Thank you very much for inviting me to speak with you. It’s an honor to be here, at this storied institution, and with the MOAA chapter whose namesake remains an inspiration to all who have served.

Although I’ve been retired from the Marines for some years now, I try to live up to the Corps’ values of honor, courage and commitment every day, both personally and professionally. I appreciate the opportunity to share with you that those values actually align closely with the values of the Federal Reserve and support our work to foster a healthy, growing economy and a stable banking system. I should also say that the economic views I share today are my own and not necessarily those of the Richmond Fed or the Federal Reserve System.¹

I started my career at the Fed after eight years on active duty as an infantry officer. At first glance, the Federal Reserve might not seem like an obvious next career move — after all, what does a Marine know about monetary policy? But as I’ll share in more detail in a few moments, the Fed is a diverse environment, by which I mean there is much more to the Fed than interest rates and inflation. The opportunity to work on multiple missions appealed to me — as did the comfort that the Fed has almost as many acronyms as we do in the military. But most
importantly, joining the Fed was a way to continue serving my country, and I see every day how that spirit of service guides my colleagues as well.

The Fed’s Governance

Before I talk about what the Fed does, let me first explain how it’s governed. The Federal Reserve is a system of 12 independent regional Reserve Banks overseen by a Board of Governors whose members are appointed by the U.S. president and confirmed by the Senate. This structure supports the Fed’s accountability to the public while keeping monetary policy free from political influence.

Each regional Reserve Bank is governed by a board of nine directors. Six directors are elected by member banks and three are appointed by the Board of Governors in Washington. While some may feel that banks have a lot of influence on our regional board, only three of the bank-elected directors actually represent banks; the other three represent the public, as do those appointed by the governors. Moreover, those who do represent banks don’t participate in selecting a Reserve Bank’s president or first vice president.

Our directors do more than oversee the Richmond Fed’s operations; they also are a unique and invaluable source of regional “grassroots” economic data. For example, our directors include the president of a bank not too far down the road in Roanoke; a senior executive at Northrop Grumman in Maryland; and the head of a manufacturer in North Carolina. They all have different perspectives and insights, which help inform my economic perspectives when I go to FOMC meetings.
Monetary Policy

There’s one of those acronyms — the Federal Open Market Committee, or FOMC, is the Fed’s monetary policymaking body. It’s composed of the seven members of the Board of Governors (when the Board is fully staffed; right now, as you may know, we have several openings) and five regional Bank presidents on a rotating basis. (Richmond votes next year). Whether or not a president is voting at any given meeting, he or she participates fully in the FOMC’s discussion and has an opportunity to weigh in on any proposed policy actions.

In the late 1970s, Congress amended the Federal Reserve Act to specify that the FOMC is charged with promoting maximum employment and stable prices — what you might have heard referred to as the “dual mandate.” I won’t try to explain precisely how the Fed works to achieve those objectives, especially as they have evolved since the financial crisis. But, generally speaking, monetary policy tools influence interest rates, which in turn affect the supply of and demand for money. Put another way, the FOMC’s monetary policy decisions influence the decisions businesses and consumers — you and I — make nearly every day about how much to spend and save and invest. And all those billions of individual decisions add up to our economy.

Bank Supervision and Regulation

The FOMC gets most of the news headlines. But as I mentioned, monetary policy is only part of what the Fed does. Another core function is bank supervision and regulation. By law, the Fed supervises all bank holding companies, savings and loan holding companies, state-chartered banks that elect to become members, foreign banks operating in the United States and
“systemically important financial institutions” (or, here we go again, SIFIs, in Fed parlance). At the Richmond Fed, we supervise some of the largest banks in the country, which have chosen to make their home in the Fifth District. Our goal is to ensure that banks are financially healthy and able to meet the needs of their customers and to ensure that banks’ deposit and lending practices are fair and access is equitable — a point I’ll come back to in a few minutes.

The Payments System

A third core function of the Fed is moving money from point A to point B, referred to as the nation’s payments system. Today, a lot of that money is in electronic form. The Fed is the largest operator of the automated clearinghouse, or ACH, network; that’s the system that enables direct deposit, online bill payment and many of the other online transactions we’ve come to depend on. We also operate Fedwire, a system for high-dollar interbank settlements, through which more than $4 trillion dollars changes hands each day.

Until the early 2000s, much of our work also involved moving paper checks between banks; on any given weekday, there were about 43,000 pounds of checks in transit. Today, Americans write a lot fewer checks, and those checks are now processed electronically. The Fed currently has just one check processing center, in Atlanta, compared to 45 centers nationwide in 2003.

Although Americans use plastic for a growing share of transactions, cash is still alive and well. Every regional Bank has a cash processing center; between the Richmond Fed’s three sites in Richmond, Charlotte and Baltimore, we process between 12 million and 14 million notes per day. Part of that process is determining if a note is still fit for circulation. The average $5 bill, for
example, has a lifespan of about five years before it becomes too worn for use. Bills that shouldn’t go back out for circulation are shredded (and recycled as products such as roofing tiles or souvenirs for people who visit the Fed). We also examine every bill to make sure it’s genuine. In Richmond, we detect between 40 and 50 counterfeits each day, which are sent to the Secret Service for further investigation. (The Fed catches only about 20 percent of the counterfeit notes passed in the United States — banks and merchants catch the vast majority of the remainder.)

Most basically, our cash service distributes coin and currency to the banks in their respective districts. But on a deeper level, this function is essential to the safety and security of our nation’s citizens. When there’s a national emergency or a natural disaster, such as the recent storms that devastated so much of the Gulf region and Puerto Rico, people need to buy food and water and diapers. They need to be able to get cash from their banks when they can’t use their credit cards because the power is out. Working with the banks and transportation carriers, there are extensive business continuity plans to ensure that your financial institutions can meet your needs in the event of an emergency.

**Community Development**

As I mentioned, part of our bank supervision role is working to ensure that banks’ lending practices are fair and equitable. One major way we do that is by assessing banks’ compliance with the Community Reinvestment Act (CRA), a 1977 law intended to discourage the practice of “redlining,” or banks’ perceived reluctance to lend in certain (typically poor and minority) neighborhoods. In the words of the law, the CRA requires banks to serve the needs of the communities in which they are chartered to do business, including these low- and moderate-
income, or LMI, communities. Such communities are a large part of our District; as of 2014, more than one-quarter of our region’s population, 8.1 million people, lived in LMI neighborhoods.

When the CRA was first enacted, Reserve Banks played an important role helping community groups navigate the administrative processes of the act. Over time, that role grew into a formal community development function that works to provide people and businesses in LMI communities with tools and connect them with resources to address credit and development issues. Just a week or so ago, for example, our Bank brought together a group of medical professionals, health advocates and financial professionals to discuss health investments in Virginia, particularly in hard-to-reach rural areas.

**Economic Outlook**

During my time at the Fed, I have learned that even the brightest policymakers, business and community leaders don’t have all the answers when it comes to the economy. People, and by extension markets, don’t always behave the way economists and policymakers might expect them to. In fact, yesterday a Nobel Prize in economics was awarded to Richard Thaler for his research on how human traits affect individual decisions and financial markets; put simply, his research found that humans often don’t act rationally. I’d like to suggest that recognizing that fact is one of the Fed’s strengths. And that is one reason the Federal Reserve System has 12 independent regional Reserve Banks: so monetary policy benefits from the diverse insights of business people, bankers, farmers and nonprofit leaders. And, as I mentioned, from medical professionals, health advocates and financial professionals, too. Another strength of the Fed is
that no one at the table during FOMC meetings presumes to have perfect foresight or knowledge; everyone is willing to listen to evidence that might contradict their own prior beliefs or understanding of the data. The debates can be vigorous, but they are always respectful.

Reasonable people can, and have, debated the wisdom and efficacy of the Fed’s past policy decisions. Based on my experience with the Fed, I’ll offer that what’s not debatable is the Fed’s unwavering commitment to do our best for the American people in meeting our statutory mission. That commitment guides us today during some admittedly uncertain times.

Turning to the current economic landscape, as you probably know the Fed targets 2 percent inflation over the long run. You’re also probably aware that inflation has been running somewhat below that target for several years; as of August, the most recent reading for the past 12 months is 1.4 percent.

Relatively weak inflation has been coupled with relatively strong improvements in other economic indicators. The unemployment rate was 4.4 percent in August and has been below 5 percent for more than a year; job growth has been steady; and other measures of the labor market suggest we’re pretty close to “maximum employment.” GDP growth was a solid 3.1 percent in the second quarter, and while we will probably see some slowdown in the third quarter due to Hurricanes Harvey and Irma, experience suggests that slowdown will be temporary. Overall, trends in wages, household spending and business investment point to the economy continuing to expand at a moderate pace over the next few years.
Historically, lower unemployment rates have been correlated with higher inflation; the basic economic mechanism is that when workers are scarce, employers raise wages, and those higher costs flow to consumers in the form of higher prices. Given how low the unemployment rate is at present, one might conclude that the current stance of monetary policy is too accommodative. But as I mentioned, inflation is actually running below the Fed’s long-run target. One possible explanation, as Chair Yellen noted in her most recent press conference, is that unusual events have lowered specific prices substantially, which has an effect on the overall price level. Since those unusual events are only temporary, inflation is likely to increase in coming months. In addition, higher gas prices as a result of the hurricanes will likely boost inflation in the very short term. Overall, the FOMC expects inflation will rise and fluctuate around 2 percent over the next few years, and that additional increases in the federal funds rate will be forthcoming.

That said, we don’t have a perfect understanding of the current behavior of inflation. Some have proposed that the relationship between unemployment and inflation has weakened over time, meaning it takes bigger swings in unemployment to trigger changes in inflation. Demographic shifts, such as baby boomers retiring and large numbers of younger workers joining the work force at lower wage rates, could also be a headwind for wage growth and inflation. Competitive pressure on firms making it difficult to raise prices, the “scarring” of many workers during the financial crisis resulting in reluctance to demand higher wages, sluggish productivity and perhaps lower consumer expectations for inflation are other hypotheses being examined at present.
With those factors in mind — but also with the knowledge that monetary policy operates with a lag — it will be important to act before inflation gets too far ahead of target. We will be watching the incoming data very closely and gradually adjusting policy to better achieve our inflation and employment objectives.

**Conclusion**

So, why do we care about achieving those objectives? Beyond the obvious answer — that we want a healthy economy and want people to have jobs so they can buy the goods and services they need — it’s because economic prosperity is essential to ensure our most basic freedoms. As Gen. Marshall said when he introduced an economic recovery package aptly referred to as the Marshall Plan, without “normal economic health…there can be no political stability and no assured peace. This Plan is directed not against any country or doctrine but against hunger, poverty, desperation and chaos. Its purpose should be the revival of a working economy in the world so as to permit the emergence of political and social conditions in which free institutions can exist.”

The relationship flows both ways. Our national security apparatus creates the environment in which our citizens feel safe to buy homes, go to school and take entrepreneurial risks. In the other direction, military strength flows from economic strength. The United States military is the strongest in the world because we can invest in the people and technology to be the strongest in the world.
There’s a classic example in economics known as “guns or butter.” The idea is to illustrate that a country makes choices about what to produce given its finite resources. The more butter, the fewer guns; the more guns, the less butter. But in the real world — in today’s world — it’s not a simple trade-off. Instead, we should think about the situation as, “no guns without butter, and no butter without guns.”

While allocating resources to guns versus butter is the purview of fiscal policy, fiscal decisions must be underpinned by a healthy, fully functioning economy. It’s been my distinct pleasure to talk to you today about the Fed’s mission to promote a healthy economy through our work on monetary policy, banking supervision, electronic payments, checks and cash and our role in community development and outreach. In short, our job is to serve the American public — to serve you.

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1 I am grateful to Jessie Romero for assistance in preparing these remarks.