The Economic Club of New York

The Honorable Richard W. Fisher
President, Federal Reserve Bank of Dallas

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Introduction

Chairman William C. Dudley

Good morning. Good morning everyone. I'm Bill Dudley. I'm the chair of the Economic Club of New York and also the head of the Federal Reserve Bank of New York. It's our great pleasure today to have Richard Fisher, the President of the Dallas Federal Reserve Bank, to speak. This is going to be his last major speech in his current position as head of the Federal Reserve. Richard is a good friend of mine. He's a very thoughtful and provocative speaker. I read his speech before I came in this morning. There are some things that I agree with and some things that I don't, but that's all par for the course with Richard. But I think you'll find it very, very interesting.

Also I was telling Richard beforehand that we set a new record for breakfast. This is the biggest turnout we've ever had at a breakfast meeting of the Economic Club of New York. So now without any further ado, we have a special guest to give a more formal introduction of Richard Fisher. That's Paul Volcker, former chair of the Federal Reserve Board, and of course the fifth president of the Federal Reserve Bank of New York. So Paul, if you could come up and introduce Richard. After Paul's introduction, Richard will speak, then we'll open it for questions and we'll try to conclude this program by 9 o'clock sharp. Paul...

Paul Volcker: Well, thank you Bill. Ladies and gentlemen, I view this occasion as something of a

coming out party. Richard Fisher is about to be released from the monastic oath of silence appropriate for a member of the Open Market Committee. I used to think that was the monastic oath of silence. Things have changed. These days, as you all know, transparency is the mantra of the Federal Reserve. Whether a lot of speaking adds to policy clarity remains to be demonstrated. (Laughter) But one thing is clear in the case of Dick Fisher. His speeches have regularly been the most eloquent, a true joy to read, in the process going on family law, pointed analogies, and somewhat excessive Texas exuberance, all the while explaining both the successes and the possible excesses of monetary policy.

Well, from whence came this man? In fact he came from Mexico. Not exactly a Latino. He had an Australian father, a Norwegian mother by way of South Africa, exposed to Latin America, both in childhood and in education, and once upon a time, had a career vision as a United States Naval Officer. That all ended somehow with degrees from both Harvard and Stanford with a year or so at Oxford in between. His professional career actively started right here on Wall Street with Brown Brothers Harriman. He was going there as a protege of one Robert Roosa as I was a few years earlier. That name isn't heard so much anymore but he was a very important figure in the life of the Federal Reserve and the U.S. Treasury.

Now all of that seems to me about as far from Texas as one could possibly get – geographically, culturally, and for that matter, politically. But Texas is where Richard put down his stakes. He actually moved Brown Brothers, a Brown Brothers office to Dallas of all places, and then he

built his own money management firm. There were intervals in public service as well, in the Treasury, back in the days of Jimmy Carter and Mike Blumenthal, and later as Deputy Special Trade Representative in a really critical period for NAFTA and for negotiations with Asia. I'll tell you; this man cannot be equaled in any GN Initiative, never at rest. He took on some of the most popular Texas politicians in running as a Democrat for the Senate – not once but twice. Now truth be told, those ventures were not victorious, but happily he found his place ten years ago as President of the Dallas Fed and he's been there for a very constructive and active period.

Now in an era in which economists claim a natural right to critical central banking leadership, Dick has brought a healthy sense of reality, sound judgment, business background, and leadership. By my standard, Richard Fisher is in the full bloom of youth. I look forward to his mature judgment this morning. (Applause)

The Honorable Richard W. Fisher

President, Federal Reserve Bank of Dallas

Well, two things. One, my father who had nothing would have given his right arm to walk into this hotel. And secondly, anybody would give their right arm to have Paul Volcker make an introduction. I want to say, Bill, I'm very grateful to speak to the Economic Club of New York on the eve of my retirement after ten years of service at the Federal Reserve Bank of Dallas. I sat through 78 regular meetings, an additional 18 special meetings of the Federal Open Market

Committee for a total of 96 meetings under three Federal Reserve Chairs over the past decade. Given what we've been through in the last decade and the crisis and the healing we have tried to engineer in its aftermath, I would argue that you have to measure the life of a Fed policymaker in dog years. And so this morning, I thought I might give some suggestions based on 70 years of service with the Federal Reserve. (Laughter)

Before doing so, let me say again I'm tremendously honored to be introduced by Paul. We do share a common heritage. He referred to it. We were both mentored by the late, great Robert V. Roosa, and we are two of what were referred to the "Roosa boys," men and women by the way, that Bob Roosa took under his wing every few years to teach real-world economics and a love for policy. Paul was "Class of 1949" in the Roosa "school;" and I was "Class of 1975." And, of course, none of the successive Roosa boys and girls, as we were referred to, could ever match the original standard, as is sometimes said about our nation's presidency. I consider Paul Volcker to be the George Washington of monetary policy – the very exemplar of leadership and integrity and dedication that needs to be an inviolable hallmark of every central banker who follows in his footsteps.

In the late 1960s and early 1970s, prudent monetary policy gave way to political expediency before the quick-and-easy approach was reined in by Paul. And were it not for his insistence that the Federal Reserve do what was politically unpopular, we would have seen our nation and, I think, the world destroyed by hyperinflation. So please join me in applauding Paul Volcker for

his service to our country. (Applause) Paul said to me as he got off stage, "Oh, to be 80 again." (Laughter)

Paul stood the ground on the principle that monetary policy should never be politicize, which brings me to the first message that I wish to impart today and that is of the overriding importance of maintaining an independent Fed.

I recently came across a little volume written by John Lanchester. It's titled, *How to Speak Money*. It was published last year. And in describing the Bank of England, he writes and I quote: "There's a lot of ritual and ceremony and protocol at the Bank, which to outsiders seems like a cross between Hogwarts, the Death Star, and Ebenezer Scrooge." Well, the same can be said of the Federal Reserve, at least by those who don't take the time to read the copious amounts of speeches and papers and explanations that the 12 Federal Reserve Banks and the Board of Governors continuously emit. It's always politically convenient to make something sound mysterious, if not malevolent, by claiming it is opaque.

Which is precisely what's happening now with Senate Bill 264: the Federal Reserve Transparency Act of 2015 and its call to "audit the Fed." The operations and finances of the Board of Governors and the 12 Federal Reserve banks are already audited, just to use Fedspeak, up the wazoo. (Laughter) And as to policy, as soon as our deliberations at the FOMC conclude, as you know we report to the public what we decide, precisely at 2:15. We publish a thorough

review of what we discussed – and all views are considered, even those of ferocious dissenters like Richard Fisher – in the form of minutes of every FOMC meeting three weeks after we meet. And we subject our Chair to a no-holds barred press conference on a quarterly basis. All of this alongside frequent speeches and press interviews by the 12 Federal Reserve Banks, including President Dudley, who voice their independent views.

My suspicion is that many of those in Congress calling for "auditing" the Fed are really sheep in wolves' clothing. Having proven themselves unable to cobble together with colleagues a working fiscal policy or to construct a regulatory regime that incentivizes rather than discourages investment and job creation – in other words, having failed at their own job – they simply find it convenient to create a bogeyman out of an entity that does its job efficiently, which is the Federal Reserve.

Now as Paul mentioned, I hail from Texas. I hail from the land of Wright Patman and Henry B. Gonzalez, and the congressman in East Texas whose name I will not mention but has a son who is now in the U.S. Senate, but I won't mention his name. I am fully aware of the appeal of Fed antipathy and the passion that it can stir. It's nothing new. Close your eyes and you hear a strident speech about auditing the Fed from one of the current bill's authors, and you can hear the echoes of radio broadcasts from the 1930s of Father Charles Coughlin, the pastor of Little Shrine of Royal Oak, Michigan, who was then probably the most popular preacher in America. He railed passionately against what he called the "money changers" and what he termed and I quote,

"the Federal Reserve banksters – and the rest of that undeserving group who without either the blood of patriotism or Christianity flowing in their veins have shackled the lives of men and women." That's very powerful and moving rhetoric.

But I am personally confident that responsible senior senators and congressmen like Senator Richard Shelby of Alabama who chairs the Senate Banking Committee on...Committee rather, on Banking, Housing and Urban Affairs, and Congressman Jeb Hensarling, the Texan who chairs the House Financial Services Committee, can prevent any meddling with monetary policy while understanding the need for their colleagues to vent and to score political points. And I find it hard to believe that wise and experienced leaders like Senator Mitch McConnell, now the Majority Leader in the Senate, would actually want the Fed's policy deliberations infected by politics. There is so much else under the purview of the Senate and the Congress to clean up the flotsam of fiscal policy and the jetsam of regulatory interference that's inhibiting job creation and economic expansion and they know it.

But we'll see. Mae West put it best: "I generally avoid temptation unless I can't resist it." (Laughter) Even the greatest political leaders have trouble resisting the temptation to fiddle with a central bank. If you go back and read Liaquat Ahamed's brilliant book, *Lords of Finance*, you'll recall that German Chancellor, the Iron Chancellor, Bismarck's closest confidante, a man named Gershon Bleichröder, warned him and I quote: "There will be occasions, Mr. Chancellor, when political considerations will have to override purely economic judgments and at such times

too politically independent a central bank will be a nuisance." We know that when the German central bank gave way into political considerations, the result was Weimar and its eventual consequences. And that the Bank deutscher Länder, having established the principle of the independent central bank which became the Bundesbank, was instrumental in Germany's rising from the ashes of World War II and becoming the economic pillar of Europe.

Who in this room isn't grateful that Paul Volcker was a political nuisance?

"Audit the Fed" is nothing more than an attempt to provide purely economic judgments and override them and to bend monetary policy to the will of politicians. It is misguided. And I pray we don't go there. I can think of nothing that would do more damage to our nation's prosperity.

Now that doesn't mean we should be deaf at the Fed to the drumbeat of concerns about our franchise.

My friend, former Senator Sam Nunn of Georgia, likes to tell the tale of a backwoods preacher who was alarmed at the drinking habits of one of his parishioners. So the preacher called the man in. He put two glasses in front of him, one was filled with water and the other was filled with whiskey. He then put a worm in the glass of water and it swam around merrily and happily. He then lifted that worm from the glass of water and put it in the glass of whiskey. It dropped to the bottom, dead. "Son," he said, "do you get the message?" "Yes, sir, I do," the parishioner said. "If

I drink whiskey, I won't get worms." (Laughter) Well, like that parishioner in the backwoods of Georgia, I don't think my colleagues and I have gotten the message at the Federal Reserve.

First, in the era of social media and über-transparency, we at the Fed just need to learn to speak plain English, rather than "Fedspeak." I have done my level best over the past decade at the Fed to speak plainly, always bearing in mind that when I speak as a Fed official, I am speaking to the American people whom I serve, not to a small group of economists or just the mavens of Wall Street.

Second, I think we at the Fed must fully and frontally address the concern of many who feel that too much power is concentrated in the New York Fed. I am a great admirer and a close friend of Bill Dudley. I consider him not only a dear friend, a man of tremendous integrity, capacity, both as a policymaker and as a regulator of the financial institutions in his district. And I have enormous respect for Simon Potter and the good women and men who work our trading desk, faithfully implementing the instructions they receive from the Federal Open Market Committee, which crafts the nation's monetary policy. And yet I understand the suspicions that surround the New York Fed.

There is an ancient Bedouin saying that one should "trust in Allah but tie your camel." I would suggest the following common-sense proposals for quelling concerns for securing our franchise as an independent Fed and, in fact, creating a more efficient policymaking and implementing

process. Now Bill, my brother, you may not like these, but I think they're needed.

And you particularly won't like the first one which is, I think, we should rotate the vice chairmanship of the FOMC. Under its current structure which has been in place since the year 1936, the president of the New York Fed is the FOMC's permanent vice chair, which renders him the second most powerful person at the table. The purpose of the FOMC is to decide policy and to instruct the New York trading desk to implement it by managing the Fed's System Open Market Account and short-term trading operations. Having the New York Fed, even someone as good, decent, and outstanding as Bill Dudley, as the FOMC's vice chair gives an appearance of a conflict of interest. To correct this, I would rotate that position every two years to one of the other 11 Federal Reserve Bank presidents.

We have a convenient mechanism for doing so. The 12 Fed presidents meet frequently to discuss operational matters under the Conference of Presidents. And I want to remind you, there are no operating entities at the Board of Governors. It's the 12 banks that lend money through their discount windows that house the people's money, that house the forces that examine banks, that operate the vaults and so on. The Conference of Presidents rotates its chair among the presidents on a biennial basis. So I would simply have the chairman of the Conference of Presidents automatically become vice chair of the FOMC on a rotational basis. And this way, over the course of two years, the Federal Reserve's representatives of all 50 states and all congressional districts would occupy the second most important slot on the FOMC, and any appearance –

appearance – of conflict of interest, would disappear.

Second, with regard to regulation, the greatest concern appears to be the problem of regulatory capture by the largest and most powerful institutions, the so-called Systemically Important Institutions, or SIFIs. Incidentally, even though it's not in my text here, I don't like term SIFI. It sounds like something you acquire after a night of indiscriminate behavior at a bar. (Laughter) We have instituted at the Board of Governors, a powerful and, to my mind, extremely able and disciplined leader on regulatory matters after taking our hands off the wheel for too long, and that's Governor Dan Tarullo I'm referring to specifically. But if that alone proves unsatisfactory to the Congress, a simple solution to me would be to have each of the SIFIs supervised and regulated by a Federal Reserve Bank staff from a district other than the one in which that institution is headquartered. Each of the Federal Reserve Banks has an able body of examiners. With a tough central disciplinary authority in Washington dispatching those troops to districts where SIFIs are concentrated, we might eliminate any perception of conflicted interest and, again, assure that regulators from all 12 Federal Reserve districts, rather than from just two cities, are deployed in maintaining the safety and soundness of our banking system.

So those are just two of the suggestions I thought would delight a New York audience in particular. And I have a third and a fourth. The third, I would give the Federal Reserve Bank presidents an equal number of votes as the Washington-based governors, save the Chair. Presently, the New York Fed gets a permanent vote, as I mentioned, and the remaining 11 banks

get four votes, with Cleveland and Chicago voting every two years and the rest voting every three years. This makes absolutely no sense to me. The population of the New York Federal Reserve district is smaller than that of the San Francisco, Atlanta, Chicago, Richmond, and the Dallas districts. You may not know that. Those are the facts. The Cleveland district is much smaller than New York's, of course, roughly equal that of Kansas City, and only slightly larger than that of St. Louis, Boston and Philadelphia – each of which has 6% or less of the country's population. Minneapolis, parenthetically, is the smallest district with fewer than 3% of the nation's population, roughly 1% of the nation's deposits.

And if you look at population growth, it's clear that the districts that get to vote most often are not the ones that are growing but the regions that were most prominent generations ago. Here's a fact. Since 1970, the Federal Reserve Bank of Cleveland's district has grown in population by less than 7%. – that's since 1970, that's not compounded annually, that's total growth, 7% – New York's by 9%, Chicago by 18%. At the other end of the spectrum, the Federal Reserve Bank of Dallas' district has grown by 123% in population, San Francisco's by 112%, Atlanta's by 105% and Richmond's by almost 70%.

The current voting schedule makes no sense to me. But I wouldn't necessarily change it just to avenge the past. I would change it to balance out the division of power between the Federal Reserve Banks that are out in the field and among the people and businesses that operate our economy and have their own independent research staffs and the Board of Governors, which is

Beltway bound geographically and is briefed and guided by a single staff. I have enormous admiration for the brilliance and integrity of the members of the Board of Governors research staff. But you will notice that in the last couple of decades, the governors have tended to vote in a block, and it brings to mind Peter Weir's romantic comedy, *Green Card*, where the character played by Gerard Depardieu chastises the woman played by Andie McDowell, saying, "You get all your opinions from the same place." The members of the Board get their opinions from the same staff; the Fed bankers who sit at the FOMC table get theirs from 12 disparate staffs who are of the same high quality as that which resides in Washington.

I would give six banks the vote to match the six governors other than the Chair. The next year, the other six would have the vote. The Chair would then be the tiebreaker if a tie was needed to be broken, though given the collegial way in which we conduct our deliberations; my guess is that a tiebreaker would be a rarity. Thus, over a two-year stretch, again, all 50 states and congressional districts would have someone representing their constituents sitting as a voter at the table. Every year, six Fed Banks whose presidents serve under board of directors chosen from within the states in their districts would match wits with the Fed governors appointed by the presidents and approved by the Congress, providing a balance between what some might consider representatives of Main Street, the bankers, and Washington factotums. To me, this is eminently sensible.

Fourth and finally, I would have the Chair hold a press conference after every FOMC meeting.

I've long advocated this. I think, particularly Janet Yellen, who is enormously talented, has the great capacity to do this. Presently, the Chair holds a press conference every quarter. In effect, this means that any change in monetary policy can only be made at quarter's end. For if we were to suddenly announce that in between quarter "X" and quarter "Y" the Chair was going to hold a press conference, it might spook and destabilize the markets. In the parlance of economics, this injects some time-dependency into our deliberations when we should be guided in making policy strictly by the state of the economy, and take action on monetary policy when it is needed. I believe the Chair should hold a press conference after every meeting to explain the whys and wherefores of the policy decision by the committee. This would add both transparency and give the FOMC greater leeway in implementing policy. Again, for the record, I have been arguing this for years at the Committee.

Now in the interest of time, I'm going to make some additional, abbreviated suggestions, based on my 70 dog years at the Fed. Policymakers must be rigorous in their analysis but they must be guided by common sense. We have developed very sophisticated models of the economy at the Fed, and they're useful for providing a framework for deliberations. And yet they are always at risk of becoming stale or inappropriate to the situation. My advice is to heed Charlie Kindleberger's warning that "different circumstances call for different prescriptions." As he said, "The art of economics is to choose the right model for the given problem, and to abandon it when the problem changes shape."

Well, right now, we're trying to understand the dynamics of inflation. We have declared a 2% intermediate target for inflation, which seems to be the standard for most central banks. Headline inflation measures show a significant shortfall presently from that target. The headline personal consumption expenditures, or PCE, price index fell 0.2% in December. Its 12-month increase was 75 basis points, down from 1.6% in June. Should this low, and still falling, rate of price inflation retard the date of liftoff from the zero-interest policy we have been operating for more than six years?

Well, I think not. We all know that headline inflation is being held down by a big decline in energy prices that began the second half of 2014. We know that once energy prices stabilize, headline inflation is likely to bounce right back up. Policy needs to take inflation into account, past inflation, but it also needs to take future inflation into account. That's just another way of saying, for policy purposes, it's inflation's medium-term trend that matters, which is why analysts and policymakers pay so much attention to core inflation measures. The widely heralded FRB/US model that's been used by the Board of Governors staff since 1996 is an example. It's built around PCE inflation excluding food and energy – a traditional measure of core inflation. Ex-food and energy PCE inflation was essentially zero in December, month over month, while the 12-month rate slipped to 1.3% from 1.5% in June.

Here's where the Kindleberger quote is relevant. A good core inflation measure strips the noise out of headline inflation and leaves the signal. By that standard, recent analysis shows that the

ex-food, ex-energy PCE inflation rate that drives the FRB/US inflation forecast is a second-rate inflation measure. An alternative measure developed at the Dallas Fed called the Trimmed Mean PCE is superior in three respects.

First, trimmed mean inflation is better insulated from transitory energy price swings. Since 1994, the start of the current 2% inflation era, conventional core inflation's correlation with changes in real price of oil is 0.26, while the trimmed mean inflation's correlation is just 0.05.

Second, as judged by the root-mean-square error – I'm sorry, but I have to drop a little Fedspeak and economic jargon here – is more closely aligned with intuitive, direct measures of trend headline inflation – like the 36-month centered average, or the headline inflation's average over the coming 24-month period – that we are only able to observe after the fact.

Third, trimmed mean inflation has shown substantially less systematic bias. I've been at the Fed now for ten years, so I had the staff go back and look. Over the past ten years, looking only at data that would have been available to us as policymakers in real time, conventional core PCE inflation has averaged 1.65% – nearly 30 basis points below headline inflation's 1.94% average. Meanwhile, trimmed mean inflation has come in at 1.83% – just 10 basis points below headline. Setting policy using conventional core as your guide to me is like navigating a ship using dead reckoning, or even a compass. It has a systematic bias. It's influenced by local anomalies in the earth's magnetic field. Using the trimmed mean to set policy is more akin to navigating by GPS,

or say navigating by the stars which is better than dead reckoning.

If you go to the Dallas Fed website, you will see our most recent posting: The 12-month trimmed mean rate held steady in December, staying within the 1.6 to 1.7% range it's occupied every month since April 2014. That's lower than the range we're shooting for, it's a whole lot less discouraging than an inflation reading of .075% or even 1.3%.

Unemployment trends give us an additional reason not to be overly concerned about the current inflation shortfall. Recently Pope Francis gave a stern lecture to the College of Cardinals about the risks of what he termed, "spiritual Alzheimer's." I worry that the Federal Open Market Committee, preoccupied with its 2% inflation target and understandably shy about moving too soon to lift off the "zero bound," is at risk of "monetary Alzheimer's."

My chief policy advisor, Evan Koenig, and I, and our Dallas research staff, particularly Anil Kumar and Pia Orrenius, have authored papers that show that the Phillips curve – that is the relationship between unemployment and wage growth – is not linear but it is instead convex, meaning that wage growth initially picks up slowly in response to unemployment rate declines, but as you approach maximum employment, inflation turns upward with increasing intensity. Up to now, we've seen and we've been in picks-up-slowly territory, with wage and salary inflation rising 0.2% each year, from 1.5% in 2011, to 1.7% in 2012, 1.9% in 2013 and 2.1% in 2014. If historical patterns hold, we'll see larger and larger increments to wage inflation going forward.

Inflation responds to slack with a long lag in today's world, where – thanks greatly to the efforts of Paul Volcker – confidence in the Federal Reserve's commitment to price stability is strong. It's easy for policymakers to take that confidence for granted, and understandable that they would want to push hard against real resource constraints in an effort to spread prosperity more broadly. However, as I have repeatedly reminded my FOMC colleagues, and they have been very tolerant in putting up with me, every single time the Fed has waited, every single time in our history that we have waited for full employment to be achieved before starting to withdraw accommodation, it's driven the economy into recession. When policymakers get too clever by half, I believe the public pays a very stiff price.

I liken monetary policy to piloting a ship, as I learned to do, as Paul referred to, at the Naval Academy. When you are at the conn, when you're at the wheel of a very large ship, you begin to slow down miles before you reach your intended destination. There are no brakes you can slam on to make a sudden stop. Ship velocity, like monetary policy, operates with a lag. If we wait to see the whites of the eyes of full employment and then have to raise rates sharply, I believe it would shock the economy and invite an adverse reaction in the financial markets. So, taking a page, even though I'm not Catholic, from Pope Francis, I hope we don't forget the past and will remember that the wisest policy option has proven to be early and gentle rises in interest rates as we approach full employment.

Now during the financial crisis, I said we were, as Americans, "the best-looking horse in the glue factory of the world economy." (Laughter) The outlook was bleak everywhere. We were hobbling along on unsure legs. And now, thanks in part, significant part, to accommodative monetary policy and the indestructible force of American entrepreneurialism, most vividly demonstrated by George Mitchell and other innovators in the energy sector, and with no thanks to the fiscal and regulatory shenanigans by a feckless Congress and president, the U.S. is now racing down the track.

Our businesses used the downturn to tighten their expense structures, to ramp up productivity and to ramp up efficiency. They have used the accommodative monetary policy of the Fed and abnormally low interest rates that we have engineered to clean up their balance sheets, replace existing debt with lower cost debt and also tightening up their equity structures, buying back shares and improving shareholder satisfaction by increasing their dividends. During the depths of the crisis, one of my most esteemed colleagues on the FOMC noted that, looking at the banks' balance sheets, "nothing on the right was right and nothing on the left was left." (Laughter) She's very esteemed because that was Janet Yellen. Now both sides of the balance sheets of most U.S. companies, as well as banks, are healthier than they have been in decades.

And here's the point: Thanks to the Fed's monetary policy and to their own ingenuity, private businesses in the United States of America – those that create real, lasting jobs – are well-groomed and fit and ready to run fast around the global track than the businesses of any other

country.

So let me conclude with the visual that I believe embodies the potential of our economy, and I'll make it New York-centric: that of Secretariat at the Belmont Stakes in 1973. And let me remind you that despite all the naysayers and doomsayers – those that said that Europe would lap America, that Japan would lap America, that China would lap America, that the BRICs would lap America, that the United States could not compete with the masses of low-cost labor that were unleashed in China and elsewhere, India, by the end of the Cold War and the advent of globalization – let me remind you that we are number one. The U.S. and its North American Free Trade Agreement partners, Mexico and Canada, form the most dynamic growth epicenter of the world. We are Secretariat, and we can win the global economic race by 31 lengths if only we are given freer rein by fiscal and regulatory authorities.

I was a child of the Cold War. We lived then under the threat of mutually assured destruction. The Wall came down. The Soviet Union disintegrated. Mao died. Communism was swept into the dustbin of history. Sure, we have a group formerly known as ISIS and the Taliban and other perpetrators of evil and we worry about them terribly. But the great powers have turned from mutually assured destruction to mutually assured competition. When I was sent by Bob Roosa to work in the Carter administration and learn, in his words, "how government can screw things up," we had a G-6 – ourselves and five nations that we interfaced with economically, financially, constantly – Canada, England, France, Italy and Germany. I like to say now we have a Gee

Whiz. We have G-20s, G-30s, a WTO, and so on. We won! And every nation is pursuing economic prosperity; every nation wants to compete to better the standards of their people. We paid a precious price in blood and treasure to win the Cold War and create a world of mutually assured competition. There's no country, there's no people, there's nobody anywhere on this planet who can outpace us. Nobody. Thank you. (Applause)

And now, in the spirit of what every signatory to Senate Bill 264 worries about, I'd be happy to avoid answering any questions you have.

QUESTION AND ANSWER PERIOD

THE HONORABLE RICHARD W. FISHER: There's a microphone in the back if you have questions. Yes sir, the gentleman there.

QUESTION: Thank you Governor Fisher. Those remarks were very thought-provoking. I did want to push back a little bit on a premise around a cardinal principle. That if something is not broken, why fix it? It would seem to me, looking at the last six years or so, you've had a combination of distrust in public institutions with economic monetary policy that has benefitted a smaller group of people, owners of assets, versus those who have labor to perform. Combining, it has created the kind of "audit the Fed" type of bills. With the passage of time, it would seem to me as it's getting increasingly evident as things begin to normalize, this too will ease and

therefore the belief in the Fed and its monetary policy will endure. So from that standpoint, one would think why try to fix something that actually is working rather well and not broken. Thank you.

THE HONORABLE RICHARD W. FISHER: Well, I actually would agree with you and I want to put you on the stand in front of Senator Rand Paul. Look, the earnest men and women that are at the central bank of the United States, the Federal Reserve, have done what they've always been doing, particularly in the legacy of Paul. They were called to duty. They did what they were supposed to do in the face of an urgent emergency. And my point is we did our job. We may have had differences of opinions at the table. I, for example, didn't want to take our balance sheet above two trillion. I lost that argument. More reasonable arguments prevailed. But in the end we get things done. And, as I said in my speech, Congress does not. We also do it in a civil manner. Even when we disagree – President Dudley and I might disagree – we are very close personal friends. We let our children play together, unlike Congress people. (Laughter) But the reality is, again at times like this the suggestions I had are simply suggestions (a) I think are needed, and (b) might address the suspicions of those that think somehow something is broken. There's no denying that when they look at a very large balance sheet like ours, that exceeds $4 trillion, and was $800 billion when I got started, then they look at the amount of reserves that are built up on the side, on the other side of the balance sheet, of $2 - $2.5 trillion, it wets any politician's appetite. But the bottom line message that I'm giving is the same as you. We do our work. They need to do theirs. And let me just say, I view our job as filling the gas tank. It's a

simple analogy. We have filled the gas tank, it may be brimming over, but there's plenty of fuel to drive this economy forward. What is needed, and it's taking place slowly, largely as I said due to the ingenuity of American entrepreneurs and business leaders, but I would like to see much better incentive to take that fuel, step on the accelerator, move the job creating forces forward for our economy. And in my view, Secretariat, which is us, we're fit, we're beautiful, we're a strong filly, a strong stallion, just open the starting gates, and we'll, at least win by 31 lengths. But it's the fiscal authorities and regulatory authorities that are holding us back. That's the message. Yes sir...Mr. Hormats.

QUESTION: Thank you very much for a terrific speech and for all your great service over the many years. I'd like to ask you, now that you're liberated from the Fed...

THE HONORABLE RICHARD W. FISHER: Not yet.

QUESTION: Almost...about to be.

THE HONORABLE RICHARD W. FISHER: Wait 'til I'm liberated. (Laughter)

QUESTION: I can't wait. Europe, and the European Central Bank, a very different kind of institution but with at least some similar goals. How do you evaluate what Draghi is doing? And there's an environment where you have a central bank operating and not only is fiscal policy not

working, there is none, essentially. It's national fiscal policies. Many of them are operating in ways that are counterproductive to what the central bank is doing. I wonder if you could comment on the role of the European Central Bank and how you see, in that environment, the kind of changes that are needed to make it work better and make the European enterprise work more effectively.

THE HONORABLE RICHARD W. FISHER: Well, I'm very hesitant to talk about other monetary authorities because my duty is to the one I am employed by. And I'm also very sympathetic because it is a new experiment. We know its purpose. Its purpose originally was, and it was debatable, if you have a single currency you will drive nations to get their fiscal house in order. The present example, of course, would be Greece. In the old days they would have devalued the drachma, inflated their way out of this thing and they'd be running down a different track. And now that option is not available unless they pull themselves out. And again, Bob, we deal with one feckless government. They have to deal with a whole group of them. So I'm very sympathetic to Mr. Draghi and his predecessor, by the way, who is an exceptionally gifted individual, and the people that designed it this way. It's sort of like Perestroika and Glasnost, which should go first? And if you think about it, there was no way you could get all the fiscal policy – they tried, through different rules – to be coordinated. And this is a forceful measure to try to get it done. I'm not going to predict who might stay and who might come in. We've added a nation and we have a nation at risk right now. But I don't think that's my role. All I can say is the answer is I'm very sympathetic. That's about as much as I think I should say. Yes sir...

QUESTION: Again I add my thanks for your remarks this morning. But looking at our system and our monetary apparatus in terms of policymaking, to those who say, because we've done, or you guys have done such a good job, you have kind of allowed the fecklessness in terms of fiscal policy and regulatory, and not having the regulatory sort of reform that you suggest in your remarks. Could you make some comments on that?

THE HONORABLE RICHARD W. FISHER: We've discussed that, at least I've discussed that sometimes at the table. Again, our job is monetary policy. But I understand the argument. If you make money cheap, and the cost of borrowing from the Treasury nil, and you pay back our profits to the Treasury, Bill and I are two of the people, two of twelve people, plus the governors that you meet, so there are nineteen of us, right now there are eighteen of us, you're looking at two of the eighteen people who have paid down the nation's deficit. We're the only ones. We pay back our profits as they were. And Bill, it's now over $500 billion that we've paid back over the recent years. So, (a) we've made the cost of borrowing a hell of a lot cheaper and, (b) we're doing something that they should be doing. And there is an argument to be put that we've taken away the incentive for them to correct their house. I'm awfully glad we did what we did because again it's enabled businesses to take the reins and run. But I agree, we've made their job a lot easier. But this is where leadership is required. I'll give you an example of leadership. You may not feel this way reading the paper this morning, particularly the front page of one of the great foreign newspapers that I like to read, The New York Times. (Laughter) But look at Mexico,

Mexico has a legislature that has voted to limit its debt as a percentage of GDP. It's a fraction of ours. It maintains a totally independent central bank. They use these low interest rates to achieve a remarkable structural reform. It's now an exporting powerhouse. And very importantly, have issued century bonds. We should have been issuing century bonds. Why would we not do that when rates are the lowest in 237 years of American history? Well, a lot of smart people have done that – Tufts University, Mexico, other countries. We didn't do it because we were worried we'd add to our interest rate burden. We came very close, by the way, in the state of Texas under Governor Perry to issuing century bonds. We even had the underwriters lined up. But we couldn't get it through the legislature. And interestingly, the Tea Party argued, we don't want to saddle our children and grandchildren with debt. Well, we have $90 billion in need for water projects in Texas. So my answer was, okay, you'll saddle them with taxes. And then we had divisions within the Democratic Party in our legislature. It's a tiny, little party within our legislature, but they wouldn't agree. Our credit rating in Texas is higher than that of the United States. And we could have issued 100-year bonds in the 4% range. That's a gift. So, yes, we've disincentived in a way but we have to take into account how Congress actually works. And I don't think that should have prevented us from doing the job we had to do because nobody else was doing the work. So, I understand the argument, but that's the reality. In the back, yes sir...

QUESTION: You spoke about how you would think about inflation going forward with respect to energy and adjusting the inflation metrics. How do you think about movements in currency, and specifically increases in the trade with the dollar, how that impacts your forecast on inflation

and Fed policy?

THE HONORABLE RICHARD W. FISHER: Well, in a couple of ways, you know the old high school formula for determining what GNP is – C plus I plus V plus or minus X. So consumption, investment, government, plus or minus net exports. And we've seen about an 18% appreciation in this current dollar rally. And obviously, depending on how you look at the composition of exports and imports and taking into account the fact that oil is priced in dollars, and we have a different position than we had before, it's going to exert some kind of drag. But the question is how heavy is the weight of that drag? I am a firm believer that the central bank of the United States should do what's right for the United States. I am sympathetic to the cries of currency wars. I find it wonderfully ironic that the first person who was critical of our accommodative monetary policy was the Brazilian Finance Minister. And then as soon as things reversed, he was critical of that and started talking about currency wars. So I think it's a factor that obviously impacts our economic growth. There are offsets to it. Seventy percent of our GDP is consumption. I've yet to talk to a retailer or an airline operator or a theme part operator or a restauranteur that isn't thrilled to death with the decline in energy prices and the strength of the dollar. And we are consumption-oriented. And the other thing that's changed, and this is where I think we might have to look at our formula again, is the way things are sourced. They're not single-country sourced. They're multiple-country sourced and then the value is added here. All you have to do is look at your little iPhone. So probably it will exert, statistically speaking, a numerical drag, but I don't think that's the sole factor that we should drive monetary policy by.

And I'd say one other thing from my experience as a market operator, which was most of my career, and parenthetically I started my career at Brown Brothers as a foreign exchange advisor, we made a lot of money off that practice. It didn't help our clients very much, but we made a lot of money off that practice, because even then with a limited number of currency, it's very difficult to hedge long term. I understand the impact it's having on corporate profits, but it's my firm belief as a former market operator that markets are manic-depressive mechanisms and this won't go on forever. It'll correct itself at some point. So I don't think we should drive policy by short-term movements in currencies, but that's my opinion. Other questions? There's one way in the back. Yes sir...

QUESTION: Thank you for taking the question. What do you think is the impact of lower oil prices on your region? I think of the million housing starts, I think something like a third are in Texas and Oklahoma. How do you see this all playing out with respect to U.S. GDP?

THE HONORABLE RICHARD W. FISHER: Well, first, I did take note of J.P. Morgan's, and I hope there's someone from J.P. Morgan in this room, their comment that Texas would go into a recession. And I was quoted in the Wall Street Journal, and I love the way they phrased it, my response was "bull droppings." (Laughter) As you know, that's not what I said. (Laughter) You have to understand, first of all, our economy is 27 million people. It's a highly diverse economy. Energy is 12% of our output, the equivalent of gross domestic product of the state of Texas. That's 2.6% of our employment and that includes support services. When we last had a reversal

like this, it was in the early 1980s and we saw oil prices come down 63%. They've now come down roughly 50% from the peak. But back then, almost a quarter of our state revenues were dependent – between 17.8% and 25% depending on which year you looked at – dependent on severance taxes and other oil-derived inputs. Today it's 4.1%; 2.6% as I said earlier of our employment is hired and works in the energy sector. And yet it does have a 12% weight in our overall output. So it'll be a negative for us. In December, our last month of employment measurement, our workforce grew at 3.67%. I love the way economists carry things out several points to the right of the decimal point, but 3.67%. And if you go back to 1990, after we came out of the last crisis, we have grown our jobs by, if you take that as a base of 100, we're at 174. So we have grown through diversity, not just totally dependent on energy. I would expect, given the rig count drop that's taken place, and you can look at the Baker-Hughes numbers every day like I do if you wish, I don't recommend you do so because it's a little depressing right now, but I can see our employment growth dropping from its blistering rate to that of the rest of the United States, or to even as low as 1% depending on how long this price discovery process the Saudis have engineered will continue. More important than that is the weight of oil in the economy. Oil and gas is 1.2% of total CAPEX in the United States. It is less than 2.6% of total employment which it is in Texas. And if you take out Texas, it's 1% of employment. So this is a net plus for the United States. And all you have to do is go to, my favorite term, a casual dining restaurant – by the way, this is not one of them here...(Laughter) And if you look at the data just released by one of the analysts at Deutsche Bank just two days ago in terms of restaurant employment, it has spiked. Restaurants are the largest employers in America – people don't realize that – for young

people like me, where I got my start at the Hawk 'n Dove in Washington, D.C. as a waiter, a busboy. So anybody that consumes fuel, you talk to CEOs of the great airlines or you talk to CEOs of Disney or any theme park operator, anything that needs energy, and almost everything needs it, they're happy campers, particularly consumers. So I believe and I think, Bill, I can say this, we believe it's a net plus for the U.S. economy, even if it brings Texas down to a slower, but positive rate of growth.

I'm going to stop here, but I can't resist, because he's not well and I just wanted to tell you one quick story just to put things in perspective. We had a joint meeting with the Federal Reserve Bank of St. Louis, our board of directors. My chairman at the time was the iconic airline executive Herb Kelleher who founded and built Southwest Airlines, his greatest achievement, other than being the single largest consumer of Wild Turkey bourbon on the planet. (Laughter) So, of course, we flew on Southwest Airlines. And as we approached, got up into the air and we were at a cruising speed of 30,000 feet, Herb takes the microphone and he says, I want to thank you for flying the airline I founded and for making me rich. And he's a folk hero in my part of the country. And you know there are people that fly on Southwest who are dressed like we are, but they also have bib overalls and shorts and whatever it may be – regular, plain, hardworking folk. And they cheered him like a rock star. And then he said, I have your attention for the next hour, and I'm going to tell you how the Federal Reserve works because on this plane today is one of the most powerful people in the global monetary system. Me, he said. He said, and I'm only chairman of the Dallas Fed and the president of the Dallas Fed is here. He sits on the

FOMC. He walks through the whole explanation, for an hour, and people were just fascinated. And when he sits down, he gets applause and they were screaming, Herb, Herb, Herb. And sitting behind me was a couple, a little man in bib overalls, and his wife. And he turned to his wife, he said, Ethel, if Herb Kelleher is involved with the Federal Reserve, why do vote for Ron Paul? I landed. I called Ben immediately. I said, you won't believe what just happened. He said, Richard, do me a favor, put Herb Kelleher on every airline all over America and fly him around constantly. Thank you very much for putting up with me.

CHAIRMAN WILLIAM C. DUDLEY: Thank you very much Richard. I certainly agree with your remarks about "audit the Fed." Then I thought you went downhill a little bit after that. But you recovered at the end. Our next meeting of the club is March 23. Our speaker will be Stan Fischer, the vice-chair of the Federal Reserve Board. Invitations are going to go out shortly. And beginning on February 17, you'll be able to make your reservations online on our website. So the reservation website goes live on February 17. And you'll be hearing more about Stan's speaking event. Thank you all for joining us and have a great day.

END OF MEETING