

## Georgia's Business # 425

**Guest: Dennis Lockhart**

**President and CEO of Federal Reserve Bank of Atlanta**

**Richard Warner:** I'm Richard Warner on Georgia's Business this week. With the financial meltdown hitting banks, retailers, car dealerships, and many of us watching TV right now, we welcome a guest with a unique perspective. Dennis Lockhart is President and CEO of the Federal Reserve Bank of Atlanta. His career includes tenure in academia, investment banking, and international finance. He took over as the Atlanta Fed's 14th CEO about two years ago. So... how bad it is?

**Dennis Lockhart:** Well, this particular quarter of the year, it's my hope that we're in the trough. Right now there is not a lot of good news economically. Fourth quarter of last year the gross domestic product came in at a contraction of 3.8 percent. It actually was a little worse than that number because there was a large inventory build-up in the fourth quarter that, in all likelihood, will not be completed in this quarter. We expect that the second quarter of the year, starting in April, will also show a contracting economy. But we're hopeful that in the second half of the year, we'll begin to see some improvement and perhaps some small growth.

**Richard Warner:** You see a U-shaped recovery?

**Dennis Lockhart:** We see a U-shaped or even conceivably something more shaped like an L with a slow and gradual improvement starting in the second half but...

**Richard Warner:** An L is just down (*laughs*).

**Dennis Lockhart:** Well, just think of an L, a little bit tilted L.

**Richard Warner:** Okay.

**Dennis Lockhart:** But in any event, our thought process is that the consumer is going to be conservative for quite some time.

**Richard Warner:** Is that a bad thing?

**Dennis Lockhart:** It's an ironic thing. In the short term, we really need consumption to get the economy moving again. We need people to be confident to consume. Over the longer term, a balancing of savings versus consumption makes sense, in effect to rebalance our economy.

**Richard Warner:** Who would have thought that a year ago, we would have been talking about Americans saving too much?

**Dennis Lockhart:** Well, Americans are saving too much perhaps in the short term, but the savings rate is likely in fact to grow from where it is today and (*pauses*) if we take a long term perspective, that's a necessary development in order to really get to a position where we're not living beyond our means.

**Richard Warner:** So many times in this show, and we've been doing this show a long time, and for a long time people have been talking about the housing bubble; that we couldn't continue to live on credit cards as a way to increase our salary essentially. It finally did happen. So, this is a necessary contraction wouldn't you say?

**Dennis Lockhart:** Well, certainly in retrospect some of this was predictable or at least appears to be an adjustment process that was a necessary reaction to several years of living a bit beyond our means.

**Richard Warner:** The core cause of this was, and you correct me if I'm wrong: we start with housing which then like dominoes goes to banks which then goes to credit cards which then goes to jobs.

**Dennis Lockhart:** The core, or lets say the initial cause, was in a relatively small area of finance, a relatively small area of the economy, the so-called Sub-Prime Mortgage Area, sub-mortgage crime back securities were downgraded and then caused a kind of cascading effect through the banking system. But, clearly the housing sector is at the center of an economy that is repairing itself. So we will probably not see substantial improvement until we see house prices stabilize and the housing sector begin to bottom out.

**Richard Warner:** I don't want to put you on the spot in terms of your role in politics in Washington and all that, but your answer would imply that whatever we're doing to try and fix this, whatever money is being spent by the government, a lot of it needs to be focused on specifically on housing as opposed to banks. Is that fair?

**Dennis Lockhart:** Well, I think you have to look at both. You have to focus on both. If there are two essential requirements for the economy to stabilize and then begin to improve, it is the stabilization of the banking system and the bottoming of the housing sector.

**Richard Warner:** Banks, it appears, are going to be nationalized to some degree.

**Dennis Lockhart:** I'm not really going to speculate about whether we'll get that far. But...

**Richard Warner:** Are haven't we already? I mean, are there banks where Uncle Sam is essentially the primary stockholder?

**Dennis Lockhart:** No there are not as a matter of fact. The capital injections that went into banks from the Trouble Asset Relief Program were preferred stock and non-voting. So, the government is not, strictly speaking, the way a board of directors would, controlling the bank on a day to day basis. Nationalization takes it one step further. It would be owning the common stock and having some control over the board of directors.

**Richard Warner:** I'm watching this at home and I'm wondering do I need to pull my money out of Bank X because I keep hearing they're having so much trouble?

**Dennis Lockhart:** At the consumer level, consumers are protected up to now \$250,000 by the Federal Deposit Insurance Corporation. So, it really isn't a concern for you and me as individuals.

**Richard Warner:** And if you have more than that, wow, you just need to put it in different banks?

**Dennis Lockhart:** If you have more than that in your checking account, then I'm going to question your cash management.

**Richard Warner:** In looking at history, and is history repeating itself? We go back to 1929 when the market tanked. The market now tanked but not nearly as much. But, nevertheless, back then, there was a lag time between the crash of 1929 and when the Depression really took hold. We're talking the early '30s? So there was a period of years there that transpired before we really hit bottom.

**Dennis Lockhart:** Much is different between that period of history and today. Scholars have looked at this, including our chairman Ben Bernanke, the chairman of the Federal Reserve System...

**Richard Warner:** Who is a scholar on the Depression?

**Dennis Lockhart:** He is a scholar on the Great Depression. There has been much inspection of what happened during that period. The generally opinion was there were policy errors, particularly errors on the part of the Central Bank, and not only not injected liquidity into the system but removing liquidity and other policy errors at the time that really bear no resemblance to the way we have reacted to this problems in recent times.

**Richard Warner:** Banks now have access to more capital. They're taking that capital in but it's generally understood that they're not lending it out.

**Dennis Lockhart:** Certainly that's the accusation that is being made now. That you've taken tarp money, trouble asset relief program money and haven't started re-lending that money and that is a matter of current debate and the banks are defending themselves in many respects fairly vigorously. I think the situation is that unquestionably banks, in reaction to a weakening economy and in reaction to growing troubled loans and troubled assets, became more conservative, more risk-averse...

**Richard Warner:** Like consumers?

**Dennis Lockhart:** But at the same time, when you talk to bankers, and I talk to bankers frequently, as you might expect, bankers say we don't have the loan demand from qualified

borrowers and we don't have opportunity. So, somewhere in there is the truth and obviously it's a mixed picture. I think what we're looking for is the conditions to develop in which consumers and businesses have confidence to make good loan applications, applications that make sense, and that the bankers have confidence that the overall economic environment and the prospects for that particular borrower make sense to lend. Recently, we've done surveys of bank-lending officers. The picture is that they tightened the terms of lending in the fourth quarter of last year, and as we begin the year, have maintained those relatively tight restraining lending terms. We're looking for those to ease. We hope they will ease as conditions improve.

**Richard Warner:** So if you're looking at the dominoes to fall in order, one of the first dominoes to fall is going to be a loosening of requirements in order to get the loan that you might want?

**Dennis Lockhart:** I think there is a bit of a chicken egg question right here but I would come around to the point of confidence. All parties in the equation have to have confidence. And there are reasons to have confidence in the future. We will get through this. The recession that we're in today actually is, will likely be a little longer but probably very similar to other recessions that we've managed our way through in the past. We have tools available to continue to address the problems in the financial markets and in the general economy. The Central Bank, the Fed has capacity to continue to grow its balance sheet, to inject liquidity into the system. There are many reasons to be confident that over the course of this year and going into 2010 that we'll get through this.

**Richard Warner:** Should we?

**Dennis Lockhart:** Should we get through it?

**Richard Warner:** Should we do all of those steps that are being taken and even more? This could come down to which side of the isle that you are on. Scientifically, do we need to be doing as much as we can or does the marketplace need to let this work itself out?

**Dennis Lockhart:** One of the lessons of history, and I fully support my colleagues that have espoused this view, is that the failure to react appropriately to weakness or financial market problems has really made the downturns deeper. So I am fully supportive of the view that aggressive action on the part of whether it's the Federal Reserve or the Treasury Department is appropriate in these circumstances.

**Richard Warner:** You know my car died two weeks ago; was not planning to buy another car. Went in and wound up having to buy another car because it would have cost more to fix the other one than it was worth, and I felt irresponsible.

**Dennis Lockhart:** There certainly is a feeling out there among consumers that now is not the time to consume and now is the time to become a little bit more austere in your habits and so forth. One of our directors summed it up by saying, it's cool not to spend, but we certainly need confident consumers who are going out and making expenditures that make sense to them within their means.

**Richard Warner:** And yet you see, this morning, the same thing every morning, I get up, I check my email and there's the layoff of the morning. It's electronics companies, it's publishers, there's so much going on that spooks customers, consumers, into not having; fooling themselves if they're confident.

**Dennis Lockhart:** And as you point out, it's the unemployment numbers or the announcement of layoffs and so forth that really do trouble people and make people anxious. A sober look at that is we're likely to see the unemployment get a little bit worse before it gets better. Employment tends to lag recovery. That is to say, when the economy begins to pick up and improve, businesses are cautious about bringing people back onto the payroll. So my realistic assumption as we go through this year is that we'll probably see more unemployment before we begin to see that turnaround.

**Richard Warner:** There are a couple of things that are different this time that could impact how fast and how strong the recovery is. One is the Internet which has been so disruptive to so many. To what extent do you think that's going to change this period of recovery compared to other ones?

**Dennis Lockhart:** I don't see the Internet unbalance as a terribly disruptive or let's say a depressing kind of element. In fact, I think the Internet has played a strong role in the improvement of productivity in the economy and has allowed forms of employment, flexible employment and so forth that have been good for society. So I'm not sure I see the Internet as something we should blame for the circumstances.

**Richard Warner:** The other, Internet the first, the second is the global banking and business system. Now this plays into your career because this is part of what you did prior to this role with the Fed. What happens in China, what happens in Asia, what happens in Europe has a direct impact on us. And while we may have been the first, there's as much or worse trouble going on there. Does this cloud it?

**Dennis Lockhart:** No question that our economy has to be looked at in a global context. No question that the rest of the world is feeling economic weakness and in some parts of the world, recession. My sense is that as things begin to improve in this country, in all likelihood we'll see improvement before other parts of the world. But you cannot look at this problem as an isolated United States problem. It really is a global problem to stage.

**Richard Warner:** We can't do very much about how other countries conduct themselves but I'm curious as we move past this, you know we saw in the last recession, a move toward greater regulation, Sarbanes-Oxley came to mind, designed to somewhat overreact to the problem that existed and cost so many people their retirement. Well, now we got on a far grander scale. Two schools of thought: one is heavy regulation to prevent this sort of thing; the other is, no, the free market should prevail. Does the Fed take a position on one side or the other? Do you?

**Dennis Lockhart:** I speak for myself. I can't speak for my colleagues. I think unquestionably there has been some failure of regulation in creating this problem, particularly in the banking system obviously, and that as we learn the lessons of this period, we will make every effort to get

regulation right. Part of that is the modernization of regulation; bringing the regulatory system up to the demands of our current financial economy. Over the last twenty to thirty years, we really had an evolution from a bank-centric system, financial system, to a market-centric system. And yet much of our regulation was focused on institutions as opposed to a mix of institutions and the markets. I think what you'll see coming out over the next year or more will be healthy discussion of regulatory reform and as I said, bringing it up to date; modernizing the way we go about overseeing the financial system.

**Richard Warner:** What does that mean to a consumer? Are the things that you won't be able to do- I mean you've already got more of a difficulty perhaps getting a loan if your credit is not really good. Moving forward, how is my experience apt to evolve as it relates to my money working with stock brokers? Or working with banks, or that? Is it going to be a much more onerous process?

**Dennis Lockhart:** At the consumer level, I wouldn't think so. One of the interesting debates around regulatory reform is how not to kill innovation; how not to so tie up the banking system or the financial system that our brains are not working on better ideas at any given time. So clearly one of the objectives of regulatory reform will be to regulate well, regulate intelligently but not in a way that crushes innovation in the system. And I think therefore the consumer has every right to expect continuing improvement and service and some new ideas being offered in terms of product.

**Richard Warner:** It's interesting that you imply a real delineation between what the consumer, and I realize that's what I asked, that what the consumer experience is and perhaps what business experience is. Are they different?

**Dennis Lockhart:** Well, they're different in the sense that much of the innovation that has taken place in past years really has been focused on the consumer, particularly in the mortgage area, and there has been innovation focused on business interest. You know businesses operate in very sophisticated set of capital markets with a very sophisticated banking system. I think the question you ask really is more appropriate. Will there be a dramatic change in the experience of you or me going into bank or you or me calling our stock broker or dealing with an insurance company or whatever?

**Richard Warner:** And the answer is?

**Dennis Lockhart:** The answer is I think it will be different for the two different customers groups but I think that consumers, where we're probably most interested, are not going to feel a regression in the quality of service.

**Richard Warner:** You have said that essentially consumers need to lighten up a little a bit. They need to loosen up a little bit. I mean, let's be sensible about this, let's not go back into heavy debt as we perhaps were. Let's not hoard all our money. To what extent is business in that same boat? Does business need to have that same attitude?

**Dennis Lockhart:** The advice I would give a business person today- really two things. First, manage your balance sheet so that it is as strong as it can be. Balance sheet strength is very important through this period. But the second is that there are opportunities now in this economy. I've talked to a number of high-level business people who recognize that this is an opportunity period and that if they have a strong balance sheet and their organization is really at its foundation, in pretty good shape, this is the time to be doing some interesting things.

**Richard Warner:** Absolutely. Those seize on the weakness of competitors to grow their business and a number of competitors as I believe it was Warren Buffet that said, when the river goes down you see who is swimming naked. There are a lot of naked businesses out there and yet, if you talk to folks in this building, folks across the street, down the road, there is a level of distrust because of what's happened to their retirement, what's happened to their investments that has caused- well, I'm wondering what you think- permanent damage?

**Dennis Lockhart:** Well, I won't speculate on whether the stock market or other investments will come back. Certainly there are many people now in shock and my generation is reconsidering their retirement plans and trying to figure out what budget they'll need when and if they retire. So, right now I would say there are many people who are having to go through pretty severe adjustments and reconsideration of their plans.

**Richard Warner:** And there is deep anger about that.

**Dennis Lockhart:** Certainly there is deep anger. I think that anger does feed some of the kind of public discussion of who's to blame and who do we point the finger at?

**Richard Warner:** And so I'm wondering, you know the Fed and the whole banking system, you know you need to go to college to fully understand how this works, so we can't go into it but when people find out who you are and what you do, but aren't experts at it, what kind of response do you get? Or do you get any of that anger directed at you with the theory that you had some ability to prevent it?

**Dennis Lockhart:** There is of course some anger, there will always be anger against some public institution but generally the feedback I get, particularly from business people, is that the Fed has stepped up and responded well to the growing weakness and the problems we've seen over the last year and a half. And generally we have gotten applause for reaction to the problems as the developed.

**Richard Warner:** Which was quick, inject money into the system.

**Dennis Lockhart:** It was quick and innovative at the same time I would say. I don't want to sit here and become either an apologist or some kind of a ra ra type supporting my institution. But I think history is definitely going to read that the Fed recognized problems and reacted quickly and reacted aggressively.

**Richard Warner:** What else can you do?

**Dennis Lockhart:** We have a lot of scope and that should be a source of some confidence to the general public for one, continuing to attack the dysfunction in particular financial markets by designing, if necessary, or by expanding existing programs that focus on market functioning. Secondly, we have scope to continue to add liquidity to the system. The jargon for that is grow the balance sheet of the Central Bank. And we can continue to do that. We've also done a lot already. When I joined the Fed in March of 2007, the federal funds rate, the base foundation rate of our interest rate system was at five and a quarter percent. Today, it's between zero and twenty-five basis points or a quarter of a percent.

**Richard Warner:** Can't go much lower than that.

**Dennis Lockhart:** Can't go any lower than that. We have brought rates down aggressively and interest rates will stimulate the economy as they become lower and people begin to recognize that they can buy house or business people can make investments at very, very reasonable rates.

**Richard Warner:** Alright Dennis, what keeps you up at night?

**Dennis Lockhart:** What keeps me up at night? There is also risk associated with any forecast. I would say that as I look at 2009, we have to see the stabilization of the banking system. As I mentioned earlier, the bottoming out of the housing sector as reflected in at least the slowing of the pace of decline of house prices; hopefully, actually the bottoming out of house prices. We do, in our forecast, consider some positive effect in the second half of the year of the stimulus package and we have to see a return of confidence.

**Richard Warner:** Dennis Lockhart, President and CEO of the Atlanta Federal Reserve and Bank, thanks for being with us.

**Dennis Lockhart:** Richard, thank you very much.

**Richard Warner:** And thank you watching. You can catch a replay of our broadcast on the radio, WCFO 1160 AM. And you can also listen in on iTunes. Just do a search on the term Georgia's Business. For now, I'm Richard Warner and for all of us here at Georgia Public Broadcasting, thanks for watching. And until next week, don't sell yourself short.