RISK, RESILIENCE & SUSTAINABLE GROWTH:

U.S. Monetary Policy in a Post-Recovery Era

Remarks by

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To

THE SYMPOSIUM ON ASIAN BANKING AND FINANCE

Hosted by:

The Federal Reserve Bank of San Francisco &

The Monetary Authority of Singapore

Singapore

May 29, 2017

AS PREPARED FOR DELIVERY

PREFACE: TRIBUTE TO TERESA CURRAN

Thank you, Ravi [Menon] … I'm delighted to have this opportunity to return to Singapore for this year's Symposium on Asian Banking and Finance.

For those of us who have been involved with this symposium over the years, this is a bittersweet occasion. Many in this room had the privilege of knowing Teresa Curran, whose steady hand guided this series for years. Teresa, who was the leader of the bank supervision division at the San Francisco Fed, had a special passion for and interest in this region of the world. The success and vibrancy of this symposium is one of her great legacies.

Teresa passed away late last year, and I'd like to dedicate my remarks and participation in this conference to her.

INTRODUCTION

Over the past decade, this symposium has become a forum for active and substantive dialogue on cooperation and collaboration across the region and the Pacific. The size of this audience and the palpable energy in this room are a testament to its success. This event and its vibrancy are also a testament to the close friendship and collaboration between the Federal Reserve Bank of San Francisco and the Monetary Authority of Singapore, our co-hosts for this event.

The philosopher William James wrote that *"our lives are like islands in the sea, or like trees in the forest."* He explained that while they appear separate on the surface, they are in fact commingled beneath the soil and through the ocean floor.[1]

A century later, these words ring as true as ever before. What happens in Singapore or San Francisco, or for that matter Seoul or Shanghai, is not contained by national borders. Rather, the impacts frequently breach the metaphorical gates that once divided East from West. In an increasingly interconnected global society and economy, what happens to one of us impacts all of us.

With that said, our economic fates are not necessarily the same. While the U.S. economy, for example, is affected by what happens around the world, it is also very dependent on domestic developments, whether monetary, fiscal, regulatory, or from another area of policy. And this is not a uniquely American phenomenon.

Because we are at once both independent and *inter*dependent, dialogues such as this symposium are so valuable.

The theme of this year's conference is "risk and resilience" in global finance. Risk and resilience are also very timely topics in U.S. monetary policy.

In the United States, we are making monetary policy decisions against the backdrop of shifting economic realities. Ever since the financial crisis took hold, our focus had been on the question of *"how to attain a sustainable recovery?"* Today, after a long, hard road, we're finally able to ask ourselves *"how do we sustain the recovery that we've worked so hard to attain?"*

[1] "Perception and Reality," in *William James Essays and Lectures*, ed. Richard Kamber. New York: Routledge, pp. 155-156.

Recognizing that the decisions we make will have global ramifications, I thought I'd focus the balance of my remarks today on the approaches we're taking in the U.S. as we make monetary policy decisions in this new "post-recovery" era.

Before I go any further, I should mention that the views expressed today are mine alone and do not necessarily reflect those of others in the Federal Reserve System.

THE U.S. ECONOMY HAS RECOVERED

As President and CEO of the Federal Reserve Bank of San Francisco, I lead the largest of 12 regional banks, which covers about one-fifth of our nation's population and economy. Among my responsibilities, I bring the perspectives of my region to the Federal Open Market Committee, or FOMC – the Federal Reserve's monetary policy committee.

The Fed has what we call a "dual mandate" – two big, overarching goals. These goals are maximum employment and price stability. We want everyone who wants a job to be able to find one and for inflation to average 2 percent per year.

I once had a T-shirt printed up that reminded folks that the decisions we make at the Fed are "data-driven." Although we live in a hyper-political era, the Fed is strictly a-political. Our independence from short-term political influence is, in fact, the most important feature of our design.[2]

When you look at how the data relate to those two big goals I mentioned – maximum employment and price stability – they paint a very clear picture: The U.S. economy has fully recovered from the global financial crisis and the ensuing recession. In fact, the U.S. economy is about as close to the Fed's dual mandate goals as we've ever been.

When it comes to employment, economists generally view the natural rate of unemployment in the U.S. – by this I mean the level consistent with an economy that is running neither too hot nor too cold – as somewhere in between 4¾ percent and 5 percent.

Today, the U.S. unemployment rate is 4.4 percent -- meaning that we've reached and even exceeded the full employment mark.

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[2] Williams (2017).

Meanwhile, although inflation has been running somewhat below the Fed's goal of 2 percent, with the economy doing well and some of the factors that have held inflation down waning, I expect we'll reach that goal by next year.

RISK

Now, I'd love to be able to tell you that the news is all rosy and that our work here is done. Unfortunately, they don't call economics "the dismal science" for nothing. I'm compelled to consider what potholes may be dotting the road ahead.

For starters, movement below the natural rate of unemployment carries with it the risk of the economy overheating, which could undermine the sustainability of the expansion.

When you're docking a boat, you don't run it in fast towards shore and hope you can reverse the engine hard later on. That looks cool in a James Bond movie, but in the real world it relies on everything going perfectly and can easily run afoul. Instead, the cardinal rule of docking is: Never approach a dock any faster than you're willing to hit it. Similarly, in achieving sustainable growth, it is better to close in on the target carefully and avoid substantial overshooting.

RESILIENCY

With the attainment of our dual mandate goals close at hand, it's more important than ever for monetary policy to work toward what I like to call a "Goldilocks economy" – an economy that doesn't run too hot or too cold.[3] We want the porridge to be just right.

Our aim is to keep the economic expansion on a sound footing that can be sustained for as long as possible. The last thing any of us want is to undermine the hard-won gains we've made since the dark days of the recession.

As it stands today, interest rates remain near historical lows, and I'm sometimes asked why we don't just keep things there. After all, if things are going well, why change? The answer is that gradually raising interest rates to bring monetary policy back to normal prevents our economy from overheating and thereby reduces the risk of a future economic correction.

[3] Williams (2017).

Now, I know there has been some general concern that as we normalize our monetary policy in the U.S. it could cause market turbulence internationally. I'm familiar with the adage that when the U.S. sneezes, the world catches a cold.

While my own primary focus as a U.S. policymaker is on what's best for our domestic economy, I want to reassure you that we are cognizant of the fact that our domestic actions have a global impact.

If you remember nothing else I've shared with you today, I hope you'll remember this: The last thing we want to do is to fuel unnecessary or avoidable volatility or disruption – whether we're talking about domestic markets or international markets.

That's why we're taking a gradual approach to normalization and why we're being very clear, transparent, and open about how we're making decisions. In fact, this is the most telegraphed monetary policy of our lifetimes.

I'd also argue that in an interconnected global economy, when one country takes action to make its economy more sustainable and resilient, that adds to the sustainability and resilience of the global economy in turn.

UNWINDING THE BALANCE SHEET

My focus to this point has been on conventional monetary policy, and I want to close by saying a few words about how we plan to unwind the unconventional strategies we adopted during the recession and recovery. If our approach on this front sounds familiar, it's by design. That's because a gradual, predictable, and clearly communicated strategy is the right way to operate, whether we're talking about normalizing interest rates or our balance sheet.

For those who might not be as familiar with the unconventional strategies we adopted during the recession, let me offer some very, very brief background: In ordinary times, the Fed focuses on affecting interest rates by setting the federal funds rate. Yet, the period since the financial crisis and Great Recession of 2007 through 2009 has been *extra*ordinary … and that's an understatement.

To save the U.S. economy from deeper recession and accelerate the economic recovery, we purchased trillions of dollars of long-term Treasury and mortgage-backed securities. These actions helped the economy achieve the relatively healthy state that it's in today.[4] After making these purchases, we significantly increased the

[4] Williams (2014) and Engen, Laubach, and Reifschneider (2015).

size of the Fed's holdings. Right now the Fed's balance sheet is around $4.5 trillion and we are currently keeping it at that level.

As I alluded to a moment ago, we're committed to slowly shrinking the balance sheet with the same sort of widely telegraphed, gradual, and – frankly – boring modus operandi that we've adopted for normalizing conventional monetary policy. This will occur "organically" over time, as securities mature or are paid off. The more public understanding there is, the lesser the risk of market disruption and volatility.

The process will begin when we're further along the path of normalizing the level of the federal funds rate.[5] Based on my forecast, this will occur sometime later this year.[6]

Of course, none of us have a crystal ball. If there were to be some sort of deteriorating of the economic outlook, or another unforeseen circumstance, this timetable would, of course, have to be altered.

It's worth noting that I view balance sheet management as something that will be taking place in the background – by that I mean that we will continue to use conventional monetary policy tools – raising and/or lowering interest rates – as the lever we operate to keep the economy from overheating or running too cold.

CONCLUSION

At the end of the day, the success of all these strategies depends on public understanding.

That's why dialogues such as the ones we're having at this symposium are so important – whether our focus is monetary policy, financial regulation, or fintech.

Ultimately, while the specific conditions in each of our countries may be different, the decisions we make on either side of the Pacific do not stop at our shores.

So thank you all for being a part of these discussions. I look forward to hearing from you throughout the symposium.

[5] Board of Governors (2017).
[6] See Federal Reserve Bank of New York (2017) for discussion of normalization of the balance sheet under different scenarios.

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