Richard W Fisher: Of moose and men (with no reference to Steinbeck)

Remarks by Mr Richard W Fisher, President and Chief Executive Officer of the Federal Reserve Bank of Dallas, before the National Association for Business Economics, Dallas, Texas, 12 September 2011.

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The views expressed by the author do not necessarily reflect official positions of the Federal Reserve System.

Thank you, Pat [Faubion]. Thank you all for inviting me to speak at this National Association for Business Economics (NABE) annual meeting.

The Federal Reserve Bank of Dallas has long been involved with NABE. Our director of research and my trusted senior policy advisor, Harvey Rosenblum, is a former NABE president (2001–02). Another of my policy advisors, Tom Siems, is a two-time winner of NABE's Edmund A. Mennis Contributed Paper Award. And Ken Rogoff, winner of this year's Adam Smith Award, is a member of the Dallas Fed's Globalization and Monetary Policy Institute advisory board.

I benefit greatly from the insights of these talented people, as well as those of Mine Yücel and Roberto Coronado, who are also speaking to you at this conference, and one of my mentors, our Dallas Fed board chairman, Herb Kelleher, who entertained you at lunch. Herb may be the only person on the planet who discovered the formula for making a retail business with high fixed costs and intense regulatory oversight not only fly but soar; his insights into how the economy works in practice, as opposed to theory, are invaluable.

I am pleased that Dick Berner, a former NABE president now at Treasury, running the Office of Financial Research, is here. I believe it was Dick who, during a round of golf at Jackson Hole [Wyo.] long ago, told me the bad joke about the fellow who suggested that a moose crossing sign be moved because "there is too much auto traffic where the sign is currently located."

I also see Bill Dunkelberg, another former NABE president, who has been most generous in sharing with me and my staff his understanding of the whys and wherefores of small business, an important input into the way we look at things at the Dallas Fed.

There are many others here today whom I would acknowledge if time permitted, but I ask their forbearance so that we can get down to business.

As learned economists, you are fully aware of the nation's predicament. Chairman [Ben] Bernanke reviewed it concisely in his speech at Jackson Hole and again, just last week, in Minneapolis. Knowing that most of you read those speeches, my guess is that you are looking to me for two things today. The first, given that you are in Dallas and the nation is in the throes of a presidential election season with two Texas contenders for their party's nomination, would be the Dallas Fed's perspective on the much-discussed Texas economy. Second, I'm guessing you are looking for some insight into what the Federal Open Market Committee (FOMC) is going to do next, insight Chairman Bernanke, as leader of our pack, wisely avoided imparting in his recent comments.

The Texas economy

On the Texas front, my colleagues and I at the Dallas Fed have lately been deluged with requests for data on all aspects of the Texas economy – which accounts for 95 percent of the Eleventh District's output and the economic activity of some 25 million of the 27 million people living in our district. If you are interested, you can go to our website (www.dallasfed.org) to receive a factual, nonpoliticized brief on the Texas economy, including the job creation figures that get bandied about in debates among presidential aspirants. We update these numbers monthly – the data for the August employment figures will be tabulated on our website on Sept. 19 – and we will keep updating them so that analysts can parse the data.

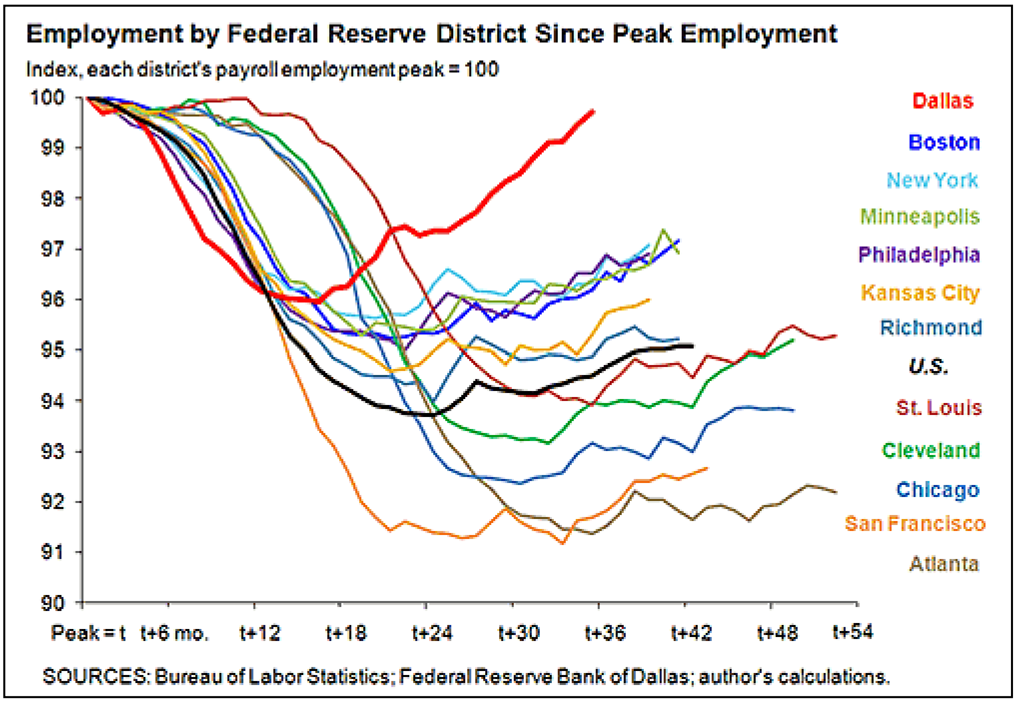
At a minimum, I am hopeful our web postings will help you separate spin from reality and fact from fiction, as well as dispel some of the stereotypes of Texas.

For example, we are blessed with abundant natural resources here, and we most definitely do benefit on net from high commodity prices; oil and gas extraction contributes about 9.5 percent to state output. Yet, when jobs are tallied, the contribution of oil and gas accounts for only 2 percent of the Texas workforce. Indeed, if you peruse our website, you will see that since the National Bureau of Economic Research proclaimed the recovery's start in June 2009, education and health services, which employs 13.5 percent of Texas' workers, and professional and business services, which employs another 12.5 percent, have gained 173,000 jobs during the recovery – nearly 60 percent of all the jobs added in Texas. The Texas workforce consists of more than just roustabouts and cowboys, though we are certainly proud of that heritage. Those of you who are here for the first time have no doubt already noticed this as you have wandered around Dallas and have seen nary an oil rig nor a cow.

While you are looking at the research material on our site, you might also look over the Texas Manufacturing Outlook Survey, which we refer to by the acronym TMOS. Since 2004, TMOS has had the highest correlation of all Fed bank surveys with the Institute for Supply Management's national manufacturing index. And you might find of interest our monthly service sector and retail outlook surveys. Mine might brief you on the most recent results of these during your session with her this afternoon.

Policy background

Enough about Texas per se. I am, however, going to put up on the screen behind me a slide that bridges developments in the Texas economy and the nation's economic predicament. I'll use this to lead into a discussion of the issues facing policymakers as we go forward.



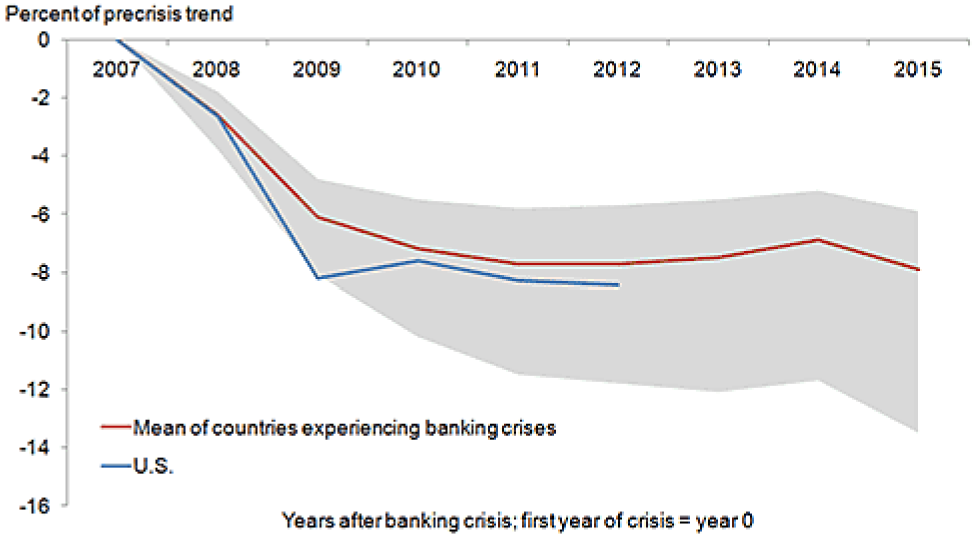
This slide was put together for a briefing recently by Harvey Rosenblum. It charts employment by Federal Reserve district from the time job creation peaked in each district until today. A quick explanation to make this easier on the eye: The bottom, or horizontal axis, is the time in months since employment peaked in each district. For example, it has been roughly 54 months since employment peaked in the Atlanta district, which is depicted by the tan bottom line; it has been 36 months since employment peaked in the Dallas district, as shown in the shorter red line at the top. Observing the vertical axis, you can see that the only Fed district that is recovering to employment levels enjoyed at the peak is Dallas. In point of fact, the only other states that are back to or have punched through their previous peak employment levels are Alaska and North Dakota, which, combined, have a population of 1.4 million good citizens. The other 11 Fed districts are hovering at levels approximately 3 to 8 percent below peak employment, while the nation as a whole – the black line – is still 5 percent below the levels that prevailed in 2008.

Of course, in Texas we have a long tradition of outperforming the nation – a tradition matched only by our long-standing reputation for modesty. The 1.1 percentage-point gap we've seen between Texas and national job growth over the current recovery corresponds almost exactly to the long-run (40-year) historical gap between our growth rate and the nation's.

The shortfall in jobs at the national level is but one indicator of the pervasive anguish of American households since the Panic of 2008. Another sign of that anguish is that average real per capita net worth in the United States has not regained the losses incurred in the latter part of the last decade. At the end of the first quarter of 2011, average per capita net worth was nearly 14 percent below the peak seen four years earlier. Real income has not fared as badly, but per capita salary income is, nevertheless, almost 2 percent below its peak in the first quarter of 2008. A likely widening of income dispersion over the period, however, suggests that median income has probably fared worse. We will get a better read on this when the Federal Reserve Board completes it triennial Survey of Consumer Finances early next year. I do not expect that survey to paint a pretty picture.

I am most aware, as are many of you, that if history is any guide, getting back to where we were will be no small task. The 2008–09 recession was precipitated by a banking crisis. A number of you, including Ken Rogoff, have shown that downturns associated with banking crises tend to be the most severe, and that clawing back lost employment and output in the aftermath of a financial crisis is most vexing. My colleague Mark Wynne, who directs our Globalization and Monetary Policy Institute, has written an excellent brief on this for our *Economic Letter* publication, which should be posted on our website today.

U.S. Postcrisis GDP Resembles Average Experience
(Selecting 2008 as the first year of the crisis in the U.S.)



NOTE: Shaded area is the 90 percent confidence interval for the mean.
SOURCES: *World Economic Outlook*, International Monetary Fund; Bureau of Economic Analysis; Blue Chip Economic Indicators; author's calculations.

This chart of output relative to precrisis trend summarizes Mark's conclusion: Since the onset of the financial crisis in 2008, "performance of real GDP in the U.S. is almost exactly in line with what we might have expected based on the average experience of other countries that have gone through banking crises."[1] This chart is most definitely not a pretty sight.

Small wonder that American consumers – and the businesses that hire and serve them – remain in a defensive crouch. The question is: How do we change the picture? How do we get the pistons of job creation, income growth and wealth restoration pumping again?

This is the gist of the discussion at the FOMC table. The press and others delineate the viewpoints around the table on an ornithological scale, dividing us up into doves and hawks. I am classified according to that delineation as a hawk. I am not offended by this, but, not unlike the stereotyping of Texas, I consider it simplistic. We are actually birds of a feather in that we are simply trying to figure out the proper way to conduct monetary policy in order to live up to our dual mandate. Each of us does our utmost to craft monetary policy so as to engender restoration of full employment in the context of price stability.

A word about price stability. At the Dallas Fed, we look at prices through a different lens than others. We are of the strong opinion that Jim Dolmas' trimmed mean analysis of personal consumption expenditures (PCE) – an analytical survey of 178 items in the consumer basket that we have tracked in a constantly updated series dating to 1977 – provides the best insight into prices impacting consumers and the likely path of prices going forward.

The Dallas Trimmed Mean PCE recorded an annualized rate of 2.4 percent in July, up from a more moderate 1.4 percent in June. Looking over the six-month horizon – which averages out some of the month-to-month wiggles – the trimmed mean is up precisely 2 percent on an annualized basis. Over the same six months, the headline PCE index is up 3.1 percent, owing to sharp increases in the prices of gasoline and, to a lesser but not unimportant extent, food. Barring further surges in those components, we would expect the headline rate to gravitate toward the trimmed mean rate of 2 percent over the coming months. We shall see.

The point is that while I feel the most important role for a central banker is to maintain price stability – and I am always on watch, hawk-like, on the inflationary front – I share with equal intensity the concern of my FOMC colleagues about the employment picture and the overall fragility of our economy. I am keen on finding ways to close the income and output gaps depicted in these two slides and restore economic momentum. I find the last employment report and the recent Federal Reserve Bank surveys of activity, including the Dallas Fed's, to be discouraging in this regard.

When people are frightened, they understandably look for a "fix." Yet, my colleagues and I are professionally beholden to beware of short-term fixes that might contradict, or place in jeopardy, the long-term duty and credibility of the central bank. I am wary of adopting any policy that might have the unintended consequence of becoming a veterinary fix rather than a more salutary repairing of the ability to propagate jobs.

It is no secret that I thought the second round of quantitative easing (QE2) ran that risk. I could not support it when it was proposed because I saw no analytically sound justification that its purported benefits would outweigh its likely costs. Similarly, at our last meeting, I felt that the benefit of stating that the FOMC anticipates economic conditions were likely to warrant holding the base rate at "exceptionally low levels … at least through mid-2013" was outweighed by the risk that such an action would be viewed as a commitment. The majority of the FOMC felt that anchoring the fed funds rate where it is for two years would assure markets and incent business activity. I felt doing so would, instead, give job-creating companies, particularly small- and medium-sized businesses, an incentive to further delay

[1] "The Sluggish Recovery from the Great Recession: Why There Is No 'V' Rebound This Time," by Mark Wynne, Federal Reserve Bank of Dallas *Economic Letter*, vol. 6, no. 9, 2011.

borrowing for expansion, given that they feel stymied both by anemic demand and discomfort with how they are taxed and regulated. It seemed to me that signaling that money would likely remain cheap for two years or more would hardly induce those with access to credit to borrow to expand and add to payrolls now.

This discomfort was compounded for me by the confusion and disorienting uncertainty arising from the debacle of the debt ceiling negotiations that took place shortly before the FOMC meeting – an uncertainty that has yet to be resolved. Moreover, it struck me that such a stance risked creating a perception that the FOMC might be a little bit trigger-happy in reacting to short-term developments in the securities markets; that we were collectively signaling there was a readily available "Bernanke Put."

The press and the Street are currently brimming over with assumptions about new fixes. Market operators are, to varying degrees, pricing in probabilities of one or more of the following: further expansion of our balance sheet; an "Operation Twist," wherein we lengthen the duration of our portfolio so as to drive down already historically low nominal intermediate and longer-term rates (rates that are below 2 percent all the way through the 10-year range and have negative yields in real terms); reducing from 25 basis points to zero what we pay on excess reserves (though the banks that deposit these reserves with us reportedly aren't able to identify a sufficient number of willing borrowers or believe they need a cushion to deal with regulatory concerns).

The Federal Reserve has done a great deal to reverse the situation that we confronted in 2008 and 2009. As I have said repeatedly, we have filled the gas tanks of the economy with affordable liquidity. What is needed now is for employers to confidently step on the pedal and engage the transmission that will use that gas to move the great job-creating machine of America forward.

Sources of uncertainty

That confidence is not lacking because of U.S. monetary policy. It is, however, my firm opinion that confidence is being significantly undermined by at least two sources of uncertainty.

One is domestic. It arises from the fiscal and regulatory authorities. Congress and the president must put together a program that will encourage growth in final demand as soon as possible by incentivizing private businesses to do what they do best to make growth in final demand possible: Expand investment, hire workers and go about the business of lifting the income and net worth of the American people. Yet, they must do so without running afoul of the need to reverse the downward spiral of the nation's finances. To this end, I am encouraged that the president and the Congress are going at it hammer and tong, searching to find the right balance between goosing up the economy short term and reining in the long-term fiscal imbalances that are imperiling our nation's future.

The second source of uncertainty has largely emanated from the European debt crisis, which intensified in the spring of 2010. At that time, risk spreads jumped, and both securities prices and confidence retreated. This helped derail the momentum that the economy had built up in late 2009 and early 2010. The sovereign debt crisis has reintensified, as you are all aware, and risk premiums in bond and stock markets are rising once again. Another global factor that undermined the pace of recovery this year, of course, was the disruptive earthquake in Japan and the economic aftershock from this tragedy.

It is hard for domestic monetary policy to offset such effects, both because they are external in nature and because it is unclear how long they will dampen the U.S. recovery. One thing is for certain: Given the effects of banking crises on economic recoveries and the interconnectedness of financial markets, it is imperative that our European partners resolve their banking issues if we are to sustain a prolonged economic upturn.

This is not to say that the Federal Reserve has no role to play. Our franchise includes assuring an efficient financial transmission mechanism. For example, everyone acknowledges that small business is the originator of jobs and the incubator of our nation's prosperity. In addition to wanting to see the whites of the eyes of growing final demand, needing clarity on fiscal policy and wanting regulatory relief, many of the small businesses that Dunk [Bill Dunkelberg] represents – and others that we survey – will need better access to the abundant and cheap liquidity the FOMC has made possible. Small businesses turn to community and regional banks for credit; their credit activity does not move the needle on the dashboards of the megabanks. It is incumbent on the Fed and other bank regulators to reduce the regulatory burdens that are inhibiting – indeed, overwhelming – community bankers whose business it is to lend to creditworthy small businesses. This is a supervisory and regulatory matter, not a matter of general monetary policy. My point is that the Fed needs to examine and perfect the transmission mechanism under its purview just as intensely as it looks at monetary policy per se.

And we must be ever-mindful that the central bank cannot carry the load alone, as Chairman Bernanke and others of us have often said. Indeed, there is great danger in any temptation to do so. A recent *Economist* article aptly summarized my perspective on this as follows: "Above all, there is a moral hazard in central-bank activism. It risks encouraging governments to sit back and let others do the work that they find too difficult themselves."[2]

If I believe further accommodation or some jujitsu with the yield curve will do the trick and ignite sustainable aggregate demand, I will support it. But the bar for such action remains very high for me until the fiscal authorities do their job, just as we have done ours. And if they do, further monetary accommodation may not even be necessary.

With that, I'll stop. And in the best tradition of central banking, I'd be happy to avoid answering any questions you might have.

[2] "The World Economy: Central Bankers to the Rescue?" *The Economist*, Aug. 13, 2011.