

# **Brief Comments on the Economy and the Business of the Dallas Fed**

---

*Remarks before the Park Cities Rotary Club*



**Richard W. Fisher**  
President and CEO  
Federal Reserve Bank of Dallas

Dallas, Texas  
February 9, 2007

---

*The views expressed are my own and do not necessarily reflect official positions of the Federal Reserve System.*

## **Brief Comments on the Economy and the Business of the Dallas Fed**

Richard W. Fisher

I am delighted to finally get to speak to the Park Cities Rotary. Before I went up to Washington to serve as a trade negotiator, I was a member of the Downtown Dallas Rotary. When my travels took me elsewhere, I would drop in on club luncheons to share the Rotarians' patriotism, camaraderie and fellowship and to delight in their sense of humor. My all-time favorite Rotary memory is from a meeting I attended while Nancy and I were vacationing with our children in Georgia. The local club had a ritual of reading aloud the names of ill or deceased members and asking for a moment of silence. They announced one fellow's name, Harry Someoneorther, who had been inactive for some time and was reported dead. To everyone's surprise, old Harry wandered in at the conclusion of the moment of silence. Without skipping a beat, the chairman stood up, recognized him and gave him the award for longest distance traveled.

I imagine Paul Harris would have grinned at that one. His wit was matched by his vision. His exhortation 102 years ago to "place emphasis on giving rather than getting" has inspired generations of Rotarians. The Federal Reserve, by the way, was the beneficiary of that giving spirit: Paul Volcker, who is considered by many to be Zeus in the pantheon of central banking gods, studied at the London School of Economics as a Rotary Foundation Scholar.

I want to talk to you today about the business of the Federal Reserve Bank of Dallas. I know you would rather have me talk about monetary policy and where interest rates might be headed. Let me disappoint you up front by telling you I am not going to do that. We held our most recent Federal Open Market Committee meeting last week, and we decided to hold the federal funds rate at 5.25 percent, where it has been since June 29. My views on the economy have not changed over the past week, even with the subsequent release of fourth quarter GDP data.

In fact, my views haven't changed since my last formal speech shortly before Christmas, which coincidentally, was to a group of Rotarians in Longview. So I'll quote from that speech to summarize how I feel about the economy today: "My guess is that we are most likely going to finish the year at a pace that exceeds the gloomy forecasts making all the headlines lately." I suggested to the Longview club that "if you net the downdrafts from the housing and auto sectors against the tailwinds from other countries growing faster than the United States, then adjust for the updrafts of a dynamic service sector and thank your lucky stars for a warm start to winter and burgeoning oil and gas inventories that have softened energy prices, I wouldn't be surprised if the economy proves to have grown at better than 2 percent, net of inflation, in the second half of this year, then picks up pace in 2007."

Well, the initial release of fourth quarter GDP proved to be a gee-whiz number of 3.5 percent, which pulled up the economy from its tepid 2 percent growth rate in the third quarter. In coming months, the fourth quarter number will be revised to account for more fulsome data on inventories, construction activity and other inputs, and it could well be revised downward. My sense is that in the end, fourth quarter growth was still in the range of 3 percent.

At this early juncture in 2007, I think it entirely reasonable to expect the economy to maintain an average pace of 3 percent growth for the year. And, if we at the Fed do our job well, we should be able to accommodate that growth rate while bringing inflation down below 2 percent.

If you'll permit me to again use a meteorological metaphor: We have some disinflationary tailwinds assisting us. There was a series of monetary policy tightenings by the FOMC that preceded the latest series of pauses that began last August. Also, moderation in energy prices proved beneficial, while continued productivity gains, although less than we had expected, should keep labor costs in check. And spillovers from the unwinding of excessive housing market speculation, including softening in the price of lumber and such commodities as zinc and copper, have all added force to the tailwinds we've been seeing. I find it instructive that, other than from corn farmers, I no longer hear business leaders muttering about "pricing power," which not too long ago was an ever-present part of inflation discussions.

Yet, we do have some inflationary headwinds to overcome. For example, economists use a theoretical metric that attempts to measure the costs of housing—something they refer to as "owner's equivalent rent," or OER. OER makes up the largest individual component of the core price index for consumer expenditures, with a 14 percent weight in the index. The way the math works, when the price of the nation's housing stock declines, this rent equivalent increases. At year end, it was rising at a rate of 4.3 percent, adding to inflationary pressures. Also, the substantial demand for skilled and some semiskilled labor is driving up wages in those important labor pools. And rapid growth in foreign economies—from China and India to our southern neighbors and our friends across the Atlantic—increases global resource utilization, tightening the availability and prices of inputs and labor that American businesses use to control their cost-of-goods-sold and enhance their productivity.

We will monitor the net effect of these headwinds and tailwinds.

I wouldn't rule out further increases in the federal funds rate if inflationary winds gain the upper hand. Indeed, if increases are needed, I would aggressively advocate for them. But for now, I am as comfortable with the inflationary outlook as a prudent central banker can be. No central banker can ever be smug about containing the risk of inflation, but I am pleased with the current direction of inflationary impulses. To quote from the FOMC statement released after our meeting last week: "Readings on core inflation have improved modestly in recent months, and inflation pressures seem likely to moderate over time." That said, I will rest a heck of a lot easier when we get the core rate down well below 2 percent and keep it there.

Mind you, this is what we are paid to do. But there are other ways to deal with inflationary pressures. Only this week, we saw one alternative approach being taken by the government of Zimbabwe, which, according to Wednesday's *New York Times*, declared inflation "illegal," promising to arrest and punish anyone who raises prices or wages. And the *Financial Times* reports that in Argentina, the government, apparently dissatisfied with the index used to measure inflation, sought to remedy the situation by replacing the economist who compiles it. Fortunately, we don't have those options. Instead, we continue to monitor price developments and discharge our duty the old-fashioned way, as always, seeking to promote sustainable, non-inflationary economic growth.

Substantial dividends accrue from a disciplined Federal Reserve. Let me cite just one example that may not readily come to mind. It wasn't too long ago that the markets were fretting about underfunded liabilities of pension plans. Recent equity market rallies around the world have mitigated that risk. Pension fund managers now have ample opportunities to secure some of their long-term funding needs in the higher quality tranches of the bond market. The 30-year Treasury bond yields 4.84 percent. If my math is right, this means someone can buy so-called stripped bonds that mature in 2037 at \$100 for 25 cents on the dollar, thus matching every dollar of their long-term liabilities for a quarter. Of course, prudent fund managers would only do that if they were confident that the Fed would continue to protect the purchasing power of those strips. If we continue to contain inflation, they will—strengthening the financial security of American workers.

Enough said about the economy. The Federal Reserve System does more than just conduct monetary policy, and I want you to know a little bit more about the Dallas Fed and the role it plays in this city and in the economy.

Let's start with a little history. President Woodrow Wilson signed the Federal Reserve Act in 1913. The act contemplated 12 regional banks across the country, and George Dealey at the *Dallas Morning News* immediately went to work to get one of them for Dallas. On April 3, 1914, Dealey succeeded—the same day, for those of you who are history buffs, that Pancho Villa's forces captured the town of Torreon. Other notable events in 1914 included the completion of the Panama Canal, the start of World War I and the invention of the air conditioner. I will leave it up to you to decide which of those events has had the most significant impact on our city!

Few Dallas institutions have survived as long as the Dallas Fed. We have been part of the downtown community since we opened, moving from temporary quarters into a stately building on Akard Street in 1921, and then to our current building on Pearl Street, just opposite the Arts District, in 1992. We have the third longest continuous business presence in downtown Dallas and are proud of it. Of the remaining downtown institutions, only the *Morning News* and Neiman Marcus predate our arrival.

The Dallas Fed has been at its best in hard times. During the Great Depression, our employees voluntarily took 5 percent pay cuts so the Bank could share the work and hire unemployed Dallasites. In an earlier recession, panicked customers stampeded a Dallas bank, demanding to withdraw their money. It was the kind of run that could ruin a bank. The head of the Dallas Fed, a man named W. F. Ramsey, showed up in an armored car with guards. They hauled a quarter million dollars into the lobby—where everyone could see it. In a scene right out of *It's a Wonderful Life*, Ramsey jumped on a desk and shouted across the crowded lobby that he had \$30 million more sitting in the Fed's vault down the street. Just like that, the bank run ended.

The Fed has come a long way from its early years. Today, we have \$39 billion in assets on our balance sheet. Last year we generated enough income to send \$1 billion back to the U.S. Treasury after paying out an annual dividend to our member banks throughout our district. We employ a thousand hard-working people in Dallas and several hundred more in our branches in Houston, San Antonio and El Paso. Each year, the Dallas Fed processes 1 billion paper checks worth about \$900 billion, plus somewhere between 240 million and 300 million electronic checks. We handle 5.4 billion circulating banknotes each year worth nearly \$92 billion. We continue to supply the liquidity our banking customers need in times of potential and real crises,

such as Y2K, the aftermath of 9/11 and the devastating hurricanes in 2005. Our Dallas operation requires an underground vault the size of a five-story building—quite something, when you realize our vault was little more than an office safe in 1914. If you ever need to do your laundry or park at a meter, call me. Our vaults contain more than 150 million quarters.

Our other responsibilities include supervising the banking industry within the Eleventh Federal Reserve District. We conduct on-site audits of our member banks and monitor bank performance and stability. We have public education programs designed to raise financial and economic literacy in our community and host many public events and conferences on significant activities within our economy. And we maintain a first-rate research department that provides me with the authoritative economic analysis I need for my role on the FOMC.

I mean it when I say first-rate. Some of you may not know that Finn Kydland, an associate of our research team for the past 14 years, won the Nobel Prize for economics in 2004. He teams up with a formidable research staff headed by Harvey Rosenblum, another Fed stalwart who, 46 years ago, also received a scholarship from a Rotary Club that made a huge difference in his education.

In short, I think you can be proud of the Dallas Fed. Like Paul Harris, George Dealey had a vision. That vision has been more than realized.

I think I'll stop right there. I would be happy to take any questions you might have and, in the best tradition of Federal Reserve officials, do my utmost to avoid answering them.