



FEDERAL RESERVE BANK  
OF SAN FRANCISCO

# Keeping the Recovery Sustainable: *The Essential Role of an Independent Fed*

*Remarks by*

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*To*

The Santa Cruz Chamber of Commerce

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*AS PREPARED FOR DELIVERY*

Thank you Professor Walsh. For those of you who do not know Carl, in addition to being a distinguished economics professor at UCSC, he's a longtime friend and associate of the San Francisco Fed, having served as a staff economist back in the 1980s and as a visiting scholar since then.

I also want to thank everyone at the Chamber for inviting me to join you here, in particular Executive Director Bill Tysseling. Bill, congratulations on your retirement!

This is an impressive organization. Your members put about 15,000 of your neighbors to work across the broad spectrum of the business community that you represent. That's music to the ears of a Fed president who's tasked with maximizing employment and price stability.

I also have a deep-rooted appreciation for how hard your jobs can be. After I graduated from college, I managed a small business called Blondie's Pizza. I know from first-hand experience and from talking to other local business owners, the daily challenges of running a business.

## FROM RECESSION TO RECOVERY

I always love coming to Santa Cruz.

I like to think of myself as connected to Santa Cruz by marriage. You see, my wife is a proud alumna of UCSC, which I guess makes me a “banana-slug-in-law.”

Before my wife and I were married – back when we were dating – I used to regularly drive down here to Santa Cruz. I have many fond memories of my visits to the city, the beaches, the boardwalk, and rides on the Giant Dipper.

So I was heartbroken for everyone in the community when I saw the devastation from the earthquake in 1989. But, the community came together to rebuild, even as some doubters suggested it would never rise again from the rubble.

Just a few short years into the rebuild, *Sunset* magazine wrote that the region had found its essence again as a quote “*lovely and goofy, laid-back but ... deeply passionate*” community.<sup>1</sup>

I think that’s a great metaphor for the way our country has rebuilt our economy after the Great Recession.

I know this has been a tough journey for a lot of people, and many are still struggling. But putting the economic recovery in perspective, we've come a very long way.

Today, the data show an economy that has recovered. As I’ll discuss further in a moment, nationwide, we’ve reached full employment. Inflation is moving toward our 2 percent target. And we’re in the eighth year of the economic expansion.

With this in mind, I thought I’d take this opportunity to share some thoughts on the role of the Fed in our country, and where I see the economy and monetary policy going. Now seems like as good a time as ever to note that the views I express are mine alone and do not necessarily reflect those of anyone else in the Federal Reserve System.

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<sup>1</sup>Fish (1995)

## THE ROLE OF THE FED

So who are we at the Fed? The short answer is that we're an amazingly nerdy group of people who pore over data, computer models, and statistical analysis.

The more specific answer is that we're a unique institution in the government, both in function and in structure. Congress has mandated that our job is to keep the economy stable and on track, with a focus on two big goals: maximum employment and price stability.

You may have heard us refer to these goals as our "dual mandate."

Contrary to the popular misconception, we're not "the feds." We're not politicians or fiscal policymakers. We don't spend money or set taxes. We don't write legislation.

And unlike politicians, we're not elected. In conducting monetary policy, we base our decisions on what's best for the long-term health of the economy, without political influence from Congress, the Administration, or others.

To my mind, this is the single most important feature of the Fed: the ability to act independently of short-term political influence... which allows us to respond to changing circumstances as needed. Across the world, independent central banks have proven to be more effective at stabilizing inflation and keeping their countries' economies performing up to their full potential than countries where the central bank is under political control.

So what exactly is it that we do? For starters, we – and we alone – set U.S. monetary policy, and we inform our decisions with economic research and real-world input from business and community leaders from across the country.

In San Francisco alone, we have over two dozen PhD economists on staff and eight boards and advisory councils that regularly meet and provide me with information about economic and financial conditions across the nine western states that make up the Fed's 12<sup>th</sup> District.

Despite what you may have heard, we don't actually print money. The Bureau of Engraving and Printing in the U.S. Treasury does that. We *do* make cash available throughout the country. We run key parts of the nation's payments system. And we conduct oversight of banks and other financial institutions.

Now, I mentioned that we're unique – one of the reasons I say this is that the Federal

Reserve System was founded, by design, to have a very interesting federated structure.

I'm president of the Federal Reserve Bank of San Francisco, which covers the largest of 12 Federal Reserve Districts. Our region contains 36 percent of the nation's landmass and about a fifth of the nation's population.

We're a private institution with our own Board of Directors, to whom I report. Our website is actually a "dot org" – [www.frbsf.org](http://www.frbsf.org).

At the same time, we're also part of the national Federal Reserve System that's overseen by the Board of Governors in Washington, D.C. The Governors are appointed by the President of the United States and confirmed by the Senate. They're full government employees, and in case you're wondering, they're a "dot gov" – [www.federalreserve.gov](http://www.federalreserve.gov).

It's my role to be the eyes and ears of what's happening in our District – your perspectives, your outlook, what keeps you up at night. This part of my job is especially important at meetings of the Federal Open Market Committee, or FOMC for short – the committee that makes monetary policy decisions.

## **GOLDILOCKS ECONOMY**

Our goal is to attain what I like to call a "Goldilocks economy" – an economy that doesn't run too hot or too cold. We want the porridge to be just right.

Of course, it's not always easy to achieve that just-right economy. Financial booms and busts such as the dot-com and housing bubbles of the past few decades can cause economic swings despite our efforts to contain them. But carefully designed monetary policy can help smooth out those fluctuations and protect families from economic turmoil.

In ordinary times, we focus on affecting interest rates by buying and selling short-term U.S. Treasury bills. Yet, the period since the financial crisis and Great Recession of 2007 through 2009 has been *extraordinary*.

Therefore, to further stimulate the ailing economy, we also purchased long-term Treasury and mortgage-backed securities—you may know this as "quantitative easing" or "QE." This helped the economy achieve the relatively healthy state that it's in today.<sup>2</sup>

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<sup>2</sup> Williams (2014) and Engen, Laubach, and Reifschneider (2015).

Again, remember that our goals are to maximize employment and price stability so that anyone who is looking for a job can find one, and the money in your wallet retains its value.

## CURRENT POLICY

As I wrap up, I want to give you a snapshot of where our economy and monetary policy are today.

In December, the FOMC nudged rates up and projected that we'd likely raise interest rates gradually in 2017. Specifically, the median projection was for three increases this year.<sup>3</sup> We stood pat after our meeting a month ago, but we'll meet again in March to assess whether the time is right to raise rates further. In my view, a rate increase is very much on the table for serious consideration at our March meeting.

I've been publicly supportive of a gradual increase in rates, and I am confident that the economy will continue to grow at a healthy pace even as we raise rates.

The aim is to keep the economic expansion on a sound footing – not too hot, not too cold – that can be sustained for as long as possible. The last thing we want is to undermine the hard-won gains we've made since the dark days of the recession.<sup>4</sup>

Now, my wife has warned me to stop using medical analogies. She's in the health sciences field and she says all my finance friends get them wrong. So I'll use a tennis analogy: You always want to position yourself for the next shot.

Given where we are now, our best position is in the middle of the court, where we can handle shots that come from either direction.

I mentioned earlier that we're currently around full employment. This doesn't mean that every man, woman, and child is working 24/7, 365 days of the year. That's not possible or even desirable. Instead, we aim for something economists call the "natural rate" of unemployment – the level where the economy is running neither too hot nor too cold. Goldilocks.

It's impossible to know exactly what the magic number is, but it's generally thought to be between 4¾ and 5 percent. With the national unemployment rate hovering around

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<sup>3</sup> Board of Governors (2016).

<sup>4</sup> See Williams (2016) for further discussion.

that lower number in recent months, we've reached that goal. If you're keeping score at home, that's less than half of where it was in the immediate aftermath of the Great Recession when it reached 10 percent.

That's not to say that no one is struggling. This economic recovery hasn't been the same for everyone. There are people who were left behind. There are people who were, frankly, left behind even in the best of times.

In many ways, Santa Cruz is a microcosm of the dichotomy we see throughout our region and throughout the country. Your area benefits from the influence of the University and a vibrant tourism sector, helping to keep job growth solid in recent years. But there aren't enough well-paid jobs in growth sectors for everyone, leaving some folks to struggle.

While unemployment in Santa Cruz has fallen by more than half from the double digit highs it reached in the aftermath of the recession, the current rate is well above the state as a whole. I know that if you're struggling, better doesn't feel good enough.

At this point, monetary policy is somewhat limited in what it can do in this regard. Greater investments in education, public and private capital, and research and development are needed to fuel economic growth and raise living standards, and those are the purview of fiscal policymakers and private businesses.

Yet, there are things we can do, and are doing at the Fed to be a part of the solution for challenges facing local communities. I'm particularly proud of my team in San Francisco who've established our Bank as a leader in Community Development – connecting the various investors, community leaders and other stakeholders in recognition that when communities thrive, it's good for everyone.

I've talked quite a bit about the employment side of things. The other side of the dual mandate coin is price stability. The FOMC has set a long run goal of 2-percent inflation and, frankly, we've been running persistently below that goal for several years. Much of this is due to the comparative strength of the dollar and a decline in energy prices. Those downward inflation pressures have been fading, however, and our graph lines are moving in the right direction to reach the 2-percent goal over the next year or so.

So given where we are in terms of unemployment and inflation, we're very close to achieving our dual mandate goals. Yet monetary policy essentially still has the pedal to the metal, with interest rates that remain near historical lows. We need to gradually ease our foot off the gas in order to avoid a "too hot" economy that in the end isn't

sustainable.

## CONCLUSION

So what does this all mean for your own businesses and families? There's a song that says "*you say it best when you say nothing at all.*" Hopefully that doesn't apply to my remarks today! In many ways, you feel our impact best when you don't feel it at all ... when you don't have to bring suitcases of cash to the gas station to fill your tank ... when you can plan for your future around the kitchen table without having to worry about finding a job in double digit unemployment. When you're not feeling the rug pulled out from under you thanks to a massive economic calamity.

Over the past several years, monetary policy has played an essential role in moving our country from recession to recovery. With over seven years of economic expansion, an economy at full employment, and inflation moving toward our 2 percent goal, it has an essential role to play today in keeping this recovery sustainable. And for those who are still left behind, it's on all of us to do our part, in our own way to help fill in the gaps. Thank you.

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