A function of money that measures the value of goods and services through the mechanism of prices.See also *medium of exchange* and *store of value*.

U.S. Treasury securities—Interest-bearing obligations of the U.S. government issued by the U.S. Department of the Treasury as a means of borrowing money. There are three types of marketable Treasury securities—bills, notes, and bonds.

velocity—Rate at which money balances turn over in a period for expenditures on goods and services (often measured as the ratio of GDP—gross domestic product—to the money stock). A larger velocity measure means that a given quantity of money is associated with a greater dollar volume of transactions.

yield on 10-year Treasury bonds—The current market interest rate or yield on U.S. Treasury bonds maturing 10 years in the future.