Buy a Ticket!
(With Reference to the Strauss Brothers, Ambassador Mike Moore, Kenneth Arrow, Financial Sharpies, Martin Luther King Jr. and Gov. Dewey)

Remarks before the Dallas Friday Group

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

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

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It has been decades since I was an active member of this prestigious forum. Last night, I attended a book party for Kathryn McGarr, Cappy McGarr and Janie Strauss McGarr's daughter. She has written a zinger of a book about her mother's uncle, Bob Strauss, one of our most accomplished and colorful public servants.[1]

The evening brought to mind the time—I believe it was in 1979 or thereabouts—when Bob was U.S. trade representative and spoke to the Friday Group. He was introduced by his brother Ted, who gave such an admiring and thorough background introduction that it went on longer than Bob had time to speak. When Bob finally stood up to the podium, right off the bat he was vintage Strauss: "G-- d---it Ted, I asked for an introduction, not a G-- d---ed travelogue!" (And it wasn't "Gosh darned.")

Even if I had the temerity to speak like Bob Strauss, I'd have no need to do so today. That was a nice, short intro, Mark [Sinclair]. Thank you.

Leaders at the Dallas Fed

Before getting into the substance of my talk, I am going to let you in on a little secret. As mentioned, I am, indeed, the CEO of a $110 billion bank, the largest in Texas, the ultimate banker's Bank of this region. But while CEOs get all the credit for running a business, the truth is they are only as good as the people they have operating their business. With me today are some of the key operators of the Federal Reserve Bank of Dallas; I want to single them out:

Helen Holcomb is my chief operating officer and chair of our senior management committee. Helen operates the Bank with remarkable efficiency and is a person of wise and insightful judgment. I do not do a thing without first consulting Helen.

Meredith Black wears two hats as our chief financial officer and chief information officer. Meredith plays a key role in management of the Federal Reserve System's information technology, on which we spend over $1 billion a year.

Joanna Kolson is our senior vice president in charge of cash operations. About $105 billion in Federal Reserve notes—ones and twos, fives and tens, twenties and fifties and one-hundred-dollar bills—passed through our vaults last year. Joanna is known as the "keeper of the vault," in addition to overseeing the management of all of our facilities.

Ann Worthy runs our lending operations—we lent over $30 billion to banks in Texas during the financial crisis in 2009 to assist them with their operating needs. Ann's keen eye made sure we were paid everything back, and at a profit.

And Mine Yücel is our senior economist. Mine was born and educated in Turkey and received her PhD from Rice. She is the Dallas Fed's leading expert on our region and also a renowned energy economist, serving as president of the International Association of Energy Economics.

Each of you has the image of a Federal Reserve note—what you call a dollar bill—at your seat. In the middle of the left side of that note is the letter "K," surrounded by two concentric circles. The outer circle says "Federal Reserve Texas;" the inner circle reads "Bank of Dallas." K is the 11th letter in the alphabet; the number 11 is printed in each of the four corners of the bill. There are 12 Federal Reserve Banks, all founded in 1913; the Dallas Fed and its branches in Houston, San Antonio and El Paso constitute the Eleventh Federal Reserve District, serving some 27 million people over an expanse of 360,000 square miles and with economic output that exceeds that of Australia and only recently fell behind that of India. (I like to tease my colleagues at the other 11 Federal Reserve Banks that our "Dallas dollars" represent greater nominal value than all the rest.)

I am blessed to serve as the president and CEO of the Dallas Fed. But in reality, I am just a pretty face; the muscle and brains of the Dallas Fed are these brilliant women and the men and women they work with and lead. Please join me in thanking them for what they do.

'Help Me Out'

Last week, I was in Washington. I had breakfast with a wise and worldly old friend from my days as a trade negotiator for the United States—Mike Moore, the former prime minister of New Zealand and director-general of the World Trade Organization who is now New Zealand's ambassador to Washington. Ambassador Moore's perspectives are different from mine; I always find them thought-provoking. The ambassador is blessed with a keen mind and the ability to deploy a pungent sense of humor, usually wrapped in a memorable analogy, in order to convey a serious message. He told me the story of a God-fearing man who prayed several times a day, imploring the Lord to let him win the lottery. Day after day, year after year, God listened to this man. Finally, He grew weary of the man's prayers and spoke to him: "Help me out, my son, so that I might help you," the Lord said. "Buy a ticket!"

This afternoon, I am going to make reference to the Federal Reserve and the job of a central banker. This is what I do for a living, and it has become reflexive for me to explain my, and my colleagues', calling. Mark has asked me to broaden my theme today, however, and I am going to do just that: I am going to suggest that our nation has a crying need for public leadership to correct what is wrong with our economy; that the Federal Reserve has provided the leadership required of it; that monetary policy cannot do it alone and must be complemented by responsible fiscal policy—policy that is exclusively the responsibility of those whom we elect to represent us in Washington; that rather than posturing for political expediency and positioning for victory at the polls in November 2012, our nation's political leaders need to actually "buy a ticket" and put themselves at risk, right now and without delay. Each passing day they fail to do so further jeopardizes our economic stability and our nation's future.

Unemployment Is THE Issue

Our great country now finds itself in a very difficult economic predicament. It is true that the situation here in Texas is relatively better than that of the nation; Texas is an oasis in a national economic desert devoid of life-giving job creation. We went into the Great Recession last and were one of the first to come out. As we have for the past 40 years, we continue to outpace the rest of the United States in employment growth by a significant margin. Since the recession officially ended in June 2009, only North Dakota (a plucky state whose population is less than that of Collin or Denton counties) has seen faster job growth than Texas.

As I speak, Texas has almost as many people employed as we did before the recession began. Our banks are in better shape than those in the rest of the country. We are benefiting from the blessings of nature, with copious amounts of oil and gas and abundant agricultural production. Our fellow citizens have seen to it that our Legislature continues to hew to a tax, regulatory and legal environment that attracts job-creating investment and encourages business formation and growth.

And yet, even in this blessed state, there are too many unemployed and underemployed, just as there are in the rest of America. We can do better. America must do better.

The question is: How?

To create employment, we must have economic growth.

The simplest of econometric equations posits that the key components of economic growth are: domestic consumption, plus foreign demand for U.S.-produced exports, plus investment by businesses, plus spending by government.

I think it is pretty clear to everyone who lives on the planet that in order to expand our economy and put our people back to work, we must rely on our ability to curry to domestic and foreign consumption and invest here at home to produce the goods and services to sell into the marketplace here and abroad. You'd have to be from Mars to believe that our financially strapped federal and state governments will be the source of much direct spending stimulus to the economy going forward.

Aesop's Fable

Presently, all eyes are focused on the ongoing budget deliberations in Washington. During the summer debt-ceiling negotiations, I was reminded of Aesop's classic fable. Rather than work like ants to build and store for difficult times, our fiscal authorities—Congress after Congress, under Republican and Democrat leadership alike, and with presidents of both parties occupying the White House—have been proverbial grasshoppers. Except for a few interludes, they have partied along for decades using the people's money as though life were an endless summer, storing nothing to draw upon for the blustery fall and the bleak winter that inevitably follow. Now a fiscal reckoning is upon us. The gig is up. Congress can no longer carry on as before, oblivious to the deleterious effect of spending our, and the successor generations', money with unfunded abandon.

Tongues firmly in cheek, clever pundits have reminded us that there are alternative versions of this fable. In 1924, Somerset Maugham wrote a version about two brothers: one an ant-like hard worker and the other a grasshopper wastrel. In the end, the grasshopper marries a rich widow, who dies and leaves him a fortune.[2] Case closed! In *Things Change*, a film released by Columbia Pictures in 1988, the character played by Don Ameche recites a version in which the grasshopper, fed up with all this moralizing about the virtues of hard work and saving for a rainy day, just up and eats the ants.

I think we can safely assume that neither of these scenarios will occur. No one is going to bail out our federal government at the last minute; there is no rich-widow equivalent for rescuing fiscal spendthrifts. The ants that are the hardworking taxpayers are, if anything, poised to chew up and spit out improvident politicians should they fail to put an end to fiscal profligacy. The fiscal authorities have no choice but to come to terms with the need to bring about a better balance between taxes and spending and to not only bend the curve, but also reverse the inexorable growth in federal debt accumulation. This is the stuff of the great negotiations taking place in Washington.

No Small Chore

This is no small chore. The parties involved must stop the hemorrhaging without inducing cardiac arrest; they must solve the long-run debt and deficit problem without, in the short run, pushing the economy back into recession, creating still more unemployment. And they not only must confront their addiction to debt and spending beyond their means, but also reorganize the tax system, redirect the money they spend and rewrite the regulations they create so as to be competitive in a world that wants to beat us at our own game.

This is an essential point. My wife, Nancy, is in Vietnam as we speak. Imagine that! When she and I were in college, we were at war, killing the Vietnamese. And they were killing us, including my close friend and high school football teammate, Greg Lavery, who was shot dead by a Vietcong sniper as he patrolled a rice paddy in 1968. Today, my wife is free to walk unafraid across a rice paddy or through the streets of Saigon and Hanoi. American companies trade and invest in Vietnam, and Vietnamese companies do so here. This is good news! We won the Cold War. Ho Chi Minh and Mao Zedong and all the brutal dictators who ruled the Soviet Union are long gone. In the blink of history's eye, we have gone from mutually assured destruction on the battlefield to mutually reinforcing competition in the marketplace. This is what we spent an entire generation of American blood and treasure to achieve, and it is a far better thing.

The consequence, however, is that we are now being challenged as the place to invest job-creating capital by the Vietnamese, the Chinese, the Indians and countless others who have decided to engage full bore in the commercial interplay of a global economy. Our business operators are obligated by their shareholders and their creditors to earn a return on investment and maximize profit; we live in a globalized, interconnected world, and money is free to go to wherever it earns the best return. The point is that our fiscal and regulatory authorities do not operate in a vacuum. It will not be enough to reach a real deal on the debt ceiling or on reining in deficits. In the post-Cold War, post-Bamboo Curtain world, there are many governments and great swathes of people outside the United States that want to attract investment and improve their lot.

In crafting a solution to the nation's fiscal crisis, our political leaders must take this new reality into account and develop an entirely new structure of incentives for private businesses and investors to put their money to work creating jobs, here at home rather than abroad.

Only fiscal authorities have the power to affect this outcome. Monetary authorities, like me and my colleagues on the Federal Open Market Committee (FOMC) of the Federal Reserve, have limited influence. We can fill the gas tank with attractively priced fuel—abundant and cheap money—needed to propel the economy. But we cannot trigger the impulse to step on the pedal and engage the transmission mechanism of job-creating investment by the private sector. This is the province of those who write our laws and regulations—the Congress of the United States.

The Limits of Monetary Policy

I happen to believe that the Federal Reserve is exhausting the limits of prudent monetary policy. The programs popularly known as QE2 and Operation Twist are, to my way of thinking, of doubtful efficacy, which is why I have not been able to support them. I suspect that, at least in the case of Operation Twist, they have so far been of greater benefit to traders and large monied interests than to job-creating businesses. But even if you believe, as the majority of my learned colleagues do, that the benefits of QE2 and Operation Twist outweigh their costs, you would be hard-pressed to now say that still more liquidity, or more fuel, is called for given the $1.5 trillion in excess bank reserves and the substantial liquid holdings businesses are hoarding above their normal working-capital needs.

Even surveys of small businesses—for example, the U.S. Chamber of Commerce's survey of companies with less than $25 million in sales and fewer than 500 employees conducted in July, or the National Federation of Independent Business survey of September—indicate that fewer than 10 percent of small enterprises (which employ half of the private sector's workers) are having problems accessing credit.[3]

I would submit that adding more liquidity, or making money still cheaper, is not the answer to our problems.

Economic Forecast—Caveat Emptor

With monetary policy having broached what I consider to be the limits of accommodation, and the federal government at sixes and sevens, what then is the economic outlook? Are we going to grow through the rest of the year and on into the next, or are we going to dip back into recession?

Forecasting economic growth is not a precise business. Economics is an art form, not a science; it is very judgmental and subjective. The FOMC is composed of 17 thoughtful, introspective and deliberate men and women. Five of the members who serve full time are in Washington as governors of the Federal Reserve Board, appointed by presidents of the United States with the approval of Congress. The remaining 12, like me, are presidents of the Federal Reserve Banks, chosen by nine-member, nonpolitical boards of directors of citizens in their districts and charged with conducting the business of the Fed in the field based on our acumen and with developing policy insights based upon what we see, hear and measure on Main Street. Together, the 17 of us formulate policy with the best judgment we can collectively muster, focused on what is in the best long-term interest of the country's economy. This is critical for the nation: Your central bank must remain independent of political influence, free from political pressures or the passions of the moment.

Within the FOMC, we each develop forecasts for the economy. To provide those forecasts, we employ sophisticated econometric models, study the entrails of numerous comprehensive surveys conducted all across the nation―like the Dallas Fed's Texas Manufacturing Outlook Survey and the Texas Retail Outlook Survey (developed under the watchful eye of Mine Yücel), and counterpart surveys conducted by other Federal Reserve Banks and the Board of Governors―and draw upon input from our boards of directors, numerous advisory boards and contacts with businesses and stakeholders nationwide and worldwide. These forecasts are helpful guideposts, but they must be kept in context.

Kenneth Arrow, a Nobel Laureate in economics, had his own perspective on forecasting. During World War II, he served as a weather officer in the U.S. Army Air Corps and worked with a team charged with the particularly difficult task of producing month-ahead weather forecasts. As Arrow and his team reviewed these predictions, they confirmed statistically what you and I might just as easily have guessed: The corps' weather forecasts were no more useful than random rolls of a die. Understandably, the forecasters asked to be relieved of this seemingly futile duty. Arrow's recollection of his superiors' response was priceless: "The commanding general is well aware that the forecasts are no good. However, he needs them for planning purposes."[4]

Keep Professor Arrow in mind when you hear economists tout precise forecasts carried out several places to the right of the decimal point. You may need economists' forecasts for planning purposes, but you should always take them with a grain of salt, even when the time horizon is a short one. I direct you to an article in the Feb. 14 edition of the *Wall Street Journal* as evidence. The *Journal* had polled 51 leading economists, and they forecast that gross domestic product would expand 3.6 percent in that very same first quarter, ending in less than a month's time.[5] Growth came in at 1.9 percent.

Headed in the Right Direction…Slowly

When economists forecast we will have growth of, say 3.6 percent, remember they are saying point-zero, three-six. It is an elaborate conceit to think anybody can be that precise in an economy as large as that of the United States, operating as it does within the context of an even larger, very dynamic, global economy. This is true for Fed economists as well as academics and those who sell their forecasts for a living. What matters most to me is the direction in which the numbers are headed and the general sense of momentum.

At this juncture, I think it sufficient to say that—assuming the people we elect to tax us and spend our money and create the rules and regulations that govern our economic behavior can get their act together, confront their own denial of most rudimentary budgetary discipline, learn to shoot straight and remove the Damocles Sword of uncertainty that they have for too long wielded over our job-creating private sector—there is plenty of potential for confidence to be bolstered and propel the economy forward at an accelerating clip. This is especially the case now that the Fed has reliquified the economy.

We need not remain stuck in the low gear of the first half of this year. Some of the temporary influences that I believe retarded growth in the first half—high gasoline and unprocessed-food prices, the supply disruptions in Japan, etc.—have passed through the system and are either being reversed or digested. To be sure, some businesses are being hit with higher input costs from imported goods and other nonlabor cost increases. Having become as lean as possible and having learned to preserve their margins by years of tight cost management and by maximizing productivity, they don't have much fat to absorb the cost of input increases. If input price increases continue or spread, these businesses will naturally attempt to pass them on to consumers, who are wary of anything else that will compress their living standards.

Inflation?

But I see a bit of a tug-of-war developing here. The issue will be whether businesses can exercise pricing power in the face of fallow consumer demand and high unemployment. As an inflation "hawk"—I don't particularly like that term; I prefer to think of myself and my 16 colleagues, hawks and doves alike, as wise owls, but so be it—I am watching this very carefully. I am aware that the Producer Price Index remains stout and that consumer prices remain sticky at current high levels. If I see inflation continuing to rise and, most important, inflationary expectations beginning to spread, I will be the first out of the box to advocate the removal of the substantial monetary accommodation now in place. I cannot think of anything more damaging to the welfare of hardworking Americans who have jobs, those who are unemployed and barely eking out a living, retirees who are earning minimum returns on their savings, or any consumer already stretched thin, than to have their purchasing power reduced by still-higher inflation. Adding the suffix "flation" to the present stagnation will only result in "stagflation," the worst of both worlds. This affliction, for example, appears to be taking place in the U.K. and is most vexing for the Bank of England.

Presently, however, I don't consider stagflation the most likely U.S. outcome. The Dallas Fed has its own measure of inflation. We track the prices of 178 items people actually use—from the cost of gasoline and food to the price paid a hairdresser and to have one's shoes repaired, the cost of guns and ammunition, beer (my favorite, being the son of an Australian who considered beer one of the basic food groups) and even funerals—in a series we have tracked and updated since 1977. We trim away abnormal monthly squiggles and calculate an underlying trend rate of inflation known as Trimmed Mean Personal Consumption Expenditures. We have found this to be the most accurate forecaster of the direction of inflation.

The six-month rate of the trimmed mean is 2 percent through August. Thus, we expect the more conventional headline indexes—now running at 3.9 percent, as measured by the Consumer Price Index, and 3 percent, as measured by the last reported personal consumption expenditures index—to gravitate toward the 2 percent level.

Job Creation Is THE Problem

The problem presently afflicting the nation is not inflation; it is job creation. Our most urgent issue is creating jobs and reducing unemployment. We have too many people out of work and for too long. This is why people have taken to the streets in New York, Boston, Philadelphia and elsewhere in those demonstrations so widely reported in the media. When people are out of work, they get desperate; when masses of people are out of work, you have the recipe for social unrest.

As I said earlier, the Federal Reserve has filled the tanks with the liquidity, or fuel, needed to create jobs. But only the fiscal authorities—the Congress and the executive branch—can provide the tax, spending and regulatory incentives to induce the private sector to step on the accelerator and engage the transmission of job creation.

Evoking Dr. King

At the beginning of this talk, I mentioned Ambassador Mike Moore of New Zealand. His most recent book is dedicated "To honorable public servants, elected or otherwise," as he put it. He then inserts a quote from Martin Luther King Jr. as follows:

"Cowardice asks the question—is it safe? Expediency asks the question—is it politic? Vanity asks the question—is it popular? But conscience asks the question—is it right? … There comes a time when one must take a position that is neither safe, nor politic, nor popular, but one must take it because it is right."[6]

I would suggest to you that the time is now. Our nation's economy is at risk. The Federal Reserve is doing everything it can to bolster unemployment without forsaking our sacred commitment to maintaining price stability. I personally don't care which party is in the White House or controls Congress. All I know is that the "honorable" members of Congress, Republicans and Democrats alike, have conspired over time, however unwittingly, to drive fiscal policy into the ditch. They purchased their elections and reelections with popular programs so poorly funded that they now threaten the economic well-being of our children and our children's children. Instead of passing the torch on to the successor generation of Americans, the Congress is simply passing them the bill. This is the opposite of honorable, and it must stop.

Back to the Land of Milk and Honey

Now, lest you think I am just another central bank sourpuss, I should tell you that I am actually encouraged that the public—from the Tea Party to the unemployed and disaffected who have taken to the streets—is forcing the politicians to focus on the dire need to get their act together. Indeed, I refuse to yield to pessimism, even as it becomes fashionable to do so. I am the child of immigrants. My parents came to this country because there was no limit to upward mobility; they came to the United States because it was the land of milk and honey. It still is. We just have to re-create a fiscal and regulatory environment that—in conjunction with the Fed conducting prudent monetary policy—will liberate the forces of entrepreneurial risk taking that have always been America's hallmark. Only then will we get back to generating the jobs and the prosperity for all of our people, not just for financial sharpies. Only then will we restore faith in the prospect of upward mobility for all, not just the few.

As to the immediate economic outlook, there are a plethora of risks above and beyond the possibility that our politicians will fail to do what is right. They range from possible trip wires that might spring from the fiscal fiasco among the 17 countries in the euro zone to the tempering of growth in many of the emerging markets we sell into. These risks could be the subject of an entire speech. But in surveying that landscape and the risks therein, let me simply say that in the parlance of A.A. Milne, I am certainly no “Tigger” when it comes to my outlook for the economy. Neither am I an “Eeyore.”

At present, we are slowly healing from the financial crisis and great panic of 2008 and 2009. I expect the healing process to continue and gather momentum over time. I think we will see that growth in the third quarter was substantially greater than what we saw in the second quarter. Absent some shock, I envision a slow but steady improvement in the economy into 2012. That is, *if* our fiscal authorities will remove their stranglehold on clarifying fiscal initiatives. If not, then, in my view, I expect job creators will remain in a defensive crouch and all bets are off.

Recalling Gov. Dewey

I realize that my view is not presently the conventional one. During the Q&A that followed a speech of mine abroad—in New York—a questioner cited the sickly economic pace of the first half of the year and then recited the consensus view that very weak growth will likely ensue for the rest of the year and beyond, seemingly to eternity. In response, I cautioned that forecasting based on current trends can be very misleading. And the consensus view—usually conveyed with confidence all the way out to three places to the right of the decimal point—is almost always wrong, even within the shortest of time periods.

I asked my interlocutor to recall the presidential election of 1948. The consensus view called for a landslide victory by Gov. Thomas E. Dewey. Indeed, an early edition of the *Chicago Tribune* on the very night of the election announced in the boldest of headlines that Dewey had won. Before going to sleep, an overconfident Dewey is reported to have turned to his wife and said, “Just think about it, darling: Tomorrow night, you are going to be sleeping with the president of the United States!”

The next morning at breakfast, Mrs. Dewey asked, “Am I going up to Washington this evening or is Harry Truman coming to our house?”

Thank you, Mark. That was something of a Ted Straussian travelogue, and I thank you for your patience in letting me cover a broad landscape. In the few minutes we have left, I would be happy to avoid answering any and all questions you might have.

Notes

[1] *The Whole Damn Deal: Robert Strauss and the Art of Politics*, by Kathryn J. McGarr, New York: PublicAffairs, 2011.
[2] See *Collected Short Stories*, by William Somerset Maugham, New York: Penguin Books, 1972.
[3] See “Little Hiring Seen by Small Business,” by Siobhan Hughes, *Wall Street Journal*, July 11, 2011. Also see Small Business Economic Trends survey, National Federation of Independent Business, www.nfib.com/research-foundation/surveys/small-business-economic-trends.
[4] *Eminent Economists: Their Life Philosophies*, ed. Michael Szenberg, Cambridge, England: Cambridge University Press, 1992.
[5] “Consumer and Business Spending to Spur Expanding U.S. Economy,” by Phil Izzo and Justin Lahart, *Wall Street Journal*, Feb. 14, 2011.
[6] *Saving Globalization: Why Globalization and Democracy Offer the Best Hope for Progress, Peace and Development*, by Mike Moore, Hoboken, N.J.: John Wiley and Sons, 2009.