FPA 2009 Corporate Dinner
Keynote Address

Featuring:

Terrence J. Checki
Executive Vice President, Federal Reserve Bank of New York

Terrence Checki:

I want to thank Noel and Gonzalo and the Foreign Policy Association (FPA) for this award, for this great honor—and for bringing together so many old friends.

I also want to thank Bill, Jerry and Paul for their exceedingly generous comments. More importantly, I would like to thank them, and all of you with whom I have worked over the years, for your patience as you educated me, and for your generosity in sharing your insights and your understanding. I am very grateful.

It is no secret that I believe the best public policy is made quietly, behind the scenes. So it is not often that I allow myself to be on this side of a microphone. Actually, I am still wondering how I did let this happen.

As you know, much of my career at the New York Fed has been spent working with countries in the Emerging World. And for much of that time, the focus was on dealing with episodes of financial stress originating there. There have also been events closer to home—9/11, Long-Term Capital Management (LTCM), the 1987 stock market crash—in which the Federal Reserve played a role in helping our markets and economy work their way through.

Those experiences taught those of us that went through them a great deal about how crises develop and unfold, and about ways they are best managed.

But even for those of us who have seen their fair share of stressful episodes, the events of the past year and a half were without precedent in terms of complexity, speed, magnitude, and frightening implications.

This was not merely distress at an institution, or troubles in a market, it was a run on the system. Liquidity, trading, and confidence collapsed virtually overnight. In an industry that runs on confidence—the root of the word credit comes from the Latin “to trust”—suddenly no institution in the world trusted or wanted to deal with another unless a central bank stood between them.

How did we get ourselves into such a mess? Much of recent commentary has focused on assigning blame, and surely there is plenty to go around. But a narrative focused mainly on finding culprits risks obscuring the deeper structural issues that were integral to the crisis, and that will need to be dealt with if we are to successfully move to a more resilient system.

The vulnerabilities at the heart of the problem—excessive complexity, leverage, and opacity—did not emerge overnight. They evolved over a period of years, against a backdrop of benign macroeconomic and financial conditions that fostered an under-appreciation of risk and a reach for yield by investors.

The past two decades were a period of enormous financial innovation, reflecting changes in technology, accounting, regulation, instrumentation and market practice. Our system evolved from one funded by intermediaries, to one largely financed by markets. The traditional ties between borrower and creditor were weakened as credit risk became just another commodity to be traded and distributed.

These developments contributed to economic vibrancy and efficiency. But they also helped obscure growing leverage and declining underwriting standards, and encouraged the fanciful belief that the US economy and financial system were infinitely resilient and could support our living beyond our means indefinitely.

The tipping point at which confidence is lost and replaced by uncertainty, mistrust and fear is never visible until after it occurs. And so it was this time.

Unprecedented policy interventions were needed to put a floor under confidence and pull us back from the brink.

And while we have come a long way since the dark days of last year, the history of this episode is still being written, and the recent celebration in markets seems oddly premature. The decline in global manufacturing and trade over the last year (which was as or more severe than the first year of the Great Depression), will cast a long shadow, notwithstanding recent improvement.

A range of vulnerabilities still remain, not only for the economy, but also with regard to the unfinished business of cleaning up the banking system and the prudent exit from unprecedented policy interventions—processes that present complex challenges, that involve potentially important indirect as well as direct effects, and that will need to be carried out without a guide book. We have been using experimental drugs on a rare disease—and while the patient’s vitals are improving, the cure could have important and long-term side-effects that need to be closely monitored.

The upshot is that a quick return to business as usual is highly unlikely. And also undesirable. Restoring growth and stability will require movement toward a new economic equilibrium, a more sustainable one; one based more on competing in the global economy, and less on spending and borrowing. Needless to say, establishing such a shift will not be without its challenges.

The broad parameters of what needs to be done seem reasonably well understood:

* We need to deliver on meaningful reform of our financial system, taking into account the lessons from the recent past. This will entail better capital and liquidity buffers, more comprehensive and systemic oversight, more robust market structures, and better tools for defusing and unwinding systemic threats.

* Our public finances need to be put back on track. We would be kidding ourselves if we believed that today's large structural fiscal deficits are consistent with a continuing strong global leadership role.

* And we need to strengthen our competitiveness in the global marketplace and rebuild our once vibrant tradable goods sector and our infrastructure.

Meeting these challenges will not be easy, and the process will necessarily take time. We need to navigate the transition from near-term support for our convalescing economy and markets into longer-term thrift and higher margins for safety in the financial sector. We face difficult choices regarding spending priorities and the means to pay for them, as well as thorny questions regarding appropriate design and oversight of our financial system.

We also face challenges in terms of our global leadership. Economics and finance have increasingly become the principle theater of engagement globally. We have enjoyed many advantages in this realm over the years: the large size of our economy and its historical dynamism, the vitality and sophistication of our financial markets, and our track record for economic management.

But the world has been changing in important ways, many of them related to continued growth in the emerging world. There is no question that the current crisis has given additional impetus to a dynamic that was already well in train: a shift in the economic center of gravity from the so-called advanced economies toward the emerging world.

The emerging world already accounts for about half of global output, and that share will almost certainly rise significantly in the years ahead, as the combination of demographics, investment and continued policy improvements propels many economies forward. We already have one new entrant to the short list of largest economies, and others are likely to join the club.

This has been a remarkable era; we are no longer alone as the central axis for the global economy. New linkages are developing across and between regions and countries, new economic and financial arrangements are being discussed, and the groundwork for new currency arrangements are being explored.

The choice that faces us is to attempt to shape these various developments—the evolution of the global financial and trade architecture and global patterns of saving and investment—or risk being shaped by them now and in the future. For my money, better to be one of the shapers than just a "shapee."

As we strive to exert leadership in the economic and financial realm, we need to keep in mind that, while we have many cards to play, our hand is not as strong as it once was, and therefore we will have to play it differently if we are to be effective.

The crisis has affected the United States' standing in the world, confidence in our economic management, and has called into question our ability to lead. We can help answer those questions by putting our house in order and delivering on the reform agenda confronting us—but this will take time. Meanwhile, our relative status is changing, as other countries expand their economic and financial footprints, and their influence.

The recent move to the G20 as the key forum for addressing global governance issues was necessary and overdue. But making that process work will be far more challenging than achieving consensus in the old club of rich nations.

While we have much common ground with the emerging world, there are numerous differences as well, with regard to income levels, views on the role of the state and markets, institutional development, political histories, and alignment on security issues. Matters are further complicated by the heterogeneity within the emerging world itself.

All of this implies a greater premium on consensus building and diplomacy on our part, recognizing that our leverage will not be what it once was. We also need to be attentive to the messages we receive (such as rumblings about the dollar and our policies and priorities) even when we disagree with them, and sensitive to signs of change in the economic environment and their potential implications (such as new trade linkages, the growth of state-linked investment vehicles, and shifts in attitudes toward capital mobility).

In sum, whether the continued evolution of the global economic and financial landscape will be an opportunity or a threat depends in part on the rest of the world, but mostly it depends on us. It depends on whether we will be ready to compete in the realm of business and finance and of ideas, and on whether we can adapt our leadership style to changing circumstances and imperatives. There is no question we have our work cut out for us, but if history has shown us anything, it is that we are at our best when we are challenged.

Let me conclude on personal note. It would be difficult to miss the criticisms that have been swirling about the Fed recently. One lesson that has been driven home to me over the years (and I think now about the examples set forth by Chairman Volcker and Secretary Brady and others in this room and elsewhere) is that it takes wisdom to know what to do in the face of crisis—and it takes courage to actually do it.

Now I am not suggesting that the decisions taken during those frenzied days last year, when markets were melting down and institutions were lined up like so many dominoes ready to topple, were wise or even necessarily right.

But what I can tell you is that those decisions were made for the right reasons. They were based on the facts as we understood them at the time—not as we wanted them to be, but as we found them—and in the time frames that circumstances required. And they were based on what we believed was needed to turn the tide and protect the citizens of this country—indeed the globe—from the unthinkable: an economic and financial breakdown of catastrophic proportion. The broad societal costs that may have been averted will remain unknowable, but those who would ignore them do little service to the public debate.

The men and women of the Federal Reserve—Bill Dudley and some of my colleagues are here tonight—are acutely aware that they hold a unique public trust; it is a rare privilege and a unifying, motivating force for them, and they execute on it every day with great skill, integrity and dedication. As they deal with the challenges ahead, I know they would welcome your encouragement and support.

Thank you.