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U.S. Economic Outlook, Monetary Policy, and Initiatives to Sustain the Flow of Credit to Households and Firms

Remarks by

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at the

Unconventional Convention of the American Bankers Association

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It is my pleasure to meet virtually with you today at the Unconventional Convention of the American Bankers Association.[1] I look forward to my conversation with Rob Nichols, but first, please allow me to offer a few remarks on the economic outlook, Federal Reserve monetary policy, and some of the initiatives we have announced to support the flow of credit to households and firms during these challenging times.

Current Economic Situation and Outlook

In the first half of this year, the COVID-19 (coronavirus disease 2019) pandemic and the mitigation efforts put in place to contain it delivered the most severe blow to the U.S. economy since the Great Depression. Gross domestic product (GDP) collapsed at an almost 32 percent annual rate in the second quarter, and more than 22 million jobs were lost in March and April. This recession was by far the deepest one in postwar history, but it also may go into the record books as the briefest recession in U.S. history. The flow of macrodata received since May has been surprisingly strong, and GDP growth in the third quarter is estimated by many forecasters to have rebounded at roughly a 30 percent annual rate. This development is especially noteworthy when set in relief against the surge in new COVID-19 cases that were reported this summer in a number of U.S. states and the coincident flatlining in a number of high-frequency activity indicators that we follow to track the effect of the virus on economic activity.

Although spending on many services continues to lag, the rebound in the GDP data has been broad based across indicators of goods consumption, housing, and investment. These components of aggregate demand have benefited from robust fiscal

[1] The views expressed are my own and not necessarily those of other Federal Reserve Board members or Federal Open Market Committee participants. I would like to thank Chiara Scotti for her assistance in preparing these remarks.

support—including expanded unemployment benefits and the Small Business Administration's Paycheck Protection Program (PPP)—as well as low interest rates and efforts by the Federal Reserve to sustain the flow of credit to households and firms. In the labor market, about half of the 22 million jobs that were lost in the spring have been restored, and the unemployment rate has fallen since April by nearly 7 percentage points to 7.9 percent as of September.

I remind you that in the spring, many voices questioned what good rate cuts, forward guidance, asset purchases, and lending programs could do in an economy in which people do not venture out to buy cars or build houses nor do companies invest to augment their capital stock. Well, the data indicate that with rates low, credit available, and incomes supported by fiscal transfers, the answer is—at least so far—that they do build houses, buy cars, and order equipment and software. That said, the COVID-19 recession threw the economy into a very deep hole, and it will take some time, perhaps another year, for the level of GDP to fully recover to its previous 2019 peak. It will likely take even longer than that for the unemployment rate to return to a level consistent with our maximum-employment mandate. However, it is worth highlighting that the Committee's baseline projections summarized in the most recent Summary of Economic Projections foresee a relatively rapid return to mandate-consistent levels of employment and inflation as compared with the recovery from the Global Financial Crisis (GFC).[2] In particular, the median Federal Open Market Committee (FOMC) participant projects that by the end of 2023—a little more than three years from now—the unemployment rate

[2] The most recent Summary of Economic Projections, an addendum to the minutes of the September 2020 meeting of the Federal Open Market Committee, is available on the Board's website at https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm.

will have fallen to 4 percent, and PCE (personal consumption expenditures) inflation will have returned to 2 percent. Following the GFC, it took more than eight years for employment and inflation to return to similar mandate-consistent levels. My baseline outlook is close to these projections, but I must also acknowledge that the economic outlook is unusually uncertain, and, moreover, that the ultimate course the economy follows will depend on the course of the virus, social-distancing norms, and mitigation efforts put in place to contain it.

The September FOMC Decision

At our September FOMC meeting, the Committee made important changes to our policy statement that upgraded our forward guidance about the future path of the federal funds rate, and that also provided unprecedented information about our policy reaction function. We indicated that, with inflation running persistently below 2 percent, our policy will aim to achieve inflation outcomes that keep inflation expectations well anchored at our 2 percent longer-run goal. We said that we expect to maintain an accommodative stance of monetary policy until these outcomes—as well as our maximum-employment mandate—are achieved, and also that we expect it will be appropriate to maintain the current 0 to 1/4 percent target range for the federal funds rate until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment, until inflation has risen to 2 percent, *and* until inflation is on track to moderately exceed 2 percent for some time. We also stated that the Federal Reserve will, over coming months, continue to increase our holdings of Treasury securities and agency mortgage-backed securities at least at the current pace to sustain smooth market functioning and help foster accommodative financial conditions, thereby supporting the flow of credit to households and businesses.

Banking Initiatives

In recent months, the Federal Reserve has announced several initiatives to support the efforts of our nation's banks to sustain the flow of credit to households and firms during these challenging times. Along with the other federal banking agencies, we have encouraged banks to work constructively with borrowers who have been affected by COVID-19—offering a customer a responsible loan modification can be a safe and sound banking practice and can help facilitate the economic recovery.[3] Turning to some issues of particular importance to small banks, we have provided temporary regulatory relief on the community bank leverage ratio, on regulatory reporting deadlines, and on appraisal requirements. We have also streamlined our bank examinations for small banks. These actions are providing banks with additional time and resources to adjust their operations to prioritize the financial needs of their customers and communities, and to play the vital role of lending to small businesses through the PPP.

With regard to actions taken that are relevant for larger institutions, we have adapted our stress-testing framework to better identify the potential effects of the pandemic on the capital positions of our banks. In June, we released the annual stress-test results and an additional sensitivity analysis that explored vulnerabilities of banks to the downside risks to the economy arising from the pandemic.[4] At the same time, to

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[3] For loan modification details, see Federal Financial Institutions Examination Council (2020), "Federal Financial Institutions Examination Council Issues Statement on Additional Loan Accommodations Related to COVID-19," press release, August 3, https://www.ffiec.gov/press/pr080320.htm.
[4] See Board of Governors of the Federal Reserve System (2020), "Federal Reserve Board Releases Results of Stress Tests for 2020 and Additional Sensitivity Analyses Conducted in Light of the Coronavirus Event," press release, June 25, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625c.htm.

ensure resilience of the largest banks, we required them to resubmit their capital plans, imposed limitations on capital distributions, and recently provided new scenarios that will be used for a second round of stress tests later this year.[5]

Among other actions to support financial intermediaries during the pandemic, in April, the Board issued an interim final rule that would exclude, on a temporary basis, U.S. Treasury securities and deposits at Federal Reserve Banks from large bank holding companies' supplementary leverage ratio.[6] The rule has helped ease strains in the U.S. Treasury market and continues to facilitate the significant inflow of customer deposits at banks that has occurred since the onset of the event.

Looking ahead, in September, the Board published an advance notice of proposed rulemaking (ANPR) that would modernize the Community Reinvestment Act (CRA) by strengthening, clarifying, and tailoring CRA regulations to ensure that they reflect the current banking landscape and better meet the core purpose of the CRA, addressing inequities in credit access and ensuring an inclusive financial services industry.[7] The ANPR proposes special provisions for minority depository institutions (MDIs), women-owned financial institutions, low-income credit unions, and community development financial institutions. Because of feedback received about lack of awareness of existing

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[5] For second-round stress-test information, see Board of Governors of the Federal Reserve System (2020), "Federal Reserve Board Releases Hypothetical Scenarios for Second Round of Bank Stress Tests," press release, September 17, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200917a.htm.

[6] For more details regarding the effect on the supplementary leverage ratio, see Board of Governors of the Federal Reserve System (2020), "Temporary Exclusions of U.S. Treasury Securities and Deposits at Federal Reserve Banks from the Supplementary Leverage Ratio," interim final rule and request for comment (Docket No. 2020-07345), *Federal Register,* vol. 85 (April 14), pp. 20578–86, https://www.federalregister.gov/documents/2020/04/14/2020-07345/temporary-exclusion-of-us-treasury-securities-and-deposits-at-federal-reserve-banks-from-the.

[7] For additional information on the CRA ANPR, see Board of Governors of the Federal Reserve System (2020), "Federal Reserve Board Issues Advance Notice of Proposed Rulemaking on an Approach to Modernize Regulations That Implement the Community Reinvestment Act," press release, September 21, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200921a.htm.

MDI provisions in the CRA regulations, the Board plans to highlight all MDI special provisions and make the credit they receive more prominent and clear in revised regulation, examination guidance, and other public documentation. In addition, we also propose four specific new MDI provisions.[8] Finally, the CRA also proposes to create incentives for bank investments in geographic areas of need outside of traditional assessment areas.

Concluding Remarks

While recovery since the spring collapse in economic activity has been robust, let us not forget that the full economic recovery from the COVID-19 recession has a long way to go, with the unemployment rate still elevated at 7.9 percent as of September and inflation still running below our 2 percent longer-run objective. It will take some time to return to the levels of economic activity and employment that prevailed at the business cycle peak in February, and additional support from monetary—and likely fiscal—policy will be needed. Speaking for the Fed, I can assure you that we are committed to using our full range of tools to support the economy and to help ensure that the recovery from this difficult period will be as robust and rapid as possible.

[8] For additional information on the new MDI provisions, see Lael Brainard (2020), "Modernizing and Strengthening CRA Regulations: A Conversation with Minority Depository Institutions," speech delivered to the National Bankers Association (via webcast), Washington, October 15, https://www.federalreserve.gov/newsevents/speech/brainard20201015a.htm.