Opening Remarks

Town Hall

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Thank you, [Curt], for that introduction, and thanks, especially, to all of you for coming tonight to this Town Hall. It is great to see so much interest in the Federal Reserve. In a few minutes, Curt will open up the floor. I hope that you'll use that opportunity to ask any questions, or offer any views, that you might have about the Federal Reserve, or the Fed as it is commonly known. I look forward to our discussion.

But first—a disclaimer. As you will hear shortly, I'm one of the 19 people who have the privilege and honor to participate in the meetings of what's called the Federal Open Market Committee (FOMC). FOMC meetings shape the course of monetary policy in the United States. But it's very important to understand that, in my remarks today, I'm telling you only my own views, and those perspectives are not necessarily those of any other FOMC participant.

Federal Reserve Structure and the Making of Monetary Policy

Let me begin with some background about the Fed. Relative to its counterparts around the world, the U.S. central bank is decentralized. The Federal Reserve Bank of Minneapolis is one of 12 regional Reserve banks that, along with the Board of Governors in Washington, D.C., make up the Federal Reserve System. Our bank represents the ninth of the 12 Federal Reserve districts, and our district includes Montana, the Dakotas, Minnesota, northwestern Wisconsin and the Upper Peninsula of Michigan.

As I mentioned, the Federal Open Market Committee—the FOMC—is the Fed's monetary policymaking body. It meets eight times per year to set the course of monetary policy. All 12 presidents of the various regional Federal Reserve banks travel from their home districts to Washington to contribute to these deliberations, along with the seven governors of the Federal Reserve Board. In this way, representatives from different regions of the country have direct input into the setting of U.S. monetary policy.

Congress requires the FOMC to make monetary policy so as to fulfill two mandates: to promote price stability and to promote maximum employment. It should be clear that these are both *Main Street* objectives that benefit all Americans. Promoting maximum employment means that the Fed is charged with doing what it can to ensure that Americans who want to work can do so. Promoting price stability means that the Federal Reserve is charged with keeping inflation close to a pre-specified target. Price stability ensures that, when people write contracts in terms of dollars, like student loans or annuities, they can have certainty about what those dollars will be able to buy in the future.

Now, in describing price stability, I've made reference to a "pre-specified target" for inflation. I haven't said what the pre-specified inflation target is. In choosing its inflation target, the FOMC weighed the costs of overly high inflation against the need to guard against potentially destructive negative inflation—so-called deflation. This assessment has led the FOMC to pick an inflation target of 2 percent. Similarly, most central banks around the world have opted for a low but still positive inflation target.

The FOMC acts to achieve its two mandates—maximum employment and price stability—by influencing interest rates through the purchase and sale of financial assets. When interest rates rise, households and firms tend to spend less and save more. The fall in spending puts downward pressure on both employment and prices. When interest rates fall, households and firms tend to spend more and save less. This puts upward pressure on employment and prices.

Of course, there are many interest rates in the economy—mortgage rates, student loan rates, corporate borrowing rates and so on. The Fed does not directly intervene in all, most or even many of these markets. Instead, Congress has restricted the Fed to trade in a small number of financial markets. Nonetheless, most economists agree that the Fed is able to influence almost all interest rates. The forces of competition in financial markets imply that the prices in one financial market necessarily influence prices in most or all financial markets. This interconnectedness levers the Fed's interventions in a small number of financial markets into an influence on the economy as a whole.

As I've said, the Fed's mandated goals are clearly Main Street ones—to promote maximum employment and price stability. But, as I've also described, the Federal Reserve acts to achieve those goals by engaging in trades in financial markets. The public discourse about the Fed often focuses on our financial transactions in isolation, and the links back to our Main Street objectives are not always apparent. This disconnect is always problematic, but in the remainder of my remarks, I'll argue that it is especially so today.

Current Monetary Policy Stance

Let me turn then to the current stance of monetary policy. Five years ago, in October 2007, the Federal Reserve had under $900 billion of assets, mostly in the form of short-term Treasuries. It was targeting a fed funds rate—the short-term interbank lending rate—of just under 5 percent. Five years later, the Federal Reserve owns nearly $3 trillion of assets, mostly in the form of long-term government-issued or government-backed securities. It plans to buy still more over the remainder of 2012. It has also been targeting a fed funds rate of under a quarter percent for nearly four years—and anticipates continuing to do so through mid-2015. In the language of central banking, the Fed's policy stance is considerably more *accommodative* than it was five years ago.

Some observers argue that the Fed has done too much, has been *too* accommodative. I strongly disagree. These critics are certainly right that the Fed's actions—tripling its balance sheet and keeping the fed funds rate near zero for years—are historically unprecedented. But it is also clear that the economy has been hit by the worst shock in 80 years. Over the past five years, Americans have lost jobs and a great deal of wealth. Relative to 2007, people remain uncertain about future employment and income. Businesses, too, are less certain about future demand for their goods. These changes and uncertainties make firms and households less willing to spend, and so push down on both employment and prices. In order to fulfill its dual mandate of promoting price stability and promoting maximum employment, the FOMC must offset these adverse shocks by making monetary policy more accommodative.

In light of the unusually large macroeconomic shock, I believe that it is misleading to assess the FOMC's actions by comparing its current choices to policy steps taken over the past 30 years. Instead, we have to assess monetary policy by comparing the economy's performance relative to the FOMC's goals of price stability and maximum employment. In particular, *if* the FOMC's policy is too accommodative, that should manifest itself in inflation above the Fed's target of 2 percent. This has not been true over the past year: Personal consumption expenditure inflation—including food and energy—is running closer to 1.5 percent than the Fed's target of 2 percent.[1]

But this comparison using inflation over the past year is at best incomplete. Current monetary policy is typically thought to affect inflation with a one- to two-year lag. This means that we should always judge the appropriateness of current monetary policy using our best possible *forecast* of inflation, not current inflation. Along those lines, most FOMC participants expect that inflation will remain at or below 2 percent over the next one to two years. Given how high unemployment is expected to remain over the next few years, these inflation forecasts suggest that monetary policy is, if anything, too tight, not too easy.

Conclusions

Let me wrap up. In my discussion about the Federal Reserve, I've described our decentralized structure, and I've emphasized our Main Street objectives of price stability and maximum employment. I see our structure and our goals as entirely complementary. In my view, having people from around the

[1]The PCE price index increased 1.5 percent from third quarter 2011 to third quarter 2012.

country—the presidents of the various regional Reserve banks—participate in monetary policy deliberations is valuable in ensuring that those discussions always put our Main Street goals at center stage.

Unfortunately, public discussion about the Fed often centers on the financial transactions that we undertake to achieve our goals. I think that this focus on our actions, as opposed to our goals, is always misleading and is especially so right now. The FOMC has provided a historically unprecedented amount of monetary accommodation. But the U.S. economy is recovering from the largest adverse shock in 80 years—and a historically unprecedented shock *should* lead to a historically unprecedented monetary policy response. We should always judge the appropriateness of the Fed's policies in terms of how the economy is doing relative to the two Main Street goals that Congress has set for the FOMC. Such a comparison does not suggest that monetary policy is currently too easy.

Thank you for your time and attention. I'll be happy to take your questions.