

Opening Remarks

Town Hall

Narayana Kocherlakota

President

Federal Reserve Bank of Minneapolis

University of Wisconsin

La Crosse, Wisconsin

September 4, 2013

Thank you 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, I will answer any questions 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. 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 American monetary policy.

Congress requires the FOMC to make monetary policy so as to fulfill two mandates: promote price stability and 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.

Current Monetary Policy Stance

With that context, let me turn to the current stance of monetary policy. Six years ago, in the fall of 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. Six years later, the Federal Reserve owns well over \$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 2013. It has also been targeting a fed funds rate of under a quarter percent for nearly five years. It anticipates continuing to do so at least until the unemployment rate, currently at 7.4 percent, falls below 6.5 percent, as long as inflation remains under control.

These policy actions—buying long-term assets and keeping short-term interest rates low—are designed to stimulate spending by households and firms, and thereby push up on both prices and employment. Is the FOMC's policy stance providing an appropriate amount of stimulus to the economy? To answer this question, we have to compare the economy's performance relative to the FOMC's goals of price stability and maximum employment. In July, the unemployment rate was 7.4 percent—much higher than the FOMC's current assessment of the longer-run normal unemployment rate, which is between 5.2 percent and 6 percent. At the same time, personal consumption expenditure inflation—including food and energy—is running well below the Fed's target of 2 percent.

But current monetary policy is typically thought to affect the macroeconomy with a one-to two-year lag. This means that we should always judge the appropriateness of *current* monetary policy in terms of what it implies for the *future* evolution of inflation and

employment. Along those lines, after its most recent meeting, the FOMC announced that it expects that inflation will remain below 2 percent over the medium term and that unemployment will decline only gradually. These forecasts imply that the Committee is failing to provide sufficient stimulus to the economy.

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 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.

To achieve its goals, the FOMC has taken some historically unprecedented monetary policy actions in recent years. 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. Indeed, the FOMC's own forecasts suggest that it should be providing more stimulus to the economy, not less.

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