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THE SEMIANNUAL MONETARY POLICY REPORT TO THE CONGRESS

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED EIGHTEENTH CONGRESS

SECOND SESSION

ON

OVERSIGHT ON THE MONETARY POLICY REPORT TO CONGRESS PURSUANT TO THE FULL EMPLOYMENT AND BALANCED GROWTH ACT OF 1978

MARCH 7, 2024

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THE SEMIANNUAL MONETARY POLICY REPORT TO THE CONGRESS

THURSDAY, MARCH 7, 2024

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 9:53 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Sherrod Brown, Chair of the Committee, presiding.

OPENING STATEMENT OF CHAIR SHERROD BROWN

Chair BROWN. The Banking, Housing, and Urban Affairs Committee will come to order. Chairman Powell, if you'd like to after your opening statement, give it again, you can certainly do that. The Fed has immense power in shaping our economy. Your job is clear; promote stable prices and maximum employment.

Today, the cost of living is still far too expensive for most Americans. The Fed has only one tool available to fight those high prices; interest rates. That tool does nothing to address the real costs. The real cost for white costs remains too high. Corporations price gouging to boost profits and make their shareholders richer. Higher interest rates don't force corporations to lower their prices, but high interest rates are raising housing costs, hindering wage growth, stifling small businesses. We all know that.

Now's the time for the Fed to decide if it's going to make good on its commitments to workers and to their families by lowering interest rates, by protecting our financial system from Wall Street executives who have used their wealth and their power to influence economic policy and avoid accountability for their risky bets.

Keeping rates too high for long, for too long strangles the economy. No one wants this, and it makes it harder for small businesses to expand and hire more workers undermining job creation. Higher rates also stifle overdue investments that are creating high quality, good paying jobs, and that are necessary for us to remain the most competitive and innovative economy in the world. High interest rates are raising housing costs, higher and higher for families, families already facing a tough market with too few options and too high prices.

I hear from so many Ohioans who feel trapped. Those who rent feel like they'll never be able to afford to buy. Those who already own their homes, feel like they'll never be able to afford a larger one if they decide to grow their family. If they're fortunate enough to have an interest rate from a couple years ago, they obviously don't want to give it up.

It limits their choices, it limits the housing supply, and by driving up construction costs, higher rates make it even harder to build new apartments and homes, so we have even less supply at exactly the same time when it's harder to afford a mortgage. Families are stuck delaying the purchase of their first home, and rent or renting for longer. That cycle drives rents up even further.

Americans pay a steep price for higher interest rates. Continued high rates are not going to make life less expensive for workers and their families. We know why prices are high years after supply chains have improved. It's the same cause of so many of the problems our economy; corporations want bigger profits to reward their executives.

In 2022, at the peak of inflation, corporate profits soared to historic levels. That's not hyperbole, that's fact. Corporate profits soared to historic levels. As you know, where those profits went, right into the pockets of their top executives. That same year, the largest multinational corporations gave out nearly $1.5 trillion, $1.5 trillion dollars in stock buybacks and dividends.

Americans today pay more for groceries than they have in 30 years. Every time you go to a grocery store. Ohioans pay for corporate executives' bonuses and stock buybacks every time you go to the grocery store. Grocery shoppers are paying for corporate executive bonuses and stock buybacks.

The biggest corporations are always finding new ways to charge people more to increase their profits. Fast food restaurants, big stores, are experimenting with electronic price tags so they can change prices constantly making it easier to sneak prices up little by little, making it harder for people to comparison shop and find the store at the lowest price.

Many companies increase their profits by charging more for less. The media started calling it shrinkflation. Senator Casey, our colleague from Pennsylvania, has particularly been a leader pointing this out. A bottle of Gatorade used to be 32 ounces. Now it's 28 ounces, but the price hasn't gone down, and if anything, it's gone up a bit. It's why I introduced legislation that would stop that kind of deceptive corporate practice. It's the kind of solution we need to take on corporate price gouging. It has nothing to do, Mr. Chairman, as you know, with higher interest rates.

The Fed doesn't only set monetary policy. You also make the rules that keep our banking system safe and sound, and consumers money safe. We've had some positive development, Mr. Chair, since the last time you testified in June, like the update to the Community Reinvestment Act. Thank you for your work on this. This took years of listening carefully to all stakeholders. It was long overdue. We'll be watching to make sure you implement this quickly. So banks are fulfilling the purpose of the Community Reinvestment Act. I spoke to Ohio bankers yesterday, most of them small banks, they understand the importance of this.

You also issued an updated capital requirements proposal called Basel III, the subject of much discussion in this Committee. Strong capital requirements are how we ensure if Wall Street bets don't pay off, shareholders and investors are on the hook, not taxpayers. Too many examples in this Committee, in this Congress, in this

country, of tax hold tax payers holding the bag for corporate misfeasance, and malfeasance, and greed.

We need these guardrails in place. I urge you to remain committed to protecting the public despite the massive amount of money big banks and their lobbyists are spending trying to kill these taxpayer protections. Let's finish the job. Let's finalize Basel III.

Last year's bank failures also demonstrate the dangers of letting the banks chip away at rules and oversight. It's entirely predictable. Bankers desperate to increase their already massive profits take big risks that undermine our economy. When things go wrong, bank executives come to regulators with their hands out, accepting no responsibility. It's why Congress must finish the job and pass our bipartisan RECOUP Act. Senator Scott and I worked on 21 to 2 in this Committee to hold senior bank executives accountable when they gamble with customers money.

When the biggest banks exercise special privilege, they do so at the peril of our broader economy. We've seen that too many times. We know that's a source of so much that's wrong in this country; big corporations using their power and influence to write the rules of our economy to the benefit of them, and their executives, and their investors, to the detriment of everyone else.

It's why I stand up for workers, and why I stand up for their right to organize. It's why I stand up to take on railroads, and drug companies, and the biggest banks, and corporations who time and time again try to rewrite the rules to increase their profit margins.

Chair Powell, I look forward to hearing you from you today, thank you, and how the Fed will work to promote an economy where everyone who wants a good job has the opportunity to find one.

Senator Scott.

OPENING STATEMENT OF SENATOR TIM SCOTT

Senator SCOTT. Thank you. Chair Powell, thank you for coming this morning. Good morning. Appreciate you being here, certainly. In 3 days, March 10th, it'll be the 1-year anniversary of the failure of the Silicon Valley Bank. SVB marked the third largest bank failure in U.S. history, and certainly the largest since the 2007/2008 financial crisis.

I've said it many times before, and I'll say it again today, that there were three major components to SVB's failure. First, the bank was rife with mismanagement. Second, there was a clear supervisory failure, and our regulators were certainly asleep at the wheel. And third, President Biden's reckless spending caused record high inflation, which resulted in drastic interest rate hikes and tremendous loss.

When you print and spend trillions of dollars at the end of Covid, we should not be surprised that we have record high inflation. Record high inflation translates into, today still, 40 percent higher for gas for your car, 30 percent higher for your food, 20 percent higher for your energy costs. The devastation the average American is facing because of Bidenomics is undeniable, but certainly measurable.

So I'm glad to spend some time talking about the state of our economy. An economy that has been ravaged, as I've just spoken about, by inflation, suffering under the weight of an open border and millions of illegal immigrants and drowning in disastrous regulations. I hear from my constituents all the time that inflation and an unsustainable cost of living continue to impact their families. For far too many, the American dream seems further and further out of reach than ever before. And frankly, the past 3 years of this Administration's failed policies have landed us right in that spot.

In fact, last month, Treasury Secretary Yellen sat before this Committee and attempted to spin a narrative of how strong the economy is, how well-off consumers are, and how much people have in the bank thanks to Bidenomics. But in the midst of this, she also admitted that many prices are not going down.

In fact, she said, and I quote, "We don't have to get these prices down." Tell that to the mechanic working in South Carolina. Tell that to the teacher trying to put gas in the tank. It is simply unacceptable because the truth is that Americans are now spending more of their income on food than they have in 30 years. The truth is that housing affordability remains at its lowest level in 40 years.

But inflation isn't the only concern I'd like to raise. I'd also like to address the economic impacts of illegal immigration. During your recent interview on "60 Minutes", you stated that over time, the U.S. economy has benefited from immigration. Let's be clear, America is a Nation of immigrants, no doubt. But when we talk about illegal immigration today, we must also face the dire reality that our towns and our cities are suffering from the adverse impacts of illegal immigration facilitated by the Biden administration's open, unsecure, and unsafe southern border.

Because of President Biden's policies, we've seen over 7 million illegal immigrants cross our borders in just 3 years. By the time this election happens this year in November, the numbers suggest it could be as high as 10 million illegal immigrants coming into our country. So we cannot have an honest conversation about the benefits of legal immigration in our labor force without also addressing the elephant in the room. Our country is strained. Our economy is strained under the weight of illegal immigration.

In fact, recent reporting has highlighted that cities and States across our country are struggling to keep pace, and some have been forced to cut public services to Americans in order to fund the cost of feeding and housing illegal immigrants. One clear example we saw in New York City were the poorest kids in the city. Minority kids in the city were stuck at home because the city was using the schools to house illegal immigrants. Another example, the city of Denver recently announced that some of its employees may have their hours cut in order to reallocate funds toward the city's migrant crisis.

How in the world is that fair to Americans? It's not. We must get the legal immigration crisis under control because if we don't, our local economies will continue to be crushed, and opportunities will continue to be stripped from our citizens and their families.

Finally, as if inflation and the negative impacts of illegal immigration were not enough, the tsunami of regulatory red tape coming from our financial regulators further threaten economic oppor-

tunity across the board. For months, we've heard bipartisan criticism of the Fed's Basel III Endgame proposal, which will restrict lending and access to credit for those who need it the most. I was certainly pleasantly surprised to hear your comments about Basel III and your thoughts on its future, when 97 percent of the comments that you receive are negative.

That's good news. Good news for the American consumer. Good news for entrepreneurs who would like to start a business, but do not have access to capital. Perhaps even good news for millennials who would love to become a first-time home buyer. The opposition to Basel III comes from a diverse array of interests; from community leaders, farmers, to housing groups. We've even heard opposition in this very room on this very Committee from Democratic Senators.

I look forward to hearing your testimony, and looking forward to asking some questions as well.

Chair BROWN. Thank you, Senator Scott. We're here today as we do every 6 months, at least, from Chair of the Federal Reserve, Jerome Powell, on monetary policy and the state of our economy. Please proceed. Thank you for your service to our country.

STATEMENT OF JEROME H. POWELL, CHAIR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. POWELL. Thank you, Chairman Brown, Ranking Member Scott, and other Members of the Committee. I appreciate the opportunity to present the Federal Reserve's Semiannual *Monetary Policy Report* today.

The Federal Reserve remains squarely focused on our dual mandate to promote maximum employment and stable prices for the American people. The economy has made considerable progress toward these objectives over the past year. While inflation remains above the FOMC's objective of 2 percent, it has eased substantially, and the slowing in inflation has occurred without a significant increase in unemployment. As labor market tightness has eased and progress on inflation, has continued the risks to achieving our employment and inflation goals have been moving into better balance. Even so, the Committee remains highly attentive to inflation risks, and is acutely aware that high inflation imposes significant hardship, especially on those least able to meet the higher costs of essentials like food, housing, and transportation. The FOMC is strongly committed to returning inflation to its 2 percent objective. Restoring price stability is essential to achieve a sustained period of strong labor market conditions that benefit all.

I'll review the current economic situation before turning to monetary policy.

Economic activity expanded at a strong pace over the past year. For 2023 as a whole, gross domestic product increased 3.1 percent, bolstered by solid consumer demand, and improving supply conditions. Activity in the housing sector was subdued over the past year, largely reflecting high mortgage rates. High interest rates also appear to have been weighing on business fixed investment.

The labor market remains relatively tight, but supply and demand conditions have continued to come into better balance. Since the middle of last year, payroll job gains have averaged 239,000

jobs per month, and the unemployment rate has remained near historical lows at 3.7 percent. Strong job creation has been accompanied by an increase in the supply of workers, particularly among individuals aged 25 to 54, and a continued strong pace of immigration. Job vacancies have declined, and nominal wage growth has been easing. Although the jobs-to-workers gap has narrowed, labor demand still exceeds the supply of available workers. The strong labor market over the past 2 years has also helped narrow longstanding disparities in employment and earnings across demographic groups.

Inflation has eased notably over the past year, but remains above the FOMC's longer-run goal of 2 percent. Total personal consumption expenditures prices, or PCE prices, rose 2.4 percent over the 12 months ending in January. Excluding the volatile food and energy categories, core PCE prices rose 2.8 percent, a notable slowing from 2022 that was widespread across both goods and services prices. Longer-term inflation expectations appear to have remained well anchored as reflected by a broad range of surveys of households, businesses, and forecasters, as well as measures from financial markets.

After significantly tightening the stance of monetary policy since early 2022, the FOMC has maintained the target range for the Federal funds rate at 5.25 to 5.5 percent since its meeting last July. We have also continued to shrink our balance sheet at a brisk pace and in a predictable manner.

Our restrictive stance of monetary policy is putting downward pressure on economic activity and inflation. We believe that our policy rate is likely at its peak for this tightening cycle. If the economy evolves broadly as expected, it will likely be appropriate to begin dialing back policy restraint at some point this year.

But the economic outlook is uncertain, and ongoing progress toward our 2 percent inflation objective is not assured. Reducing policy rates restraint too soon or too much could result in a reversal of progress that we've seen in inflation, and ultimately require even tighter policy to get inflation back to 2 percent. At the same time, reducing policy restraint too late or too little could unduly weaken economic activity and employment. In considering any adjustments to the target range for the policy rate, we will carefully assess the incoming data, the evolving outlook, and the balance of risks. The Committee does not expect that it will be appropriate to reduce the target rate until it has gained greater confidence that inflation is moving sustainably toward 2 percent.

We remain committed to bringing inflation back down to our 2 percent goal, and to keeping longer-term inflation expectations well anchored. Restoring price stability is essential to set the stage for achieving maximum employment and stable prices over the longer-run.

To conclude, we understand that our actions affect communities, families, and businesses across the country. Everything we do is in service to our public mission. We at the Federal Reserve will do everything we can to achieve our maximum employment and price stability goals. Thank you.

Chair BROWN. Thank you, Mr. Chairman.

Now, you've acknowledged the Fed likely waited too long to raise rates when prices shot up in 2021. We can't make that mistake again, Mr. Chair, at the expense of workers. If the Fed waits until unemployment starts increasing, it may be too late to cut rates in time to save American jobs. Why shouldn't the Fed act now to prevent workers from losing their jobs rather than reacting after the fact?

Mr. POWELL. So we're well aware of that risk, of course, and very conscious of avoiding it. And what we expect and what we're seeing is continued strong growth, a strong labor market, and continuing progress in bringing inflation down, if that happens, if the economy evolves over that path, then we do think that the process of carefully removing the restrictive stance of policy can and will begin over the course of this year.

Chair BROWN. I mean, I know we've had this conversation publicly here, and privately also, that working people are hit the hardest with inflation. They're also hit the hardest when companies try to cut costs with layoffs. This town too often seems to forget that maximum employment is part of the Fed's dual mandate.

Let me ask you about bank supervision. Senator Scott mentioned that last year's bank failures illustrate the need for strong oversight. SVB grew too big, too fast. Fed supervision didn't react decisively enough. The Fed in response undertook an assessment of its supervisory process to identify and address gaps related to the speed, the force, the agility, if that's the right word, if it's supervision.

Explain what concrete steps the Federal Reserve's taken to strengthen supervision in any specific areas where work to make improvements is ongoing.

Mr. POWELL. So this is a very broad area of work. There are, you know, many, many people in the Federal Reserve System who are involved in supervision, thousands of them, and there's a rule book. And so there's been careful study, and thought, and a lot of listening to understand how we can meet those goals. Being quicker and more effective, basically, is how I would say it.

If you look at Silicon Valley Bank, we weren't quick enough, and we weren't effective enough where we were in. And so, we're working hard to develop a new rule book and another other set of practices, which is still going to be evidence-based and fair, but it's going to involve earlier interventions and more effective ones. And, you know, I think this is work that's ongoing, and will be for some time.

Chair BROWN. Thank you. The job of the Fed, of all public officials, is to serve the American people, not their stock portfolios. We've seen abuses in this body. We've seen abuses at the Federal Reserve. I wrote to you last month asking the Fed to identify substantive penalties for board officials who violate the trading rules. Where is that in the process, and I expect these rules in place before the next monetary policy hearing in 6 months. Where is it?

Mr. POWELL. So our own Inspector General gave us six things to work on. I read the list from beginning to end, and the sixth one was what you said, and I just said, we're going to do all of these. Let's get going. So we've done five of them, and we're working on the sixth.

Chair BROWN. And it will be finished within 6 months when you're back?

Mr. POWELL. I want to get it right. I certainly hope so, and expect so.

Chair BROWN. Expect so is a better answer than hope.

So one last question. More and more many companies use algorithms that combine competitors' price information to engage in what they call dynamic pricing or surge pricing. You know that corporate PR teams worked hard on this. Just another way for corporations to make it harder for consumers to seek out lower prices and to pad corporate profits. Are you concerned that the wide adoption of these price gouging strategies, these pricing schemes, if you will, will contribute to inflation?

Mr. POWELL. I mean, I think it works both ways. Let me say this, you know, we're well aware of this trend, and we're monitoring it. Remember that prices go down when there's no one in the store, and they go up when there are a lot of people. If you're doing dynamic pricing—same thing with the ride companies. It works both ways. I don't know that it will have implications for inflation. It would certainly have implications for consumers who need to be informed.

Chair BROWN. You think that this kind of surge pricing might lower prices overall?

Mr. POWELL. I mean, my understanding is that the idea is that in slow periods, prices actually go down, and in busy periods they go up.

Chair BROWN. But these are sophisticated economists working for these big companies, and they're not going to do things to lower their profits.

Mr. POWELL. You know, I think the price mechanism is incredibly important in our economy. I think we need to give companies the freedom to do that as long as they're not fixing prices, or failing to disclose the nature of the price changes to the public.

Chair BROWN. I have a few seconds. Research has indicated constrained supply was behind a significant amount of the inflation we've seen over the last few years. If the supply chain, for instance, of autos had been more resilient, or if there had been more housing availability, would that have made your job easier?

Mr. POWELL. Yes. In a word, yeah. A big part of the inflation was—and we saw it in 2023—when the supply chain problems unwound and when the labor supply shock that we had unwound as well. We saw inflation come down very quickly in the second half of the year. But it is also down to, you know, tight monetary policies playing a role as well.

Chair BROWN. Which leads me to the to the plea with you to speak out about inflation, about the contribution of corporate profits and greed to inflation. Thank you.

I'm done.

Senator SCOTT. Oh, I know you are done.

Chair BROWN. You find yourself agreeing with me more and more often? Is that why? Senator Scott. That would be a nightmare and I'm awake.

[Laughter.]

Senator SCOTT. So what I would say, however, is that the fact of the matter is that so often, if in fact, 60—I actually listened to what you said, which was remarkable; the fact that 60 percent of Americans today can't afford a $1,000 emergency.

I can't imagine how the average millennial affords a down payment for a home. I can't imagine how they take into consideration when they're looking at a snapshot of their financial future fixing, and repairing, or having a plan for obsolescence that happens for every homeowner in the country. So, I think the issue is far more complicated, and would love to delve into that over the next 4 minutes and 18 seconds.

But my first question is a combination between the challenges of illegal immigration and crime. It seems like every single week there's another story of another city underwater attempting to feed and house millions of illegal immigrants and American taxpayers are footing that bill.

Like I mentioned in my opening statement, just recently in Denver, we saw city workers having their hours essentially zeroed out so that the city could allocate more resources for the illegal immigrants. In San Francisco, they say that the average cost between San Francisco and Oakland because of crime is almost $4 billion.

Couple that with in New York, you see Governor Hochul bringing out the National Guard and the State Police to help reduce the impact of crime. At the same time, Mayor Adams says he needs more money because the state of affairs from illegal immigrants in the city devastating the economy, scaring the citizens, and reducing the opportunity for business as usual to return to New York City.

So my question is, can you explain how our economy is expected to continue shouldering the burden and the costs because of illegal immigration? And what, if any, information do you have as it relates to the impact of this surge of crime in our major cities on the economic outcomes of those cities? Because I heard the discussion that when you have more folks in the store, you have more shoppers. Except for these days, when you have more folks in the store, sometimes they're just there to steal.

Mr. POWELL. So you quoted my statement earlier, and it was an accurate quote for which I thank you. But I would say right before that, what I said was immigration policy, very important, very much under discussion, and it's none of our business. We don't set immigration policy, and we don't comment on it, so.

Senator SCOTT. But you commented on immigration. So my point though is that when you're going to tell a story, please tell the whole story, especially when the Nation is frustrated by nearly 10 million folks by the end of this year coming to the country and having the kind of negative impact on prices, on crime, on the challenges that everyday Americans, especially Americans living in the poorest parts of America face on a daily basis.

Mr. POWELL. So as you accurately quoted, I was referring—I said over time——

Senator SCOTT. Yeah.

Mr. POWELL. ——so I was referring to the history, which with you agreed. So I was staying as far as I possibly could from the current political context, and it's really not appropriate for us. We're independent. We like to remain that way, and the way we

do that, one of the ways is by staying out of political issues that we really aren't assigned. And so, the kinds of issues you're talking about are very, very real. I don't deny that, but they're really not for us.

Senator SCOTT. So the Fed does not consider the impact of 10 million illegal immigrants coming to our country and the cost associated with those illegal immigrants, the impact on States like New York, or California, or Illinois, where the devastation of crime ravishing the poorest Americans has an impact. We don't take that into consideration.

Mr. POWELL. So we do, and so does the Congressional Budget Office. We do try to estimate population, and we try to estimate the effective immigration, legal or illegal on the size of the workforce, and on GDP. If you look at the Congressional Budget Office, as you probably know, a detailed assessment of all the things like that, we don't really have a way—and we do look at the finances in the aggregate of State and local governments—that's in the hiring that they do. So that's something we look at, but we wouldn't do a very specific assessment like that. I mean, CBO probably would, but we wouldn't do that.

Senator SCOTT. Thank you.

Chair BROWN. Thank you, Senator Scott. Senator Menendez of New Jersey is recognized.

Senator MENENDEZ. Thank you, Chairman. Before I begin my questions, I want to celebrate that in the past year, we have seen the first Latino Federal Reserve Governor and the first ever Latino Federal Reserve Bank president. These are historic milestones that show we are finally making progress. Something that I have been at for quite some time to the leadership of our economic institutions. So I want to applaud that, and Mr. Chairman, I hope that progress can continue and extend to the rest of the Federal Reserve staff.

Mr. POWELL. Thank you.

Senator MENENDEZ. I agree with my friend, the Ranking Member, that when you tell a story, you should tell the whole story. Mr. Chairman, are you aware of the *Washington Post*, February 27th article that says, "The economy is roaring. Immigration is a key reason"?

Mr. POWELL. I don't recall that, but I would've read it.

Senator MENENDEZ. Let me read it to you. "Immigration has propelled the U.S. job market further than just about anyone expected, helping cement the country's economic rebound from the pandemic as the most robust in the world." It goes on to say, "Economists and labor experts say the surge in employment was ultimately key to solving unprecedented gaps in the economy that threatened the country's ability to recover from prolonged shutdowns."

Would you take issue with those statements?

Mr. POWELL. You know, there are a lot of adjectives and adverbs in there that you wouldn't see in Fed world, but the——

Senator MENENDEZ. Take out the adjectives and give me on the substance.

Mr. POWELL. Yeah. The story is, I think, broadly that there was a very significant increase in the size of the workforce last year,

and it was happening all during the year, and we were wondering what it was.

And the answer was it was really two things. It was labor first participation, but it was also immigration. And if you look at the Congressional Budget Office numbers, it kind of makes sense because there was a lot of growth, wages were coming down, the economy is bigger, and those are probably in part effect.

This is without making any judgments on immigration or immigration policy, but I think that's an economic fact.

Senator MENENDEZ. I'm not suggesting that. I'm just suggesting the facts are that we had 10 or 11 million jobs that were going unfulfilled in our economy. They lacked the productivity that is necessary for success economically. And as part of that, clearly, immigration helped fuel part of our revival coming out of the pandemic.

In fact, those were the people who were the essential workers when the rest of us were staying home. So I agree we need to do what is necessary to have a regularized border, but I also think that just to create the context of immigration as a scourge is absolutely wrong.

Let me turn to another question. In my view, the sticky inflation we've been seeing in the housing sector is principally due to the massive nationwide housing shortage. The Fed's *Monetary Policy Report* attributes the shortage to restrictive zoning, high interest rates, and tighter underwriting by banks. I would also add to that list underfunding of key HUD programs that shore up and expand our supply of affordable housing. If the housing supply shortage continues to grow, are we likely to see continued housing inflation?

Mr. POWELL. Yes, we are.

Senator MENENDEZ. And housing's already becoming less and less affordable for low- and middle-income Americans. According to the National Low Income Housing Coalition's 2023 *Out of Reach* report, a worker earning the minimum wage in New Jersey would have to work two full-time jobs to afford a modest one-bedroom rental home at fair market rate. Do you agree that increasingly unaffordable housing is a problem for the economy?

Mr. POWELL. I think there are two things going on. One is a longer-term housing shortage, and the other is the pandemic effects and the associated higher interest rates, which are things that will pass through. When all that passes through and rates are normalized, we'll still have the underlying housing shortage and it's going to be causing upward pressure on housing prices.

Senator MENENDEZ. Now, the *Monetary Policy Report* noted that, "Home purchases by low-income households have fallen disproportionately more because mortgage lenders impose maximums on the ratio of a borrower's debt service payments to the borrower's income."

I'm worried about how this dynamic will interact with the recently proposed capital requirements proposal, which according to analysis from the Urban Institute, would disproportionately the cost of mortgages for Black, Hispanic, and low- and moderate-income borrowers.

Given this, isn't there a risk that if the capital rules implemented without changes, that it could make it even harder for disadvantaged borrowers to attain home ownership?

Mr. POWELL. There is a risk like that, and we're very focused on it.

Senator MENENDEZ. And hopefully you're working to mitigate it?

Mr. POWELL. Yes.

Senator MENENDEZ. Thank you, Mr. Chairman.

Chair BROWN. Senator Rounds from South Dakota.

Senator ROUNDS. Thank you, Mr. Chairman.

Chairman Powell, welcome back. Look, first of all, I've appreciated the way that you've approached the discussions in front of this Committee, and I understand your desire to stay as neutral as possible with regard to the politics involved in an election year. But I do have some questions here specifically with regard to the Basel III Endgame proposal.

An analysis of that proposal found that 97 percent were either opposing it or expressing substantial concerns. In the hearing last March on the *Monetary Policy Report*, you stated that the Federal Reserve is a consensus organization, and you said, and I quote, "I will do everything I can, possibly, do to bring people together in consensus and have a capital framework that could be broadly supported."

My question to that is, do you currently believe that there is a consensus on this capital framework?

Mr. POWELL. I believe that we will have one. I'm fairly confident that we will have such a consensus when we do move forward.

Senator ROUNDS. So we could expect that you will probably not call a vote on the proposal until you believe that there is a consensus?

Mr. POWELL. I think that's right. I mean, we're just in the process of digesting the comments and then making the appropriate changes.

Senator ROUNDS. Thank you. As you are aware, I've waited several times on the concerns that I have with regard to Basel III Endgame, including I'm concerned about the lack of transparency, the negative effects on mortgage lending and home affordability by disincentivizing banks from offering high loan to value loans that primarily help first-time home buyers and low to modern income borrowers.

I'm concerned that the proposal will make buying a home harder than it already is for many, and further down the road, I fear that it could disincentivize mortgage lending from the largest banks, particularly with regard to the secondary market and their impact on even smaller banks that do business with them.

Would you be willing to withdraw the proposal or re-propose with significant modifications, particularly addressing the concerns that I and others have on this Committee raising, specifically, with regard to the impact? And I'm thinking of Freddie and Fannie, in particular, and what the impact might be. What would you see as the process involving those particular issues?

Mr. POWELL. So on those issues, we're well aware of and very focused on those issues. We haven't decided what to do about that yet, but we get it on those issues.

In terms of process, we're not at the stage of making that decision. I will say, if it turns out to be appropriate when we get to that point for us to re-propose parts or all of the thing, then we won't hesitate to do so.

Senator ROUNDS. OK. Thank you. It makes me feel a little bit better because I do think there are some very serious problems that would occur if the Basel III Endgame as proposed goes into effect. And most certainly, am hoping that the Federal Reserve will find a consensus on this, and it sounds like that may very well include some significant modifications if it were to be brought at all. Is that a fair statement?

Mr. POWELL. I expect there will be material and broad changes to the proposal before it comes back to the Board for consideration.

Senator ROUNDS. Thank you, sir. With regard to the economy today, a limited level of price growth is believed to help facilitate economic expansion, reduce the risk of recession, and help businesses and consumers' plan. However, during the Biden administration, we saw inflation climb to 13 percent, and those prices are now the new norm.

I know that you make it a policy not to comment on the Administration's fiscal policy, but it is well known that—I really do believe that high inflation and high prices have been a direct result of President Biden's policies, failed in many cases, and that the Federal Reserve has, and that the Federal Reserve has limited tools to address some of the problems that these policies created.

We talk about supply side versus demand side on these costs. What have been some of the unintended consequences from raising the Federal funds rate as rapidly—as you felt that you had to as the chair and as the Committee—I know that we talked a little bit about SVB and the failure there, their inability to look at treasuries and the increasing interest rates and so forth.

But can you talk a little bit about some of the things that you've seen that were negative with regard to trying to respond to those high inflation rates?

Mr. POWELL. Yes. So high interest rates are hard for businesses. They're hard for people. They're the tool that we have to use to bring inflation down. And our job at this time, when high inflation comes, it is the Fed's job to restore price stability. And that's what we're doing.

You point to the losses in banks. That was a very substantial thing, and obviously the supervisors, and that was us, you know, didn't get to that problem. We were aware of it, but we didn't probably appreciate it enough.

Another surprise, though, is that we were able to get this far and get inflation down this quickly without seeing a big increase in unemployment, and that's just a great result. That's just a surprise. It's not consistent with the historical record, but it's a really positive thing.

Senator ROUNDS. Thank you. And I just know that the only tools you got available were demand side tools.

Mr. POWELL. Yeah, that's right.

Senator ROUNDS. Thank you. Thank you, Mr. Chairman.

Mr. POWELL. Thank you.

Chair BROWN. Senator Warner of Virginia is recognized.

Senator WARNER. Well, thank you, Mr. Chairman. Chairman Powell, it's great to see you. You know, I would point out to my good friend from South Dakota, I do think, you know, if we'd gone back 1 year to 18 months ago, nobody would've predicted the soft landing.

And I know you're not ready to declare victory by any means, but the fact that inflation has come down, and I actually think some of the things like the CHIPS Bill, the Infrastructure Bill, and some of President Biden's policies have actually kept the economy growth rate at the levels that have allowed you to bring down inflation without seeing a dramatic rise in unemployment. And again, that'll be something we'll probably have the opportunity to litigate over the next 8 or 9 months.

I want to take my time on issues around less about monetary policy and more about regulation. You know, I think we can never presume that we're out of the woods on financial stability as we saw with the New York Community Bank yesterday, the stock plunge and the capital infusion. You know, one area that I raised with you a year ago and I'm going to reraise today, and that is nonbank lending.

The fact that nonbank lending to non-financial firms now is actually exceeding regulated bank lending. And let me be clear, you know, the nonbank financial sector has done productive things in our society over the years. But when folks like former New York Fed President, Dudley, and former Fed Governor Grosvenor recently said that they had worries about this reliance on the nonbank financial sector could lead to overall economic lack of stability, I guess, what do you think—I've got a three-part question.

What do you think are the risks as we see this push-out effect of more and more lending going outside the regulated perimeter to the nonbank sector? How much do we really know about these institutions? And one of the things, they have very smart, sophisticated investors, but one of those very smart, sophisticated investors said, "Well, hey, we don't like the lending profile right now, and we want you to not make any additional loans for the next 6 to 9 months." Do you think our system would be able to pick up the slack?

Mr. POWELL. So we have the regulated banking system where you've got a lot of transparency, you've got deposit insurance, you've got access to the discount window and all those things; regulation. If you go outside that, most of the funding that we see now in these vehicles is sophisticated investors who are actually limited partners, meaning they can't pull their money out. They've signed a contract. They've funded these deals.

And so, what you see now in the nonbank financial sector is significantly that kind of thing. So it doesn't have the run risk. The point is, the bigger it grows and the more diverse it gets, it is happening outside the regulatory perimeter. And you worry that when there is another crisis, you'll be surprised, but there'll be ways that that financial structure too can break down, and it does break down, in ways we don't anticipate.

So I think we need to be smart about the way—intermediation is absolutely moving out of the banks into the capital markets and into nonbank financial institutions. That's what's been happening

for a long, long time. I just think we need to be thoughtful about understanding where the risks are emerging.

Senator WARNER. And that sophisticated investor may rightfully say, hey, we don't want you to lend anymore for a X period of time. But that may then, at that moment of crisis, mean that the lending capabilities completely dry up.

And one of the things I never completely understood until I got a little better explanation recently, why the large, regulated banks weren't more complaining about this nonbank lending. But as I got to understand a little bit more of the—and again, I'm not per se criticizing on the nonbank lending, but many of the regulated banks actually lend to these large institutions. So they make money off of those relationships, and maybe that's, again, an explanation of why they're not being more critical.

I only got 40 seconds left, but I would like to come back to another thing that we've talked about a lot, and that is the question of use of the discount window. I believe one of the original tools that the Fed had I know banks say, well, we're concerned about the stigma. I've got some legislation that would actually require mandatory use of the discount window. I'd love your comment on that.

And also, just the idea that having the mechanics of the discount window open, potentially even 24/7, because we saw with SVB, they won, they didn't know how to use it. But two, if they wanted to use it in the nonbank hours, could they get access?

Mr. POWELL. There's a lot of work to do on the discount window. You're absolutely right. It needs to be brought up technologically into the modern age. We need to do more to eliminate the stigma problem. And we need to make sure that banks are, you know, actually able to use it when they need to use it. And, you know, that's a broad work program that we're on right now, and it's very important.

Senator WARNER. I know you're working on it, but I would look forward to working more, and I'd invite other colleagues. I really do think before we start adding a whole host of other regulatory issues, we ought to use some of the tools that are out there.

Chair BROWN. Senator Tillis of North Carolina.

Senator TILLIS. Welcome, Chair Powell, and Gus sends his regards. If you have time after the hearing, you ought to go by and see him. He's a dog in our office, but——

Mr. POWELL. I don't want to disturb his nap.

Senator TILLIS. But thank you for being here. I want to get back on this Basel III proposal. Senators Lummis, Coons, Gillibrand, and I, sent a letter indicating our concerns with the current proposal, but I think it's also worth noting that the number of other organizations, a diverse group that are not normally aligned on policy. You've got Bank Trades, National Housing Conference, NAACP, Habitat for Humanity, National Community Reinvestment Coalition, the list goes on, who have concerns with the current proposal.

Here's my concern. I think we're trying to make the best of what was foundationally a bad proposal. And so, I'm in the category of people who think that it should be re-proposed, because I think one of the reasons why I did not support Mr. Barr's nomination is I felt like we were going to be here.

I mean, it was pretty clear to me before he ever got confirmed on the Board that we were going to be in this place some months or years later. And here we are. And I think that the industry felt the same way. All of these stakeholders, some of them are in banking trades, some of them are on the other side of the spectrum.

So, I'd like to cast my vote or provide some weight to the idea that we should re-propose it. And what we ought to do is talk about the reality of increasing capital, or that the prospect of increasing capital requirements doesn't concern me. I think the prior Fed supervisor made comments publicly that maybe we needed to raise capital standards.

But what we did here in this proposal, and I heard in that dialog, is let's deal with puts and takes. Let's talk about raising capital requirements, but let's also talk about reducing the cost of the regulatory burden today if we can do it responsibly.

There's no evidence of that in the current proposal, and I think that that may actually produce a different set of comments that would be instructive to a final proposal that I think realistically will include some increasing capital requirements.

So over what time horizon do you think we would expect to either try to make the best of this foundation, or go back and take a look at it at a new foundation and re-propose it?

Mr. POWELL. You know, we're going to work through it as quickly as we can and should. I will say it's more important to get it right than it is to do it fast. We're not in a hurry, but my guess is we'll work this out over the course of this year.

Senator TILLIS. Yeah. Well, you know, if you take a look at the outsized cost of operational risks, the long list of concerns that I have publicly and privately expressed on the current proposal, I do think sometimes it's easier to knock down what I think is a poor foundation and build a better house. So again, just wanted to make that comment publicly.

The question about shrinkflation. I tell you some of these words that we come up with. But, you know, President Biden's using the idea of shrinkflation and you know, chastising manufacturers for creating smaller portion sizes for potato chips—I'll use that as one example.

But if you have rising input cost, and you're not able to control that, and you're in a marginal business to begin with, and now you're saying you can't even reduce the quantities, how does a business that's not making a profit make that work?

Mr. POWELL. I mean, we see inflation at the aggregate level as a mismatch between supply and demand. And as we've seen supply get better, and we've seen demand cool off a bit—it was very hot coming out of the pandemic. We've seen inflation coming down.

Senator TILLIS. We saw food inflation between 2010–2021 at 18 percent over 11 years, and over the last 3 years, we've seen it at 21 percent. I think that we have an industry that's trying to actually provide products that that consumers want, and now they're being chastised for trying to figure out how to make the numbers work.

So this whole idea of shrinkflation is just confounding to me. I'm going to submit some for the record. I want to stay on time.

But I have a question. I think the Chair mentioned, and if I misunderstood this I'm sure the Chair will clarify, but I thought in his opening comments he suggested that stock buybacks and paying out dividends were a key factor in inflation. Do you, as just a matter of policy, see stock buybacks and dividends is one of the top five reasons we're experiencing the inflation when we have right now?

Mr. POWELL. First, I guess I see stock buybacks and dividends as just the same thing in a different form. And I don't know, I wouldn't comment on anything that the Chair even may have said. I'd like to avoid that.

Senator TILLIS. I'm not going to ask you about policy because I think you're consistent on that, but I just can't imagine that if we decided to outlaw stock buybacks and dividend payments, that would have a material effect on inflation.

So, I'm not going to ask you to respond to that, but there are some people that by inference you could assume that they think that that would be helpful. For one, I'm not an economist, but I just can't imagine that it would be, you know, one of the things that would make your job easier. Can you at least opine on that?

Mr. POWELL. Banning stock buybacks and dividends?

Senator TILLIS. Yeah.

Mr. POWELL. Yeah. I think that would be quite a change in our capital markets.

Senator TILLIS. Me too.

Mr. POWELL. I mean, this is just money going back to shareholders from companies——

Senator TILLIS. Me too.

Mr. POWELL. ——that have nothing to do with it.

Senator TILLIS. Thank you, Mr. Chair.

Chair BROWN. Well done, Senator Tillis. Senator Smith of Minnesota is recognized.

Senator SMITH. Thank you, Mr. Chair, and thank you Chair Powell. It's great to see you here, again. I appreciate your testimony, and I'm going to focus my questions on housing and housing affordability.

As you have well pointed out, overall, prices have moderated considerably since the Fed began raising rates. Yet, housing costs have remained stubbornly resilient or high leaving us really no closer to addressing the affordability crisis that I think that we have, and was there well before the pandemic.

Shortly before the Fed began tightening, Chair Powell, and you came before the Committee, I asked you about how higher interest rates could exacerbate this unaffordability problem that we have by making mortgages more expensive and also hindering housing development. And I think that at the time you argued that we have excess housing demand during the pandemic, and that was kind of at the root of higher costs, and that your goal, the Fed's goal, was to bring demand closer in line with supply.

So, my first question is this. So the housing market has cooled significantly over the last 2 years. Is it your view that it is cooled enough so that housing supply and demand is better in balance? And following on that, you know, given the Fed's limited tools, understanding that, at what point will you think that you've done all that you can to lower housing demand?

My view is that we're well past time in Congress to take action on the housing supply side, but I'm interested in how you see this dynamic.

Mr. POWELL. So, you know, we're not focused so much on housing and housing inflation. We're really focused on the aggregate, which is also goods and our non-housing services. That's way more than half of PCE inflation. There are things in the housing sector that we didn't fully anticipate. One of them was just that people in very low interest rate homes, with very low interest rate mortgages aren't selling.

Senator SMITH. Right.

Mr. POWELL. So the quantity of homes that's available is incredibly low, and that's why there's very little in the way of existing home sales. And that drives up existing home sale prices, but also new home sale prices. So again, there's two sets of factors. There's the longer-run issue, and then there's the factors associated with the pandemic, and the inflation, and our response to it. I think as the overall inflation continues to come down and rates then come down, you'll see the housing market start to heal and get better, and housing affordability should go up again. But you're still going to be left with the longer-term problem of supply.

Senator SMITH. Right. I think that's right. I mean, what I see in Minnesota is that higher interest rates are of course, driving up the cost of construction. They're driving up the cost of mortgage rates. You're seeing people who aren't leaving a house that maybe is a little too small for them because they can't afford it. You know, just as you're saying, people are staying in there and their homes longer. And so there's sort of this double whammy of construction slowing at the same time that there is this great need to address housing supply.

One of the things that you know, is happening, it's interesting, a recent analysis by Zillow found that the monthly mortgage payment on a—let me get this right. A recent analysis by Zillow found that the monthly mortgage payment on a $343,000 home, assuming 10 percent down payment, is about $2,200 a month.

OK. So, $2,200 a month. That means the cost of owning a typical home is higher than 30 percent of median income, which is kind of the measure of affordability. And so, we've got a lot of issues with people just being priced out of the home of the housing market.

So from where I sit, the cumulative issues of higher mortgage rates are just really a challenge, and until we can get to the bottom of that, we're going to have a hard time addressing the housing affordability challenge that we have.

Would you like to comment on that?

Mr. POWELL. Yes. I agree with all of that. I mean, we don't actually—home prices don't actually go into the calculation of inflation. It's really rents and——

Senator SMITH. Right.

Mr. POWELL. ——owner's equivalent rent. But I agree the housing market is in a very, very difficult situation. And, you know, the sooner we can get back to price stability and restore interest rates to lower levels, the sooner it can start healing.

Senator SMITH. Yeah. Thank you. Thank you, Mr. Chair.

Chair BROWN. Thank you, Senator Smith. Senator Kennedy of Louisiana is recognized.

Senator KENNEDY. Mr. Chairman, thank you for being here. Thank you for your service. I think I've said before, I believe you and your team probably saved the world economy during the pandemic economic meltdown when the whole world wanted dollars by establishing the currency swap line. So, I thank you for that.

You gave an interview, Mr. Chairman, on February 4th of this year to CBS, 60 minutes, I think. Is that right?

Mr. POWELL. Yeah.

Senator KENNEDY. I ordered a transcript of that hearing, which I read. I learned a lot reading it. You were asked a question about inflation, and you were asked a question about prices declining. And here was your response. I'd like to quote you, if that's OK. "So the prices of some things will decline, others will go up, but we don't expect to see a decline in the overall price level. That doesn't tend to happen in economies except in very negative circumstances."

Did I quote you accurately?

Mr. POWELL. I believe you did.

Senator KENNEDY. OK. Later in the interview, you were asked about the national debt. Do you recall that?

Mr. POWELL. I don't actually, but I'm sure that's right.

Senator KENNEDY. OK. Well, at least according to the transcript, your answer was, and again, I'm quoting you, "In the long run, the United States is on an unsustainable fiscal path. The U.S. Federal Governments on an unsustainable fiscal path, and that just means that the debt is growing faster than the economy. So it is unsustainable." Do you remember saying that?

Mr. POWELL. I've said that many times. I think that's uncontroversial.

Senator KENNEDY. OK. Later in the interview, you said, I want to quote, "You know, I would just say this, integrity is priceless. And at the end, that's all you have. And we plan on keeping ours." Is that an accurate statement?

Mr. POWELL. Yes, it is.

Senator KENNEDY. OK. That's why I want to ask you about the FDIC. Have you read the article in the *Wall Street Journal* entitled, "Strip Clubs, Lewd Photos, and Boozy Hotel: The Toxic Atmosphere at Bank Regulator, FDIC".

Mr. POWELL. I think I did read that a couple months ago.

Senator KENNEDY. Did you read the article entitled, I quote again, "FDIC Lawyer Stayed on Paid Leave for Weeks After Child Porn Arrest".

Mr. POWELL. I don't remember that one.

Senator KENNEDY. OK. Did you read the article entitled, also in the *Wall Street Journal*, quote, "FDIC Chair Known for Temper Ignored Bad Behavior in Workplace".

Mr. POWELL. I read so much. You know, I can't—I remember the broad story, but not particular stories.

Senator KENNEDY. Did you read the article in which a former female employee of the FDIC allegedly recalled her male colleagues saying women needed to use sex to get ahead at the FDIC?

Mr. POWELL. I do not recall that. No.

Senator KENNEDY. OK. Did you read the article in which a female risk management examiner during a lunch with a male examiner said she had become friendly with that examiner, and he complained to her about his marriage, allegedly telling her he wasn't getting enough sex. And she allegedly said, "Obviously, if I walked —" or he allegedly said, "Obviously, if I walked into this office and you were naked, I'd fuck you right here."

Mr. POWELL. I do not remember that, and I think I would.

Senator KENNEDY. OK. Do you remember the article about Mr. Randall Ditch, a supervisory examiner in Denver who allegedly was demoted in 2014 to a non-supervisory examiner position in Tulsa after having sex twice with a subordinate female employee, and a number of other rule violations?

In this article, it says, allegedly, Mr. Ditch had urged the woman, "Do not be a pussy," and drink a shot of whiskey during work hours, the records show. Do you recall that at all?

Mr. POWELL. I do not recollect that.

Senator KENNEDY. OK. Here's my question, I could go on for a while——

Chair BROWN. You could go on, but you're not going to go on. So you've passed your 5 minutes. Do your question once.

Senator KENNEDY. Sir?

Chair BROWN. Senator Kennedy, your time is already expired. You can do one. You did 5 minutes. Consumed the whole 5 minutes with your monologue of——

Senator KENNEDY. Well, you did 6 minutes. I timed it.

Chair BROWN. I asked my——

Senator KENNEDY. You did 6 minutes.

Chair BROWN. Senator Kennedy, for months I have let you go way over the 5 minutes. You get your question——

Senator KENNEDY. But you did 6 minutes.

Chair BROWN. I Chair this Committee.

Senator KENNEDY. I understand. You still did 6 minutes. Check the record.

Chair BROWN. I'm going to order you—you're going to be at 6 minutes and 15 seconds if you continue this argument, or you're going to ask your question.

Senator KENNEDY. I'll ask my question. I just wanted the record to be clear, Mr. Chairman.

Mr. Chairman, in light of these allegations, if they're proven, how can the FDIC lead this charge for Basel III Endgame, which is going to turn the banking community upside down?

Mr. POWELL. I don't know how I would make the connection to Basel III. I'll say it's deeply troubling things, obviously, but again, you know, as you point was, if proven, and I mean, I think we have to decide Basel III on its merits. And we're not looking to the FDIC to lead this, by the way. We're looking at the Fed to do what the Fed thinks is right. That's what we're going to do. We don't look to, and they don't look to us to lead them.

Chair BROWN. Thank you, Chair Powell. Senator Butler is——

Senator KENNEDY. Thank you——

Chair BROWN. ——recognized.

Senator KENNEDY. ——Mr. Chairman.

Mr. POWELL. Thank you.

Chair BROWN. Senator Butler is recognized.

Senator BUTLER. Thank you so much, Chair, and Chair Powell. Good to see you in person, and thanks for the time to talk.

I want to pick up a little bit where Senator Smith was in relationship to housing, housing affordability, and hopefully draw a little bit on the point that you were making about rents. It definitely is an important crisis in my State of California, and I know across the country where, at least, according to the California Department of Housing and Urban Development, renters in San Diego are paying about 50 percent of what is—they're spending more than 50 percent of what is considered affordable.

And statewide, the majority of renters, more than 3 million households, are spending more than 30 percent toward rent. Nearly one-third, more than 1 in 5 million households pay more than 50 percent of their income toward rent. And the Chicago Fed President, Goolsbee, even referred to housing as a missing piece of the puzzle in the Fed's path to lower inflation.

So to the continued conversation, and I know a point that you've made that about how inflation has a disproportionate impact on lower income households who are focused on spending more of their monthly budgets on housing, how is the Fed's monetary policy impacting the supply of affordable rentals?

Mr. POWELL. I don't know that we're affecting the supply of affordable housing. If you think of affordable housing as something that's connected to some sort of Government program, that's not our bailiwick. I mean, our interest rates do affect the affordability of housing, though.

Senator BUTLER. And there was a key point that you made in an earlier, I think, reference about—and in your response to Senator Smith about the monetary policy and the calculation of rents. Can you just spend a couple—just briefly talk about that? I want to have one last issue I want to get to before I run out time.

Mr. POWELL. It's hard to talk about it briefly. It's actually very conceptually challenging to think about housing inflation. Do you include the cost of financing it? Do you include the sale prices? And the answer is, we don't. We convert ownership into an imputed rent, and that's two-thirds of homes are owned, and then we actually measure rents. But, you know, leases only turned over once a year. So you look at market rents, and then, you know, what's happening with newly signed leases, maybe very different from what was happening a year ago.

So it's complicated, but the good thing is it, we understand all that, and we look through that. We look at housing services overall as one of the three important categories, along with non-housing services, and goods inflation.

Senator BUTLER. Thank you for that. And in the line of affordability and housing, again, sort of very general, I think, to the broad monetary policy and state of our economy and unique to California—and I raised this with Secretary Yellen when she was here as well. The insurance gaps that are presenting themselves due to the impact of climate change, and where 1 in 5 residents in California live in areas of that risk flooding. And all 58 counties have a history of flood damage. And we are seeing more and more

home insurance providers, actually withdrawing from, from the State.

You and I had talked a little bit about this in our preparation for today's conversation. Can you talk to me about or share with us how it is that you—or what you think the impact might be of this sort of protection gap in insurance coverage on the overall stability of financial institutions in the broader economy?

Mr. POWELL. So it is clear that insurance of various different kinds, housing insurance, but also automobile insurance, and things like that, that's been a significant source of inflation over the last few years. And it's to do with a million different factors. It's nothing that we control from a regulatory or a supervisory standpoint.

You know, in the longer-term, companies are withdrawing from writing insurance in some coastal areas. And you've got to think 10 years from now, how are you going to get housing insurance? And, you know, maybe the Government will have to step in, but it's a significant issue.

Senator BUTLER. Thank you, Chair Powell.

Mr. POWELL. Thank you.

Chair BROWN. Senator Vance of Ohio is recognized.

Senator VANCE. Thanks, Mr. Chair, and my gratitude to you and the Ranking Member for doing this hearing. And thank you Chairman Powell, for being here. It's good to see you, again.

I think these hearings are always very important. Actually, gives us an opportunity to sort of provide some oversight to what's going on with the Fed, and better understand some of the things that you guys are doing that affect our constituents.

And I wanted to sort of focus on the Basel III regulations, Chairman Powell, and specifically, the way that there have been various proposals to sort of draw them down to focus on the regional banks. And to just go back to sort of one of the most significant crises, obviously in our banking sector, of course, the collapse of SVB and First Republic.

You know, you and I have spoken in private, and I believe in public, but one of the concerns that I have is when we talk about increasing capital requirements on the banks, if the banks were under higher capital requirements in the run-up to the crisis, there's maybe an argument that SVB, for example, would've bought more long-term treasuries which, of course, would've exposed their balance sheet to even more treasury bond risk. And that, of course, would've maybe hastened the collapse of SVB.

And, I guess, I want to start here with, you know, when we talk about some of the Basel regulations, what was the original intent? In other words, what was the original sort of proposal for which banks would fall under those regulations in which would escape them?

Mr. POWELL. You mean this time around or earlier on?

Senator VANCE. This time around.

Mr. POWELL. So it's the 37 largest banks. Well, there's four categories of banks, including the G–SIBs, and this is down through the fourth category. The proposal that's out there now, I think, does extend to category 4, as well as 3, 2, and 1.

Senator VANCE. So what's the minimum assets under management that you guys have proposed under——

Mr. POWELL. $100 billion.

Senator VANCE. ——the current Basel regulations?

Mr. POWELL. $100 billion.

Senator VANCE. $100 billion.

Mr. POWELL. Yeah.

Senator VANCE. And sort of that sort of gets to my concern here because I know there's some discussion about whether you'd apply them at $700 billion of AUM or $100 billion of AUM. And maybe you could just sort of walk me through that decision process at the Fed, where you guys are, and what would sort of justify drawing down from a $700 billion threshold to $100 billion threshold?

Mr. POWELL. So there's the G–SIBs. There's——

Senator VANCE. Of course.

Mr. POWELL. ——the eight identified G–SIBs, and then there's one category 2, I guess, and then there are the big regionals. And those tend to be, you know, big regional banks, and they're category 3, and one of them is a 2, I guess. But they have a different tailored level of regulation. Then category 4 had significant tailoring.

And the question is, you know, we have to ask the question, since SVB was a category 4, we've got to ask the question what, if anything, needs to be changed in the way they were regulated, supervised from a capital liquidity standpoint.

So there was tailoring all the way down. And then below $100 billion, of course, those are community banks, and that's a different regime as well. This makes sense. We want to have a diverse banking sector that's a great benefit to our country and very unusual for an advanced economy. So it's something we want to preserve.

Senator VANCE. Yeah. And I'm sure you know, Chairman Powell, but just to put this on the record, I mean, a lot of the commercial lending, a lot of the real estate lending, a lot of the consumer lending, about half of that lending, consumer lending is provided by the regional banks. I believe the Huntington in my home State of Columbus is the number one SBA lender in the entire country.

So to your point, I think these do provide incredibly important benefits to our economy. And, you know, you hear a lot of people talk about the American economic miracle, and I do wonder if part of that is because we don't have the same type of financial system that has sort of dominated in Western Europe and other First World economies.

I'm curious, in the process of amending the Basel requirements, I mean, have you guys made a decision about where to set the threshold yet, and when do you expect to set that threshold?

Mr. POWELL. We haven't made any final decisions. We put out for proposal some months ago, a proposal, and we've gotten a lot of comments, as I'm sure you're aware. We're chewing through those and digesting them, and we're just at the beginning now to sit down and talk about the changes that we will appropriately make to the original proposal.

Senator VANCE. And when do you expect to sort of issue a final proposal?

Mr. POWELL. I think it's going to take some time. I think it's more important to do it right than it is to do it fast. My guess is we'll get through this and be done over the course of this year, but it could be faster than that. It could be slower than that.

Senator VANCE. So I'm wondering, just being mindful of time, I have about 30 seconds left. Would you be willing to commit to say that in the process of amending, the Fed will remove the regional bank draw down and limit Basel's application directly to the G–SIBs, or $700 billion, or above?

Mr. POWELL. I can't get that specific at this point, but, you know, we're clearly looking at the whole tailoring issue.

Senator VANCE. OK. I appreciate that. And again, I just repeat, Chairman Powell, given what actually happened with the banking sector with SVB and First Republic, I just encourage you guys not to apply a regulation that doesn't actually solve the underlying problem. I fear that if you apply this to banks of $100 billion dollars and above, you actually are doing just that.

So with that in mind, I'll yield. Thanks, Mr. Chair.

Chair BROWN. Thanks, Senator Vance. Senator Tester of Montana is recognized.

Senator TESTER. Yeah. Thank you, Chairman Brown, and thank you for being here, Chair Powell. We appreciate your work in a difficult situation, but I think you've done a really good job. And so thank you for that.

The success at the Fed on your mandate for strong employment and stable prices is critical for small businesses, on Main Street, for farmers, for ranchers, for Montana families. You follow all the metrics. From your perspective, where is the economy at now, and where's it going?

Mr. POWELL. You know, the economy's growing at a healthy, sustainable, solid, strong pace. And that's one thing. Second thing I'd say is the labor market is very strong and quite tight still. 3.7 percent unemployment for the last 24 months. That's the longest period since, you know, 50 years. And the third thing is inflation. Inflation was too high. It's come down very sharply since the beginning of last year. If you look at the 12-month number, the headline number has come down from the 5s down to 2.4. And the core number is at 2.8. I think it was at 4.9 a year ago.

So these are big declines. So we're in a very different place and a healthy place. We are going to use our tools to try to keep that strong economy, keep that strong labor market while we continue to make progress on inflation.

Senator TESTER. One of the areas where there has been inflation, and I don't exactly know where it's at now, but food rose quite rapidly. And by the way, I'm a farmer. We didn't get much of that. In fact, we didn't get any of it. Prices now compared to what they were a year ago are actually off compared to whether 6 years ago, they're up, but compared to whether a year ago they're down.

And so my question to you, Chairman Powell, is there anything you can do specifically to deal with food costs as the Fed?

Mr. POWELL. I'm telling a farmer his business, but if you look at the food cost to the consumer, part of that is commodity costs. And that was partly spiked as, you know, because of Ukraine; grains and oil and that kind of thing. But the rest of it is a lot of costs

in the supply chain from when it leaves the farm to get, you know, collected, and processed, and trucked around, and then put on the shelves, and then the stores.

You know, and all those costs are just part of the general economy. So as the labor market cools off from its overheated status 2 years ago, you will see, and you have seen, you know, food inflation flattening out. And so, you know, the really high rates of inflation have come down. The prices, of course have not.

Senator TESTER. Correct. I would just say that cattle's doing better. Grain actually has dropped in price at the farm gate, and I don't want to get into that debate with you at all because we probably agree, but it'd take too long, take too much time. We got other stuff to talk about.

Mr. POWELL. I'd be learning from you.

Senator TESTER. You've discussed in previous hearings the impacts that the pandemic shut downs and supply chain issues have had on economies globally. How does the U.S. economy look today compared to our competitor Nations, particularly China?

Mr. POWELL. Well, I start with the advanced economies. You know, we're doing the best of anybody. We've got the strongest growth and the lowest inflation of the advanced economies. China is a whole different story. China's having, you know, significant difficulties with its economy right now, and they're in a very different place, certainly, than we are.

Senator TESTER. And so to repeat that, what I heard you say is that the economy of the United States is basically in better shape than any other economy in the world.

Mr. POWELL. Any other major economy. Yes.

Senator TESTER. OK. Look, one of the other challenges out there is housing in communities all across this country, whether you're in Montana, whether you're in a city in Ohio. Workforce housing in particular is a top priority, top commodity, so to speak. Plenty of folks, great organizations are working to address this. I meet them every day, and I appreciate the work they're doing. But how do these housing supplies issues show up in the data that the FOMC uses to make decisions?

Mr. POWELL. So housing prices don't go into the data. Housing stats, and renovations, and things like that are just business activity and that shows up. But when it comes to inflation, we convert ownership into an imputed rent, and then we look at rents. That's how we look at all that. So, we're not directly affected by changes in housing prices, but over time, those will drive rents up.

Senator TESTER. So is it fair to ask, are there economic trends that you see for housing?

Mr. POWELL. Yes. So there's two big things going on. One is we have this underlying shortage of housing, and it's due to things like, you know, difficulties of zoning, a lot of them close in to cities, places that are already built, and so more difficult to get zoning, more difficult to get people and materials, and all that. That's one thing, and that's not going away.

Then there's just a ton of things happening because of the pandemic, because of inflation, because of higher rates. And those are in the short-term, they're weighing on the housing market. But as

rates come down and that all goes through the economy, we're still going to be back to a place where we don't have enough housing.

Senator TESTER. Well, once again, thank you, Chairman Powell, for your work. I very much appreciate it.

Thank you, Chairman Brown.

Mr. POWELL. Thanks.

Chair BROWN. Thanks, Senator Tester. Senator Cramer of North Dakota.

Senator CRAMER. Thank you, Mr. Chairman.

Chairman Powell, good to see you. Thank you for being here. It's been a rather uneventful couple of days for you considering you've spent 2 days in this place, and I'm not going to upset that, by the way, just so you know. But I did appreciate your response earlier to Senator Scott when he asked about immigration, and you said, you know, the Fed hasn't been assigned that.

So I want to bring up something else you haven't been assigned to, that you and I have talked about over the years, and that, of course, is climate; the role of climate in your job, the role of climate risk in banking. And you've often said, I think the most common statement was, "We should stick to our knitting," I think, is one of yours. "Stay in our lane," similar to what you said, probably to Senator Scott.

But that said, in October, the Fed, the OCC, the FDIC, issued climate guidance, as you know, for management of covered institutions. And so, I'm just kind of curious, did Congress somewhere along the line give the Fed authority over climate policy as well, or is that another one of those things that somebody just took on? And I realized you're not the dictator of the Fed, only the chairman of the Fed, but I'd be interested in, as the chairman, your views on it.

Mr. POWELL. Our assignment is the safety and soundness of banks, in that they understand and can manage the risks that they face. That's our assignment.

And we said in climate world, we would do two and only two things. One of them was to do illustrative climate scenarios so that—you know, the banks are already doing this. The large banks who are subject to, they're already doing it because they're doing business internationally and they don't have any choice.

So we said we'd do that, and we also said that we'd offer guidance not on the level of climate risk or anything like that, just on what you had to do to be in a position to assess. For my thinking, that's it. That's what we're doing. There are no new initiatives. We're not going to change our capital requirements to reflect climate risk or anything like that. I'm really determined that we are not a climate policymaker, and that that is really the business of elected officials.

Senator CRAMER. Very good. Thank you. I'm going to bring up one other topic, I don't know if it's been brought up today, and that's Central Bank Digital Currency. And I think from a lot of my friends out there, I think there's—some—well, I know there's some confusion. I mean, I'm easy to confuse, but there are a lot of people that get confused about what is meant by the Administration's admonition to continue researching, experimenting, looking at some sort of, you know, Central Bank Digital Currency.

I think people back home look at that and go, oh my gosh, you know, they're going to control this now. And could you maybe just differentiate a little bit what people think of in terms of a Bitcoin, or their held digital currencies versus what essential bank digital currency, who, in my view, should emulate cash, right? It still should be about the dollar, not about some different kind of currency.

Could you just sort of help people back home better understand why they shouldn't be quite so frightened?

Mr. POWELL. First of all, I want to say that we're nowhere near recommending or let alone adopting a central bank digital currency in any form. But the idea is that as technology has evolved, money has become digital, so.

But the Government doesn't issue digital money. It's digital. If you look at your bank account, people don't hold those physical dollars. They're digital. So the thought was that the Government could create a digital form of money that people could then transfer among themselves.

Now, of course, that raises a concern that if that were a Government account, that the Government would see all your transactions, and that's just something we would not stand for, or do, or propose here in the United States. That is how it works in China, for example, but that's not what we're—if we were to ever to do something like this, and we're a very long way from even thinking about it, we would do this through the banking system.

The last thing we would want, we the Federal Reserve would want, would be to have individual accounts for all Americans or any Americans for that matter. Only banks have accounts at the Fed, and that's the way we're going to keep it. So it's just really—it's a question of following technology as it evolves and in a way that serves the public better. People don't need to worry about a central bank digital currency. Nothing like that is remotely close to happening anytime soon.

Senator CRAMER. That was very helpful. Thank you, Mr. Chairman. Thank you, Chairman.

Chair BROWN. Thank you, Senator Cramer. Senator Cortez Masto of Nevada is recognized.

Senator CORTEZ MASTO. Thank you, Mr. Chairman. Chairman Powell, great to see you, again. Thank you for all of your good work.

I want to talk a little bit about the commercial real estate and what's happening there. The Financial Stability Oversight Council's *2023 Annual Report* identified commercial real estate as a financial risk. And the Fed's monetary report also noted commercial real estate prices continue to decline, especially in the office, retail, and multifamily family sectors. I'm especially concerned that because of the low levels of transactions in the office sector prices have not yet fully reflected the true decline in the value.

So can you expand on the emerging risks the Federal Reserve has identified in the commercial real estate market, one? And then, I'm curious, can you discuss the compound risks identified in commercial real estate lending, particularly at banks with large CRE concentrations and high fractions of uninsured deposits?

Mr. POWELL. Sure. Let me see. I think there are just very, very few transactions in commercial real estate right now, particularly in the troubled areas. So, it's not a question of prices still falling, it's a question that you don't have that kind of price discovery. You just have to assume that the prices are very low and have come down a lot.

So, on commercial real estate we have a secular change in people working from home. This is one big part of it. That means that in many cities, the downtown office district is very underpopulated. There are empty buildings in many major and minor cities, and it also means that all the, you know, retail that was there to service the thousands and thousands of people who work in those buildings, they're under pressure too, and banks will have made loans to many of those buildings. Not all of them, but many.

So this we've known for some years. And so, what do we do? We have identified the banks that have high commercial real estate concentrations, particularly office and retail, and other ones that have been affected a lot. We identify them, and we are in dialog with them around, you know, do, do you have your arms around this problem? Do you have enough capital? Do you have enough liquidity? Do you have a plan? You're going to take losses here. Are you being truthful with yourself and with your owners?

And so we've been working with them. And so for some time we've been doing that, and this is a problem that we'll be working on for years more. I'm sure there will be bank failures, but this is not the big banks. If you look at the very big banks, it's not a first order issue for any of the very large banks. It's more, you know, small- and medium-sized banks that have these issues. We're working with them, we're getting through it. I think it's manageable is the word I would use, but it's a very active thing for us and the other regulators, and it will be for some time.

Senator CORTEZ MASTO. Thank you. Do you have concerns? Well, let me just ask you this. As you're talking with these small- and medium-sized banks, because we know that there's always could be a contagion, which we've seen in the past. Do you have concerns that if they fail, that somehow this is going to impact the, the financial sector, and are you prepared and trying to address that and prevent that from happening?

Mr. POWELL. We're trying to stay ahead of that. So we also reached out to banks that had high concentrations of uninsured deposits, and particularly underinsured deposits and a lot of commercial real estate in the office sector. So we're well aware of that issue, and we just trying to stay ahead of it on a bank-by-bank basis and overall. And so far, we've been able to do that.

Senator CORTEZ MASTO. Thank you. Let me jump to another issue that has been on my radar. The Federal Housing Finance Agency's report on the Federal Home Loan Banks concluded that the distinction between the FHLBanks' role and that of the Federal Reserve Discount Window as lender of last resort has not been clear, especially during times of market stress.

During the 2023 banking turmoil, we saw banks rely on advances from the Federal Home Loan Banks and didn't even have relationships with the Federal Reserve to use its discount window. I know you've talked a little bit about this with Senator Warner,

but how is the Federal Reserve working with the Federal Home Loan Banks to ensure that banks establish protocols to borrow from the Fed's discount window prior to times of stress?

Mr. POWELL. So we work with the Federal Home Loan Banks because in many cases, banks were moving their loan from the Federal Home Loan Bank to the Fed. So, we need to have smooth transfer. We need to be in good touch with them.

Even more important than that though, is that banks, any bank in the United States, needs to be in touch with the discount window, know how to be able to access it, be able to access it, have appropriate collateral, have control of that collateral. You know, in many cases it was just incredibly inefficient and took a long time for banks to actually go through that function.

The Federal Home Loan Banks are actually ahead of us in technology. We know that we need to really invest in technology to modernize the discount window, and also we need to do more to get our banks, all of them, in touch with the discount window in a way that they can use it quickly, should they need to do so.

Senator CORTEZ MASTO. Thank you.

Chair BROWN. Thank you, Senator Cortez Masto. Senator Hagerty of Tennessee is recognized.

Senator HAGERTY. Thank you, Chairman Brown. Welcome, Chairman Powell.

Under your tenure, Mr. Chairman, the Fed has taken the stance that the 2 percent inflation target shouldn't be viewed as a snapshot in time, but rather it needs to be achieved, "sustainably." When inflation was running well above the 2 percent target back in 2021 and early 2022, the Fed was patient and allowed rates to offset the below target inflation that had occurred in the years prior.

It strikes me as odd now that while we're still well above target inflation and have been well above for the prior year, markets seemed to expect the Fed to immediately cut even before we've breached the 2 percent inflation threshold.

So my question is, if the inflation rate reaches 2 percent, would that be considered a return to the target rate on a sustainable basis, or is it still the case that inflation would need to more or less overcorrect to well below 2 percent before the Fed makes the rate cut adjustments?

Mr. POWELL. So we it would take us a while to really get comfortable that inflation had settled in sustainably at 2 percent, but that's not our test for changing interest rates. Interest rates right now are well into restrictive territory. They're well above neutral. And we've said we would not wait for inflation to get down to 2 percent because if you wait, that monetary policy works with long and variable lags.

So we've said, you know, for some years that that we would start restoring the Federal funds rate to a more normal, almost neutral level. We're far from neutral now.

Senator HAGERTY. Yeah.

Mr. POWELL. And so, assuming the economy moves along the lines we expect, we do plan on starting the process of dialing back restrictions.

Senator HAGERTY. I'm just trying to square and look for the symmetry. I know we sort of allowed the economy to overshoot when inflation was high, and we sort of made up for prior years of low inflation. I'm trying to square that with the fact that——

Mr. POWELL. We didn't actually do that. We adopted a framework that said we would do that, but then suddenly a few months later, we got almost an explosion of very high inflation. That's not what we were looking. We said, you know, moderately above or modestly above 2 percent. This was not modestly above 2 percent, and we reacted—we thought that the mistake we made was we thought that that inflation would go away——

Senator HAGERTY. That it was transitory.

Mr. POWELL. Transitory. Which means it goes away quickly without effort by us. We figured out at the end of '21 that that was not the case and we acted.

Senator HAGERTY. And you don't seem see that same abrupt dynamic coming the other way. You're more comfortable with that?

Mr. POWELL. No. Look, I think we're in the right place, which is we're waiting to become more confident that inflation is moving sustainably at 2 percent. When we do get that confidence and we're not far from it, it'll be appropriate to begin to dial back the level of restriction so that we don't drive the economy into recession rather than normalizing policy as the economy gets back to normal.

Senator HAGERTY. Yeah. Can we go to the balance sheet and talk about that? We've seen a dramatic expansion of the Fed's balance sheet over the past couple of decades. In 2005, it was at $800 billion. It's at $7.5 trillion today. It's doubled since the pandemic was underway, and through quantitative tapering, the Fed is attempting to reduce its footprint.

And the concern I have is, on the other hand, Government spending tends to just continue to be profligate. We're running now a trillion-dollar deficit every 100 days, and we're flooding the market with treasury debt, and we're push putting upward pressure on interest rates as a result.

And what I think that is lost on many of us here is that the spending levels will only make your job harder when it comes to lowering interest rates. Not to mention there's a tacit expectation that the Fed step in once the markets can no longer absorb our new issuance.

I think this is a very serious problem. I think it deserves more attention, and I think we're now at a point where your objectives may be, you know, very much at odds with the behavior of our fiscal policy.

And am I missing something here, Mr. Chairman, or does increased net issuance by the Treasury lead to higher rates?

Mr. POWELL. I mean, in principle, more supply should lead to modestly higher rates, but that's not going to affect what we do. That's not a problem for us. Our balance sheet normalization is running very much as expected. We've decreased the size of our holdings by almost $1.5 trillion, and——

Senator HAGERTY. I hear you. I just think it's troubling that we continue to put fiscal pressure by continuing to put—again, we're running a deficit of $1 trillion every 100 days, and the issuance is required to deal with that, or putting a lot more pressure, I think,

on the Fed, and again, making your job harder. I think we need to take that into consideration.

Another component of this topic your colleague, Governor Waller, said he'd liked the Fed to shift its holdings toward a larger share of short-term treasuries. In fact, prior to the financial crisis, about a third of the Fed's holdings were in bills. Now they're around 3 percent of your total securities holdings.

Do you share the goal with Governor Waller, and if so, how long will it take us to get there?

Mr. POWELL. Take a while. You know, that's an issue—in our FOMC meeting in a couple of weeks, we're going to have our first really deep dive on what to do with the balance sheet. That's one of the issues. I don't think we'll deal with that at this meeting, but over time, you know, you'd love not to own a lot of MBS, and I can see a case for shortening the maturity. But it's not something, you know, that would happen quickly, we're not actively looking at that. That's sort of a longer-term aspiration that I think he was saying.

Senator HAGERTY. Just one final point, Mr. Chairman. You and I have talked about this before. We're in an election year. You're getting a lot of pressure, I hear, from lawmakers to adjust rates. I'm not telling you to raise rates or lower rates, but I'm just here to emphasize the fact that the credibility of the Fed depends on your remaining data-driven. The credibility of our currency as the reserve currency of the world depends on that, and I encourage you to continue to maintain that posture.

Thank you.

Mr. POWELL. Will do.

Chair BROWN. Thanks, Senator Hagerty. Senator Warren of Massachusetts.

Senator WARREN. Thank you, Mr. Chairman.

So, it's been a year since we had the second, third, and fourth largest bank failures in American history. Greedy bank executives were part of the problem, and the Fed as the chief regulator of the biggest banks was part of the problem. Under your leadership and direction, the Fed steadily weakened rules for the biggest billionaire banks. Exactly the banks that failed last March. In other words, Chair Powell, you failed to do your job to keep these big banks in line.

Now, when these banks blew up, you went into spin mode, promising that the Fed would do better. After years of hemming and hawing, you finally agreed to put in place Basel III rules that would strengthen capital standards for the biggest banks, and I mean the biggest banks. These are the Fed's proposed rule would apply to only 37 of the Nation's 4,500 banks. Only the banks that have $100 billion or more in capital.

Now, Chair Powell, when you testified before this Committee last June, I asked you about taking responsibility for bank failures. And you said, "The main responsibility I take is to learn the right lessons from this, and to undertake to address them so we don't have a situation like this where we had unexpectedly a large bank fail and spread contagion into the banking system."

And as part of learning those lessons, you also said that, "you agree with and support," Vice Chair for Supervision Barr's rec-

ommendations for strengthening the Fed's rules and supervisory practices for the big banks, and that you are, "confident they will lead to a stronger and more resilient banking system."

So, I just want to be clear. You haven't backed down from any of your comments from a year ago, have you, Chair Powell? Write lessons, don't let this happen again, supporting Vice Chair Barr's recommendations, which includes stronger capital standards?

Mr. POWELL. No.

Senator WARREN. You still stand by all that?

Mr. POWELL. Yeah.

Senator WARREN. Good, good. I'm glad to hear that. Now, I understand that those 37 big banks don't like higher capital rules because they are like insurance. You know, they would make the bank safer, but they cost a little money and would nip into the bank's profits. So, these 37 banks are swinging their very considerable weight around to try to weaken the capital rules. They've spent tens of millions of dollars running ads during Sunday night football, and millions more for an army of lobbyists to try to twist arms here in Congress.

Impressive spending, but who exactly are they trying to impress? A man on the inside? You know, despite all you said last year when the banks failed about supporting Vice Chair Barr's recommendations to strengthen rules for big banks, public reporting now says that you are driving efforts inside the Fed to weaken the capital rule.

You even told the House Financial Services Committee representatives yesterday that you think it's, "very plausible," that you withdraw the rule. As one analyst put it, "I don't think they will pass a final rule without Powell's support," suggesting that the rules will have to be weakened, "to appease Powell."

So, Chair Powell, I'm having trouble reconciling the statements you made last year, which you say you hold onto, statements you made when the headlines were all about three giant bank failures, and now, your reported efforts to quietly weaken the rules that would strengthen capital standards for giant banks and prevent more bank failures.

So let me just give you a chance to clarify the record here. Are you committed to finalizing the strongest version of the Basel III capital rules this year?

Mr. POWELL. Let me first say that we have taken and are taking many more steps to deal with the problems that revealed themselves with Silicon Valley Bank, and that's around supervision, we have a strong liquidity——

Senator WARREN. I appreciate that, but I'm just asking about the Basel III rules. The ones that you have been required for years now to put in place and have dragged your feet on.

Mr. POWELL. The Basel III rules are not directly related—they're not the thing that is directly related to Silicon Valley Bank. As you point out, they're a longer-run thing. And I would just say that we put them out for comment, we got the comments, anybody's free to go read the comments.

My view is that it will be appropriate to make material and broad changes to that before we finalize it. And in terms of—I didn't say——

Senator WARREN. Material and broad changes to strengthen the rules?

Mr. POWELL. Material and broad changes, and, you know, we're talking about what that'll mean in the end. I did not say that we would withdraw the rule. You know, there's a concept of re-proposal, and I said we hadn't made a decision on that. But if that turns out to be appropriate in the view of the Board of Governors, then that's something we would look at doing.

Senator WARREN. So everything you said a year ago about supporting the vice chair, who is responsible for writing these rules?

Mr. POWELL. You and I had a long colloquy.

Senator WARREN. Yes, we did.

Mr. POWELL. If you read it again, it's on your——

Senator WARREN. That I have.

Mr. POWELL. ——website, you will see that I'm doing exactly what I said I would do in the colloquy.

Senator WARREN. No. You said you would support Vice Chair Barr to get us strong rules, and now he is putting out rules——

Mr. POWELL. No. That was about Silicon Valley Bank.

Senator WARREN. ——and you're talking about reproposing.

Mr. POWELL. The vice chair of supervision has every right to bring proposals to the Board. That has happened. But as I made clear in our colloquy, you're not the comptroller of the currency. When I do monetary policy, I have one vote. There are 11 other voters, and that's the way it works. It's not different for the vice chair for supervision.

Senator WARREN. You are the leader of the Fed, and when the heat was on last year, you talked a lot about getting tougher on the banks. But now the giant banks are unhappy about that, and you've gone weak kneed on this. The American people need a leader at the Fed who has the courage to stand up to these banks and protect our financial system.

Thank you, Mr. Chairman.

Chair BROWN. Senator Daines of Montana is recognized.

Senator DAINES. Chairman, thank you. Chairman Powell, thanks for being here. Good to see you. I can tell you, Montanans are continuing to see the impacts across the board from inflation that's been brought on by the policies of this Administration and by my colleagues across the aisle. And I commend you for the job you have done in trying to reign in inflation, and I encourage you to continue the fight despite political pressures you may face. Last time I checked, it's going to get a little more political around here between now and November.

I'm also encouraged, contrary perhaps to my colleague from Massachusetts, I'm encouraged by your comments yesterday that there will be broad changes to the Basel III proposal, which as it's currently proposed, would've significant detrimental impacts to credit cost and availability to small businesses.

And last, I commend your answer yesterday that the Fed is not a climate agency, and considering the impact of climate change is not a factor in achieving your given mandate, Congressional mandate, of maximum employment and stable prices.

Mr. Chairman, I recently joined many of my colleagues in writing to you about my concerns about the long-term debt proposal that

would mandate regional banks issue new long-term debt. I'm concerned that this will have a disproportionate impact on smaller regional banks because they're required to hold their long-term debt at both the parent holding company and insured depository bank levels.

Could you explain how this aligns with the tailoring requirements set forth in the financial reform bill that we passed back in 2018, Senate Bill 2155.

Mr. POWELL. So I have a longer-term debt proposal that aligns with that. So, first of all, that's been out for comment on that one. The comments are in, we're reviewing it. So I don't want to say too much, but the theory of it, in the first place, was that they're not—those banks are not subject to the living will process to the extent that the G–SIBs are. And this was sort of meant to be a middle step to make them more resolvable without imposing all of the burdens that we impose on the 8 G–SIBs to have very elaborate resolution plans. So that was the thinking, I think, on the calibration of it and all that.

We have voluminous comments. We're looking at them, we'll make an assessment, and move forward as appropriate.

Senator DAINES. Well, thank you. And I know our smaller regional banks would be happy to hear that thoughtful deliberation.

Mr. Chairman, understandably, you've had to raise interest rates to fight the fires of inflation brought on by reckless Democrat spending. However, a major side effect of that is the impact the rising rates are having on the cost of servicing the out-of-control national debt. Senator Haggerty alluded to this a bit in his questioning minutes ago.

Looking at CBO reports, interest payments on our debt will increase 32 percent this year, and will now exceed spending for the entire defense department. I have significant concerns. Many do here in Washington. Many Americans do that we've eventually reach a point where fiscal policy and monetary policy converge. Meaning, that the Fed would ultimately have to worry about the impact rate-setting would have on Government debt or even potentially the risk of a default.

Chairman Powell, I know fiscal policy is not in your purview, but could you ever foresee a situation where fiscal irresponsibility snowballs to a point that the Fed would have to factor this into its decisionmaking?

Mr. POWELL. You know, I think we're a long way from that, and that's a terrible place to be. That's a place where some poor, emerging market countries have found themselves over the years. For the United States to get that point, I think it's unlikely, but I do think that—and it's not our business, we should stay out of this fiscal business—but I'll say what other Fed chairs have said, which is we really need to get back to that discussion about fiscal sustainability.

And both sides need to get together. The kinds of things that have to happen can only be done on a bipartisan basis, and so I really hope that we go back to a place where those discussions are happening again.

Senator DAINES. I've heard from a number of stakeholders about upcoming changes to liquidity regs, including a new ultra short-

term liquidity requirement. As with any policy decision, establishing the facts matters. It's important that financial regulators have a complete, thorough understanding of the financial environment before releasing a half-baked proposal rule or guidance.

My question is, what do you believe is a sufficient time period that would allow your agency to accurately calibrate new, sound, and reasonable liquidity requirements?

Mr. POWELL. That is a great question and when we're struggling, particularly, with all the other things that are going on. You know, we're looking at some—and this is in response to Silicon Valley Bank—we're looking at some liquidity innovations, and we're asking ourselves; which form should that take and how long should it be out for come and that sort of thing. We're not ready to do that yet, but that's the question we're asking.

Senator DAINES. Follow-on question then I'm finished, Mr. Chairman. Will you confirm that prior to the Federal Reserve issuing any new liquidity requirements, it will first conduct all necessary data collection that would allow for meaningful analysis of all potential policy options?

Chair BROWN. And please keep your answer short, Mr. Chairman.

Mr. POWELL. Maybe.

Chair BROWN. That's very short. Thank you.

Mr. POWELL. We can talk about this more, but I don't want to make a really specific commitment like that without talking to the people who are, you know, carefully in touch with this, but that, that is the right thought.

Senator DAINES. Thanks, Chairman.

Chair BROWN. Thank you. Senator Fetterman from Pennsylvania is recognized.

Senator FETTERMAN. Well, seniority——

Chair BROWN. Well, he got here last. Although if Senator Warnock sits down in the next 5 seconds, he's next. So, Senator Warnock, are you ready, or you want to go to in 5? You're oh so generous with each other.

Senator WARNOCK. I'm happy to have the junior colleague go first.

Chair BROWN. Senator Fetterman's recognized.

Senator FETTERMAN. ——much, much better with time.

Senator WARNOCK. OK.

Chair BROWN. All right. Senator Warnock is recognized from Georgia.

Senator WARNOCK. Thank you very much, Mr. Chairman. Banks spending on buybacks is rising again, and their consumer small business banking revenue has sharply increased. Interest rates are high, yet the interest being paid to depositors, ordinary working families, working people with bank accounts, not a lot of money. In Wall Street, accounts remain low.

Chairman Powell, I'm concerned that when banks don't increase the interest rates on bank accounts, families are losing out on dollars that could be in their pockets. Again, they don't have the kinds of portfolios that some of the folks in this room would have. Is that good for the economy, and are you concerned that banks under your supervision are doing this?

Mr. POWELL. Are not paying sufficient?

Senator WARNOCK. That's correct.

Mr. POWELL. That's a question I haven't heard. Of course, they have the option of putting their money in money market funds, and banks compete with each other. But I'll be happy to look into that. I hadn't heard that concern.

Senator WARNOCK. You know, and I think it is worth taking a look at many lower-income individuals and families. Again, they don't have some of the sophisticated products yet. Money markets are available, but we saw high interest rates, and that not being reflected in what depositors are able to benefit from. Could those individuals and families benefit from a high interest rate on their deposits?

Mr. POWELL. Sure, and, you know, for a long time we had a lot of mail from people to the Fed saying, you know, you should raise interest rates because we're not getting anything on our checking accounts. So, we solved that problem.

Senator WARNOCK. I don't think we're asking for that, but given the reality, the question, yeah. So let me pivot. The *Monetary Policy Report* states that while demand for housing has fallen, the strong labor market has kept prices high. That matches what I've been seeing in Georgia. Too many folks can't afford a home.

According to the *Monetary Policy Report*, mortgage rates were averaging around 7 percent last month. That's tough for lower-income home buyers. Increases of just the percentage point or two can be the difference between owning a home or not. Are you concerned about this interplay between lower demand, yet stubbornly high prices, and what it means for folks trying to buy a home? And what do you think is driving these high prices?

Mr. POWELL. So the housing market is in a very challenging situation right now. You have this longer-run housing shortage, but at the same time, you've got a bunch of things that have to do with the pandemic, and the inflation, and our response with higher rates.

So you have a shortage of homes available for sale because many people are living in homes with a very low rate mortgage that they can't afford to refinance. So they're not moving, which means the supply of regular existing homes that are for sale is historically low, and very low transaction rate.

That actually pushes up prices of other existing homes and also of new homes, because they're just not enough supply. The builders are busy, but they're running into, you know, all kinds of supply issues still around zoning, and workers, and things like that. So, it's quite challenging.

And of course, rates are high. So people who are buying, a lot of the buyers are cash buyers or are able to actually pay without a mortgage because mortgages are expensive. I will say the first problem of supply is a longer-run problem.

The other problems associated with low-rate mortgages, and high rates, and all that, those will abate as the economy normalizes and as rates normalize. But we'll still be left with the housing market nationally where there's a housing shortage.

Senator WARNOCK. There's no question we have a supply issue. And this issue of high prices, lack of supply, of course, dispropor-

tionately impacts some communities more than others. According to the *Monetary Policy Report*, the employment rate for the Black prime age labor force that is between 25 and 54 years of age reached a historical peak in 2023.

The gap between Black and White prime age employment dropped to a nearly 50-year low at around 3 percent. We can appreciate progress, but a 3 percent gap is still significant.

Would you agree that it is important to continue focusing on narrowing this gap, and if so, what tools does the Federal Reserve have to do this work?

Mr. POWELL. It's very important, and the single best thing we can do is get prices under control, get inflation under control so that we can have a long expansion with—the record is clear that a long expansion really gives significant benefits to people at the low end of the income spectrum because the labor market gets very tight, inflation is low, and they benefit more than anybody. So that's where we were before the pandemic, and we'd like to get back to that place.

Senator WARNOCK. Thank you so very much. I think there's some other legislative tools that Congress could use, and I'm happy to continue to work with the chair in the ways that we've already done to improve that rate, that difference. Thank you.

Chair BROWN. For sure. Thank you, Senator Warnock. Senator Lummis from Wyoming is recognized.

Senator LUMMIS. Thank you, Mr. Chairman. Welcome. It's nice to see you, Mr. Powell.

My first question is about CDBCs. There's been some chatter lately on the social media that people are concerned about the Fed creating a CDBC without legislative authorization. You and I have discussed that before, and as you know, there are other means other than a CDBC that could use digital assets to create a secure and instant payment system other than a CDBC.

So the question is this, do you still agree that the Federal Reserve cannot introduce a U.S. Central Bank Digital Currency without Congressional authorization?

Mr. POWELL. Yes, I do.

Senator LUMMIS. Thank you. That really calms people's fears. The people who are concerned that we could end up with something like the digital you warned that is used as a means of surveillance. So I think that that will calm some of those discussions down. Thank you so much.

My next question is about your core CPE. Now, as you know, there's a disconnect between how you measure inflation and how the American people see inflation, because the American people are spending their money on gasoline, and food, and rent, things that have gone up a lot. And they hear about these improvements in the economy that they're not seeing in their everyday lives.

So can you explain what measures you use to evaluate inflation? And just explain to the American people why you don't factor in the things they spend money on every day like food and gasoline.

Mr. POWELL. Actually, we do. Our statutory target is inflation. It's not core inflation. And if you look at headline inflation over the last 12 months, that's it. That's our goal. It's 2.4 percent. Core inflation is actually higher than that. It's 2.8 percent. And the reason

is that some energy and food prices have come down, and those don't count in core.

So our overall legal target is headline inflation, which is, you know, it's our best effort to capture the cost of living that people face. It's not perfect. You have to make all kinds of judgments that aren't easy. I mentioned housing earlier. How do you measure housing inflation? Lots of issues, but that's what we target.

The reason we look at core, though, is that headline inflation tends to be more volatile, and it tends to be pushed around by commodity prices, which really don't relate to the overall state of the economy. Is it tight as it's loose? So core tends to be a better predictor of overall inflation than overall inflation is. I know that's complicated, but ultimately though, our target is headline inflation, which does include food and energy.

Senator LUMMIS. Mr. Chairman, I'd like to include a letter in the record that Senator Tillis, and I, and two Democrats on this Committee have submitted with regard to Basel III.

Chair BROWN. Without objection.

Senator LUMMIS. Thank you very much. My question is this; what do you think is more likely that it will be harder for consumers to buy a house and small business to obtain a loan under Basel III, or will lending just migrate outside the banking system, which may be harder to assess because it's opaque?

Mr. POWELL. I'm sorry, I didn't get your question. I apologize.

Senator LUMMIS. OK. So with regard to Basel III, and if there are more constraints on lending activity, what is more apt to be the consequence of that? That it's harder for consumers to buy a house or a small business to get a loan, or that lending just migrates outside of the traditional banking system.

Mr. POWELL. So if there were anything that constricted credit in the banking system, they would probably be both things. Probably there'd be fewer loans made, but in addition, there would be nonbank lenders that are more than happy to make that loan.

Senator LUMMIS. I have a chicken in the egg question here. Starting with TARP in 2008, there has been a very aggressive printing of U.S. dollars up until today. And it particularly went on hyperdrive during that 22-month period of Covid.

So my question is, which comes first? Congress spending more and so you respond by printing more money, or are they separate considerations?

Mr. POWELL. I think it's hard to get my mind around that question. We don't print money to fund the deficit. That's not what happens. But when the Government borrows, it borrows. The Government borrows to fund deficits is what happens.

Senator LUMMIS. Right. And so that would indicate to me that you do respond, because we, in deficit spending, are creating a demand to borrow, and you're responding by——

Mr. POWELL. Well, we're not making loans though. You know, we're not lending money to the Government. We're not financing these deficits.

Senator LUMMIS. And so, there's no chicken in the egg relationship?

Mr. POWELL. There's not really. No, no. I'd have to think about this. I've got to think about the way—why don't we continue this?

Senator LUMMIS. Yeah, I'd love to. And your thoughts earlier about fiscal sustainability and how we can work with you, and bipartisan maybe next year, to address these issues. You know, when you say things, you have to be careful because what you say sends ripple effects outside of this building, but it would sure be nice if we could sit down with you on a bipartisan basis and have those discussions in a frank way.

Chair BROWN. Thank you. Senator Lummis. Senator Fetterman of Pennsylvania is recognized.

Senator FETTERMAN. No, no——

Chair BROWN. All right. Senator Van Hollen of Maryland is recognized.

Senator VAN HOLLEN. Let me start by thanking Senator Fetterman for his allowing me to question. Mr. Chairman, good to see you.

Real wages are up, right? That's good news.

Mr. POWELL. Yes. Over the last couple of years you know, wages have been going up more than inflation. Real wages broadly are up.

Senator VAN HOLLEN. That means more families have more spending power in their budgets, right?

Mr. POWELL. Yes.

Senator VAN HOLLEN. Worker productivity's up, right?

Mr. POWELL. Yes, it is.

Senator VAN HOLLEN. Corporate profits are up, right?

Mr. POWELL. I believe so.

Senator VAN HOLLEN. And worker productivity is rising faster than corporate profits, right?

Mr. POWELL. I don't know the answer to that. That may well be right.

Senator VAN HOLLEN. The charts I show suggest that. So that would indicate that unless, you know, corporations decide to pocket as profits more of the gains they get from their workers' labor, that we should be able to continue to have increases in real wages. Is that right?

Mr. POWELL. Yeah.

Senator VAN HOLLEN. And so, it's important, I think, that, you know, people recognize that these corporations are doing better than ever, and they are deciding now to essentially return the gains made through their workers' productivity, which is going up more, to shareholders. Obviously, shareholders, we're going to get a profit. But the question is whether or not workers share in that profit to the extent of their worker productivity.

And as you know, we've seen a great gap over decades between rising worker productivity and real wages, and we're hoping to close that gap. Would you agree that it would be good for a more inclusive economy if worker wages tracked worker productivity increases?

Mr. POWELL. I think if you include benefits, that's a significant part of that gap. I've looked into that, but not for some years. But I mean, generally speaking, people's compensation should equal—should be over time, equal to increases in productivity.

Senator VAN HOLLEN. I appreciate that. And I also want to—there's the tradeoff on workers' wages, and there's also an issue with price gouging, right? So we have seen record profits, we've

also seen very high prices these corporations are charging for things like groceries.

Now, I listened to a little bit of exchange with the chairman earlier, and of course I think your answer was, you know, people will charge what consumers will pay. But it should be known that these corporations are reaping much larger profits now than they were pre-COVID, for example, right?

Mr. POWELL. I mean, some of them are. I'm not super focused on individual corporate profits, but yeah, corporate profits, I gather, have been high overall.

Senator VAN HOLLEN. Right. I mean, they're high for a couple reasons. One is that they're charging consumers, for example, the grocery stores a lot of money. And the other would be if they're not sharing the benefits of labor productivity with their employees.

So I think because we've heard a lot claims by some of our Republican colleagues about the causes of price increases, I think it's very important that American consumers recognize that corporations are choosing to charge them more at the grocery store or engaging in things like shrinkflation rather than—in order to have more of their profits.

Let me turn briefly to a letter that I sent to the vice chair of supervision and some of the other Federal regulators in January of this year regarding the Basel III capital requirements, and I support the overall effort on Basel.

We did raise concerns with respect to a specific issue, which is the harmful, and we think unnecessarily harmful impact it could have on clean energy tax credit investments. And all of the regulators testifying that day, including the vice chairman, said they recognized this was a significant issue and hoped to address it. Would you agree with that?

Mr. POWELL. Yes, I would.

Senator VAN HOLLEN. Thank you. Thank you, Mr. Chairman. Thank you, Senator Fetterman.

Chair BROWN. Thank you, Senator Van Hollen. Senator Fetterman of Pennsylvania is recognized.

Senator FETTERMAN. Yes, I love that. All right. So it's great to be here with you today.

Now, I don't know, maybe some people in America were talking about a cookie that was $18, and I was alarmed, and I hope we investigate that there is a cookie that costs $18. And do you believe that an anecdote on Twitter about a cookie that costs $18, is that reflective of our economy and where we're at or not?

Mr. POWELL. I certainly hope not. I don't do much shopping these days, but that sounds like a pretty expensive cookie.

Senator FETTERMAN. Yeah. And now, I believe that the American economy now is the envy of the world after everything right now, correct?

Mr. POWELL. We are, yes. We're performing very well compared to our peer group.

Senator FETTERMAN. Yeah. Pretty great. And is it fair to say that the stock markets are all up at record highs, right?

Mr. POWELL. Pretty close.

Senator FETTERMAN. Yeah. And inflation has been pretty effectively addressed, right?

Mr. POWELL. It's been coming down sharply since the middle of last year. Yes. We've got a ways to go on that, but we've made a lot of progress.

Senator FETTERMAN. And corporate profits are pretty robust. Is that fair?

Mr. POWELL. I believe it is.

Senator FETTERMAN. OK. Well, if we can agree that—and I don't understand why more people seem to be talking about a cookie that cost $18, but that seems to be against the evidence as well. But given that now since things are pretty great, and we're in a really great place, but now I am concerned, and there's rumors going around that Basel they're going to change and they're going to reducing the capital, right?

And, I guess, I'm concerned about that because I don't know why we would want to—and also, I wouldn't want the record to reflect on you're much smarter than I am, but I would be concerned that things are in a really great place right now. We can all agree on that. I would be concerned to change something like that because I wouldn't want to have something again like what happened with SVB, and I just wanted to get your take on that.

Mr. POWELL. Sure. So U.S. banks are well capitalized, and generally speaking, they're quite well capitalized, and we're not talking about reducing current capital levels at all. Really, in the Basel III Endgame, capital may well go up.

And what we're talking about is whether the proposal that was put out by the bank regulatory agencies, including the Fed, and which has now been the subject of quite a lot of comment whether—you know, what changes will be appropriate to that. That's what we're talking about. We're not talking about reducing existing capital requirements.

Senator FETTERMAN. Oh, OK. Well, and then I also want to play off of a comment made by my colleague from Tennessee, and I actually agreed with him, and he's concerned about the deficit. About it is $1 trillion for every 100-dollar-days.

So now, if the Federal Government had added $3.5 trillion to the deficit by extending the Trump tax cuts, would that increase or decrease inflation?

Mr. POWELL. So I'm going to fall back on our long-time reluctance to comment on fiscal policy. We take year to fiscal policy decisions, whatever they may be. We take them as they are and we conduct monetary policy to achieve 2 percent inflation, but we don't score inflation. CBO does that. They'll make a judgment on that, but it's not something we do because we're an independent agency, and that requires us to stay the heck out of politics.

Senator FETTERMAN. So I don't want to put you on the spot, but would those kind of tax cuts help addressing inflation or inflame inflation?

Mr. POWELL. I don't know what the effects would be on inflation. I do know, broadly speaking, we need to get to a place where revenues and spending are better aligned. And I think everybody knows that. And, you know, I think we used to talk about this a lot 10 years ago, and we're not talking about it so much anymore. That's understandable. The pandemic was a special thing, but I do think it would be great to get back to that on a bipartisan basis.

Senator FETTERMAN. OK. Well, I have about 30 seconds left. I just want to go on the record. I think you've done a really great job, and I think our economy—and I do agree that it is the envy of the world as well. And I'm confused that more people are talking about cookies, or McDonald's meals, and those kinds of a thing. It's not reflective on the strength of this as well too, and I just want to thank you for your service.

Mr. POWELL. Thank you, sir.

Senator FETTERMAN. Mr. Chairman.

Chair BROWN. Thank you, Senator Fetterman. That's the last question. And thanks for your generosity and yielding to colleagues whom you got here before.

Thank you, Chair Powell, for joining us today, and every 6 months, and sometimes more often. I look forward to working with you in your work to strengthen our economy. Senators who wish to submit questions for the hearing record are due 1 week from today, March 14th.

To Chair Powell, please submit response to those questions for the record no more than 45 days from the day you received them. Thank you again for your testimony.

Mr. POWELL. Thank you, Mr. Chairman.

[Whereupon, at 12:05 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF CHAIR SHERROD BROWN

The Fed has immense power in shaping our economy. Your job is clear: promote stable prices and maximum employment.

Today, the cost of living is still far too expensive for most Americans. The Fed only has one tool available to fight those high prices—interest rates. And that tool does nothing to address the real cause for why costs remain too high: corporations price gouging to boost their profits and make their shareholders richer.

High rates don't force corporations to lower their prices—but high interest rates are raising housing costs, hindering wage growth, and stifling small businesses.

Now is the time for the Fed to decide if it is going to make good on its commitment to workers and to their families—by lowering interest rates and protecting our financial system from Wall Street executives who have used their wealth and power to influence economic policy and to avoid accountability for their risky bets.

Keeping rates too high for too long strangles the economy.

No one wants this. It makes it harder for small businesses to expand and hire more workers, undermining job creation.

Higher rates also stifle overdue investments that are creating high-quality, good-paying jobs and that are necessary for us to remain the most competitive and innovative economy in the world.

And high interest rates are raising housing costs higher and higher for families who were already facing a tough market with too few options and too high prices.

I hear from so many Ohioans who feel trapped: those who rent feel like they'll never be able to afford to buy. And those who already own their homes feel like they will never be able to afford a larger one if they decide to grow their family. If they're fortunate enough to have an interest rate from a couple of years ago, they don't want to give it up.

That limits their choices, and it limits the housing supply.

And by driving up construction costs, higher rates make it even harder to build new apartments and homes—so we have even less supply at exactly the same time when it's harder to afford a mortgage.

Families are stuck delaying the purchase of their first home and renting for longer. And that cycle drives rents up even further.

Americans are paying a steep price for high interest rates. And continued high rates are not going to make life less expensive for workers and their families.

We know why prices are high years after supply chains have improved. It's the same cause of so many of the problems in our economy:

Corporations want bigger profits to reward their executives.

In 2022, at the peak of inflation, corporate profits soared to historic levels. And you know where those profits went—right into the pockets of their top executives.

That same year, the largest multinational corporations gave out nearly one-and-a-half-trillion dollars in stock buybacks and dividends.

Americans today pay more for groceries than they have in 30 years.

And Ohioans are paying for corporations' executive bonuses and stock buybacks every time they go to the grocery store.

And the biggest corporations are always finding new ways to charge people more to increase their profits.

Fast food restaurants and big stores are experimenting with electronic price tags, so they can change prices constantly—making it easier to sneak prices up little by little, and making it harder for people to comparison shop and find the store with the lowest price.

And many companies increase their profits by charging more for less—the media has started calling it "shrinkflation." Your bottle of Gatorade used to be 32 ounces, now it's 28 ounces—but the price hasn't gone down. If anything, it's gone up a little bit.

It's why I introduced legislation that would stop that kind of deceptive practice.

That's the kind of solution we need to take on corporate price gouging—and it has nothing to do with higher interest rates.

The Fed doesn't only set monetary policy. You also make the rules that keep our banking system sound and consumers' money safe.

We have had some positive developments since the last time you testified in June, like the update to the Community Reinvestment Act rule. Chair Powell, thank you for your work on this—this took years of listening carefully to all stakeholders and was long overdue. We'll be watching to make sure you implement this quickly so that banks are fulfilling the purpose of the Community Reinvestment Act.

You also issued an updated capital requirements proposal called Basel III.

Strong capital requirements are how we ensure that if Wall Street's bets don't pay off, shareholders and investors are on the hook—not taxpayers.

We need these guardrails in place. I urge you to remain committed to protecting the public, despite the massive amounts of money big banks and their lobbyists are spending to try to kill these taxpayer protections. Let's finish the job and finalize Basel III.

Last year's bank failures also demonstrate the dangers of letting the banks chip away at rules and oversight.

It's entirely predictable—bankers desperate to increase their already-massive profits take big risks that undermine our economy. And when things go wrong, the bank executives come to regulators with their hands out, accepting no responsibility.

It's why Congress must finish the job and pass our bipartisan RECOUP Act—it passed this Committee 21-to-2—to hold senior bank executives accountable when they gamble with customers' money.

When the biggest banks exercise special privilege, they do so at the peril of our broader economy.

And we know that's the source of so much that's wrong in this country: big corporations using their power and influence to write the rules of our economy to the benefit of them and their executives and their investors—and to the detriment of everyone else.

That's why I stand up for workers and their right to organize.

It's why I stand up to take on the railroads and the drug companies, and the biggest banks and corporations who time and time again try to rewrite the rules to increase their profit margins.

Chair Powell, I look forward to hearing from you today how the Fed will work to promote an economy where everyone who wants a good job can find one.

PREPARED STATEMENT OF SENATOR TIM SCOTT

Chair Powell, thank you for coming this morning. Good morning—appreciate you being here.

In three days, on March 10, it will be the 1-year anniversary of the failure of the Silicon Valley Bank.

SVB marked the third largest bank failure in U.S. history and certainly, the largest since the 2007–2008 financial crisis.

I've said it many times before, and I'll say it again today, there were three major components to SVB's failure: first, the bank was rife with mismanagement; second, there was a clear supervisory failure and our regulators were certainly asleep at the wheel; and third, President Biden's reckless spending caused record high inflation, which resulted in drastic interest rate hikes and tremendous loss.

When you print and spend trillions of dollars at the end of COVID, we should not be surprised that we have record-high inflation. Record-high inflation translates into today, still, 40 percent higher for gas for your car, 30 percent higher for your food, 20 percent higher for your energy costs.

The devastation the average American is facing because of Bidenomics is undeniable, but certainly measurable.

So I'm glad to spend some time talking about the state of our economy—an economy that has been ravaged—as I've just spoken about—by inflation, suffering under the weight of an open border and millions of illegal immigrants, and drowning in disastrous regulations.

I hear from my constituents all the time that inflation and an unsustainable cost of living continue to impact their families. For far too many, the American Dream seems further and further out of reach than ever before.

And frankly, the past 3 years of this Administration's failed policies have landed us right in that spot.

In fact, last month, Treasury Secretary Yellen sat before this Committee and attempted to spin a narrative of how strong the economy is, how well-off consumers are, and how much people have in the bank, thanks to Bidenomics.

But, in the midst of this, she also admitted that many prices are not going down.

In fact, she said, "we don't have to get these prices down."

Tell that to the mechanic working in South Carolina, tell that to teacher trying to put gas in the tank.

It is simply unacceptable.

Because the truth is that Americans are now spending more of their income on food than they have in 30 years.

The truth is that housing affordability remains at its lowest level in 40 years.

But, inflation isn't the only concern I'd like to raise. I'd also like to address the economic impacts of illegal immigration.

During your recent interview on "60 Minutes", you stated that "over time. the U.S. economy has benefited from immigration."

Let's be clear, America is a Nation of immigrants—no doubt.

But when we talk about illegal immigration today, we must also face the dire reality that our towns and our cities are suffering from the adverse impacts of illegal immigration facilitated by the Biden administration's open, unsecure, and unsafe southern border.

Because of President Biden's policies, we've seen over seven million illegal immigrants cross our borders in just 3 years. By the time this election happens this year, in November, the numbers suggest it could be as high as 10 million illegal immigrants coming into our country.

So, we cannot have an honest conversation about the benefits of legal immigration in our labor force without also addressing the elephant in the room—our country is strained, our economy is strained, under the weight of illegal immigration.

In fact, recent reporting has highlighted that cities and States across our country are struggling to keep pace, and some have been forced to cut public services to Americans in order to fund the costs of feeding and housing illegal immigrants.

One clear example. we saw in New York City, where the poorest kids in the city, minority kids in the city, were stuck at home because the city was using the schools to house illegal immigrants.

Another example—the city of Denver recently announced that some of its employees may have their hours cut in order to reallocate funds toward the city's migrant crisis. How in the world is that fair to Americans? It's not.

We must get the illegal immigration crisis under control because if we don't, our local economies will continue to be crushed and opportunities will continue to be stripped from our citizens and their families.

Finally, as if inflation and the negative impacts of illegal immigration were not enough, the tsunami of regulatory-red tape coming from our financial regulators further threatens economic opportunity across the board.

For months we have heard bipartisan criticism of the Fed's Basel III Endgame proposal, which will restrict lending and access to credit for those who need it most.

I was certainly, pleasantly surprised to hear your comments about Basel III and your thoughts on its future. When 97 percent of the comments that you receive are negative that's good news. Good news for the American consumer, good news for entrepreneurs who want to start a business but do not have access to capital, perhaps even good news for millennials who would love to become a first-time homebuyer.

The opposition to Basel III comes from a diverse array of interests—from community leaders, to farmers, to housing groups. We've even heard opposition in this very room, on this very Committee, from Democratic senators.

I look forward to your testimony and looking forward to asking some questions as well.

PREPARED STATEMENT OF JEROME H. POWELL

CHAIR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MARCH 7, 2024

Chair Brown, Ranking Member Scott, and other Members of the Committee, I appreciate the opportunity to present the Federal Reserve's semiannual *Monetary Policy Report*. The Federal Reserve remains squarely focused on our dual mandate to promote maximum employment and stable prices for the American people. The economy has made considerable progress toward these objectives over the past year.

While inflation remains above the Federal Open Market Committee's (FOMC) objective of 2 percent, it has eased substantially, and the slowing in inflation has occurred without a significant increase in unemployment. As labor market tightness has eased and progress on inflation has continued, the risks to achieving our employment and inflation goals have been moving into better balance.

Even so, the Committee remains highly attentive to inflation risks and is acutely aware that high inflation imposes significant hardship, especially on those least able to meet the higher costs of essentials, like food, housing, and transportation. The FOMC is strongly committed to returning inflation to its 2 percent objective. Restoring price stability is essential to achieve a sustained period of strong labor market conditions that benefit all.

I will review the current economic situation before turning to monetary policy.

Current Economic Situation and Outlook

Economic activity expanded at a strong pace over the past year. For 2023 as a whole, gross domestic product increased 3.1 percent, bolstered by solid consumer de-

mand and improving supply conditions. Activity in the housing sector was subdued over the past year, largely reflecting high mortgage rates. High interest rates also appear to have been weighing on business fixed investment.

The labor market remains relatively tight, but supply and demand conditions have continued to come into better balance. Since the middle of last year, payroll job gains have averaged 239,000 jobs per month, and the unemployment rate has remained near historical lows, at 3.7 percent. Strong job creation has been accompanied by an increase in the supply of workers, particularly among individuals aged 25 to 54, and a continued strong pace of immigration. Job vacancies have declined, and nominal wage growth has been easing. Although the jobs-to-workers gap has narrowed, labor demand still exceeds the supply of available workers. The strong labor market over the past 2 years has also helped narrow long-standing disparities in employment and earnings across demographic groups. [1]

Inflation has eased notably over the past year but remains above the FOMC's longer-run goal of 2 percent. Total personal consumption expenditures (PCE) prices rose 2.4 percent over the 12 months ending in January. Excluding the volatile food and energy categories, core PCE prices rose 2.8 percent, a notable slowing from 2022 that was widespread across both goods and services prices. Longer-term inflation expectations appear to have remained well anchored, as reflected by a broad range of surveys of households, businesses, and forecasters, as well as measures from financial markets.

Monetary Policy

After significantly tightening the stance of monetary policy since early 2022, the FOMC has maintained the target range for the Federal funds rate at 5¼ to 5½ percent since its meeting last July. We have also continued to shrink our balance sheet at a brisk pace and in a predictable manner. Our restrictive stance of monetary policy is putting downward pressure on economic activity and inflation.

We believe that our policy rate is likely at its peak for this tightening cycle. If the economy evolves broadly as expected, it will likely be appropriate to begin dialing back policy restraint at some point this year. But the economic outlook is uncertain, and ongoing progress toward our 2 percent inflation objective is not assured. Reducing policy restraint too soon or too much could result in a reversal of progress we have seen in inflation and ultimately require even tighter policy to get inflation back to 2 percent. At the same time, reducing policy restraint too late or too little could unduly weaken economic activity and employment. In considering any adjustments to the target range for the policy rate, we will carefully assess the incoming data, the evolving outlook, and the balance of risks. The Committee does not expect that it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent.

We remain committed to bringing inflation back down to our 2 percent goal and to keeping longer-term inflation expectations well anchored. Restoring price stability is essential to set the stage for achieving maximum employment and stable prices over the longer run.

To conclude, we understand that our actions affect communities, families, and businesses across the country. Everything we do is in service to our public mission. We at the Federal Reserve will do everything we can to achieve our maximum employment and price stability goals.

Thank you. I am happy to take your questions.

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[1] A box in our latest *Monetary Policy Report*, "Employment and Earnings Across Demographic Groups", discusses differences in labor market outcomes among segments of the population.

RESPONSES TO WRITTEN QUESTIONS OF CHAIR BROWN FROM JEROME H. POWELL

Q.1. Commercial real estate (CRE) investments make up a substantial share of economic activity—nearly 3 percent of total GDP in 2022. Commercial banks hold approximately $3 trillion in CRE debt. In the latest Federal Reserve *Monetary Policy Report*, the Board writes, "Commercial real estate (CRE) prices continued to decline, especially in the office, retail, and multifamily sectors, and low levels of transactions in the office sector likely indicated that prices had not yet fully reflected the sector's weaker fundamentals." [1] Community and regional banks have substantial CRE holdings potentially making them more vulnerable to financial stress as prices decline.

In light of recent events, what is the Fed's view of the risks CRE poses to the banking system, and how is the Fed confronting those risks through its supervisory activities?

Commercial banks have been a significant source of credit for multifamily housing. [2] Millions of Americans live in multifamily housing.

What steps is the Fed taking to monitor emerging risks unique to the multifamily housing sector?

A.1. As noted in the April 2024 *Financial Stability Report*, [3] the banking system remains resilient, with sound capital and liquidity levels in the fourth quarter. However, the value of commercial real estate (CRE) property prices remained high relative to rental income, particularly for the office sector.

CRE has been a supervisory focus for the Federal Reserve. As noted in our May 2024 *Supervision and Regulation (SR) Report*, [4] Federal Reserve supervisors remain focused on monitoring banks with concentrations in CRE loans. Supervisors are particularly focused on assessing whether risk management practices at these banks are commensurate with the level of concentration and the composition of a bank's CRE loan portfolio. The Federal Reserve is also closely monitoring banks' CRE lending in the multifamily sector.

As part of the supervisory process, examiners, when appropriate, develop supervisory plans and conduct examinations to assess CRE risks specific to a bank and the risk characteristics of its CRE loan portfolio by property sector. For a bank with a CRE loan concentration, examiners complete procedures to appropriately assess the activity and the associated risks to the bank. When there are weaknesses in risk management practices or safety-and-soundness issues, examiners make recommendations to a bank to address the weaknesses, or when the matter is more serious, examiners will take supervisory action.

In June 2023, the Federal Reserve along with the Federal Deposit Insurance Corporation, National Credit Union Administra-

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[1] *https://www.federalreserve.gov/publications/files/20240301-mprfullreport.pdf*

[2] *https://www.nmhc.org/research-insight/quick-facts-figures/quick-facts-investment-returns-on-apartments/quick-facts-mortgage-debt-outstanding/*

[3] See *https://www.federalreserve.gov/publications/files/financial-stability-report-20240419.pdf.*

[4] See *https://www.federalreserve.gov/publications/files/202405-supervision-and-regulation-report.pdf.*

tion, and the Office of the Comptroller of the Currency issued an interagency *Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts*.[5] The interagency policy statement was issued to assist financial institutions, given current challenges and risks facing CRE lending. The statement is a principles-based resource for financial institutions to consider when engaging with borrowers experiencing financial difficulties. While this interagency policy statement is only one part of the Federal Reserve's larger supervision program and broader outreach efforts to inform the public and industry of CRE risks and supervisory expectations, it reinforces a key message to the industry that financial institutions should work prudently and constructively with creditworthy commercial borrowers experiencing financial difficulties. It also clarifies that such a message applies in all stages of the economic cycle. The interagency policy statement is further intended to promote supervisory consistency among examiners, enhance the transparency of CRE loan accommodation and workout arrangements, and ensure supervisory policies and actions do not inadvertently curtail the availability of credit to sound borrowers.

Q.2. Chairman Powell, diversity of perspectives and experiences are critical for the Fed as it makes decisions that affect all Americans. The Fed has made good progress in recent years at improving racial and gender diversity within its leadership, but it's also critical that there are voices represented beyond just the business and financial realms and leaders with ties to the communities they serve. This year the Cleveland and Philadelphia Reserve Banks will be selecting new Presidents. Both Presidents will serve as FOMC voting members and act as regional economic policy leaders for their respective districts. The Board's input in this process weighs heavily on the presidential committee's final decision.

Additionally, the Board selects three Class C Directors for each of the 12 Federal Reserve Regional Banks. These directors oversee management of the Regional Banks and select their bank's president. It is vital that Class C Directors can speak to the local needs of workers, consumers, community banks, and the business community.

Please describe the Fed's recent efforts to increase thought diversity and select leaders with connections to Federal Reserve districts across the System's leadership?

A.2. The Federal Reserve System (System) is committed to fostering and leveraging diversity at all levels of our organization. My colleagues and I agree that we make better decisions on behalf of the American people when we draw from a rich pool of perspectives and experiences.

The Board of Governors (Board) works closely with each of the Federal Reserve Banks (Reserve Banks) to identify and recruit highly qualified directors who can contribute to the System's understanding of economic conditions in their respective Districts and the Nation. As you noted, we have made significant progress in increasing gender, racial, and ethnic diversity among directors, and we are committed to maintaining these gains. Collectively, nearly

[5] The Supervision and Regulation Letter 23-5 is available at *https://www.federalreserve.gov/supervisionreg/srletters/SR2305.htm.*

70 percent of current Class C and Class B directors, who represent the public and are responsible for selecting their Reserve Bank's leadership, are diverse in terms of gender and/or race/ethnicity.

Further, the current Class C and Class B directors provide the System with a window into the economic well-being and interests of workers, families, consumers, and communities through their affiliations with a wide array of sectors and industries, as well as organizations, such as labor unions, nonprofits, hospital systems, and colleges and universities. The Reserve Banks also benefit from the perspectives of their Class A directors, including community and regional bankers, who are elected by the member banks in their respective Federal Reserve Districts to represent those banks. And as you know, the Class A directors do not have a role in selecting Reserve Bank leadership.

Using the lessons from recent searches for Reserve Bank presidents and other senior System leaders, the Board has communicated clear expectations to ensure that the search process is robust, transparent, fair, and inclusive, and generally conforms to best practices. Recent Reserve Bank president searches have all emphasized the importance of executive leadership and community engagement in addition to policymaking capabilities. Additionally, the search committees proactively reach out to their District's communities and constituencies and engage with the public through digital media and events and solicit nominations of candidates. My colleagues and I at the Board, as well as the search committees, are committed to continue conducting robust searches to identify the best leaders.

Q.3. The Bank Holding Company Act requires the Fed to consider the effects of the proposed transaction on the convenience and needs of the community to be served when assessing mergers and acquisitions. Yet the Fed approved the formation of Truist, which went on to close nearly one thousand branches and still plans to close more after missing financial targets, which the merger was supposed to assure.

What is the Fed doing to make sure that future merger decisions do not result in the surviving entity failing to meet its communities' convenience and needs?

A.3. The Federal Reserve Board (Board) takes seriously its responsibility to review bank merger proposals under the relevant statutory factors set forth in the Bank Holding Company Act of 1956 (BHC Act). These factors include the financial and managerial resources of the organizations involved and of the proposed combined institution; the convenience and needs of the communities to be served by the resulting institution; the Community Reinvestment Act performance of the involved depository institutions; the effectiveness of the parties in combatting money laundering; and the effects of the proposal on competition and financial stability.

Q.4. The Fed is the only one of the three banking regulators that hasn't moved officially to review its merger policy.

When can we expect to see the Fed release an update to its bank merger guidance?

A.4. The Federal Reserve currently is reviewing its bank merger framework to determine whether any adjustments would be appro-

priate to improve our merger analysis. This includes a review of each of the statutory factors that the Federal Reserve must consider in evaluating merger proposals. As part of this process, Board staff have been engaging in discussions with staff of the other banking agencies regarding our bank merger frameworks, and with staff of the U.S. Department of Justice regarding its ongoing review of the joint bank merger guidelines.

Q.5. The Fed also has a financial stability mandate for mergers, but it approved an acquisition by Silicon Valley Bank—then an already fast-growing institution that quickly rose to become one of the 25 largest banks in the country—acquiring another multibillion-dollar bank without noting any concerns about financial stability risks.

What is the Fed doing to make sure that future merger decisions do not create or exacerbate systemic risks to financial stability?

A.5. The Board has developed a comprehensive, multifaceted framework for evaluating how a particular proposed merger may affect risks to financial stability. Under the framework, the Board analyzes five key factors: (i) the size of the resulting firm; (ii) the availability of substitute providers for any critical products or services offered by the resulting firm; (iii) the interconnectedness of the resulting firm with the banking or financial system; (iv) the extent to which the resulting firm contributes to the complexity of the financial system; and (v) the extent of the cross-border activities of the resulting firm. These metrics are intended to capture the systemic importance of the combined organization and the incremental effect of the transaction on the systemic footprint of the acquiring institution. The Board also considers qualitative factors indicative of the relative degree of difficulty of resolving the resulting firm, such as the opaqueness and complexity of a firm's internal organization. Further, the Board considers the resulting firm's global systemically important bank score and factors that may mitigate the effect of a proposed transaction on financial stability. However, the Board has been clear that these factors are not exhaustive or dispositive, and that any analysis under the financial stability factor is holistic.

Q.6. A growing share of workers engage in "gig" work or other forms of part-time employment. While part-time work can be useful for many workers who have other familial or personal responsibilities, like attending school, workers in alternative work arrangements often have unpredictable or inconsistent hours, leading to greater financial insecurity.

Please explain how the Fed considers alternative work arrangements including "gig" worker or part-time workers in its monetary policy decision making?

A.6. As part of our statutory mandate to promote maximum employment and stable prices, we monitor a variety of labor market data, including data on part-time employment, to assess the extent to which labor is underutilized. The available data on part-time employment indicates whether individuals are working part time for economic reasons (e.g., because they could not find full-time work or because of a period of weak demand at their employer) or for non-economic reasons (e.g., because they are students, have

childcare responsibilities, or have other family or personal obligations that precludes full-time work). Individuals working part time for economic reasons could work more if demand was higher and so provide an indication of the position of the economy relative to maximum employment. An unusually large amount of part-time work for economic reasons, for example, could suggest that the economy is relatively far from maximum employment.

The share of workers working part time for economic reasons was 2.8 percent in April, well toward the lower end of the range for this metric over the past 30 years. Over the past year, as the unemployment rate has increased slightly, so has the share of workers working part time for economic reasons, suggesting that the labor market remains tight, but not quite as tight as it was a year ago.

If unemployment remained low, but an elevated number of people were working part time for economic reasons, this might suggest the economy was below maximum employment, and we would take that into consideration. Of course, any assessment of the position of the economy relative to maximum employment would also take into account a large variety of other labor market indicators.

Q.7. Efforts are currently underway to increase public safety communications on the National Mall. The National Mall has long been a difficult place to deploy critical communications infrastructure, but there remains a public safety and homeland security imperative to ensure first responders can communicate. FirstNet Authority provided my office a copy of a letter it sent the Federal Reserve on November 16, 2023, requesting a meeting and discussing the possible installation of FirstNet wireless equipment on property managed by the Federal Reserve.

Please provide an update on the Fed's involvement in this initiative and any ideas the Fed may have to help address the challenges with public safety communications.

A.7. Federal Reserve staff often engage with entities that are interested in procurement or services opportunities with the Board. We would be happy to follow-up directly with your staff on this issue.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM JEROME H. POWELL

Q.1. The Federal Reserve (Fed) announced in October 2023 that it would undertake a supplemental data collection to better understand the effects of the Basel III Endgame proposal.[1] Subsequently, during a fireside chat on January 9, 2024, Vice Chair Barr indicated that the public would have an opportunity to comment of the results of the Fed's analysis of the data.[2]

Does the Fed intend to reopen the comment period on the Basel III Endgame rule to allow for comments on the data results? If not, how does the Fed plan to provide the public with an opportunity to comment?

What, if any, data does the Fed plan to release as part of the results?

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[1] *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020b.htm*
[2] *https://whfdc.org/events/EventDetails.aspx?id=1812706&group=*

Will independent analysis of the data collected be possible?

A.1. We have received voluminous substantive comments on the capital proposal, as well data from the quantitative impact studies. We are in the process of reviewing and assessing the data and the comments received on the proposal. While we have not yet made any decisions on how to proceed, I am confident that the final product will be one that is analytically well-grounded and will have broad support among the Board of Governors (Board) and the public.

Q.2. In response to a question regarding whether the Fed was willing to withdraw the Basel III Endgame proposal or re-propose with significant modifications, you stated, "[I]n terms of process, we're not at the stage of making that decision. I will say if it turns out to be appropriate, when we get to that point, for us to propose parts or all of the thing, then we won't hesitate to do so." You went on to state, "[I] expect there will be material and broad changes to the proposal before it comes back to the [sic] board for consideration."

Do you agree that "material and broad" changes to any Federal agency proposal would require additional notice and comment periods to allow the public an opportunity to review and comment to ensure transparency and accountability in the rulemaking process? If not, please explain.

What is a realistic timeline for when the Fed and the other Federal banking agencies would decide to withdraw or re-propose the Basel III Endgame proposal?

A.2. We have received voluminous substantive comments on the capital proposal, as well data from the quantitative impact studies. We are in the process of reviewing and assessing the data and the comments received on the proposal. While we have not yet made any decisions on how to proceed, I am confident that the final product will be one that is analytically well-grounded and will have broad support among the Board and the public.

Q.3. In response to questions regarding the impact of rising interest rates on the affordability of housing and whether housing supply and demand are in balance, you stated, "There are things in the housing sector that we didn't fully anticipate, and one of them was . . . that people in homes with very low interest rate mortgages aren't selling. So, the quantity of homes that's available is incredibly low and that's why there's very little in the way of existing home sales and that drives up existing home sale prices but also new home sale prices."

Please explain what the Fed anticipated would happen to housing supply and demand when interest rates were raised in response to inflation.

Has the Fed considered what impact significant additional demand stimulus would have on housing affordability in the current supply constrained housing market? If yes, please explain.

What would that mean for homeowners, renters, and the Fed's ability to bring down inflation?

A.3. Rising mortgage rates typically reduce overall demand in the residential real estate market. The run-up in rates through late-2023 contributed to an increase in typical mortgage payments for

new borrowers that caused home sales to fall sharply.[3] However, several other factors have supported underlying demand for housing and prevented significant price declines, including the robust job market and the increased prevalence of remote work.

Housing supply has also faced constraints from both short- and long-term factors. In the short term, higher interest rates and tighter underwriting by banks significantly increased builders' costs of financing, thereby discouraging new construction. In addition, a variety of longer-term factors—including zoning and other regulatory hurdles and shortages of labor and materials—have prevented construction from keeping up with underlying demand.

The interplay between demand and supply has unfolded differently across different segments of the housing market. High mortgage rates have discouraged some potential sellers with low rates on their current mortgages from moving, which has kept the existing home market unusually thin. Indeed, there has been a dramatic reduction in the number of people both selling and bidding on homes. The shortage of available existing homes for sale has pushed some remaining homebuyers toward newly constructed homes and supported a modest rebound in single-family construction since the middle of last year. In contrast, after rising to historically high levels in 2022, multifamily construction starts have fallen more recently in response to builders' concerns about oversupply (which is showing up in falling occupancy rates and a slowdown in rents).

Q.4. Last October, the Fed took the unprecedented step of issuing principles for climate-related financial risk management. The "principles" function as guidance, instructing financial institutions on how they should be conducting business as it relates to with climate risks. You stated when the guidance was adopted, "It is not the Fed's role to tell banks which businesses they can and cannot lend to, and this guidance is not intended to do so."[4] Governor Bowman warned when voting against the guidance, " . . . I am concerned that the guidance could be used by the Federal Reserve and other Federal banking agencies to pursue climate policies leveraging the opacity of the supervisory process."[5]

What safeguards are in place to ensure that this new guidance will not be abused by regulators to push political climate agendas?

A.4. The Federal Reserve neither prohibits nor discourages financial institutions from providing banking services to customers of any specific class or type, as permitted by law or regulation. The decision regarding whether to make a loan or to open, close, or maintain an account rests with the financial institution, so long as the financial institution complies with applicable laws and regulations.

In October 2023, the Federal Reserve, jointly with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, finalized Principles for Climate-Related Financial Risk Management for Large Financial Institutions (the principles)

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[3] For more details, see the box "Recent Housing Market Developments" in the March 2024 *Monetary Policy Report*.

[4] *https://www.federalreserve.gov/newsevents/pressreleases/powell-statement-20231024b.htm*

[5] *https://www.federalreserve.gov/newsevents/pressreleases/bowman-statement-20231024b.htm*

that provide a high-level framework for the safe and sound management of exposures to climate-related financial risks for large financial institutions, those with $100 billion or more in total assets. The principles are squarely focused on prudent and appropriate risk management, reflecting that the Federal Reserve's responsibilities with respect to climate change are narrow and tightly linked to our responsibilities for bank supervision. The Federal Reserve is not—nor do we seek to be—a climate policymaker.

Q.5. Given that the joint banking agencies issued the Basel III Endgame and Long-Term Debt proposals a little over a month apart and closed the comment period for both proposals on the same date:

Do the agencies plan to finalize both rules at the same time?

Has the Fed conducted any analysis on the combined impact of the two proposals?

A.5. We are in the process of carefully considering comments on all aspects of the proposals, including how each proposal would interact with other rulemaking proposals and impact the U.S. economy and regulated firms. While we have not yet made any decisions on how to proceed, I am confident that the final product will be one that is analytically well-grounded and will have broad support among the Board and the public.

Q.6. The Federal Reserve Bank of New York recently detailed the rise in household debt, increasing 1.2 percent in the fourth quarter of 2023.[6] The data also reflects that credit card and auto loan delinquencies are continuing to rise, with bank credit card loan delinquencies now at their highest level in over a decade.[7]

Is the Fed concerned with this increasing trend amongst borrowers?

Did the Fed consider short-term borrowing costs and a potential increase in debt and delinquency when making the decision to quickly increase interest rates in response to inflation?

A.6. Although credit card balances on the whole have risen over the past year, this largely reflects a continued reversal of declines seen in the early stages of the pandemic. Adjusted for inflation, credit card balances have reached their prepandemic levels (as of the fourth quarter of 2023).

Credit card delinquency rates fell to near-record lows during the pandemic; they have since risen above their prepandemic levels and currently stand at about their long-run average starting from the early 2000s (excluding the period of the 2007–08 financial crisis and its aftermath). The rise in delinquencies to date is not likely to have material effects on the aggregate economy or on financial stability, but we will continue to monitor developments and the resulting implications for the economy.

Q.7. On February 15, 2024, the Federal Reserve released for the first time four hypothetical scenarios in addition to its annual stress tests.[8] The Fed contends that these hypothetical scenarios

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[6] *https://www.newyorkfed.org/newsevents/news/research/2024/20240206*
[7] *https://fred.stlouisfed.org/series/DRCCLACBS*
[8] *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20240215a.htm*

will help provide insight into the resiliency of the U.S. banking system and will not have an impact on bank capital requirements.

Will the results of these scenarios be used by bank examiners in the supervisory process?

Will the results of these scenarios factor into a firm's CAMELs ratings?

A.7. In February 2024, the Federal Reserve Board released the hypothetical scenarios for its annual stress test, which helps ensure that large banks can lend to households and businesses even in a severe recession. Additionally, for the first time, the Board released four hypothetical elements designed to probe different risks through its exploratory analysis of the banking system. The exploratory analysis will not affect bank capital requirements. The elements of the exploratory analysis will complement the 2024 stress test by providing aggregate banking system results against different economic and financial conditions. The exploratory analysis can inform supervisory analysis and deepen our understanding of the resilience of the banking system. Exploratory analysis will not determine capital requirements or firms' ratings.

Q.8. According to a USDA forecast released in February—weak commodity prices, high interest rates, and lingering inflationary pressures will likely sink farm income for a second straight year in 2024. Persistent inflation continues to elevate costs for farmers and ranchers on inputs ranging from labor to equipment to fertilizer. There is widespread concern amongst our agricultural producers and lenders that weakening commodity prices will make it difficult for farmers and ranchers to turn a profit in the near future, resulting in a credit squeeze with reverberations across rural economies. While our agricultural producers and lenders recognize the cyclical nature of their industry and the need to prepare for near-term ups and downs, they should not have to worry about constraints that will limit the ability of banks to serve America's food producers. There is also a growing awareness of the Basel III Endgame proposal's impact on farmers and ranchers' access to capital and cost of borrowing, as well as the role banks have in providing market stability and price discovery functions.

How does the Fed plan to address the uneven inflation recovery for our farmers and ensure future credit availability?

Does the Fed plan to thoughtfully address the concerns raised by stakeholders in the agriculture sector with the Basel III Endgame proposal? If so, how?

A.8. We have received voluminous substantive comments on the capital proposal, as well data from the quantitative impact studies. We are aware of the concerns that commenters have raised about the impact of the rule on the agriculture sector. We are in the process of reviewing and assessing the data and the comments received on this issue and other aspects of the proposal. I am confident that the final product will be one that is analytically well-grounded and will have broad support among the Board and the public.

Q.9. It seems that the Fed, along with the other banking regulators, have been on a crusade to promulgate as much new regulation as possible. Regulations touching everything from climate change, mergers and acquisition, liquidity requirements, and just

about everything in-between. For regulated entities and policymakers alike, it is extremely difficult to keep pace with the flood of proposals being rushed out. Financial institutions are now spending countless hours and millions of dollars just to understand these new rules and proposals, let alone comply with them.

How often, if ever, has the Fed analyzed the combined impacts and costs of all the new regulations to banks, other industries, consumers, and our economy?

A.9. Congress and the American people rightly expect us to achieve an effective and efficient regulatory regime that keeps our financial system strong and protects our economy, while imposing no more burden than is necessary. Striking this balance is critical, but it is also challenging. Therefore, public input and thoughtful deliberation are essential. Proposals put forward by the Board are accompanied by economic impact analyses. Where appropriate, those analyses acknowledge the potential interactions of the proposals with other regulations. In addition, many of those proposals, and notably the Basel III Endgame and the Long-Term Debt proposals requested comment on the interaction with other outstanding proposals.

Q.10. During the March 6 hearing before the House Financial Services Committee, you indicated that the Fed is working on a package of liquidity measures which directly address the Silicon Valley Bank (SVB) failure.

Does the Fed intend to gather and analyze thorough data and information prior to releasing a proposed rule or guidance?

What is the timeline for release of a proposal addressing these liquidity measures?

A.10. The events of the first half of 2023—in particular, the unprecedented level and speed of deposit outflows at a few firms—have underscored the importance of liquidity risk management. In light of this experience, the Board is carefully considering how we supervise and regulate liquidity risk. Any changes to our liquidity rules would be expected to go through the normal notice and public comment process.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR FETTERMAN FROM JEROME H. POWELL

Q.1. We are a year out from the Silicon Valley Bank blow up and bailout. Isn't it true that increasing capital requirements, as the Fed is proposing in its NPRM, would reduce the costs and likelihood of bailing out greedy, mismanaged banks like SVB?

Do you stand by the Fed's assessment that the NPRM to increase capital requirements will increase lending costs by just 3 basis points?

A.1. We have received voluminous substantive comments on the capital proposal, as well data from the quantitative impact studies. We are in the process of reviewing and assessing the data and the comments received, including those on the impact of the proposal on lending costs. I am confident that the final product will be one that is analytically well-grounded and will have broad support among the Federal Reserve Board (Board) and the public.

Q.2. Your predecessor, Paul Volcker, once said that "just about whatever anyone proposes, no matter what it is, the banks will come and claim that it will restrict credit and harm the economy . . . it's all [baloney]."[1] Do you agree that claims about increasing capital requirements are without merit?

A.2. We have received voluminous substantive comments on the capital proposal, as well data from the quantitative impact studies. We are in the process of reviewing and assessing the data and the comments received. I am confident that the final product will be one that is analytically well-grounded and will have broad support among the Board and the public.

Q.3. All the big banks claim that increasing capital requirements would be terrible because equity funding is allegedly so much more expensive than debt funding. Yet many American companies are funded primarily through equity. Apple, for example went for decades without issuing debt, funding its operations through equity and not issuing dividends. The big banks do the exact opposite: loading up on debt and shoveling their earnings out to shareholders as fast possible.

Did Steve Jobs somehow mismanage Apple by not loading up on debt like the big banks do?

What benefits, if any, do working Pennsylvanians get from letting federally insured banks remain highly leveraged and shovel profits out the door as fast possible?

A.3. We have received voluminous substantive comments on the capital proposal, as well data from the quantitative impact studies. We are in the process of reviewing and assessing the data and the comments received. I am confident that the final product will be one that is analytically well-grounded and will have broad support among the Board and the public.

Q.4. Do you agree with SEC Chair Gensler that stablecoins are basically just poker chips at the crypto casino? Aren't stablecoins just the newest quote-unquote "safe" asset that will blow up the economy and get bailed out?

A.4. Payment stablecoins are a form of private money, subject to the same run risk as all such forms of money. Depending on their specific design and use case, stablecoins may pose risks to U.S. consumers, financial institutions, and the broader payment system, especially if they grow to a large scale. Any instrument that is claimed to represent the U.S. dollar must be well-regulated to protect U.S. households and businesses. The principle of "same risk, same regulation" will ensure an even playing field for stablecoins versus more traditional forms of money-like assets. This principle iterates that when crypto companies are engaging in the same activities as traditional financial intermediaries, leading to the same risks, they should be subject to the same rules.

As described in the interagency President's Working Group on Financial Markets "Report on Stablecoins" in 2021, legislation from Congress is integral to ensuring risks associated with stablecoins

[1] Jeff Connaughton, "The Payoff: Why Wall Street Always Wins", Prospecta Press, 2012, p.200.

are adequately managed.[2] The report also noted that stablecoins, if appropriately regulated and well-designed, could support faster, more efficient, and more inclusive payment options. Any legislation on stablecoins should include a Federal statutory prudential framework for stablecoins that fully addresses the risks they pose.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM JEROME H. POWELL

Q.1. Last September, the Federal Reserve, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency proposed a rule to require certain large bank holding companies to issue and maintain a minimum amount of long-term debt.

My Republican colleagues on this Committee and I, led by Senator Britt, sent you a letter on January 17, highlighting our concern that the lack of tailoring in the Long Term Debt proposed rule contradicts the statutory requirements of the Economic Growth, Regulatory Relief, and Consumer Protection Act (S. 2155).

The proposed rule fails to apply tailoring principles and treats Category II, III, and IV financial institutions in an identical fashion for purposes of long-term debt issuances. It also imposes an additional burden to category II–IV banks by requiring them to issue LTD at both the parent holding company and bank level, where U.S. Globally Systemically Important Banks, or "G–SIBs" need only to issue LTD from the parent company.

Chair Powell, will you commit to tailoring the LTD final rule, in accordance with the spirit and letter of S. 2155?

A.1. Differentiating regulatory requirements based on the characteristics of banking organizations has long been an important feature of the Federal Reserve Board's (Board) regulatory framework. I am committed to maintaining the strength and diversity of the banking system so that it can continue to provide financial services and access to credit for households and businesses. It is important that our regulation and supervision reflect the size and risks associated with different firms. The proposal invited the public to comment on the Board's proposed differentiation of the long-term debt requirements, and whether the Board should adjust the proposed application and scope of the rule. We are in the process of carefully considering these and other comments received on the proposal. While we have not yet made any decisions on how to proceed, I am confident that the final product will be one that is analytically well-grounded and will have broad support among the Board and the public.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR VANCE FROM JEROME H. POWELL

Q.1. In 2020, the Federal Reserve gave BlackRock assurances that, as long as they stay below 25 percent ownership of a bank, they will not be labeled Bank Holding Companies (BHCs). The Federal Reserve has also given State Street and other asset managers similar commitments. However, as you may know, this is not the only

[2] See *https://home.treasury.gov/system/files/136/StableCoinReport-Nov1-508.pdf.*

trigger in the Bank Holding Company Act to be designated a BHC. Another criteria that can trigger a BHC designation is whether a company "directly or indirectly exercises a controlling influence over the management or policies of the second company."

And I should note that when the Federal Reserve granted these assurances, your agency also required the asset managers make various commitments. One of these states that the asset managers will not "exercise or attempt to exercise a controlling influence over the management or policies of any Bank or any of its subsidiaries."

While I appreciate the Federal Reserve requiring these commitments, I'm concerned that both the regulators and the public lack insight into whether the asset managers are abiding by these requirements. As you may know, BlackRock, Vanguard, and State Street file shortened beneficial ownership disclosures—13G filings rather than 13D filings—due to their status as passive investors. As a result, the public and regulators lack insight into their stewardship activities and more specifically, insight into their engagement with executives at, and boards of, banks and other portfolio companies in which they are invested.

Given this, I'm worried the big three asset managers may not be abiding by their commitments and instead hiding pertinent activities from the Federal Reserve, SEC, and other regulators.

With that in mind, will the Federal Reserve reevaluate assurances made to State Street and BlackRock regarding BHC designation and consider labeling them BHCs if the asset managers continue to avoid disclosing their corporate stewardship activities?

A.1. Asset managers invest on behalf of their clients in regulated banking entities, including Federal Reserve Board-regulated banking entities. A number of asset managers have engaged in discussions with Federal Reserve Board (Board) staff about how and when statutory control requirements apply to their investment activity in Board-regulated banking entities. As a result of this engagement, some asset managers have provided commitments to the Board to limit their investments, activities, and relationships with respect to Board-regulated banking entities. In each case, the asset managers have committed that they will not "attempt to influence the dividend policies; loan, credit, or investment decisions or policies; pricing of services; personnel decisions; operations activities (including the location of any offices or branches or their hours of operation, etc.); or any similar activities or decisions of any Board-regulated banking entity or any of its subsidiaries." [1]

[1] See the appendices in Letter from Scott G. Alvarez, General Counsel, Board of Governors of the Federal Reserve System, to Satish M. Kini, Debevoise & Plimpton LLP (April 11, 2013), at *https://www.federalreserve.gov/supervisionreg/legalinterpretations/bhc-changeincontrol20130413.pdf*; Letter from Mark E. Van Der Weide, General Counsel, Board of Governors of the Federal Reserve System, to Anne E. Robinson, Managing Director, General Counsel and Secretary, The Vanguard Group, Inc. (November 26, 2019), at *https://www.federalreserve.gov/supervisionreg/legalinterpretations/bhcchangeincontrol20191126a.pdf*; Letter from Scott G. Alvarez, General Counsel, Board of Governors of the Federal Reserve System, to Jeffrey Hare, DLA Piper LLP (April 27, 2016), at *https://www.federalreserve.gov/bankinforeg/LegalInterpretations/bhc-changeincontrol20160427.pdf*; Letter from Scott G. Alvarez, General Counsel, Board of Governors of the Federal Reserve System, to Satish M. Kini, Debevoise & Plimpton LLP (June 15, 2017), at *https://www.federalreserve.gov/bhc—changeincontrol20170615.pdf*; Letter from Mark E. Van Der Weide, General Counsel, Board of Governors of the Federal Reserve System, to Donald S. Waack, Mayer Brown LLP (April 5, 2018), at *https://www.federalreserve.gov/bhc-changeincontrol20180405.pdf*; Letter from Mark E. Van Der Weide, General Counsel, Board of Governors of the Federal Reserve System, to William

Continued

These commitments are conditions imposed in writing in connection with the interpretive letters, and firms that fail to comply with their commitments are subject to the Board's enforcement authority.[2] Like other investors that provide commitments to the Board, asset managers are required to certify their compliance with the commitments on request. For example, BlackRock and Vanguard provided such certifications in April 2024 and March 2023, respectively.

The Board can and does monitor the ownership levels of investors, including asset managers, in Board-regulated banking entities in several other ways. Every parent bank holding company and savings and loan holding company is required to file annual reports with the Board. Among other things, this report requires each holding company to list each securities holder that owns, controls, or holds with the power to vote 5 percent or more of any class of voting securities of the holding company as of its fiscal year end.[3] This information allows Federal Reserve staff to monitor ownership levels in Board-regulated banking entities (including ownership by asset managers) and ensure compliance with filing obligations under the Bank Holding Company Act, Home Owners' Loan Act, and the Change In Bank Control (CIBC) Act. Furthermore, during an inspection of a holding company, Federal Reserve supervisors also review and discuss the composition and strategy of the firm's board of directors and management with the firm's management. The inspection provides supervisors visibility into whether there are any change of control or undue influence issues, including with respect to the influence of asset managers. Additionally, for any asset manager that files a CIBC Act notice with the Board, the Board typically requests a list of all entities in which the asset manager has an equity investment over a certain threshold, and the percentage of voting equity owned.

Q.2. You noted insurance prices are rising due to "a million different factors." Isn't it true that since the COVID–19 pandemic inflation in insurance cost inputs have risen faster, and higher on a cumulative basis, than broader inflation?

For auto insurance this might include cost inputs such as used cars and trucks values, motor vehicle parts and equipment, and motor vehicle repair and maintenance costs. For homeowners insurance this might include costs inputs such as single-family residential construction trade services and labor, rent of shelter and household furnishings and operations.

Can you share the extent to which these costs have risen since the COVID–19 pandemic in comparison to broader CPI or PPI, for the same time period?

J. Sweet, Jr., Skadden, Arps, Slate, Meagher, and Flom LLP (December 3, 2020), at *https://www.federalreserve.gov/supervisionreg/legalinterpretations/blackrock-letter-20201203.pdf*; and Letter from Mark E. Van Der Weide, General Counsel, Board of Governors of the Federal Reserve System, to Robert J. Rhatigan, Dechert LLP (May 6, 2021), at *https://www.federalreserve.gov/supervisionreg/legalinterpretations/virtus-letter-20210506.pdf*.

[2] See 12 U.S.C. §1818.

[3] See "Instructions for the Preparation of the Annual Report of Holding Companies, Reporting Form FR Y-6, Report Item 3: Securities Holders", GEN-9 (Effective December 2022), at *https://www.federalreserve.gov/apps/reportingforms/Download/DownloadAttachment?guid=63605a60-09b7-4bf5-b0cc-c931beb9b0b1*.

In comparing CPI and PPI data from the Bureau of Labor Statistics for these specific insurance cost inputs and inflation in premiums for private passenger auto insurance and premiums for homeowners insurance, could you share if insurance premiums are keeping pace with these cost inputs, meaning as high and as fast?

A.2. Insurance plays an important role in transferring risk to the financial sector participants best positioned to manage and hold it. While the Federal Reserve does not regulate the way insurance is provided or the types of insurance provided, a significant erosion in the availability and affordability of insurance could have adverse effects on the broader economy. Gaps in insurance protection can have consequences for homeowners, businesses, and State and local governments, as well as for the value of their assets. These effects in turn may impact the safety and soundness of supervised institutions, the stability of the financial system, or the broader economy.

Although comprehensive and timely data to monitor trends in insurance markets are limited, some evidence suggests that the cost of certain types of insurance (e.g., motor vehicle insurance and homeowners' insurance) has risen much faster than overall inflation. According to the consumer price index (CPI), vehicle insurance premiums are up more than 40 percent since December 2019, and the cost of vehicle maintenance and repair (likely the largest cost factor for insurers) has increased 35 percent. Data from the National Association of Insurance Commissioners suggest insurance revenues, a rough proxy for the price of insurance, have also risen faster than overall inflation.[4] Specific comparisons between cost inflation and insurance rates are difficult due to lags between when insurers experience claim costs and when they reflect them in rates. Insurance rates also reflect competitive decisions and, in some States, regulatory rate approvals.

The recent rise in insurance costs reflects a combination of factors, including rising home and vehicle prices, an increase in the cost of materials and labor for repairs, a rise in the cost of reinsurance, changes in postpandemic driving behaviors, greater building in high-risk areas, litigation rules and trends, and growing losses from more frequent or severe weather events. Mitigation actions that reduce the likelihood or severity of insurance claims may help in reducing increases in insurance premiums.

Insurance availability reflects individual insurer decisions balancing several factors. Some of the key considerations include: the extent to which insurers are confident that they can measure and price the risks they are assuming; the extent they can charge a premium that reflects the risk, their input costs, and their financial and competitive goals; the extent that coverages fit their strategic and risk management goals; and any constraints from regulation and capital capacity. Insurance insolvencies also have the potential to affect the availability and affordability of insurance.

Government-run insurance programs can provide support to markets where private insurance coverage is insufficient. As you note, there may also be other measures, such as those related to loss pre-

[4] Homeowners insurance is out of scope for the CPI. The CPI includes "rental equivalence" to measure the cost of home ownership, and insurance costs are assumed to be captured by owners' equivalent rent, so there is no easy way to gauge the precise impact.

vention, that are effective in maintaining the availability and affordability of private insurance coverage.

Q.3. Aside from these economic factors, there may be other factors, such as growth in exposures in high weather risk regions, increasing litigation, and regulatory environments. Could you expand on these various other factors that are significantly contributing to rising insurance costs?

A.3. Please see my response to Question 2.

Q.4. In your testimony you mentioned some companies "are withdrawing from writing insurance" in certain regions and made reference to the effects of "insurance coverage on the overall stability of the financial institutions in the broader economy."

Would you agree that it is a prudent business decision to take steps to de-risk if a company is not allowed to charge the premiums indicated by the costs being assumed?

To ensure companies are well positioned financially to cover future liabilities, would you agree it is important for an insurance company to maintain a high "Financial Strength Rating", and ratings downgrades stemming from issues such as diminished capital and surplus due to excessive losses and delays in rate approvals, can have financially adverse consequences on a company?

You noted the Fed is "monitoring the rising costs of insurance and its impacts on macro economy". Would you agree that it negatively affects consumers if insurance companies become insolvent because rates are "inadequate" and premiums too low? Would you agree that it negatively affects the broader financial sector if insurance companies become insolvent because rates are "inadequate" and premiums too low?

A.4. Please see my response to Question 2.

Q.5. You noted the increases in insurance prices have "been adding meaningfully to inflation." Would you agree that insurance company solvency, much like any business, depends on revenue streams that are adequate to cover costs and expenses?

This means, in the insurance context, insurance departments must approve adequate rates, which is charged as premium, to ensure a functioning insurance market? And is it appropriate to compare current overall inflation measures with the increases in insurance premiums needed because rates have been suppressed in some markets for several years?

A.5. Please see my response to Question 2.

Q.6. In your testimony you pondered whether "the Government will have to step in" due to a lack of insurance. To ensure a healthy and functioning insurance market, companies must be able to charge an adequate rate to cover their losses and expenses. Though, with rising losses and underlying cost inputs, would you agree the Government should incentivize the adoption and enforcement of building codes and proven mitigation and resiliency measures to reduce risk, which as a result, could significantly improve affordability and availability by reducing overall losses?

A.6. Please see my response to Question 2.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR HAGERTY FROM JEROME H. POWELL

Q.1. In reference to the Federal Reserve's consideration of potential changes to proposed rules to strengthen capital requirements for large banks (the "Basel proposal"), you stated: "[My] guess is this can be done this year, but it could be faster than that."

If the Basel proposal is resubmitted, will the Federal Reserve provide a public comment period that is the same duration as the public comment period for the initial proposal? If not please provide context as to why this would not be the case.

A.1. We have received voluminous substantive comments on the capital proposal, as well data from the quantitative impact studies. We are in the process of reviewing and assessing the data and the comments received on the proposal. While we have not yet made any decisions on how to proceed, I am confident that the final product will be one that is analytically well-grounded and will have broad support among the Federal Reserve Board and the public.

Q.2. There has been significant concern raised about the mortgage capital provisions in the Basel proposal.

Are there any concerns raised in comment letters that the Fed is currently working on addressing?

A.2. We have received voluminous substantive comments on the capital proposal, as well data from the quantitative impact studies. We are aware of the concerns that commenters have raised about the mortgage capital provisions. We are in the process of reviewing and assessing the data and the comments received on the proposal. While we have not yet made any decisions on how to proceed, I am confident that the final product will be one that is analytically well-grounded and will have broad support among the Federal Reserve Board and the public.

Q.3. The Fed currently holds about $2.6 trillion of mortgage-backed securities (MBS) in its securities portfolio, about a quarter of the total MBS market. Kansas City Federal Reserve President Esther George has stated that Fed officials agree in principle that the central bank's securities portfolio should only include assets issued by the U.S. Treasury—not those backed by mortgages.

How is the Fed considering the effects of reducing its MBS footprint on housing markets?

A.3. The Federal Reserve conducts monetary policy in pursuit of its statutory mandate to promote price stability and maximum employment. In response to the pandemic, the Federal Reserve purchased large volumes of Treasury securities and agency mortgage-backed securities (MBS) in the amounts needed to ensure smooth market functioning and the effective transmission of monetary policy to broader financial conditions. With the economic recovery well along, the Federal Reserve began to gradually reduce the size of its securities holdings beginning in June of 2022 consistent with its previously announced principles and plans for reducing the size of

the balance sheet.[1] Since then, the Federal Reserve's securities holdings have declined by about $1.6 trillion.

At present, the Federal Reserve's agency MBS holdings stand at about $2.4 trillion and are running off at a pace of about $15 billion per month. As noted in the Federal Open Market Committee's (FOMC) statement of Principles for Reducing the Size of the Balance Sheet, in the longer run, the FOMC intends to hold primarily Treasury securities in the Federal Reserve System Open Market Account (SOMA) portfolio, thereby minimizing the effect of Federal Reserve holdings on the allocation of credit across sectors of the economy. The gradual pace of runoff of agency MBS implies that returning to a SOMA portfolio that consists primarily of Treasury securities will take some time. For example, the SOMA annual report includes some illustrative projections for the Federal Reserve's balance sheet.[2] In these projections, agency MBS holdings decline by about $1.6 trillion over the next 10 years. The agency MBS market has adapted well to the gradual reduction in the Federal Reserve's holdings and that process seems likely to continue to proceed smoothly, with the Federal Reserve's presence in this market continuing to diminish over time.

[1] See *https://www.federalreserve.gov/newsevents/pressreleases/monetary20220126c.htm* and *https://www.federalreserve.gov/newsevents/pressreleases/monetary20220504b.htm.*

[2] See *https://www.newyorkfed.org/medialibrary/media/markets/omo/omo2023-pdf.pdf.*

For use at 11:00 a.m. EST
March 1, 2024

MONETARY POLICY REPORT

March 1, 2024

Board of Governors of the Federal Reserve System

Letter of Transmittal

Board of Governors of the
Federal Reserve System

Washington, D.C., March 1, 2024

The President of the Senate
The Speaker of the House of Representatives

The Board of Governors is pleased to submit its *Monetary Policy Report* pursuant to section 2B of the Federal Reserve Act.

Sincerely,

Jerome H. Powell

Jerome H. Powell, Chair

Statement on Longer-Run Goals and Monetary Policy Strategy

Adopted effective January 24, 2012; as reaffirmed effective January 30, 2024

The Federal Open Market Committee (FOMC) is firmly committed to fulfilling its statutory mandate from the Congress of promoting maximum employment, stable prices, and moderate long-term interest rates. The Committee seeks to explain its monetary policy decisions to the public as clearly as possible. Such clarity facilitates well-informed decisionmaking by households and businesses, reduces economic and financial uncertainty, increases the effectiveness of monetary policy, and enhances transparency and accountability, which are essential in a democratic society.

Employment, inflation, and long-term interest rates fluctuate over time in response to economic and financial disturbances. Monetary policy plays an important role in stabilizing the economy in response to these disturbances. The Committee's primary means of adjusting the stance of monetary policy is through changes in the target range for the federal funds rate. The Committee judges that the level of the federal funds rate consistent with maximum employment and price stability over the longer run has declined relative to its historical average. Therefore, the federal funds rate is likely to be constrained by its effective lower bound more frequently than in the past. Owing in part to the proximity of interest rates to the effective lower bound, the Committee judges that downward risks to employment and inflation have increased. The Committee is prepared to use its full range of tools to achieve its maximum employment and price stability goals.

The maximum level of employment is a broad-based and inclusive goal that is not directly measurable and changes over time owing largely to nonmonetary factors that affect the structure and dynamics of the labor market. Consequently, it would not be appropriate to specify a fixed goal for employment; rather, the Committee's policy decisions must be informed by assessments of the shortfalls of employment from its maximum level, recognizing that such assessments are necessarily uncertain and subject to revision. The Committee considers a wide range of indicators in making these assessments.

The inflation rate over the longer run is primarily determined by monetary policy, and hence the Committee has the ability to specify a longer-run goal for inflation. The Committee reaffirms its judgment that inflation at the rate of 2 percent, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the Federal Reserve's statutory mandate. The Committee judges that longer-term inflation expectations that are well anchored at 2 percent foster price stability and moderate long-term interest rates and enhance the Committee's ability to promote maximum employment in the face of significant economic disturbances. In order to anchor longer-term inflation expectations at this level, the Committee seeks to achieve inflation that averages 2 percent over time, and therefore judges that, following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time.

Monetary policy actions tend to influence economic activity, employment, and prices with a lag. In setting monetary policy, the Committee seeks over time to mitigate shortfalls of employment from the Committee's assessment of its maximum level and deviations of inflation from its longer-run goal. Moreover, sustainably achieving maximum employment and price stability depends on a stable financial system. Therefore, the Committee's policy decisions reflect its longer-run goals, its medium-term outlook, and its assessments of the balance of risks, including risks to the financial system that could impede the attainment of the Committee's goals.

The Committee's employment and inflation objectives are generally complementary. However, under circumstances in which the Committee judges that the objectives are not complementary, it takes into account the employment shortfalls and inflation deviations and the potentially different time horizons over which employment and inflation are projected to return to levels judged consistent with its mandate.

The Committee intends to review these principles and to make adjustments as appropriate at its annual organizational meeting each January, and to undertake roughly every 5 years a thorough public review of its monetary policy strategy, tools, and communication practices.

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Note: This report reflects information that was publicly available as of noon EST on February 29, 2024. Unless otherwise stated, the time series in the figures extend through, for daily data, February 27, 2024; for monthly data, January 2024; and, for quarterly data, 2023:Q4. In bar charts, except as noted, the change for a given period is measured to its final quarter from the final quarter of the preceding period.

For figures 33 and 40 as well as figure C in the box "Recent Housing Market Developments," note that the S&P/Case-Shiller U.S. National Home Price Index, the S&P 500 Index, and the Dow Jones Bank Index are products of S&P Dow Jones Indices LLC and/or its affiliates and have been licensed for use by the Board. Copyright © 2024 S&P Dow Jones Indices LLC, a division of S&P Global, and/or its affiliates. All rights reserved. Redistribution, reproduction, and/or photocopying in whole or in part are prohibited without written permission of S&P Dow Jones Indices LLC. For more information on any of S&P Dow Jones Indices LLC's indices, please visit www.spdji.com. S&P® is a registered trademark of Standard & Poor's Financial Services LLC, and Dow Jones® is a registered trademark of Dow Jones Trademark Holdings LLC. Neither S&P Dow Jones Indices LLC, Dow Jones Trademark Holdings LLC, their affiliates, nor their third-party licensors make any representation or warranty, express or implied, as to the ability of any index to accurately represent the asset class or market sector that it purports to represent, and neither S&P Dow Jones Indices LLC, Dow Jones Trademark Holdings LLC, their affiliates, nor their third-party licensors shall have any liability for any errors, omissions, or interruptions of any index or the data included therein.

Summary

While inflation remains above the Federal Open Market Committee's (FOMC) objective of 2 percent, it has eased substantially over the past year, and the slowing in inflation has occurred without a significant increase in unemployment. The labor market remains relatively tight, with the unemployment rate near historically low levels and job vacancies still elevated. Real gross domestic product (GDP) growth has also been strong, supported by solid increases in consumer spending.

The FOMC has maintained the target range for the federal funds rate at 5¼ to 5½ percent since its July 2023 meeting. The Committee views the policy rate as likely at its peak for this tightening cycle, which began in early 2022. The Federal Reserve has also continued to reduce its holdings of Treasury and agency mortgage-backed securities.

As labor market tightness has eased and progress on inflation has continued, the risks to achieving the Committee's employment and inflation goals have been moving into better balance. Even so, the Committee remains highly attentive to inflation risks and is acutely aware that high inflation imposes significant hardship, especially on those least able to meet the higher costs of essentials.

The FOMC is strongly committed to returning inflation to its 2 percent objective. In considering any adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent.

Recent Economic and Financial Developments

Inflation. Consumer price inflation has slowed notably but remains above 2 percent. The price index for personal consumption expenditures (PCE) rose 2.4 percent over the 12 months ending in January, down from a peak of 7.1 percent in 2022. The core PCE price index—which excludes volatile food and energy prices and is generally considered a better guide to the direction of future inflation—rose 2.8 percent in the 12 months ending in January, and the slowing in inflation was widespread across both goods and services prices. More recently, core PCE prices increased at an annual rate of 2.5 percent over the six months ending in January, though measuring inflation over relatively short periods risks exaggerating the influence of idiosyncratic or temporary factors. Measures of longer-term inflation expectations are within the range of values seen in the decade before the pandemic and continue to be broadly consistent with the FOMC's longer-run objective of 2 percent.

The labor market. The labor market has remained relatively tight, with job gains averaging 239,000 per month since June and the unemployment rate near historical lows. Labor demand has eased—as job openings have declined in many sectors of the economy—but continues to exceed the supply of available workers. Labor supply has trended higher over the past year, reflecting a continued strong pace of immigration and increases in the labor force participation rate, particularly among prime-age workers. Reflecting the improved balance between labor demand and supply, nominal wage gains slowed in 2023, but they remain above a pace consistent with 2 percent inflation over the longer term, given prevailing trends in productivity growth.

Economic activity. Real GDP increased 3.1 percent last year, notably faster than in 2022 despite tighter financial conditions, including elevated longer-term interest rates. Consumer spending grew at a solid pace, and housing market activity started to turn back up in the second half of last year after

having declined since early 2021. However, real business fixed investment growth slowed, likely reflecting tighter financial conditions and downbeat business sentiment. In contrast to GDP, manufacturing output was little changed, on net, last year, a downshift following two years of robust post-pandemic gains.

Financial conditions. Conditions in financial markets tightened considerably further over the summer and early fall before reversing course toward the end of the year. The FOMC raised the target range for the federal funds rate a further 25 basis points at its meeting last July, bringing the overall increase in the target range for this tightening cycle to 525 basis points. The market-implied expected path of the federal funds rate has moved up, on net, since the middle of 2023, and yields on longer-term nominal Treasury securities are notably higher on balance. Credit remains generally available to most households and businesses but at elevated interest rates, which have weighed on financing activity. Lending by banks to households and businesses slowed notably since June as banks continued to tighten standards and demand for loans softened.

Financial stability. Overall, the banking system remains sound and resilient; although acute stress in the banking system has receded since last March, a few areas of risk warrant continued monitoring. Upward pressure on asset valuations continued, with real estate prices elevated relative to rents and high price-to-earnings ratios in equity markets. Borrowing from nonfinancial businesses and households continued to increase at a pace slower than that of nominal GDP, and the combined debt-to-GDP ratio now sits close to its 20-year low. Vulnerabilities from financial-sector leverage remain notable. While risk-based bank capital ratios stayed solid and increased broadly, declines in the fair values of fixed-rate assets have been sizable relative to the regulatory capital at some banks. Meanwhile, leverage at hedge funds has stabilized at high levels, and leverage at life insurers increased to values close to the historical averages but with a liability composition that has become more reliant on nontraditional sources of funding. Most banks maintained high liquidity and stable funding, while bank funding costs continue to increase. (See the box "Developments Related to Financial Stability" in Part 1.)

International developments. Following a rebound in early 2023, growth in foreign economic activity was subdued in the second half of last year. Economic growth was particularly weak in advanced foreign economies (AFEs) as monetary policy tightening weighed on activity and high inflation eroded real household incomes. Structural adjustment to higher energy prices in Europe continued to hinder economic performance, while property-sector weakness and sluggish domestic demand restrained Chinese economic activity. Foreign headline inflation has fallen further, reflecting declines in core and food inflation. However, the pace of disinflation has varied across countries and sectors, with the moderation in goods inflation generally outpacing that in services inflation.

Most foreign central banks paused policy interest rate hikes in the second half of last year and have since held rates steady. Policy rate paths implied by financial market pricing suggest that central banks in many AFEs are expected to begin lowering their policy rates in 2024. Several central banks in emerging market economies have already begun easing monetary policy. The trade-weighted exchange value of the U.S. dollar has increased slightly, on net, since the middle of last year.

Monetary Policy

Interest rate policy. After significantly tightening the stance of monetary policy since early 2022, the FOMC has maintained the target range for the policy rate at 5¼ to 5½ percent since its meeting last July. Although the FOMC judges that the risks to achieving its employment and inflation goals are moving into better balance, the Committee

remains highly attentive to inflation risks. The Committee has indicated that it does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent. In considering any adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks.

Balance sheet policy. The Federal Reserve has continued the process of significantly reducing its holdings of Treasury and agency securities in a predictable manner, contributing to the tightening of financial conditions.[1] Beginning in June 2022, principal payments from securities held in the System Open Market Account have been reinvested only to the extent that they exceeded monthly caps. Under this policy, the Federal Reserve has reduced its securities holdings about $640 billion since mid-June 2023, bringing the total reduction in securities holdings since the start of balance sheet runoff to about $1.4 trillion. The FOMC has stated that it intends to maintain securities holdings at amounts consistent with implementing monetary policy efficiently and effectively in its ample-reserves regime. To ensure a smooth transition, the FOMC intends to slow and then stop reductions in its securities holdings when reserve balances are somewhat above the level that the FOMC judges to be consistent with ample reserves.

Special Topics

Employment and earnings across groups. An exceptionally tight labor market over the past two years has been especially beneficial for historically disadvantaged groups of workers. As a result, many of the long-standing disparities in employment and wages by sex, race, ethnicity, and education have narrowed, and some gaps reached historical lows in 2023. However, despite this narrowing, significant disparities in absolute levels across groups remain. (See the box "Employment and Earnings across Demographic Groups" in Part 1.)

Housing sector. The rise in mortgage rates over the past two years has reduced housing demand, resulting in a steep drop in housing activity in 2022 and a marked slowing in house price growth from its historically high pace. Offsetting factors boosting housing demand, such as the robust job market and the increased prevalence of remote work, have prevented significant price declines. High mortgage rates have also discouraged some potential sellers with low rates on their current mortgages from moving, which has kept the existing home market unusually thin. The shortage of available existing homes has pushed some remaining homebuyers toward new homes and supported a modest rebound in construction of single-family homes later in 2023. In contrast, multifamily starts rose to historically high levels in 2022 but have more recently fallen back because of builders' concerns about the effect of the significant amount of new multifamily supply on rents and property prices. (See the box "Recent Housing Market Developments" in Part 1.)

Federal Reserve's balance sheet and money markets. The size of the Federal Reserve's balance sheet has decreased since June as the FOMC continued to reduce its securities holdings. Despite ongoing balance sheet runoff, reserve balances—the largest liability on the Federal Reserve's balance sheet—edged up as declines in the usage of the overnight reverse repurchase agreement facility—another Federal Reserve liability—more than matched the decline in assets. (See the box "Developments in the Federal Reserve's Balance Sheet and Money Markets" in Part 2.)

Monetary policy rules. Simple monetary policy rules, which prescribe a setting for the policy

1. See the May 4, 2022, press release regarding the Plans for Reducing the Size of the Federal Reserve's Balance Sheet, available on the Board's website at https://www.federalreserve.gov/newsevents/pressreleases/monetary20220504b.htm.

interest rate in response to the behavior of a small number of economic variables, can provide useful guidance to policymakers. With inflation easing and supply and demand conditions in labor markets coming into better balance, the policy rate prescriptions of most simple monetary policy rules have decreased recently and now call for levels of the federal funds rate that are close to the current target range for the federal funds rate. (See the box "Monetary Policy Rules in the Current Environment" in Part 2.)

PART 1
RECENT ECONOMIC AND FINANCIAL DEVELOPMENTS

Domestic Developments

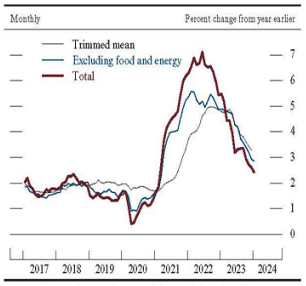
Inflation has eased but remains elevated

After surging in 2021 and 2022, inflation slowed notably last year. The price index for personal consumption expenditures (PCE) rose 2.4 percent over the 12 months ending in January, down from a peak of 7.1 percent in 2022, though still above the Federal Open Market Committee's (FOMC) longer-run objective of 2 percent (figure 1). The core PCE price index—which excludes volatile food and energy prices—rose 2.8 percent over the 12 months ending in January. More recently, core PCE prices increased at an annual rate of 2.5 percent over the six months ending in January, though measuring inflation over relatively short periods risks exaggerating the influence of idiosyncratic or temporary factors (figure 2). The trimmed mean measure of PCE prices constructed by the Federal Reserve Bank of Dallas—which provides an alternative approach to reducing the influence of idiosyncratic price movements—increased 3.3 percent over the 12 months ending in December, somewhat higher than the core index (figure 1).

Consumer energy prices have declined, while food price inflation has slowed markedly

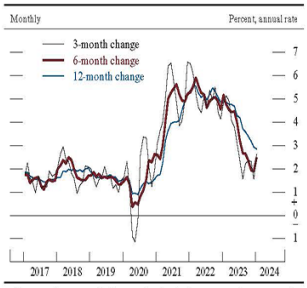
After hovering around $80 per barrel in the first half of last year, oil prices rose notably in late summer, albeit to levels still well below those seen in 2022, but have since declined, on net, to around $83 per barrel (figure 3). Gasoline prices have followed a similar pattern. The moderation in oil prices last fall reflects weak economic activity abroad and increases in U.S. and other non-OPEC (Organization of the Petroleum Exporting Countries) oil production. Since late last year, geopolitical tensions in the Middle East and rerouting of shipping away from the Red Sea have placed some upward pressure on oil

1. Personal consumption expenditures price indexes



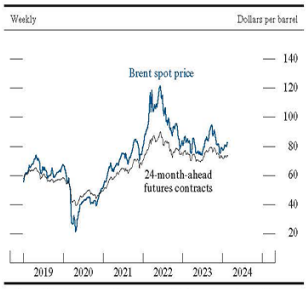
NOTE: Trimmed mean data extend through December 2023.
SOURCE: For trimmed mean, Federal Reserve Bank of Dallas; for all else, Bureau of Economic Analysis; all via Haver Analytics.

2. Core personal consumption expenditure price index



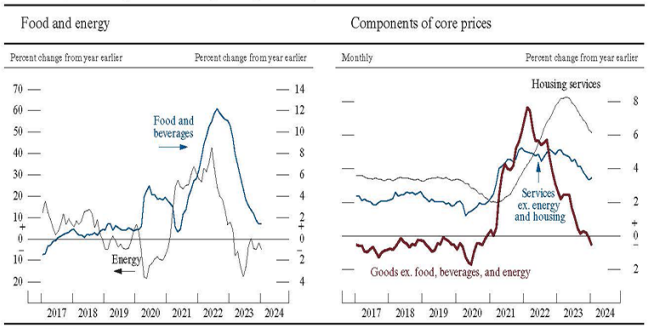
SOURCE: Bureau of Economic Analysis, personal consumption expenditures via Haver Analytics.

3. Spot and futures prices for crude oil



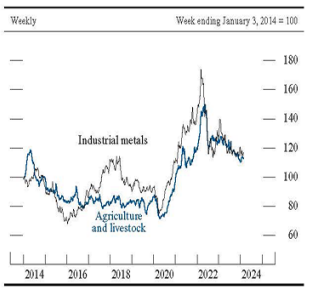
NOTE: The data are weekly averages of daily data and extend through February 23, 2024.
SOURCE: ICE Brent Futures via Bloomberg.

4. Subcomponents of personal consumption expenditures price indexes



NOTE: The data are monthly.
SOURCE: Bureau of Economic Analysis via Haver Analytics.

5. Spot prices for commodities



NOTE: The data are weekly averages of daily data and extend through February 23, 2024.
SOURCE: For industrial metals, S&P GSCI Industrial Metals Spot Index; for agriculture and livestock, S&P GSCI Agriculture & Livestock Spot Index; both via Haver Analytics.

prices. Continuing geopolitical tensions pose an upside risk to energy prices. Natural gas prices remain well below the elevated 2022 levels due to strong production and high inventory levels. All told, consumer energy prices fell 4.9 percent in the 12 months ending in January (figure 4, left panel).

Food price inflation slowed markedly last year, as prices of agricultural commodities and livestock fell (figure 5). This moderation brought the 12-month change in food prices down to 1.4 percent in January, a substantial slowing from the 11 percent increase recorded over 2022 (figure 4, left panel).

Prices of both energy and food products are of particular importance for lower-income households, for which such necessities account for a large share of expenditures. Reflecting the sharp increases seen in 2021 and 2022, these price indexes are about 25 percent higher than before the pandemic.

Core goods prices have been declining as supply bottlenecks ease and import price inflation falls . . .

Outside of food and energy prices, there has been significant deceleration across the main spending categories, though disinflation

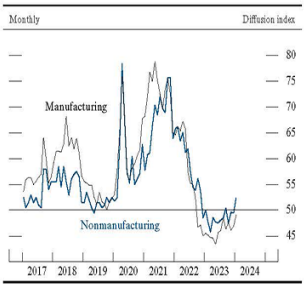
has been more pronounced in some than in others (figure 4, right panel). Core goods prices fell 0.6 percent in the 12 months ending in January, and the deceleration was broad based, as the supply chain issues and other capacity constraints that had earlier boosted inflation so much eased substantially. For example, suppliers' delivery times had lengthened considerably during the pandemic but have been getting shorter over the past year (figure 6). Core goods inflation was also held down last year by a net decline in nonfuel import prices, which, in turn, largely reflected falling commodity prices (figure 7).

. . . while core services price inflation has been slowing but remains elevated

Price inflation for both housing services and core services other than housing slowed over the past year, though it remains elevated. Increases in housing services prices began to moderate, coming in at 6.1 percent in the 12 months ending in January, down from a peak of more than 8 percent (figure 4, right panel). This slowing is consistent with the notably smaller increases in market rents on *new* housing leases to new tenants seen since late 2022 (figure 8). Because prices for housing services measure the rents paid by *all* tenants (and the equivalent rent implicitly paid by all homeowners)—including those whose leases have not yet come up for renewal—they tend to adjust slowly to changes in rental market conditions. The softening in market rents therefore points to a continued deceleration in housing services prices over the year ahead.

Prices for nonhousing core services—a broad group that includes services such as travel and dining, financial services, and car repair—rose 3.5 percent in the 12 months ending in January, down from their recent peak of 5.2 percent (figure 4, right panel). As labor costs are a significant input in these service sectors, the ongoing softening of labor demand and improvements in labor supply should contribute to a further slowing in core services price inflation as labor cost growth moderates.

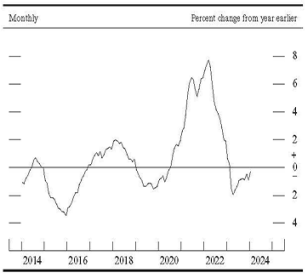
6. Suppliers' delivery times



NOTE: Values greater than 50 indicate that more respondents reported longer delivery times relative to a month earlier than reported shorter delivery times.

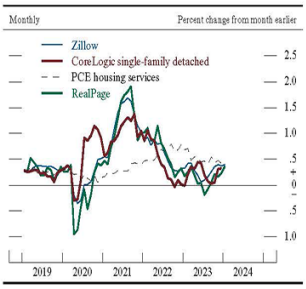
SOURCE: Institute for Supply Management, *Report on Business*, via Haver Analytics.

7. Nonfuel import price index



SOURCE: Bureau of Labor Statistics via Haver Analytics.

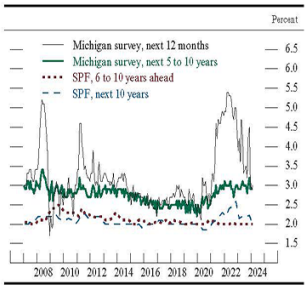
8. Housing rents



NOTE: CoreLogic data extend through December 2023. Zillow, CoreLogic, and RealPage measure market-rate rents—that is, rents for a new lease by a new tenant.

SOURCE: Bureau of Economic Analysis, PCE, via Haver Analytics; CoreLogic, Inc.; Zillow, Inc.; RealPage, Inc.; Federal Reserve Board staff calculations.

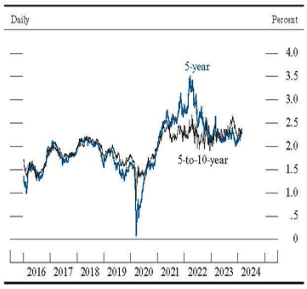
9. Measures of inflation expectations



NOTE: The Survey of Professional Forecasters (SPF) data are quarterly and extend through 2024:Q1. The data for the Michigan survey are monthly and extend through February 2024; the February data are preliminary.

SOURCE: University of Michigan Surveys of Consumers; Federal Reserve Bank of Philadelphia, SPF.

10. Inflation compensation implied by Treasury Inflation-Protected Securities



NOTE: The data are at a business-day frequency and are estimated from smoothed nominal and inflation-indexed Treasury yield curves.

SOURCE: Federal Reserve Bank of New York; Federal Reserve Board staff calculations.

Measures of longer-term inflation expectations have been stable, while shorter-term expectations have fallen back

The generally held view among economists and policy analysts is that inflation expectations influence actual inflation by affecting wage- and price-setting decisions. Survey-based measures of expected inflation over a longer horizon have generally been moving sideways over the past year, within the range seen during the decade before the pandemic, and they appear broadly consistent with the FOMC's longer-run 2 percent inflation objective. This development is seen for surveys of households, such as the University of Michigan Surveys of Consumers, and for surveys of professional forecasters (figure 9). For example, the median forecaster in the Survey of Professional Forecasters, conducted by the Federal Reserve Bank of Philadelphia, continued to expect PCE price inflation to average 2 percent over the five years beginning five years from now.

Moreover, inflation expectations over a shorter horizon—which tend to follow observed inflation more closely—have been reversing their earlier run-ups. In the Michigan survey, the median value for inflation expectations over the next year was 3.0 percent in February, well below the peak rate of 5.4 percent observed in spring 2022. Expected inflation for the next year as measured in the Survey of Consumer Expectations, conducted by the Federal Reserve Bank of New York, has also declined, on net, over this period and has returned to the range of values seen before the pandemic.

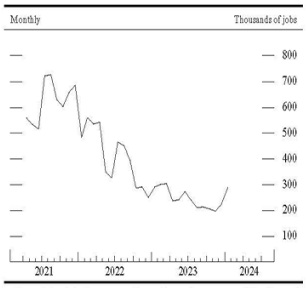
Market-based measures of longer-term inflation compensation, which are based on financial instruments linked to inflation such as Treasury Inflation-Protected Securities, are also broadly in line with readings seen in the years before the pandemic and consistent with inflation returning to 2 percent. These measures have been little changed, on net, since last summer (figure 10).

The labor market remains strong

Payroll employment gains have been robust, averaging 239,000 since June of last year. The pace of job gains has nevertheless been softening, having averaged more than 375,000 per month in 2022 and about 290,000 in the first half of 2023 (figure 11). This slowing has come primarily from the professional and business services, manufacturing, and leisure and hospitality sectors, which tend to be cyclically sensitive. In contrast, employment growth has remained strong in the health-care and social assistance sector and at state and local governments, which tend to be less cyclically sensitive and are still recovering from pandemic-era staffing shortages.

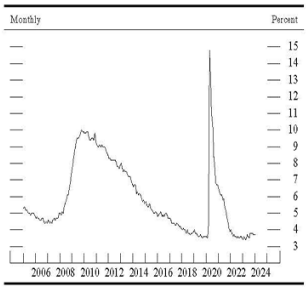
The unemployment rate edged up, on net, since the middle of last year, but at 3.7 percent in January, it is only slightly above its pre-pandemic level and remains very low by historical standards (figure 12). Indeed, unemployment rates among most age, educational attainment, sex, and ethnic and racial groups are near their respective historical lows (figure 13). (The box "Employment and Earnings across Demographic Groups" provides further details.)

11. Nonfarm payroll employment



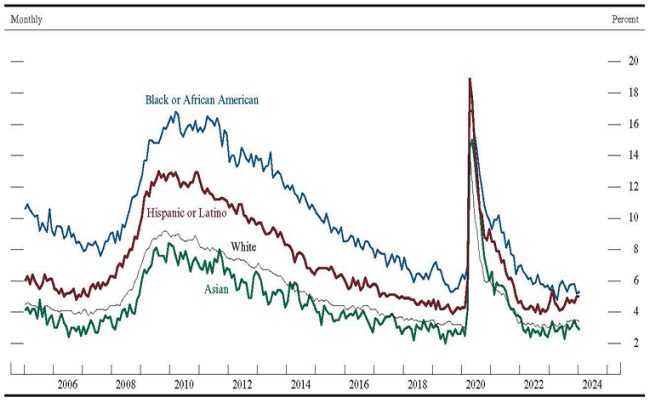
NOTE: The data shown are a 3-month moving average of the change in nonfarm payroll employment.
SOURCE: Bureau of Labor Statistics via Haver Analytics.

12. Civilian unemployment rate



SOURCE: Bureau of Labor Statistics via Haver Analytics.

13. Unemployment rate, by race and ethnicity



NOTE: Unemployment rate measures total unemployed as a percentage of the labor force. Persons whose ethnicity is identified as Hispanic or Latino may be of any race. Small sample sizes preclude reliable estimates for Native Americans and other groups for which monthly data are not reported by the Bureau of Labor Statistics.
SOURCE: Bureau of Labor Statistics via Haver Analytics.

Employment and Earnings across Demographic Groups

Economic expansions have tended to narrow long-standing disparities in employment and earnings across demographic groups, which can help make up for disproportionate losses experienced during downturns. These benefits have been especially pronounced during the current expansion, which has been characterized by an exceptionally tight labor market and robust demand for workers over the past two years.

Among prime-age individuals (ages 25 to 54), employment for Black or African American workers, which declined more relative to white and Asian workers in early 2020, reached a historical peak in 2023 (figure A, left panel). As a result, the gap in the employment-to-population (EPOP) ratio between prime-age Black and white workers fell to its lowest point in almost 50 years.[1] Hispanic or Latino workers experienced especially large employment losses in 2020, due in part to greater exposure to the industries most affected by the pandemic.[2] By early 2022, however, this group's EPOP ratio gap relative to prime-age white workers had recovered to its 2019 average and has remained near this historically low level for the past two years. The EPOP ratio for prime-age Asian workers was also historically high in early 2023, although it has since moved down closer to its 2019 level.[3]

Similarly, the EPOP ratio for prime-age women increased steadily over the past two years and reached a record high in 2023 (figure A, right panel). As a result, the EPOP ratio gap between prime-age men and women fell to a record low. The recent increase in female employment is mostly attributable to rising labor force participation, which had also been increasing briskly before the pandemic, bolstered by a growing share of women with a college degree.[4] Other factors, including tight labor market conditions and greater availability of remote-work options, may have also contributed to rising prime-age female labor force participation.[5]

(continued)

1. In fact, for the population aged 16 or older, the EPOP ratio was the same for Black and white individuals in January 2024 (not shown). This equivalence, however, partly reflects the fact that these groups have different age distributions, with whites older, on average, and thus more likely to be retired.

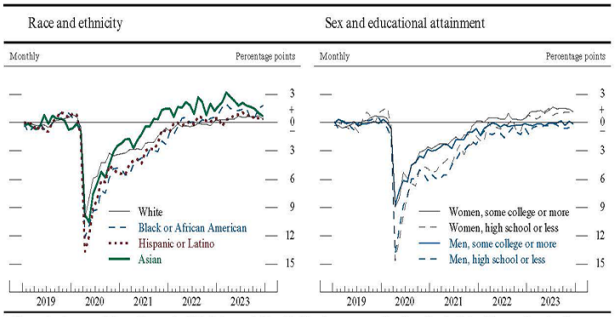
2. On the relationship between occupation, industry, and the differential effect of the COVID-19 pandemic across demographic groups, see Guido Matias Cortes and Eliza Forsythe (2023), "Heterogeneous Labor Market Impacts of the COVID-19 Pandemic," *ILR Review*, vol. 76 (January), pp. 30–55.

3. As monthly series have greater sampling variability for smaller groups, we do not plot EPOP ratio estimates for American Indians or Alaska Natives.

4. For a discussion of the contribution of educational attainment to prime-age female labor force participation before the pandemic, see Didem Tüzemen and Thao Tran (2019), "The Uneven Recovery in Prime-Age Labor Force Participation," Federal Reserve Bank of Kansas City, *Economic Review*, vol. 104 (Third Quarter), pp. 21–41, https://www.kansascityfed.org/Economic%20Review/documents/652/2019-The%20Uneven%20Recovery%20in%20Prime-Age%20Labor%20Force%20Participation.pdf.

5. For a discussion on access to remote work and participation rates, see Maria D. Tito (2024), "Does the Ability to Work Remotely Alter Labor Force Attachment? An Analysis of Female Labor Force Participation," FEDS Notes (Washington: Board of Governors of the Federal Reserve System, January 19), https://doi.org/10.17016/2380-7172.3433.

A. Prime-age employment-to-population ratios compared with the 2019 average ratio, by group



NOTE: The data extend through December 2023. Prime age is 25 to 54. All series are seasonally adjusted by the Federal Reserve Board staff.
SOURCE: Bureau of Labor Statistics; U.S. Census Bureau, Current Population Survey; Federal Reserve Board staff calculations.

Robust labor demand over the past two years has also reversed pandemic-induced employment losses across education groups. For both prime-age men and women, the EPOP ratio fell significantly more for workers with a high school diploma or less compared with those with at least some college education, largely reflecting industry exposure to pandemic-related closures or some differences in the ability to work remotely across jobs. Notably, the EPOP ratio declined similarly for men and women with the same education level, a result that contrasts with those in previous recessions, in which male EPOP losses have historically outpaced female losses.[6] The unusually large effect on women during the pandemic also reflects the industry composition of job losses, as well as caregiving needs.[7]

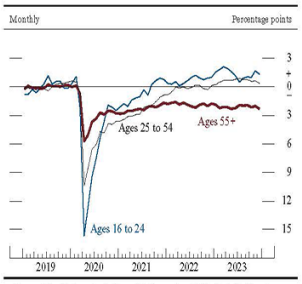
While employment disparities across many demographic groups are now within historically narrow ranges, substantial gender, racial, and ethnic gaps remain, underscoring long-standing structural factors. Currently, prime-age women are employed at a rate 11 percentage points less than men, while prime-age Black and Hispanic workers are employed at a rate 3 to 4 percentage points less than white workers. Further, the differential effect of the pandemic on the employment of older workers has proven highly persistent. The EPOP ratio for workers aged 55 or older remains approximately 2 percentage points below its pre-pandemic level and has changed little since late 2021 (figure B). This shortfall is wholly attributable to decreases in labor force participation stemming from increased retirements concentrated among workers aged 60 or older.[8]

In addition to narrowing many employment gaps, historically tight labor market conditions over the past two years have also led to strong nominal wage growth, especially for groups at the lower end of the earnings distribution. As shown in the top-left panel of figure C, real wage growth—as measured by the Federal Reserve Bank of Atlanta's Wage Growth Tracker and deflated by the personal consumption expenditures price index—has been consistently stronger for workers in lower wage quartiles.[9]

Stronger wage growth at the bottom of the income distribution is reflected in the experiences of different education and demographic groups. In the first two years of the recovery, real wage growth was stronger for workers with a high school diploma or less relative to workers with a bachelor's degree or more (figure C, top-right panel) and, in the past two years, has also been stronger for nonwhite workers relative to white workers (figure C, bottom-left panel). Wages for men and women, by contrast, have largely grown in tandem (figure C, bottom-right panel).[10] In addition to the influence of a tight labor market, differences in wage

(continued on next page)

B. Employment-to-population ratios relative to 2019 average, by age



NOTE: The data extend through December 2023. Data before January 2023 are estimated by Federal Reserve Board staff in order to eliminate discontinuities in the published history.

SOURCE: Bureau of Labor Statistics; U.S. Census Bureau, Current Population Survey; Federal Reserve Board staff calculations.

6. See Claudia Goldin (2022), "Understanding the Economic Impact of COVID-19 on Women," *Brookings Papers on Economic Activity*, Spring, pp. 65–110, https://www.brookings.edu/wp-content/uploads/2022/03/16265-BPEA-Sp22_Goldin_WEB-Appendix.pdf; and Stefania Albanesi and Jiyeon Kim (2021), "Effects of the COVID-19 Recession on the US Labor Market: Occupation, Family, and Gender," *Journal of Economic Perspectives*, vol. 35 (Summer), pp. 3–24.

7. On the role of caregiving, see Joshua Montes, Christopher Smith, and Isabel Leigh (2021), "Caregiving for Children and Parental Labor Force Participation during the Pandemic," FEDS Notes (Washington: Board of Governors of the Federal Reserve System, November 5), https://www.federalreserve.gov/econres/notes/feds-notes/caregiving-for-children-and-parental-labor-force-participation-during-the-pandemic-20211105.html.

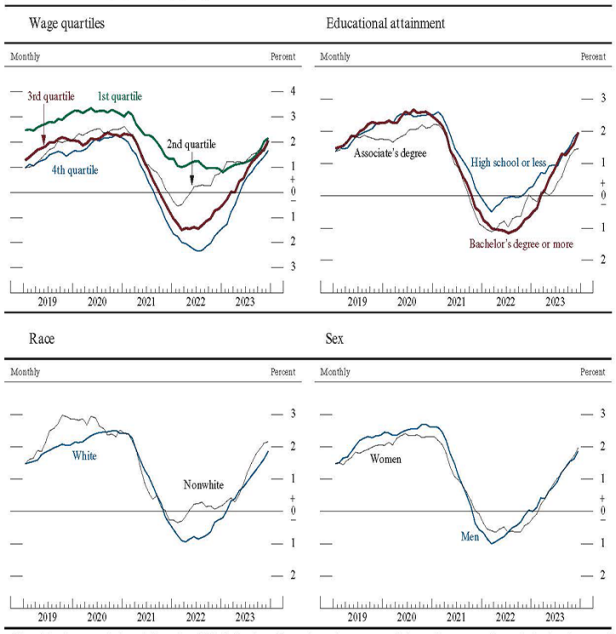
8. For an analysis on the increase in retirements following the pandemic, see Joshua Montes, Christopher Smith, and Juliana Dajon (2022), " 'The Great Retirement Boom': The Pandemic-Era Surge in Retirements and Implications for Future Labor Force Participation," Finance and Economics Discussion Series 2022-081 (Washington: Board of Governors of the Federal Reserve System, November), https://doi.org/10.17016/FEDS.2022.081.

9. To reduce noise due to sampling variation, which can be pronounced when considering disaggregated groups' wage changes, the series shown in figure C are the 12-month moving averages of the groups' median 12-month real wage changes. Thus, by construction, these series lag the actual real wage changes.

10. The measure of real earnings growth shown in the figure uses the same price index for all groups, but inflation experiences can differ across demographic groups because of differences in what they purchase or where they shop. See Jacob Orchard (2021), "Cyclical Demand Shifts and Cost of Living Inequality," working paper, February (revised September 2022).

Employment and Earnings *(continued)*

C. Median real wage growth, by group



NOTE: The data extend through December 2023. Series show 12-month moving averages of the median percent change in the hourly wage of individuals observed 12 months apart, deflated by the 12-month moving average of the 12-month percent change in the personal consumption expenditures price index. In the top-left panel, workers are assigned to wage quartiles based on the average of their wage reports in both Current Population Survey outgoing rotation group interviews; workers in the lowest 25 percent of the average wage distribution are assigned to the 1st quartile, and those in the top 25 percent are assigned to the 4th quartile.

SOURCE: Federal Reserve Bank of Atlanta, Wage Growth Tracker; Bureau of Labor Statistics; U.S. Census Bureau, Current Population Survey.

growth across groups partially reflect factors specific to the post-pandemic recovery, such as the sectoral composition of labor demand and supply. Wages, for instance, grew faster than average in the leisure and hospitality industry, a relatively low-wage sector that suffered disproportionate employment losses during the pandemic, followed by a surge in vacancies that employers struggled to fill as the economy reopened.

Over the past year, real wages have been rising for all groups shown here, and differences in real wage growth across groups have narrowed considerably. While the labor market is still tight by historical standards, factors disproportionately boosting wage growth for the lowest earners have largely faded. In 2023, nominal wage growth slowed for workers with below-median earnings but stepped up for workers above the median. Even so, the gaps in relative wages between workers in the first three quartiles and those in the highest quartile continue to close, albeit at a slower pace.

Labor demand has been gradually cooling . . .

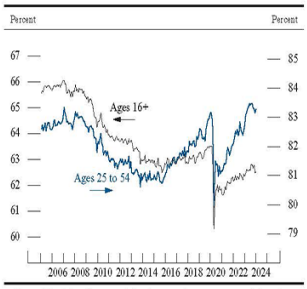
Demand for labor continued to cool last year but remains robust. The Job Openings and Labor Turnover Survey (JOLTS) indicated that there were nearly 9 million job openings at the end of 2023—down about 3 million from the all-time high recorded in March 2022 but still around 2 million above pre-pandemic levels. An alternative measure of job vacancies constructed by the Federal Reserve Board staff using job postings data from the large online job board Indeed also shows that vacancies continued to move gradually lower through mid-February but remained above pre-pandemic levels. In addition, measures of layoffs, such as initial claims for unemployment insurance and the rate of layoffs and discharges in the JOLTS, have remained very low by historical standards.

. . . and labor supply has increased further . . .

Meanwhile, the supply of labor has continued to increase on net. The labor force participation rate, which measures the share of people either working or actively seeking work, continued to trend higher for most of last year but has softened in recent months (figure 14). Importantly, labor force participation for prime-age workers increased notably through last September and, although it has edged down more recently, remains above its pre-pandemic level.

Labor supply was also boosted last year by relatively strong population growth. The Census Bureau estimates that the resident population increased 1.7 million (0.5 percent) in 2023, with almost 70 percent of that increase coming from immigration.[2] Last

14. Labor force participation rate, by age

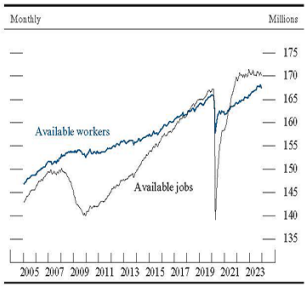


NOTE: The labor force participation rate is a percentage of the relevant population. Data are monthly, and values before January 2023 are estimated by Federal Reserve Board staff in order to eliminate discontinuities in the published history.

SOURCE: Bureau of Labor Statistics via Haver Analytics; U.S. Census Bureau; Federal Reserve Board staff calculations.

2. A recent report from the Congressional Budget Office estimates that immigration has been considerably higher than in the Census Bureau's estimates in recent years; see Congressional Budget Office (2024), *The Demographic Outlook: 2024 to 2054* (Washington: CBO, January), https://www.cbo.gov/publication/59697. The labor force estimates published by the Bureau of Labor Statistics are based on the civilian noninstitutionalized population aged 16 or older, which constitutes about 80 percent of the resident population.

15. Available jobs versus available workers



NOTE: The data extend through December 2023. Available jobs are employment plus job openings as of the end of the previous month. Available workers are the labor force. Data for employment and labor force before January 2023 are estimated by Federal Reserve Board staff in order to eliminate discontinuities in the published history.

SOURCE: Bureau of Labor Statistics via Haver Analytics; U.S. Census Bureau; Federal Reserve Board staff calculations.

year's rate of population growth was slightly faster than in 2022 and about twice as fast as in 2020 and 2021, when growth was held down by COVID-19-related increases in mortality and restrictions on immigration. Although population growth has largely returned to its pace from the years preceding the pandemic, it remains well below its average from 1990 to 2015.

. . . but the labor market remains relatively tight

Even with easing labor demand and rising labor supply, the labor market remains relatively tight. Some indicators suggest that the labor market remains tighter than before the pandemic, while others have returned to their 2019 ranges, when the labor market was also relatively tight. The number of total available jobs (measured by employed workers plus job openings) still exceeds the number of available workers (measured by the labor force). This jobs–workers gap was around 2.8 million in December, down markedly from its peak of 6.0 million recorded in March 2022 but still above its 2019 average of 1.1 million (figure 15).[3] In contrast, the percentage of workers quitting their jobs each month, an indicator of the availability of attractive job prospects, was 2.2 percent in December, close to its 2019 average. Surveys indicate that households' and small businesses' perceptions of labor market tightness have also come down from their recent peaks. In addition, business contacts in nearly all Federal Reserve Districts cited signs of a cooling labor market, such as larger applicant pools and lower turnover rates; however, some employers continued to report difficulty finding workers, particularly employers seeking specialized skills.[4]

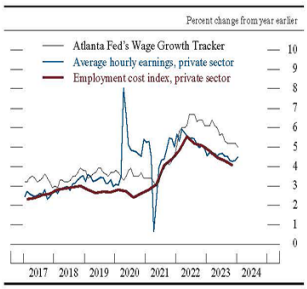
3. The ratio of job openings to unemployment shows that there were 1.4 job openings per unemployed person in December 2023. For comparison, this ratio averaged 1.2 in 2019 and 0.6 over the 10-year period from 2010 to 2019.

4. See the January 2024 Beige Book, available on the Board's website at https://www.federalreserve.gov/monetarypolicy/publications/beige-book-default.htm.

Wage growth has slowed but remains elevated

Consistent with the easing in labor market tightness, nominal wage growth slowed in 2023 but remains elevated (figure 16). Total hourly compensation as measured by the employment cost index increased 4.2 percent over the 12 months ending in December, a noticeable slowing from the 5.1 percent increase in 2022. Other aggregate measures, such as average hourly earnings (a less comprehensive measure of compensation) and the Federal Reserve Bank of Atlanta's Wage Growth Tracker, which reports the median 12-month wage growth of individuals responding to the Current Population Survey, have slowed as well. With PCE prices having risen 2.6 percent in 2023, these measures suggest that most workers saw increases in the purchasing power of their wages over the past year.

16. Measures of change in hourly compensation



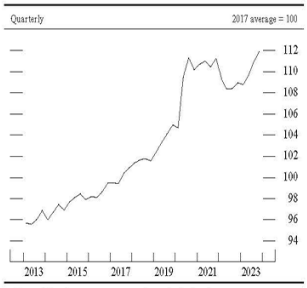
NOTE: For the private-sector employment cost index, change is over the 12 months ending in the last month of each quarter; for private-sector average hourly earnings, the data are 12-month percent changes; for the Atlanta Fed's Wage Growth Tracker, the data are shown as a 3-month moving average of the 12-month percent change.
SOURCE: Bureau of Labor Statistics; Federal Reserve Bank of Atlanta, Wage Growth Tracker; all via Haver Analytics.

Labor productivity strengthened last year

The extent to which nominal wage gains raise firms' costs and act as a source of inflation pressure depends importantly on the pace of productivity growth. Labor productivity in the business sector has been extremely variable since the pandemic began, increasing sharply in 2020 and then declining, on average, over 2021 and 2022 (figure 17). Productivity is reported to have risen a robust 2.7 percent last year. When averaged over the pandemic period, output per hour rose at a moderate average annual rate of 1½ percent, in line with the average rate of growth observed during the business cycle from the fourth quarter of 2007 to the fourth quarter of 2019.

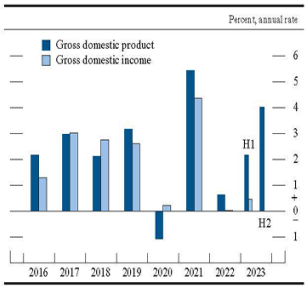
As always, the pace of future productivity growth remains highly uncertain. It is possible that productivity growth could remain at around this same moderate pace. However, it is also possible that the rapid adoption of new technologies like artificial intelligence and robotics—as well as the high rate of new business formation that the pandemic brought about—could boost productivity growth above that pace in coming years.

17. U.S. labor productivity



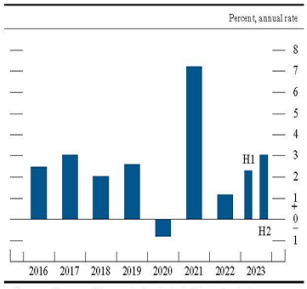
NOTE: The data are output per hour in the business sector.
SOURCE: Bureau of Labor Statistics via Haver Analytics.

18. Change in real gross domestic product and gross domestic income



NOTE: The data for gross domestic income extend through 2023:H1. The key identifies bars in order from left to right.
SOURCE: Bureau of Economic Analysis via Haver Analytics.

19. Change in real personal consumption expenditures



SOURCE: Bureau of Economic Analysis via Haver Analytics.

Gross domestic product rose at a solid pace last year

Real gross domestic product (GDP) is reported to have increased at an annual rate of 4.0 percent in the second half of 2023, up from 2.2 percent in the first half. For 2023 as a whole, GDP increased 3.1 percent, notably faster than in 2022 despite restrictive financial conditions, including elevated longer-term interest rates (figure 18).[5] Among the components of GDP, consumer spending rose solidly in the second half of last year, and residential investment started to turn back up following its earlier sharp declines, but growth of business investment slowed.

In contrast to GDP, manufacturing output was little changed, on net, last year, a downshift following two years of robust post-pandemic gains. Motor vehicle production continued to rebound from supply chain disruptions in 2021 and 2022, although last year's production was held down by strikes at several major automakers. Outside of motor vehicles, industrial production generally moved sideways last year, but it was down from its post-pandemic peak in early 2022, as inventories normalized and new orders fell back.

Consumer spending growth was resilient even as household finances deteriorated

Consumer spending adjusted for inflation grew at a solid rate of 3.0 percent in the second half of 2023 and 2.7 percent for last year as a whole (figure 19). Consumers' resilience in the face

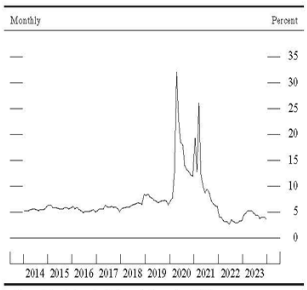
5. Real gross domestic income (GDI) has been notably weaker than GDP in recent quarters; both series measure the same economic concept, and any difference between the two figures reflects measurement error. GDI reportedly increased at a 0.8 percent pace in the first three quarters of last year after having been unchanged over the four quarters of 2022—well below the corresponding figures for GDP. As a result, productivity calculated from the income side of the national accounts would also be considerably weaker than the published figures over the past couple of years.

of tight financial conditions was supported by the strong labor market and rising real incomes. Indeed, after declining, on average, in 2021 and 2022, real disposable personal income increased robustly last year. However, last year's spending was also accompanied by households drawing down their liquid assets, such as checking accounts, and by relying more on credit. Indeed, the saving rate was 3.9 percent in the fourth quarter of 2023, well below pre-pandemic levels (figure 20). In addition, although household wealth relative to income remains high in the aggregate, it has declined, on net, since the end of 2021 and so is likely providing less support to consumer spending. Consumer spending since the pandemic has been more robust than measures of consumer sentiment would suggest. Although sentiment in the Michigan survey has improved markedly in recent months, it remains much further below its pre-pandemic level than does a similar measure from the Conference Board, which puts more weight on labor market conditions (figure 21).

Consumer financing conditions tightened last year

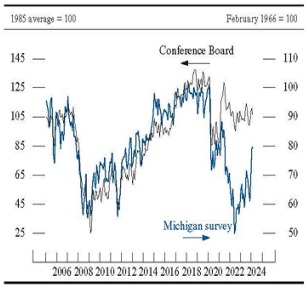
Credit remains available for most consumers, though interest rates on both credit cards and auto loans remain higher than the levels observed in 2018 at the peak of the previous monetary policy tightening cycle. Indeed, interest rates on credit cards have continued to increase since the first half of last year. In addition, banks reported continued tightening of lending standards across consumer credit products, in part reflecting lenders' concerns about further deterioration in credit performance and higher funding costs. Delinquency rates for credit cards rose further over the second half of 2023, while those for auto loans flattened out; both rates are notably above levels observed just before the pandemic. Reflecting these and other factors, consumer credit expanded moderately during the second half of last year, driven by robust growth in credit card balances and modest growth in

20. Personal saving rate



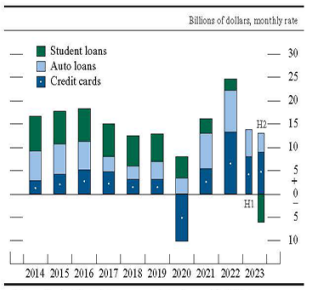
NOTE: The data extend through December 2023.
SOURCE: Bureau of Economic Analysis via Haver Analytics.

21. Indexes of consumer sentiment



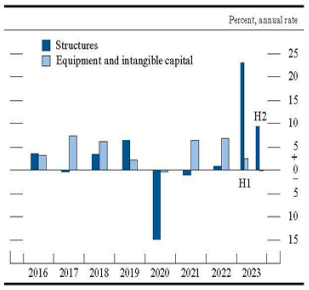
NOTE: The data are monthly and extend through February 2024. The February data for the Michigan survey are preliminary.
SOURCE: University of Michigan Surveys of Consumers; Conference Board.

22. Consumer credit flows



NOTE: Student loan balances were little changed in 2023:H1.
SOURCE: Federal Reserve Board, Statistical Release G.19, "Consumer Credit."

23. Change in real business fixed investment



NOTE: Business fixed investment is known as "private nonresidential fixed investment" in the national income and product accounts. The key identifies bars in order from left to right. Equipment and intangible capital investment was little changed in 2023:H2.
SOURCE: Bureau of Economic Analysis via Haver Analytics.

auto loans (figure 22). In contrast, student loan balances fell in the second half of last year, in large part driven by the cancellation of debt for certain borrowers in income-driven repayment plans.

Residential investment turned around and grew modestly in the second half of 2023

After declining steeply in 2022 on the heels of the substantial rise in mortgage interest rates, residential investment fell a bit further in the first half of 2023 but picked up in the second half of the year. The pickup in housing activity since mid-2023 masked some important differences across components of the market, with sales of existing homes much weaker than sales of new homes and with construction of single-family homes remaining relatively solid while multifamily construction declined. (The box "Recent Housing Market Developments" provides further discussion.)

Capital spending growth softened amid tighter financial conditions and subdued sentiment

Tighter financial conditions and downbeat business sentiment led to a slowdown in business investment spending growth in the second half of 2023 (figure 23). Equipment investment spending declined in the second half of the year, while investment in intellectual property products—which include software and research and development—continued to decelerate from its solid pace of growth over the previous few years. Investment in nonresidential structures, which had surged in early 2023 because of a boom in manufacturing construction—especially for factories that produce semiconductors or electric vehicle batteries—also decelerated in the second half of 2023, although the level of structures investment remained much higher than in previous years. Although indicators of business sentiment and profit expectations have improved in recent months, sentiment remains subdued.

Recent Housing Market Developments

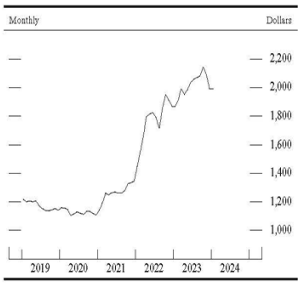
The rise in mortgage interest rates since early 2022 has reduced the overall demand for housing and slowed activity in the housing sector appreciably. The change in mortgage rates was unusually large and rapid, with 30-year fixed rates rising from about 3.2 percent in January 2022 to almost 8 percent in October 2023, the highest level since 2000 (figure A). Although mortgage rates have declined somewhat since October, they still averaged around 7 percent in February 2024.

The run-up in mortgage rates through late 2023, combined with a further rise in house prices, resulted in a sharp increase in typical mortgage payments and has reduced housing demand and home sales. The median monthly principal and interest payment on newly originated home-purchase mortgages for owner-occupied properties increased from below $1,400 in January 2022 to around $1,800 in early 2023 and has remained around that elevated level (figure B). As a result, home sales (including both new and existing properties) have fallen sharply over the past two years. Home purchases by low-income households have fallen disproportionately more, because mortgage lenders impose maximums on the ratio of a borrower's debt service payments to the borrower's income.[1]

A. Mortgage interest rates

NOTE: The data are contract rates on 30-year, fixed-rate conventional home mortgage commitments and extend through February 22, 2024.
SOURCE: Freddie Mac Primary Mortgage Market Survey via Haver Analytics.

B. Median monthly mortgage payments



NOTE: The data shown are median monthly scheduled principal and interest payments on home purchase mortgages for owner-occupied properties by month of rate lock. The Optimal Blue data are aggregated and anonymized. The data do not contain lender or customer identities or complete rate sheets.
SOURCE: Optimal Blue LLC, Optimal Blue Mortgage Price Data.

However, several other factors have supported underlying demand for housing, somewhat limiting the effect of higher mortgage rates. First, the labor market has remained strong, with historically low unemployment and real wage growth turning positive last year. Second, households may still be gradually adjusting to long-term remote or hybrid work flexibility by seeking additional space. Third, a rising fraction of buyers have been able to purchase homes with cash rather than taking out mortgages. The share of homes purchased with cash was about 15 percent in 2020 and increased to about 25 percent in 2023, with the drop in home sales concentrated in mortgage borrowers.

Housing supply has also faced constraints, due to both short- and long-term factors. In the short term, higher interest rates and tighter underwriting by banks significantly increased builders' costs of financing, discouraging new construction. In the long term, despite a surge in construction in late 2020 and 2021, it appears that a variety of factors—including zoning and other regulatory hurdles—have prevented construction from keeping up with underlying demand, resulting in a gross housing vacancy rate that is at a historical low.[2]

(continued on next page)

1. See Daniel Ringo (2022), "Declining Affordability and Home Purchase Borrowing by Lower Income Households," FEDS Notes (Washington: Board of Governors of the Federal Reserve System, July 8), https://doi.org/10.17016/2380-7172.3160.

2. See Joseph Gyourko and Raven Molloy (2015), "Chapter 19—Regulation and Housing Supply," *Handbook of Regional and Urban Economics*, vol. 5, pp. 1289-337.

Recent Housing Market Developments *(continued)*

The recent performance of home prices reflects this interplay between housing demand and supply. House price growth slowed rapidly from its historically high pace in response to the jump in interest rates, but it has bounced back recently on a year-over-year basis, leaving house price levels near record highs (figure C).

The interplay between demand and supply has played out quite differently across segments of the housing market. In particular, the contrast between the evolution of new and existing home sales has been notable (figure D). Many households purchased homes or refinanced when fixed mortgage rates were at historically low levels in 2020 and 2021, and, as a result, the majority of outstanding mortgages have interest rates below 4 percent (figure E). If these homeowners with low mortgage rates want to move to a different home with a new mortgage, their new mortgage payment would be much higher. As a result, many homeowners who might otherwise have moved have instead opted to remain in their current home. The net effect has been an unusually thin market for existing homes, with a dramatic reduction in the number of people both selling and bidding on homes. The decline in the supply of existing homes for sale also makes it difficult for the remaining buyers in the market to find their preferred home and may be driving some to the new home market even as overall sales are depressed. New homebuilders have also been able to offer buyers

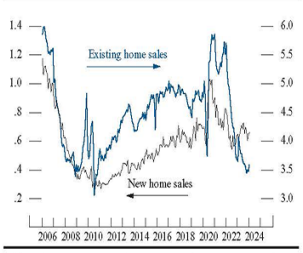
(continued)

C. Growth rate in house prices

NOTE: CoreLogic and S&P/Case-Shiller data extend through December 2023.

SOURCE: CoreLogic, Inc., Home Price Index; Zillow, Inc., Real Estate Data; S&P/Case-Shiller U.S. National Home Price Index. The S&P/Case-Shiller index is a product of S&P Dow Jones Indices LLC and/or its affiliates. (For Dow Jones Indices licensing information, see the note on the Contents page.)

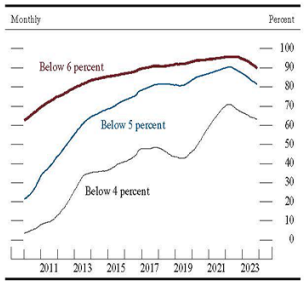
D. New and existing home sales



NOTE: The data are monthly. New and existing home sales include only single-family sales.

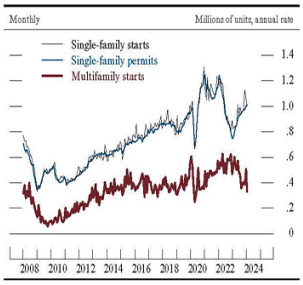
SOURCE: For new home sales, U.S. Census Bureau; for existing home sales, National Association of Realtors; all via Haver Analytics.

E. Distribution of interest rates on outstanding mortgages



NOTE: The data extend through November 2023. The sample only includes outstanding mortgages current on their payments.
SOURCE: Black Knight McDash.

F. Private housing starts and permits



SOURCE: U.S. Census Bureau via Haver Analytics.

significant incentives while still maintaining positive profit margins. The relative strength in the new home demand has encouraged builders to increase the rate of new construction after having sharply pulled back in 2022 when rates first started to rise (figure F).

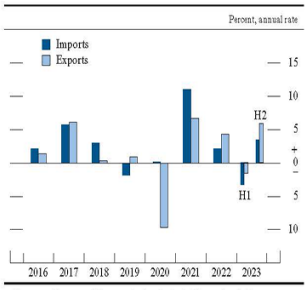
The balance between supply and demand in the multifamily market—which is dominated by rental units—is fundamentally different from that in the single-family market. Initially, as the pandemic eased, market rents surged along with single-family home prices in response to the increased demand for living space, whether owned or rented. These higher rents encouraged a dramatic increase in multifamily starts from what were already quite strong historical levels, averaging 510,000 units per year in 2021 and 2022, compared with an average of 314,000 units per year from 2000 to 2020. Construction of multifamily properties remained strong through 2022 even as single-family construction declined sharply. Unlike the cost of buying a home, rental demand is not directly harmed by higher mortgage rates and may even be supported, to some extent, by a shift away from home purchases as rates rise. Multifamily projects also take significantly longer to plan and build than single-family projects and are slower to react to changing economic conditions. Over the past year, we have seen more new properties delivered to the market, which contributed to increases in multifamily vacancy rates and a significant deceleration in market rents. These developments, combined with concerns about the effect of the large amount of new supply still scheduled to be delivered to market over the next year, have started to drive down prices of existing multifamily properties. As a result, the rate of new multifamily construction has come back down over the past year even as single-family construction has picked back up.

Business financing conditions were moderately restrictive overall, but credit remained generally available

Credit remained generally available to most nonfinancial corporations but at elevated interest rates and amid moderately restrictive financial conditions overall. Banks continued to tighten lending standards for all loan types over the second half of last year, and business loan growth at banks continued to slow. In contrast, issuance of corporate bonds remained solid across credit categories, although well below the levels prevailing at the beginning of the tightening cycle.

For small businesses, which are more reliant on bank financing than large businesses, credit conditions tightened further over the second half of last year. Surveys indicate that credit supply for small businesses has tightened further, and interest rates on loans to small businesses moved higher and now stand near the top of the range observed since 2008. Loan default and delinquency rates have also increased and now slightly exceed their pre-pandemic rates.

24. Change in real imports and exports of goods and services



SOURCE: Bureau of Economic Analysis via Haver Analytics.

Trade recovered in the second half of 2023

Real imports remained relatively unchanged for the year as a whole after declining in the first half of last year and then recovering over the second half as domestic demand picked up (figure 24). Despite lackluster foreign growth, exports picked up more strongly than imports over the second half of the year. As such, net exports added about 0.3 percentage point to GDP growth in the fourth quarter of 2023 after being neutral for growth in the previous two quarters. The current account deficit narrowed slightly in the third quarter of 2023 to 2.9 percent of GDP, remaining larger than before the pandemic.

Federal fiscal policy actions were roughly neutral for GDP growth in 2023

Federal purchases grew modestly in 2023, and several recently enacted policies began to boost

investment and consumption. This support to economic activity was about offset by the unwinding of the remaining pandemic-related fiscal policy support. All told, the contribution of discretionary changes in federal fiscal policy to real GDP growth was roughly neutral last year.

The budget deficit and federal debt remain elevated

After surging to 15 percent of GDP in fiscal year 2020, the budget deficit declined through 2022 as the imprint of the pandemic faded (figure 25). The budget deficit edged up to 6.3 percent of GDP in fiscal 2023 as tax receipts declined from their elevated level in 2022 and net interest outlays increased.[6]

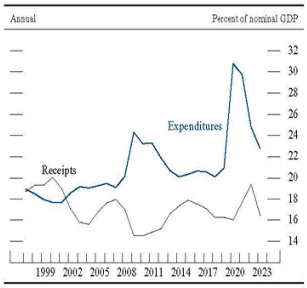
As a result of the unprecedented fiscal support enacted early in the pandemic, federal debt held by the public jumped roughly 20 percentage points to 100 percent of GDP in fiscal 2020—the highest debt-to-GDP ratio since 1947 (figure 26). After falling slightly through 2022, the debt-to-GDP ratio edged up in 2023, as rising interest rates contributed to higher net interest outlays. The Congressional Budget Office projects that further increases in interest costs, along with positive primary deficits—that is, total deficits less interest payments—will produce a steady rise in the debt-to-GDP ratio in the years to come.

Most state and local government budget positions remained strong . . .

Federal policymakers provided a historically high level of fiscal support to state and local governments during the pandemic; this aid, together with robust state tax collections in 2021 and 2022, left the sector in a strong

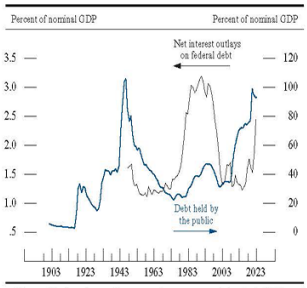
6. The growth of the deficit between fiscal years 2022 and 2023 would have been larger had it not been for the Administration's announced student debt relief program, which raised the fiscal 2022 deficit $380 billion, and the Supreme Court's reversal of the policy, which lowered it $330 billion in fiscal 2023.

25. Federal receipts and expenditures



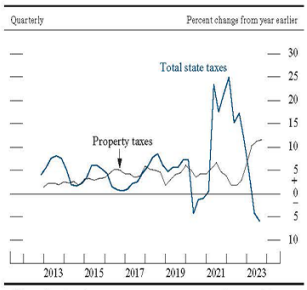
NOTE: The receipts and expenditures data are on a unified-budget basis and are for fiscal years (October through September); gross domestic product (GDP) data are on a 4-quarter basis ending in Q3.
SOURCE: Department of the Treasury, Financial Management Service; Office of Management and Budget and Bureau of Economic Analysis via Haver Analytics.

26. Federal government debt and net interest outlays



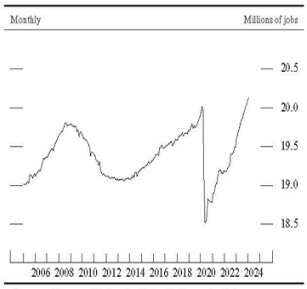
NOTE: The data for net interest outlays are annual, begin in 1948, and extend through 2023. Net interest outlays are the cost of servicing the debt held by the public. Federal debt held by the public equals federal debt less Treasury securities held in federal employee defined-benefit retirement accounts, evaluated at the end of the quarter. The data for federal debt are annual from 1901 to 1951 and a 4-quarter moving average thereafter and extend through 2023:Q3. GDP is gross domestic product.
SOURCE: For GDP, Bureau of Economic Analysis via Haver Analytics; for federal debt, Congressional Budget Office and Federal Reserve Board, Statistical Release Z.1, "Financial Accounts of the United States."

27. State and local tax receipts



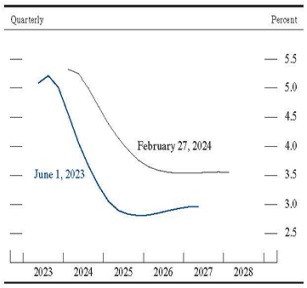
NOTE: Receipts shown are year-over-year percent changes of 4-quarter moving averages, begin in 2012:Q4, and extend through 2023:Q3. Property taxes are primarily collected by local governments.
SOURCE: U.S. Census Bureau, Quarterly Summary of State and Local Government Tax Revenue.

28. State and local government payroll employment



SOURCE: Bureau of Labor Statistics via Haver Analytics.

29. Market-implied federal funds rate path



NOTE: The federal funds rate path is implied by quotes on overnight index swaps—a derivative contract tied to the effective federal funds rate. The implied path as of June 1, 2023, is compared with that as of February 27, 2024. The path is estimated with a spline approach, assuming a term premium of 0 basis points. The June 1, 2023, path extends through 2027:Q2 and the February 27, 2024, path through 2028:Q1.
SOURCE: Bloomberg; Federal Reserve Board staff estimates.

budget position overall (figure 27). Although state tax revenues weakened in 2023—mainly reflecting a normalization of receipts from elevated levels in the previous year as well as the effects of recently enacted tax cuts in some states—taxes as a percentage of GDP remained above recent historical norms. Moreover, states' total balances (that is, including rainy day fund balances and previous-year surplus funds) continued to be near all-time highs. Nevertheless, budget situations varied widely across the states, with some states—particularly those that depend heavily on capital gains tax collections—facing tighter budget conditions. At the local level, overall property tax receipts rose briskly in 2023.

. . . contributing to brisk growth in employment and construction spending

Employment in state and local governments rose strongly in 2023, as some pandemic-related headwinds, such as an increase in retirements, have abated and wages became more competitive relative to those in the private sector (figure 28). Similarly, real construction outlays grew rapidly, reflecting easing bottlenecks and support from federal grants. By the end of 2023, both employment and construction spending were roughly back to their pre-pandemic levels.

Financial Developments

The expected level of the federal funds rate over the next few years is now higher than it was last June on net

Market-based measures of the expected federal funds rate rose considerably over the summer and early fall before moving down toward the end of 2023. On net, the market-implied policy rate path rose notably for year-end 2024, and somewhat more modestly for year-end 2025 and 2026 (figure 29).[7] Financial market prices imply that the federal funds rate will decline

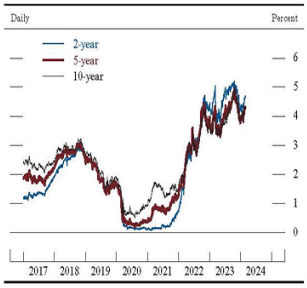
7. These measures are based on market prices for overnight index swaps for the effective federal funds rate and are not adjusted for term premiums.

from current levels following the March 2024 FOMC meeting, reaching about 4.6 percent and about 3.7 percent by year-end 2024 and year-end 2025, respectively. Consistent with these market-implied measures, survey respondents in the Blue Chip Financial Forecasts published at the beginning of February expect the policy rate to begin to decrease in the second quarter of 2024 and reach 4.4 percent by year-end 2024. On net, respondents have significantly revised upward their expectations of the federal funds rate path since last June's survey.

Yields on long-term U.S. nominal Treasury securities fluctuated considerably

Yields on long-term nominal Treasury securities began to increase in the spring of 2023 and rose markedly through mid-October before reversing course sharply, with the 10-year Treasury yield reaching a peak of about 5 percent before falling to just below 4 percent by the end of last year (figure 30). So far this year, long-term nominal Treasury yields have increased, with the 10-year Treasury yield rising to about 4.4 percent by late February. In contrast, short-term Treasury yields have been little changed, on net, since early June.

30. Yields on nominal Treasury securities

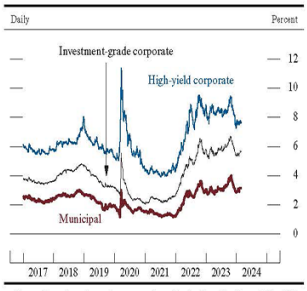


SOURCE: Department of the Treasury via Haver Analytics.

Yields on other long-term debt fluctuated with Treasury yields

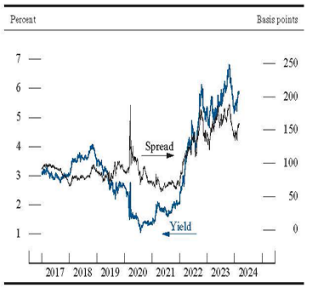
Corporate bond yields declined across credit categories since June, on net, amid sizable fluctuations that accompanied the observed large movements in long-term Treasury yields (figure 31). Spreads on corporate bonds over comparable-maturity Treasury securities narrowed notably, on net, especially for speculative-grade bonds, to levels in the lower range of their historical distributions. Similarly, municipal bond spreads over comparable-maturity Treasury securities narrowed substantially since June and are now fairly low relative to their historical distributions across credit ratings. Overall, corporate and municipal credit quality remained solid, with a low volume of defaults in both markets despite some increase in corporate bond defaults.

31. Corporate bond yields, by securities rating, and municipal bond yield



NOTE: Investment-grade corporate reflects the effective yield of the ICE Bank of America Merrill Lynch (BofAML) triple-B U.S. Corporate Index (C0A4). High-yield corporate reflects the effective yield of the ICE BofAML High Yield Index (H0A0). Municipal reflects the yield to worst of the ICE BofAML U.S. Municipal Securities Index (U0A0).
SOURCE: ICE Data Indices, LLC, used with permission.

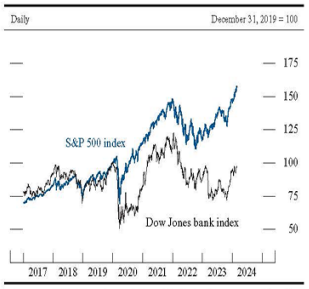
32. Yield and spread on agency mortgage-backed securities



NOTE: The data are daily. Yield shown is for the uniform mortgage-backed securities 30-year current coupon, the coupon rate at which new mortgage-backed securities would be priced at par, or face, value for dates after May 31, 2019; for earlier dates, the yield shown is for the Fannie Mae 30-year current coupon. Spread shown is to the average of the 5-year and 10-year nominal Treasury yields.

SOURCE: Department of the Treasury; J.P. Morgan. Courtesy of J.P. Morgan Chase & Co., Copyright 2024.

33. Equity prices



SOURCE: S&P Dow Jones Indices LLC via Bloomberg. (For Dow Jones Indices licensing information, see the note on the Contents page.)

Yields on agency mortgage-backed securities (MBS)—an important pricing factor for home mortgage interest rates—rose notably over the summer before falling back down toward the end of last year (figure 32). So far this year, yields on agency MBS have increased, standing in late February at levels notably above those in June 2023. The MBS spread decreased slightly since June, on net, but remained elevated relative to pre-pandemic levels, at least partly due to high interest rate volatility, which reduces the value of holding MBS.

Broad equity price indexes increased

The S&P 500 index increased significantly since June, on net, above the record-high levels seen at the end of 2021 (figure 33). Following a substantial decline over late summer and early fall, the S&P 500 index recovered toward the end of the year, as long-term interest rates declined, and continued to rise over the start of 2024. Meanwhile, small-cap firms, whose equity prices have significantly underperformed broad equity indexes, experienced substantial increases in their equity valuations in recent months amid better economic prospects, including expectations of a less restrictive monetary policy. Bank equity prices rose, on net, retracing some of the declines that had occurred over the first half of 2023 and that had been associated with strains in the banking sector. In the case of the largest banks, equity prices rose above their early-2023 levels; regional bank equity prices had only a partial retracement. One-month option-implied volatility on the S&P 500 index—the VIX—increased moderately until late October but subsequently declined to reach levels somewhat lower than those prevailing in early June. (For a discussion of financial stability issues, see the box "Developments Related to Financial Stability.")

Developments Related to Financial Stability

This discussion reviews vulnerabilities in the U.S. financial system. The framework used by the Federal Reserve Board for assessing the resilience of the U.S. financial system focuses on financial vulnerabilities in four broad areas: asset valuations, business and household debt, leverage in the financial sector, and funding risks. Acute stress in the banking system has receded since last spring, and banks' regulatory risk-based capital ratios remained solid and increased broadly, as bank profits were robust and banks reduced capital distributions. Nonetheless, declines in the fair value of fixed-rate assets at some banks have been sizable relative to regulatory capital. Valuation pressures increased modestly, with equity markets close to all-time highs in real terms and real estate prices still high relative to fundamentals. Credit to nonfinancial businesses and households continued to decrease relative to gross domestic product (GDP), and this ratio now sits close to its 20-year low. However, funding vulnerabilities remain notable. Hedge fund leverage is elevated, partly due to elevated activity in the cash–futures basis trade.

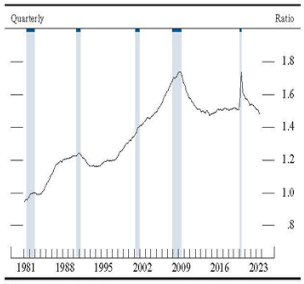
Broad equity prices are now at levels close to historical highs, driven mostly by performance of the largest companies. Nominal long-term Treasury yields rose to a 15-year peak in October but have now fallen to levels close to those from a year ago. Commercial real estate (CRE) prices continued to decline, especially in the office, retail, and multifamily sectors, and low levels of transactions in the office sector likely indicated that prices had not yet fully reflected the sector's weaker fundamentals. Prices of single-family residential properties, which held steady through the first quarter of 2023, have started rising again, albeit modestly, and remain high relative to market rents.

Vulnerabilities arising from household and nonfinancial business leverage remain moderate. The combined debt of both sectors as a share of GDP sat close to its lowest level in 20 years and continues to decrease (figure A). In the household sector, balance sheets remain strong, and homeowners' equity shares of houses are now at their highest levels in at least 30 years. Nonfinancial businesses' ability to service debt also remains adequate, as the pass-through of higher policy rates has so far been muted by the large share of long-term fixed-rate debt. Direct lending to nonfinancial businesses by private credit funds and other private investors has been growing rapidly. While risks from leverage and investor redemption appear limited, the sector remains opaque, making it difficult to assess vulnerabilities.

Vulnerabilities in the financial sector remain notable, as losses in the fair value of long-dated bank assets remain significant. Risk-based capital ratios increased broadly across all bank categories and sit well above regulatory minimums, driven both by robust bank profitability and by a decrease in shareholder payouts at the largest banks. Credit quality at banks remained strong, although the quality of CRE loans backed by office, retail, and multifamily buildings continued its decline, a result of the lower demand for downtown real estate prompted by the shift toward telework. Some smaller regional and community banks with high concentrations of CRE loans are also highly reliant on uninsured deposits, potentially compounding vulnerabilities. Leverage at hedge funds stabilized at a high level as the Treasury cash–futures basis

(continued on next page)

A. Private nonfinancial-sector credit-to-GDP ratio



NOTE: Data extend through 2023:Q3. The shaded bars with top caps indicate periods of business recession as defined by the National Bureau of Economic Research: July 1981 to November 1982, July 1990 to March 1991, March 2001 to November 2001, December 2007 to June 2009, and February 2020 to April 2020. GDP is gross domestic product.

SOURCE: Federal Reserve Board, Statistical Release Z.1, "Financial Accounts of the United States"; Bureau of Economic Analysis, national income and product accounts; Federal Reserve Board staff calculations.

Developments Related to Financial Stability *(continued)*

trade continued to grow, suggesting a risk of sudden deleveraging if volatility in Treasury markets increases unexpectedly. Leverage at life insurers also increased, although to levels near the middle of its historical distribution.

In terms of funding risks, liquidity remains ample, and deposits have stabilized recently. The number of banks with large declines in fair value relative to their regulatory capital and heavy reliance on uninsured deposits has declined significantly since March 2023. Overall, banks' reliance on short-term wholesale funding remained much lower than the typical range before the banking reforms of the previous decade. Money market funds continued to grow throughout the second half of 2023, mostly because of increases in retail prime funds.

A routine survey of market contacts on salient shocks to financial stability highlights several important risks. Adverse developments in longer-term interest rates could potentially strain credit supply in vulnerable sectors. A related risk, the reemergence of banking-sector stress at some institutions, might further constrain the supply of credit, particularly at banks with large CRE concentration and a high fraction of uninsured deposits. Geopolitical risks remain salient, including Russia's war against Ukraine and potential spillovers of the Israel–Hamas war, and could cause strains in parts of the U.S. financial system.

Major asset markets functioned in an orderly way, but liquidity has remained low

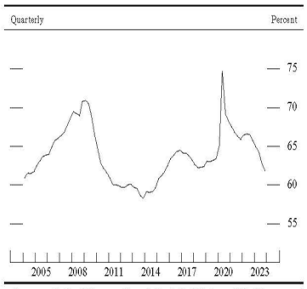
Treasury securities market functioning has continued to be orderly, but liquidity remained low by historical standards. The persistence of low liquidity is broadly in line with enduring high interest rate volatility, as future economic conditions and the policy rate path remain particularly uncertain. Market depth—a measure of the availability of contracts at the best quoted prices—for Treasury securities remains near historically low levels, particularly in the case of short-term Treasury securities. With regard to liquidity in the equity market, market depth based on S&P 500 futures was little changed and remained somewhat low compared with pre-COVID levels. Corporate and municipal secondary bond markets continued to function well; transaction costs in these markets were fairly low by historical standards.

Short-term funding market conditions remained stable

Conditions in overnight bank funding and repurchase agreement (repo) markets remained stable. Since June, the effective federal funds rate and other unsecured overnight rates have been a few basis points below the interest rate on reserve balances, while the Secured Overnight Financing Rate has been at or slightly above the offering rate on the overnight reverse repurchase agreement (ON RRP) facility. Take-up at the ON RRP facility has declined substantially since June. This decline reflects a significant increase in the net supply of Treasury bills and relatively more attractive rates on alternative short-term investments such as private repo.

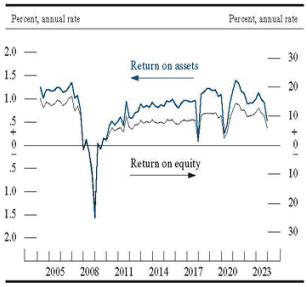
Money market funds (MMFs), the largest investors in the ON RRP facility, accounted for much of the decline in ON RRP take-up as they made a substantial reallocation of their investments toward Treasury bills and private repo. Both prime and government MMFs have seen a notable increase in assets under management since June, as relatively favorable

34. Ratio of total commercial bank credit to nominal gross domestic product



SOURCE: Federal Reserve Board, Statistical Release H.8, "Assets and Liabilities of Commercial Banks in the United States"; Bureau of Economic Analysis via Haver Analytics.

35. Profitability of bank holding companies



NOTE: The data are quarterly.
SOURCE: Federal Reserve Board, Form FR Y-9C, Consolidated Financial Statements for Holding Companies.

yields continue to attract funds previously held on deposit in the banking sector. Weighted average maturities at both prime and government MMFs increased in anticipation of fewer policy rate increases.

Bank credit growth continued to slow over the second half of 2023

The slowdown in bank credit growth was broad based, with growth in outstanding balances for all major loan categories slowing from earlier in the year, likely reflecting the effects of higher interest rates, tighter credit availability, and economic uncertainty (figure 34). Banks in the Senior Loan Officer Opinion Survey on Bank Lending Practices reported tighter standards and weaker demand over the third and fourth quarters, continuing trends for standards and demand that have been reported since the middle of 2022. Delinquency rates on bank loans generally rose in the second half of 2023—with the largest increases for commercial real estate and consumer loans—but remained around ranges observed before the pandemic except for consumer loans. Bank profitability moved down in the second half of 2023 to levels below those that prevailed before the pandemic (figure 35).

International Developments

Foreign economic growth slowed in the second half of 2023

Following a rebound in early 2023, foreign activity was subdued overall in the second half of last year, although with some variation across countries. In advanced foreign economies (AFEs), several factors restrained growth, including the tightening of monetary policy over the past two years—which weighed on credit growth and investment—and an erosion of real household incomes amid high inflation rates. In Europe, ongoing structural adjustment to higher energy prices also continued to hinder the performance of energy-intensive sectors. Economic indicators point to continued weakness in AFE growth in early 2024.

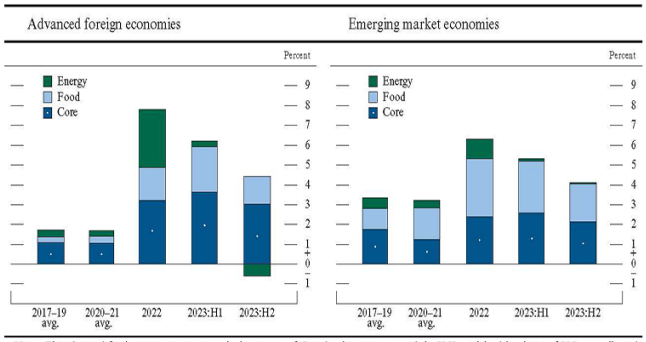
In China, a post-pandemic boost to economic growth early in 2023 faded by the second quarter, and property-sector weakness and sluggish domestic demand have remained a constraint on economic activity. Policy stimulus targeting infrastructure and manufacturing investment bolstered Chinese growth in the second half of the year, enabling the government to meet its 2023 growth target.

In emerging market economies (EMEs) other than China, economic activity slowed in the second half of last year but was more resilient overall than in the AFEs. Industrial production in emerging Asia excluding China began recovering, supported by a rebound in global demand for high-tech products that was driven in part by the artificial intelligence and electric vehicle sectors.

Inflation abroad has continued to ease but remains elevated

Foreign headline inflation has continued to decline since the middle of last year, reflecting lower core and food inflation (figure 36). Both the subsiding effects of past global supply bottlenecks and the drag on demand from monetary policy tightening have eased

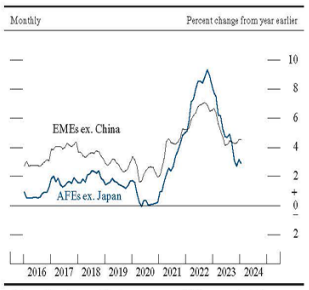
36. Components of foreign consumer price inflation



NOTE: The advanced foreign economy aggregate is the average of Canada, the euro area, and the U.K., weighted by shares of U.S. non-oil goods imports. The emerging market economy aggregate is the average of Argentina, Brazil, Chile, Colombia, Hong Kong, India, Indonesia, Israel, Malaysia, Mexico, the Philippines, Russia, Saudi Arabia, Singapore, South Korea, Taiwan, Thailand, and Vietnam, weighted by shares of U.S. non-oil goods imports, and begins in 2017:Q2. The inflation measure is the Harmonised Index of Consumer Prices for the euro area and the consumer price index for other economies. The data show percent changes from year-ago levels.

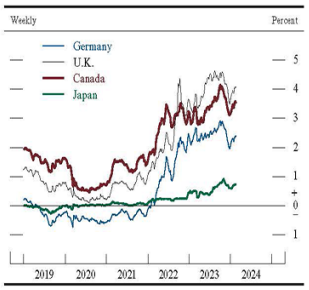
SOURCE: Federal Reserve Board staff calculations; Haver Analytics.

37. Consumer price inflation in foreign economies



NOTE: The advanced foreign economy (AFE) aggregate is the average of Canada, the euro area, and the U.K., weighted by shares of U.S. non-oil goods imports. The emerging market economy (EME) aggregate is the average of Argentina, Brazil, Chile, Colombia, Hong Kong, India, Indonesia, Israel, Malaysia, Mexico, the Philippines, Russia, Saudi Arabia, Singapore, South Korea, Taiwan, Thailand, and Vietnam, weighted by shares of U.S. non-oil goods imports. The inflation measure is the Harmonised Index of Consumer Prices for the euro area and the consumer price index for other economies.
SOURCE: Federal Reserve Board staff calculations; Haver Analytics.

38. Nominal 10-year government bond yields in selected advanced foreign economies



NOTE: The data are weekly averages of daily benchmark yields and extend through February 23, 2024.
SOURCE: Bloomberg.

inflationary pressures (figure 37). However, the pace of disinflation has varied across sectors and countries. The deceleration in goods prices abroad has generally outpaced that in services prices, as in the U.S. Inflation remains above target in Europe but has been running near zero in China. Although the flare-up in geopolitical tensions in the Middle East and accompanying disruptions to shipping through the Red Sea have had only limited effects on consumer prices in general and on global energy prices in particular, further escalation in tensions could disrupt global momentum toward restoring lower inflation.

Foreign central banks are maintaining a restrictive monetary policy stance

Most foreign central banks paused their interest rate hikes in the second half of last year and have since held policy rates steady, acknowledging the cumulative tightening of policy and progress in lowering inflation. Policy rate paths implied by financial market pricing suggest that many AFE central banks are expected to begin reducing interest rates in 2024. Several EME central banks have already begun easing monetary policy. However, foreign central banks have generally continued to emphasize in their communications that progress toward achieving their inflation goals could slow or even reverse, including from resilience in labor markets, wage growth, or geopolitical developments leading to higher commodity prices and trade costs.

Financial conditions abroad have been volatile but have eased, on balance, since mid-2023

Near-dated AFE sovereign yields declined toward the end of last year as central banks signaled they had reached or neared the end of policy rate tightening. Longer-term sovereign yields unwound most of the increase registered earlier in 2023 (figure 38). One exception was Japan, where the central bank widened the band around its yield curve control target, allowing yields on 10-year government securities to increase, on net, in 2023.

Since mid-2023, the broad dollar index—a measure of the exchange value of the dollar against a trade-weighted basket of foreign currencies—increased slightly on net (figure 39). The dollar index was volatile, increasing significantly as U.S. yields rose from July to October and then reversing most of these increases as U.S. yields declined.

Many major foreign equity indexes rose across AFEs and EMEs, although gains were near zero in the U.K., consistent with stagnant economic activity (figure 40). Chinese equity prices were an exception, with declines amid pessimism about growth prospects and a pullback by foreign investors from Chinese markets. Flows to EME-focused investment funds turned negative in mid-2023, as yields on advanced-economy bonds rose more than those in emerging economies. These outflows eased toward the end of the year as AFE yields fell. EME sovereign spreads narrowed moderately last year.

39. U.S. dollar exchange rate index

NOTE: The data, which are in foreign currency units per dollar, are weekly averages of daily values of the broad dollar index and extend through February 23, 2024. As indicated by the arrow, increases in the data reflect U.S. dollar appreciation and decreases reflect U.S. dollar depreciation.

SOURCE: Federal Reserve Board staff calculations; Federal Reserve Board, Statistical Release H.10, "Foreign Exchange Rates."

40. Equity indexes for selected foreign economies

NOTE: The data are weekly averages of daily data and extend through February 23, 2024.

SOURCE: For the euro area, Dow Jones Euro Stoxx Index; for Japan, Tokyo Stock Price Index; for China, Shanghai Composite Index; for the U.K., FTSE 100 Index; all via Bloomberg. (For Dow Jones Indices licensing information, see the note on the Contents page.)

Part 2
Monetary Policy

After one additional increase in July, the Federal Open Market Committee has held the federal funds rate steady . . .

The Federal Open Market Committee (FOMC) has maintained the target range for the federal funds rate at 5¼ to 5½ percent since its July 2023 meeting (figure 41). The Committee views the policy rate as likely at its peak for this tightening cycle; since early 2022, the FOMC raised the target range a total of 525 basis points. The FOMC's policy tightening actions have reflected its commitment to return inflation to its 2 percent objective. Restoring price stability is essential to achieve a sustained period of strong labor market conditions that benefit all.

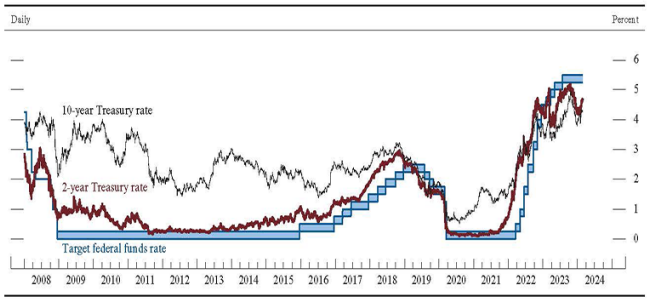
As labor market tightness has eased and progress on inflation has continued, the risks to achieving the Committee's employment and inflation goals have been moving into better balance. Even so, the Committee remains highly attentive to inflation risks and is acutely aware that high inflation imposes significant hardship, especially on those least able to meet the higher costs of essentials, like food, housing, and transportation. In considering any adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 percent.

. . . and has continued the process of significantly reducing its holdings of Treasury and agency securities

The FOMC began reducing its securities holdings in June 2022 and, since then, has continued to implement its plan for significantly reducing the size of the Federal Reserve's balance sheet in a predictable manner.[8] Since September 2022, principal payments from securities held in the System

8. See the May 4, 2022, press release regarding the Plans for Reducing the Size of the Federal Reserve's Balance Sheet, available on the Board's website at https://www.federalreserve.gov/newsevents/pressreleases/monetary20220504b.htm.

41. Selected interest rates



NOTE: The 2-year and 10-year Treasury rates are the constant-maturity yields based on the most actively traded securities.
SOURCE: Department of the Treasury; Federal Reserve Board.

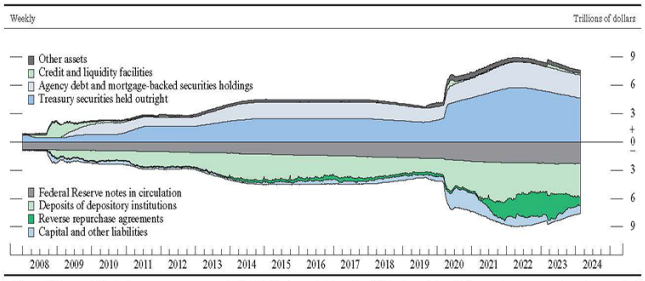
Open Market Account (SOMA) have been reinvested only to the extent that they exceeded monthly caps of $60 billion per month for Treasury securities and $35 billion per month for agency debt and agency mortgage-backed securities. As a result of these actions, the SOMA holdings of Treasury and agency securities have declined about $1.4 trillion since the start of balance sheet reduction to around $7.1 trillion, a level equivalent to about 25 percent of U.S. nominal gross domestic product as compared with a peak of 35 percent reached at the end of 2021 (figure 42). Despite this decline in SOMA holdings, reserve balances increased $217 billion, to a level of around $3.5 trillion, as the corresponding decline in the Federal Reserve's liabilities was concentrated in usage of the overnight reverse repurchase agreement facility. (See the box "Developments in the Federal Reserve's Balance Sheet and Money Markets.")

The FOMC has stated that it intends to maintain securities holdings at amounts consistent with implementing monetary policy efficiently and effectively in its ample-reserves regime. To ensure a smooth transition, the FOMC intends to slow and then stop reductions in its securities holdings when reserve balances are somewhat above the level that the FOMC judges to be consistent with ample reserves. Once balance sheet runoff has ceased, reserve balances will likely continue to decline at a slower pace—reflecting growth in other Federal Reserve liabilities—until the FOMC judges that reserve balances are at an ample level. Thereafter, the FOMC will manage securities holdings as needed to maintain ample reserves over time.

The FOMC will continue to monitor the implications of incoming information for the economic outlook

As already indicated, the FOMC is strongly committed to returning inflation to its 2 percent objective, and, in considering any adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. Its assessments will take into account a wide range of information, including readings on labor market conditions, inflation pressures and inflation expectations,

42. Federal Reserve assets and liabilities



NOTE: "Other assets" includes repurchase agreements, FIMA (Foreign and International Monetary Authorities) repurchase agreements, and unamortized premiums and discounts on securities held outright. "Credit and liquidity facilities" consists of primary, secondary, and seasonal credit; term auction credit; central bank liquidity swaps; support for Maiden Lane, Bear Stearns Companies, Inc., and AIG; and other credit and liquidity facilities, including the Primary Dealer Credit Facility, the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Commercial Paper Funding Facility, the Term Asset-Backed Securities Loan Facility, the Primary and Secondary Market Corporate Credit Facilities, the Paycheck Protection Program Liquidity Facility, the Municipal Liquidity Facility, and the Main Street Lending Program. "Agency debt and mortgage-backed securities holdings" includes agency residential mortgage-backed securities and agency commercial mortgage-backed securities. "Capital and other liabilities" includes the U.S. Treasury General Account and the U.S. Treasury Supplementary Financing Account. The key identifies shaded areas in order from top to bottom. The data extend through February 21, 2024.
SOURCE: Federal Reserve Board, Statistical Release H.4.1, "Factors Affecting Reserve Balances."

and financial and international developments. The Committee has noted that it is also prepared to adjust its approach to reducing the size of the balance sheet in light of economic and financial developments.

In addition to considering a wide range of economic and financial data, the FOMC gathers information from business contacts and other informed parties around the country, as summarized in the Beige Book. The Federal Reserve has regular arrangements under which it hears from a broad range of participants in the U.S. economy about how monetary policy affects people's daily lives and livelihoods. In particular, the Federal Reserve has continued to gather insights into these matters through the *Fed Listens* initiative and the Federal Reserve System's community development outreach.

Policymakers also routinely consult prescriptions for the policy interest rate provided by various monetary policy rules. These rule prescriptions can provide useful benchmarks for the FOMC. However, simple rules cannot capture all of the complex considerations that go into the formation of appropriate monetary policy, and many practical considerations make it undesirable for the FOMC to adhere strictly to the prescriptions of any specific rule. Nevertheless, some principles of good monetary policy can be brought out by examining these simple rules. (See the box "Monetary Policy Rules in the Current Environment.")

Developments in the Federal Reserve's Balance Sheet and Money Markets

The Federal Open Market Committee (FOMC) continued to reduce the size of the Federal Reserve's System Open Market Account (SOMA) portfolio, consistent with its plans for reducing the size of the Federal Reserve's balance sheet. Since the time of the June 2023 report, total Federal Reserve assets have decreased $806 billion, leaving the total size of the balance sheet at $7.6 trillion, $1.3 trillion smaller since the reduction in the size of the SOMA portfolio began in June 2022 (figures A and B). This discussion reviews recent developments in the Federal Reserve's balance sheet and money market conditions.

While the reduction in the size of the SOMA portfolio has continued as planned, amid the banking-sector developments of spring 2023, the Federal Reserve provided liquidity to help ensure the stability of the banking system and the ongoing provision of money

(continued)

A. Balance sheet comparison

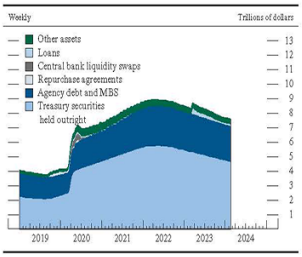
Billions of dollars

	February 21, 2024	June 14, 2023	Change (since June 2023)	Change (since Fed's balance sheet reduction began on June 1, 2022)
Assets				
Total securities				
Treasury securities	4,661	5,160	−499	−1,109
Agency debt and MBS	2,417	2,561	−144	−293
Net unamortized premiums	274	298	−24	−63
Repurchase agreements	0	0	0	0
Loans and lending facilities				
PPPLF	3	8	−5	−17
Discount window	2	4	−2	2
BTFP	164	102	62	164
Other credit extensions	0	180	−180	0
Other loans and lending facilities	15	28	−13	−20
Central bank liquidity swaps	0	0	0	0
Other assets	44	48	−4	2
Total assets	**7,582**	**8,388**	**−806**	**−1,333**
Liabilities				
Federal Reserve notes	2,280	2,292	−12	50
Reserves held by depository institutions	3,523	3,306	217	166
Reverse repurchase agreements				
Foreign official and international accounts	340	328	12	74
Others	575	2,109	−1,534	−1,390
U.S. Treasury General Account	789	135	654	8
Other deposits	164	220	−56	−84
Other liabilities and capital	−89	−2	−87	−157
Total liabilities and capital	**7,582**	**8,388**	**−806**	**−1,333**

NOTE: MBS is mortgage-backed securities. PPPLF is Paycheck Protection Program Liquidity Facility. BTFP is Bank Term Funding Program. Components may not sum to totals because of rounding.

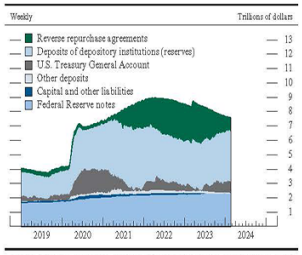
SOURCE: Federal Reserve Board, Statistical Release H.4.1, "Factors Affecting Reserve Balances."

B. Federal Reserve assets



NOTE: MBS is mortgage-backed securities. The key identifies shaded areas in order from top to bottom. The data extend through February 21, 2024.
SOURCE: Federal Reserve Board, Statistical Release H.4.1, "Factors Affecting Reserve Balances."

C. Federal Reserve liabilities



NOTE: "Capital and other liabilities" includes Treasury contributions and is negative on February 21, 2024, because of the deferred asset that the Federal Reserve reports. The key identifies shaded areas in order from top to bottom. The data extend through February 21, 2024.
SOURCE: Federal Reserve Board, Statistical Release H.4.1, "Factors Affecting Reserve Balances."

and credit to the economy.[1] Loans under the Bank Term Funding Program—which made additional funding and liquidity available to eligible depository institutions to support American businesses and households and which will cease making new loans as scheduled on March 11, 2024—have increased $62 billion since June 2023 (figure A).[2]

Despite the ongoing reduction in the Federal Reserve's securities holdings, reserve balances—the largest liability item on the Federal Reserve's balance sheet—have increased $217 billion since June 2023, given other changes in the composition of the Federal Reserve's liabilities over this period.[3] Since June 2023, usage of the overnight reverse repurchase agreement (ON RRP) facility has declined $1.5 trillion, while balances in the Treasury General Account have increased $654 billion (figures A and C). On net, changes in these and other nonreserve liabilities have resulted in an increase in reserve balances.

After remaining above $2 trillion during the first half of 2023, usage of the ON RRP facility has declined to

(continued on next page)

1. The loans that were extended to depository institutions (DIs) placed into Federal Deposit Insurance Corporation (FDIC) receivership in March 2023 have been fully repaid. The Federal Reserve Banks' loans to these DIs are secured by pledged collateral, and the FDIC provides repayment guarantees. For additional information, see Board of Governors of the Federal Reserve System (2024), "Additional Information on Other Credit Extensions," webpage, January 4, https://www.federalreserve.gov/monetarypolicy/additional-information-on-other-credit-extensions.htm.

2. The Bank Term Funding Program (BTFP) was established under section 13(3) of the Federal Reserve Act with the approval of the Secretary of the Treasury. The BTFP offers loans of up to one year to banks, savings associations, credit unions, and other eligible DIs against collateral such as U.S. Treasury securities, U.S. agency securities, and U.S. agency mortgage-backed securities. For more details, see Board of Governors of the Federal Reserve System (2024), "Bank Term Funding Program," webpage, February 13, https://www.federalreserve.gov/financial-stability/bank-term-funding-program.htm.
The interest rate applicable to new BTFP loans has been adjusted such that the rate on new loans extended from January 25, 2024, through program expiration will be no lower than the interest rate on reserve balances in effect on the day the loan is made. This rate adjustment ensures that the BTFP continues to support the goals of the program in the current interest rate environment. After March 11, 2024, banks and other DIs will continue to have ready access to the discount window to meet liquidity needs. For additional information, see Board of Governors of the Federal Reserve System (2024), "Federal Reserve Board Announces the Bank Term Funding Program (BTFP) Will Cease Making New Loans as Scheduled on March 11," press release, January 24, https://www.federalreserve.gov/newsevents/pressreleases/monetary20240124a.htm.

3. Reserve balances consist of deposits held at the Federal Reserve Banks by DIs, such as commercial banks, savings banks, credit unions, thrift institutions, and U.S. branches and agencies of foreign banks. Reserve balances allow DIs to facilitate daily payment flows, both in ordinary times and in stress scenarios, without borrowing funds or selling assets.

Federal Reserve's Balance Sheet and Money Markets *(continued)*

about $575 billion amid the ongoing reduction in the Federal Reserve's balance sheet and the substantial increase in net supply of Treasury securities. Reduced usage of the ON RRP facility largely reflects money market funds shifting their portfolio toward higher-yielding investments, including Treasury bills and private-market repurchase agreements.

The ON RRP facility is intended to help keep the effective federal funds rate within the target range. The facility continued to serve this intended purpose, and the Federal Reserve's administered rates—the interest rate on reserve balances and the ON RRP offering rate—were highly effective at maintaining the effective federal funds rate within the target range as the FOMC tightened the stance of monetary policy.

The Federal Reserve's expenses have continued to exceed its income over recent months. The Federal Reserve's deferred asset increased $82 billion since last June to a level of $152 billion.[4] Negative net income and the associated deferred asset do not affect the Federal Reserve's conduct of monetary policy or its ability to meet its financial obligations.[5]

4. The deferred asset is equal to the cumulative shortfall of net income and represents the amount of future net income that will need to be realized before remittances to the Treasury resume. Although remittances are suspended at the time of this report, over the past decade and a half, the Federal Reserve has remitted over $1 trillion to the Treasury.

5. Net income is expected to turn positive again as interest expenses fall, and remittances will resume once the temporary deferred asset falls to zero. As a result of the ongoing reduction in the size of the Federal Reserve's balance sheet, it is expected that interest expenses will fall over time in line with the decline in the Federal Reserve's liabilities.

Monetary Policy Rules in the Current Environment

As part of their monetary policy deliberations, policymakers regularly consult the prescriptions of a variety of simple interest rate rules without mechanically following the prescriptions of any particular rule. Simple interest rate rules relate a policy interest rate, such as the federal funds rate, to a small number of other economic variables—typically including the current deviation of inflation from its target value and a measure of resource slack in the economy.

Since 2021, inflation has run above the Federal Open Market Committee's (FOMC) 2 percent longer-run objective, and labor market conditions have been tight. Although inflation remains elevated, it has eased considerably over the past year, and labor supply and demand have come into better balance. Against this backdrop, the simple monetary policy rules considered in this discussion have called for elevated levels of the federal funds rate over 2021, 2022, and the first half of 2023, but the rates prescribed by these rules have now declined to values close to the current target range for the federal funds rate at 5¼ to 5½ percent. In support of its goals of maximum employment and inflation at the rate of 2 percent over the longer run, the FOMC has maintained the federal funds rate at 5¼ to 5½ percent since July while continuing to reduce its holdings of Treasury securities and agency debt and agency mortgage-backed securities.

Selected Policy Rules: Descriptions

In many economic models, desirable economic outcomes can be achieved over time if monetary policy responds to changes in economic conditions in a manner that is predictable and adheres to some key design principles. In recognition of this idea, economists have analyzed many monetary policy rules, including the well-known Taylor (1993) rule, the "balanced approach" rule, the "adjusted Taylor (1993)" rule, and the "first difference" rule.[1] Figure A shows these rules, along with a "balanced approach (shortfalls)" rule, which responds to the unemployment rate only when it is higher than its estimated longer-run level.[2] All of the simple rules shown embody key design principles of good monetary policy, including the requirement that the policy rate should be adjusted by enough over time to ensure a return of inflation to the central bank's longer-run objective and to anchor longer-term inflation expectations at levels consistent with that objective.

All five rules feature the difference between inflation and the FOMC's longer-run objective of 2 percent. The five rules use the unemployment rate gap, measured as the difference between an estimate of the rate of unemployment in the longer run (u_t^{LR}) and the current unemployment rate; the first-difference rule includes the change in the unemployment rate gap rather than its level.[3] All but the first-difference rule include an estimate of the neutral real interest rate in the longer run (r_t^{LR}).[4]

(continued on next page)

1. The Taylor (1993) rule was introduced in John B. Taylor (1993), "Discretion versus Policy Rules in Practice," *Carnegie-Rochester Conference Series on Public Policy*, vol. 39 (December), pp. 195–214. The balanced-approach rule was analyzed in John B. Taylor (1999), "A Historical Analysis of Monetary Policy Rules," in John B. Taylor, ed., *Monetary Policy Rules* (Chicago: University of Chicago Press), pp. 319–41. The adjusted Taylor (1993) rule was studied in David Reifschneider and John C. Williams (2000), "Three Lessons for Monetary Policy in a Low-Inflation Era," *Journal of Money, Credit and Banking*, vol. 32 (November), pp. 936–66. The first-difference rule is based on a rule suggested by Athanasios Orphanides (2003), "Historical Monetary Policy Analysis and the Taylor Rule," *Journal of Monetary Economics*, vol. 50 (July), pp. 983–1022. A review of policy rules is provided in John B. Taylor and John C. Williams (2011), "Simple and Robust Rules for Monetary Policy," in Benjamin M. Friedman and Michael Woodford, eds., *Handbook of Monetary Economics*, vol. 3B (Amsterdam: North-Holland), pp. 829–59. The same volume of the *Handbook of Monetary Economics* also discusses approaches to deriving policy rate prescriptions other than through the use of simple rules.

2. The balanced-approach (shortfalls) rule responds asymmetrically to unemployment rates above or below their estimated longer-run value: When unemployment is above that value, the policy rates are identical to those prescribed by the balanced-approach rule, whereas when unemployment is below that value, policy rates do not rise because of further declines in the unemployment rate. As a result, the prescription of the balanced-approach (shortfalls) rule has been less restrictive than that of the balanced-approach rule since 2022:Q1.

3. Implementations of simple rules often use the output gap as a measure of resource slack in the economy. The rules described in figure A instead use the unemployment rate gap because that gap better captures the FOMC's statutory goal to promote maximum employment. Movements in these alternative measures of resource utilization tend to be highly correlated. For more information, see the note below figure A.

4. The neutral real interest rate in the longer run (r_t^{LR}) is the level of the real federal funds rate that is expected to be consistent, in the longer run, with maximum employment and stable inflation. Like u_t^{LR}, r_t^{LR} is determined largely by nonmonetary factors. The first-difference rule shown in figure A does not require an estimate of r_t^{LR}, a feature that is touted by proponents of such rules as providing an element of

Monetary Policy Rules *(continued)*

A. Monetary policy rules

Taylor (1993) rule	$R_t^{T93} = r_t^{LR} + \pi_t + 0.5(\pi_t - \pi^{LR}) + (u_t^{LR} - u_t)$
Balanced-approach rule	$R_t^{BA} = r_t^{LR} + \pi_t + 0.5(\pi_t - \pi^{LR}) + 2(u_t^{LR} - u_t)$
Balanced-approach (shortfalls) rule	$R_t^{BAS} = r_t^{LR} + \pi_t + 0.5(\pi_t - \pi^{LR}) + 2min\{(u_t^{LR} - u_t), 0\}$
Adjusted Taylor (1993) rule	$R_t^{T93adj} = max\{R_t^{T93} - Z_t, \text{ELB}\}$
First-difference rule	$R_t^{FD} = R_{t-1} + 0.5(\pi_t - \pi^{LR}) + (u_t^{LR} - u_t) - (u_{t-4}^{LR} - u_{t-4})$

NOTE: R_t^{T93}, R_t^{BA}, R_t^{BAS}, R_t^{T93adj}, and R_t^{FD} represent the values of the nominal federal funds rate prescribed by the Taylor (1993), balanced-approach, balanced-approach (shortfalls), adjusted Taylor (1993), and first-difference rules, respectively.

R_{t-1} denotes the realized nominal federal funds rate for quarter $t-1$, π_t is the 4-quarter price inflation for quarter t, u_t is the unemployment rate in quarter t, and r_t^{LR} is the level of the neutral real federal funds rate in the longer run that is expected to be consistent with sustaining maximum employment and inflation at the Federal Open Market Committee's 2 percent longer-run objective, π^{LR}. In addition, u_t^{LR} is the rate of unemployment expected in the longer run. Z_t is the cumulative sum of past deviations of the federal funds rate from the prescriptions of the Taylor (1993) rule when that rule prescribes setting the federal funds rate below an effective lower bound (ELB) of 12.5 basis points.

The Taylor (1993) rule and other policy rules are generally written in terms of the deviation of real output from its full capacity level. In these equations, the output gap has been replaced with the gap between the rate of unemployment in the longer run and its actual level (using a relationship known as Okun's law) to represent the rules in terms of the unemployment rate. The rules are implemented as responding to core personal consumption expenditures (PCE) inflation rather than to headline PCE inflation because current and near-term core inflation rates tend to outperform headline inflation rates as predictors of the medium-term behavior of headline inflation. Box note 1 provides references for the policy rules.

Unlike the other simple rules featured here, the adjusted Taylor (1993) rule recognizes that the federal funds rate cannot be reduced materially below the effective lower bound (ELB). By contrast, during the pandemic-induced recession, the standard Taylor (1993) rule prescribed policy rates that were far below zero. To make up for the cumulative shortfall in policy accommodation following a recession during which the federal funds rate is constrained by its ELB, the adjusted Taylor (1993) rule prescribes delaying the return of the policy rate to the (positive) levels prescribed by the standard Taylor (1993) rule until after the economy begins to recover.

Policy Rules: Limitations

As benchmarks for monetary policy, simple policy rules have important limitations. One of these limitations is that the simple policy rules mechanically respond to only a small set of economic variables and thus necessarily abstract from many of the factors that the FOMC considers when it assesses the appropriate setting of the policy rate. In addition, the structure of the economy and current economic conditions differ in important respects from those prevailing when the simple policy rules were originally devised and proposed. As a result, most simple policy rules do not

(continued)

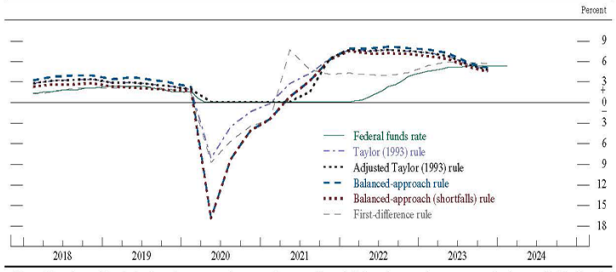
robustness. However, this rule has its own shortcomings. For example, research suggests that this sort of rule often results in greater volatility in employment and inflation than what would be obtained under the Taylor (1993) and balanced-approach rules.

take into account the ELB on interest rates, which limits the extent to which the policy rate can be lowered to support the economy. This constraint was particularly evident during the pandemic-driven recession, when the lower bound on the policy rate motivated the FOMC's other policy actions to support the economy. Relatedly, another limitation is that simple policy rules do not explicitly take into account other important tools of monetary policy, such as balance sheet policies. Finally, simple policy rules are not forward looking and do not allow for important risk-management considerations, associated with uncertainty about economic relationships and the evolution of the economy, that factor into FOMC decisions.

Selected Policy Rules: Prescriptions

Figure B shows historical prescriptions for the federal funds rate under the five simple rules considered. For each quarterly period, the figure reports the policy rates prescribed by the rules, taking as given the prevailing economic conditions and survey-based estimates of u_t^{LR} and r_t^{LR} at the time. All of the rules considered called for a highly accommodative stance of monetary policy in response to the pandemic-driven recession, followed by positive values as inflation picked up and labor market conditions strengthened. In 2022 and during the first half of 2023, the prescriptions of the simple rules for the federal funds rate were between 4 and 8 percent; these values are well above the levels observed before the pandemic and reflect, in large part, elevated inflation readings. Because inflation has eased recently, the policy rates prescribed by these rules have now declined to values that are close to the federal funds rate.

B. Historical federal funds rate prescriptions from simple policy rules



NOTE: The rules use historical values of core personal consumption expenditures inflation, the unemployment rate, and, where applicable, historical values of the midpoint of the target range for the federal funds rate. Quarterly projections of longer-run values for the federal funds rate, the unemployment rate, and inflation used in the computation of the rules' prescriptions are interpolations to quarterly values of projections from the Survey of Primary Dealers. The rules' prescriptions are quarterly, and the federal funds rate data are the monthly average of the daily midpoint of the target range for the federal funds rate and extend through February 2024.

SOURCE: Federal Reserve Bank of Philadelphia; Federal Reserve Bank of New York, Survey of Primary Dealers; Federal Reserve Board staff estimates.

PART 3
SUMMARY OF ECONOMIC PROJECTIONS

The following material was released after the conclusion of the December 12–13, 2023, meeting of the Federal Open Market Committee.

In conjunction with the Federal Open Market Committee (FOMC) meeting held on December 12–13, 2023, meeting participants submitted their projections of the most likely outcomes for real gross domestic product (GDP) growth, the unemployment rate, and inflation for each year from 2023 to 2026 and over the longer run. Each participant's projections were based on information available at the time of the meeting, together with her or his assessment of appropriate monetary policy—including a path for the federal funds rate and its longer-run value—and assumptions about other factors likely to affect economic outcomes. The longer-run projections represent each participant's assessment of the value to which each variable would be expected to converge, over time, under appropriate monetary policy and in the absence of further shocks to the economy. "Appropriate monetary policy" is defined as the future path of policy that each participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her individual interpretation of the statutory mandate to promote maximum employment and price stability.

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, under their individual assumptions of projected appropriate monetary policy, December 2023

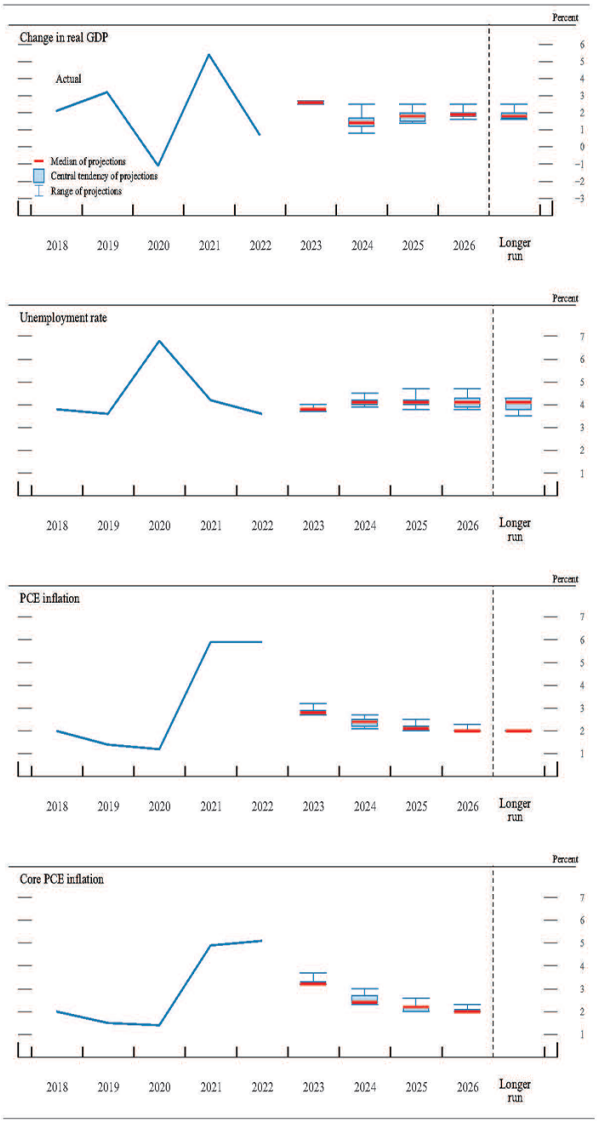
Percent

Variable	Median[1]					Central tendency[2]					Range[3]				
	2023	2024	2025	2026	Longer run	2023	2024	2025	2026	Longer run	2023	2024	2025	2026	Longer run
Change in real GDP	2.6	1.4	1.8	1.9	1.8	2.5–2.7	1.2–1.7	1.5–2.0	1.8–2.0	1.7–2.0	2.5–2.7	0.8–2.5	1.4–2.5	1.6–2.5	1.6–2.5
September projection	2.1	1.5	1.8	1.8	1.8	1.9–2.2	1.2–1.8	1.6–2.0	1.7–2.0	1.7–2.0	1.8–2.6	0.4–2.5	1.4–2.5	1.6–2.5	1.6–2.5
Unemployment rate	3.8	4.1	4.1	4.1	4.1	3.8	4.0–4.2	4.0–4.2	3.9–4.3	3.8–4.3	3.7–4.0	3.9–4.5	3.8–4.7	3.8–4.7	3.5–4.3
September projection	3.8	4.1	4.1	4.0	4.0	3.7–3.9	3.9–4.4	3.9–4.3	3.8–4.3	3.8–4.3	3.7–4.0	3.7–4.5	3.7–4.7	3.7–4.5	3.5–4.3
PCE inflation	2.8	2.4	2.1	2.0	2.0	2.7–2.9	2.2–2.5	2.0–2.2	2.0	2.0	2.7–3.2	2.1–2.7	2.0–2.5	2.0–2.3	2.0
September projection	3.3	2.5	2.2	2.0	2.0	3.2–3.4	2.3–2.7	2.0–2.3	2.0–2.2	2.0	3.1–3.8	2.1–3.5	2.0–2.9	2.0–2.7	2.0
Core PCE inflation[4]	3.2	2.4	2.2	2.0		3.2–3.3	2.4–2.7	2.0–2.2	2.0–2.1		3.2–3.7	2.3–3.0	2.0–2.6	2.0–2.3	
September projection	3.7	2.6	2.3	2.0		3.6–3.9	2.5–2.8	2.0–2.4	2.0–2.3		3.5–4.2	2.3–3.6	2.0–3.0	2.0–2.9	
Memo: Projected appropriate policy path															
Federal funds rate	5.4	4.6	3.6	2.9	2.5	5.4	4.4–4.9	3.1–3.9	2.5–3.1	2.5–3.0	5.4	3.9–5.4	2.4–5.4	2.4–4.9	2.4–3.8
September projection	5.6	5.1	3.9	2.9	2.5	5.4–5.6	4.6–5.4	3.4–4.9	2.5–4.1	2.5–3.3	5.4–5.6	4.4–6.1	2.6–5.6	2.4–4.9	2.4–3.8

NOTE: Projections of change in real gross domestic product (GDP) and projections for both measures of inflation are percent changes from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The projections for the federal funds rate are the value of the midpoint of the projected appropriate target range for the federal funds rate or the projected appropriate target level for the federal funds rate at the end of the specified calendar year or over the longer run. The September projections were made in conjunction with the meeting of the Federal Open Market Committee on September 19–20, 2023. One participant did not submit longer-run projections for the change in real GDP, the unemployment rate, or the federal funds rate in conjunction with the September 19–20, 2023, meeting, and one participant did not submit such projections in conjunction with the December 12–13, 2023, meeting.

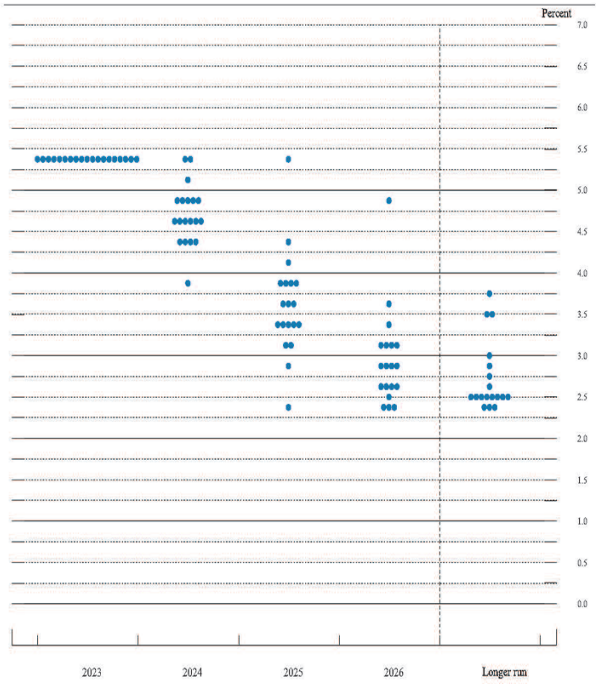
1. For each period, the median is the middle projection when the projections are arranged from lowest to highest. When the number of projections is even, the median is the average of the two middle projections.
2. The central tendency excludes the three highest and three lowest projections for each variable in each year.
3. The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.
4. Longer-run projections for core PCE inflation are not collected.

Figure 1. Medians, central tendencies, and ranges of economic projections, 2023–26 and over the longer run



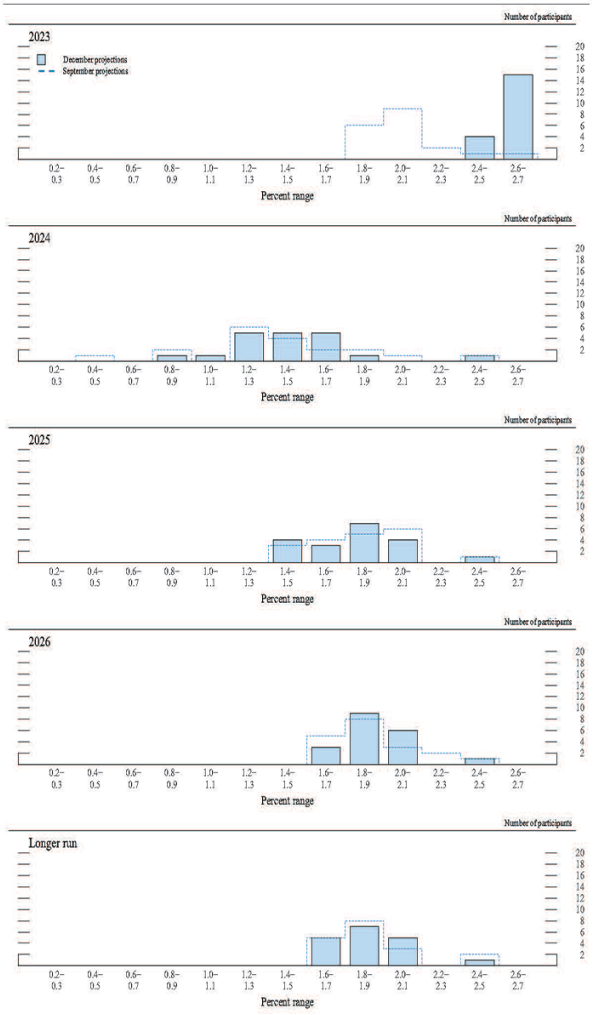
NOTE: Definitions of variables and other explanations are in the notes to table 1. The data for the actual values of the variables are annual.

Figure 2. FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate



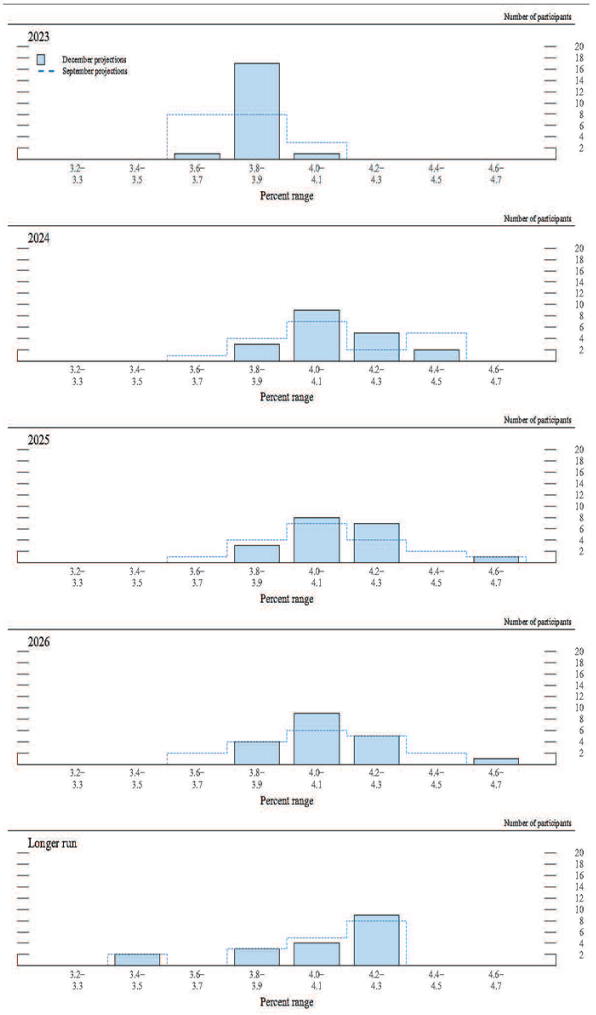
NOTE: Each shaded circle indicates the value (rounded to the nearest 1/8 percentage point) of an individual participant's judgment of the midpoint of the appropriate target range for the federal funds rate or the appropriate target level for the federal funds rate at the end of the specified calendar year or over the longer run. One participant did not submit longer-run projections for the federal funds rate.

Figure 3.A. Distribution of participants' projections for the change in real GDP, 2023–26 and over the longer run



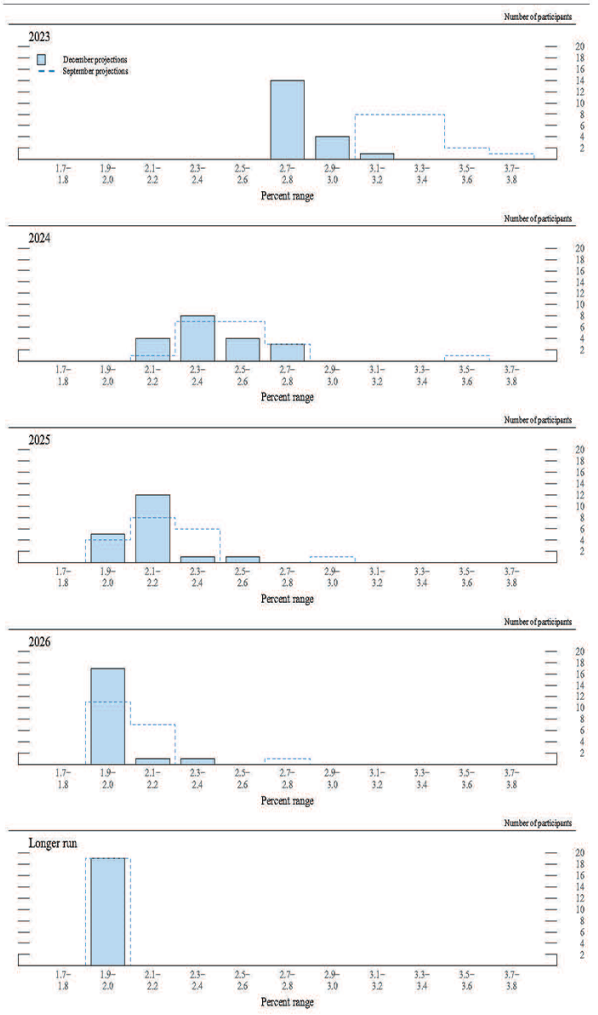
NOTE: Definitions of variables and other explanations are in the notes to table 1.

Figure 3.B. Distribution of participants' projections for the unemployment rate, 2023–26 and over the longer run



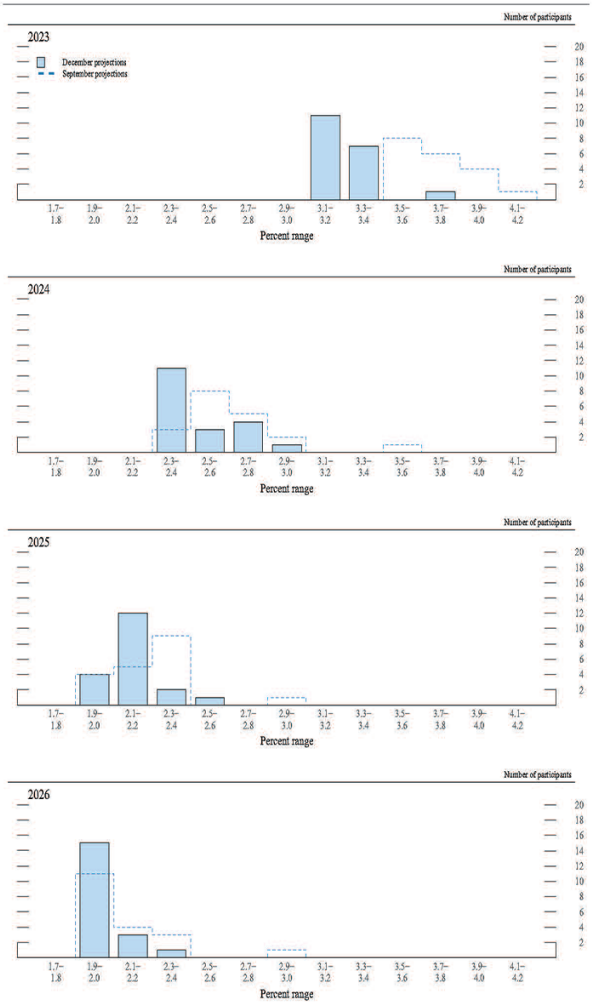
NOTE: Definitions of variables and other explanations are in the notes to table 1.

Figure 3.C. Distribution of participants' projections for PCE inflation, 2023–26 and over the longer run



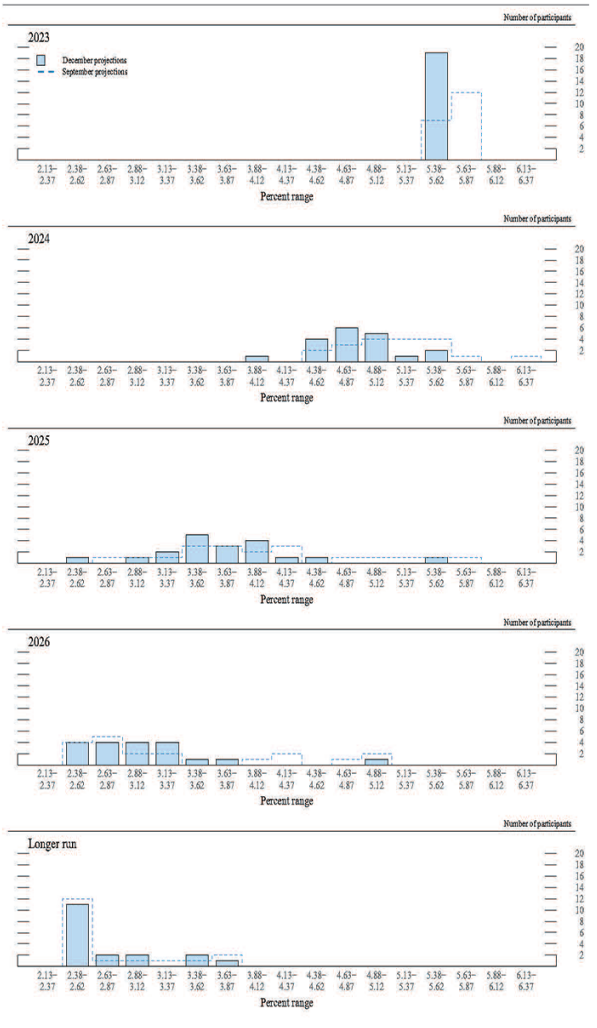
Note: Definitions of variables and other explanations are in the notes to table 1.

Figure 3.D. Distribution of participants' projections for core PCE inflation, 2023–26



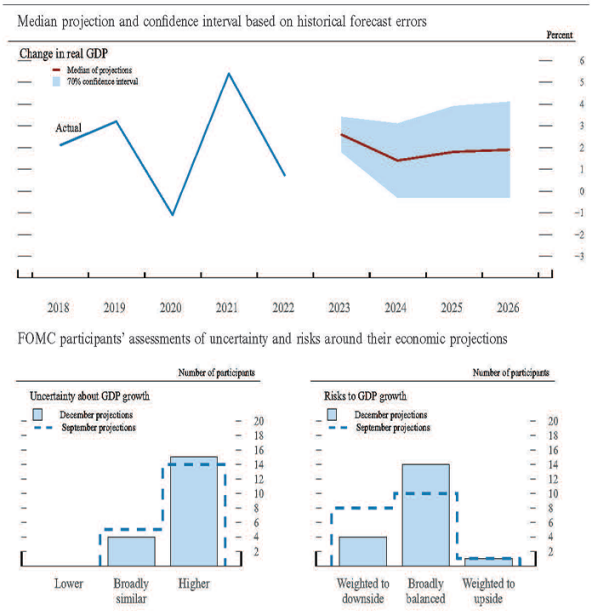
NOTE: Definitions of variables and other explanations are in the notes to table 1.

Figure 3.E. Distribution of participants' judgments of the midpoint of the appropriate target range for the federal funds rate or the appropriate target level for the federal funds rate, 2023–26 and over the longer run



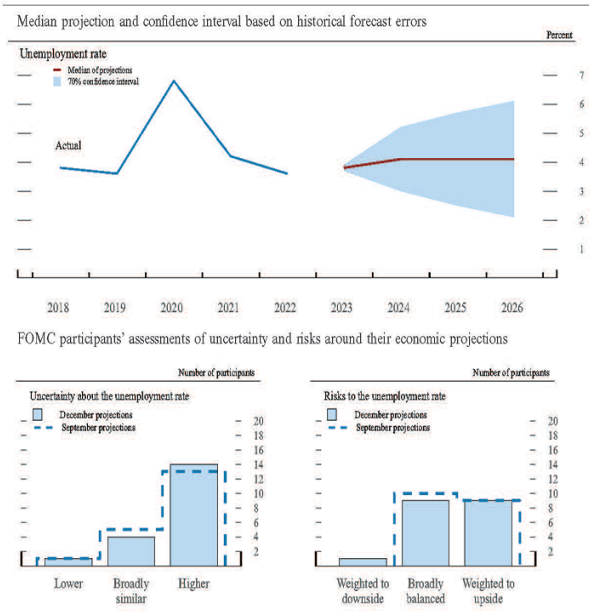
Note: Definitions of variables and other explanations are in the notes to table 1.

Figure 4.A. Uncertainty and risks in projections of GDP growth



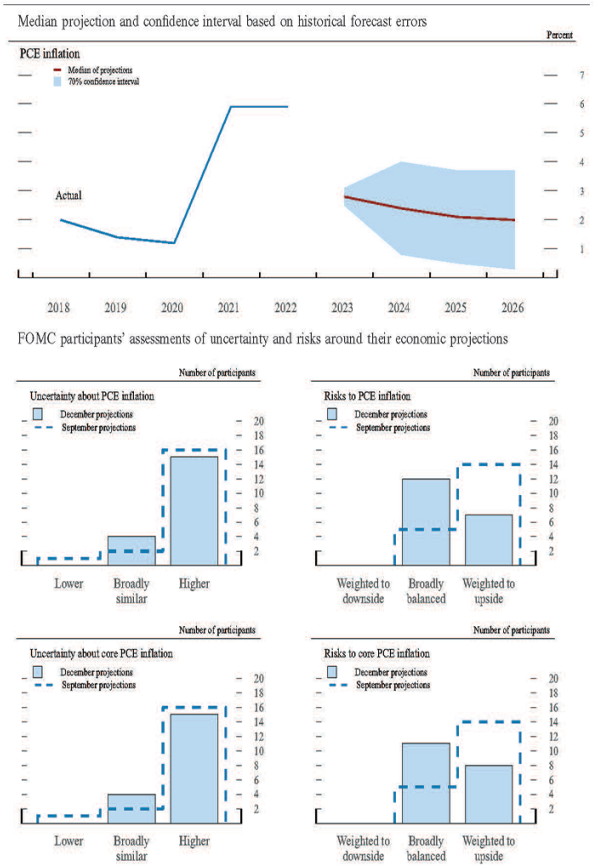
NOTE: The blue and red lines in the top panel show actual values and median projected values, respectively, of the percent change in real gross domestic product (GDP) from the fourth quarter of the previous year to the fourth quarter of the year indicated. The confidence interval around the median projected values is assumed to be symmetric and is based on root mean squared errors of various private and government forecasts made over the previous 20 years; more information about these data is available in table 2. Because current conditions may differ from those that prevailed, on average, over the previous 20 years, the width and shape of the confidence interval estimated on the basis of the historical forecast errors may not reflect FOMC participants' current assessments of the uncertainty and risks around their projections; these current assessments are summarized in the lower panels. Generally speaking, participants who judge the uncertainty about their projections as "broadly similar" to the average levels of the past 20 years would view the width of the confidence interval shown in the historical fan chart as largely consistent with their assessments of the uncertainty about their projections. Likewise, participants who judge the risks to their projections as "broadly balanced" would view the confidence interval around their projections as approximately symmetric. For definitions of uncertainty and risks in economic projections, see the box "Forecast Uncertainty."

Figure 4.B. Uncertainty and risks in projections of the unemployment rate



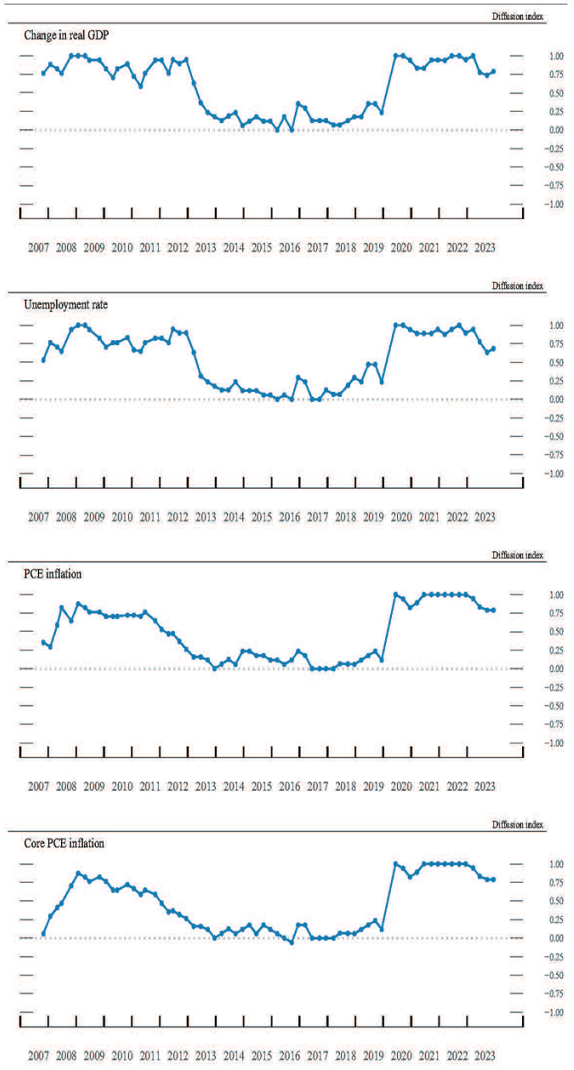
NOTE: The blue and red lines in the top panel show actual values and median projected values, respectively, of the average civilian unemployment rate in the fourth quarter of the year indicated. The confidence interval around the median projected values is assumed to be symmetric and is based on root mean squared errors of various private and government forecasts made over the previous 20 years; more information about these data is available in table 2. Because current conditions may differ from those that prevailed, on average, over the previous 20 years, the width and shape of the confidence interval estimated on the basis of the historical forecast errors may not reflect FOMC participants' current assessments of the uncertainty and risks around their projections; these current assessments are summarized in the lower panels. Generally speaking, participants who judge the uncertainty about their projections as "broadly similar" to the average levels of the past 20 years would view the width of the confidence interval shown in the historical fan chart as largely consistent with their assessments of the uncertainty about their projections. Likewise, participants who judge the risks to their projections as "broadly balanced" would view the confidence interval around their projections as approximately symmetric. For definitions of uncertainty and risks in economic projections, see the box "Forecast Uncertainty."

Figure 4.C. Uncertainty and risks in projections of PCE inflation



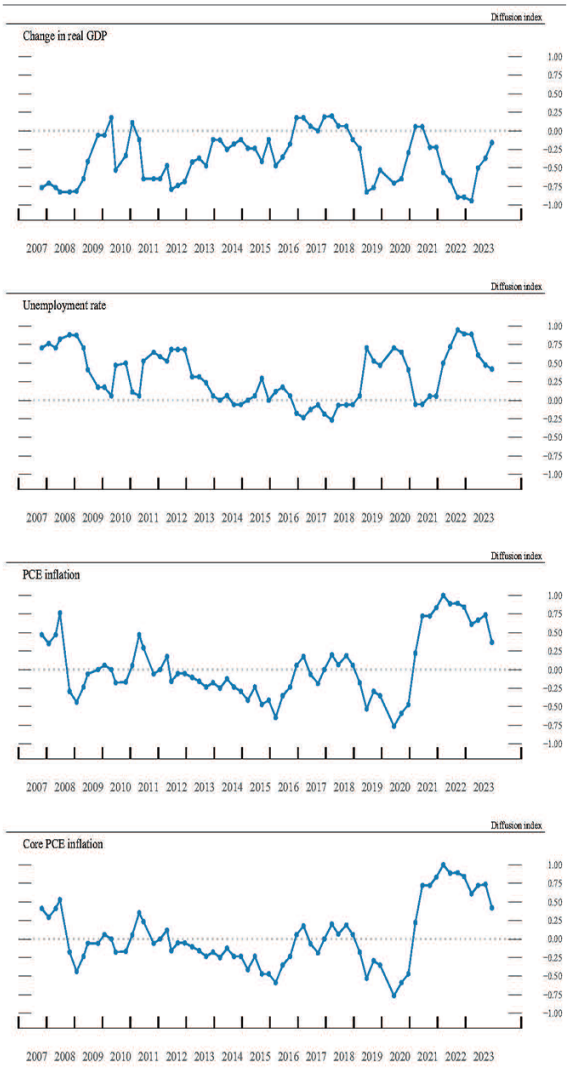
NOTE: The blue and red lines in the top panel show actual values and median projected values, respectively, of the percent change in the price index for personal consumption expenditures (PCE) from the fourth quarter of the previous year to the fourth quarter of the year indicated. The confidence interval around the median projected values is assumed to be symmetric and is based on root mean squared errors of various private and government forecasts made over the previous 20 years; more information about these data is available in table 2. Because current conditions may differ from those that prevailed, on average, over the previous 20 years, the width and shape of the confidence interval estimated on the basis of the historical forecast errors may not reflect FOMC participants' current assessments of the uncertainty and risks around their projections; these current assessments are summarized in the lower panels. Generally speaking, participants who judge the uncertainty about their projections as "broadly similar" to the average levels of the past 20 years would view the width of the confidence interval shown in the historical fan chart as largely consistent with their assessments of the uncertainty about their projections. Likewise, participants who judge the risks to their projections as "broadly balanced" would view the confidence interval around their projections as approximately symmetric. For definitions of uncertainty and risks in economic projections, see the box "Forecast Uncertainty."

Figure 4.D. Diffusion indexes of participants' uncertainty assessments



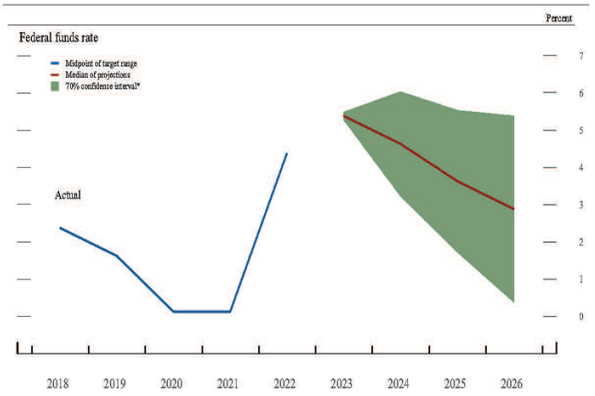
NOTE: For each SEP, participants provided responses to the question "Please indicate your judgment of the uncertainty attached to your projections relative to the levels of uncertainty over the past 20 years." Each point in the diffusion indexes represents the number of participants who responded "Higher" minus the number who responded "Lower," divided by the total number of participants. Figure excludes March 2020 when no projections were submitted.

Figure 4.E. Diffusion indexes of participants' risk weightings



NOTE: For each SEP, participants provided responses to the question "Please indicate your judgment of the risk weighting around your projections." Each point in the diffusion indexes represents the number of participants who responded "Weighted to the Upside" minus the number who responded "Weighted to the Downside," divided by the total number of participants. Figure excludes March 2020 when no projections were submitted.

Figure 5. Uncertainty and risks in projections of the federal funds rate



NOTE: The blue and red lines are based on actual values and median projected values, respectively, of the Committee's target for the federal funds rate at the end of the year indicated. The actual values are the midpoint of the target range; the median projected values are based on either the midpoint of the target range or the target level. The confidence interval around the median projected values is based on root mean squared errors of various private and government forecasts made over the previous 20 years. The confidence interval is not strictly consistent with the projections for the federal funds rate, primarily because these projections are not forecasts of the likeliest outcomes for the federal funds rate, but rather projections of participants' individual assessments of appropriate monetary policy. Still, historical forecast errors provide a broad sense of the uncertainty around the future path of the federal funds rate generated by the uncertainty about the macroeconomic variables as well as additional adjustments to monetary policy that may be appropriate to offset the effects of shocks to the economy.

The confidence interval is assumed to be symmetric except when it is truncated at zero - the bottom of the lowest target range for the federal funds rate that has been adopted in the past by the Committee. This truncation would not be intended to indicate the likelihood of the use of negative interest rates to provide additional monetary policy accommodation if doing so was judged appropriate. In such situations, the Committee could also employ other tools, including forward guidance and large-scale asset purchases, to provide additional accommodation. Because current conditions may differ from those that prevailed, on average, over the previous 20 years, the width and shape of the confidence interval estimated on the basis of the historical forecast errors may not reflect FOMC participants' current assessments of the uncertainty and risks around their projections.

* The confidence interval is derived from forecasts of the average level of short-term interest rates in the fourth quarter of the year indicated; more information about these data is available in table 2. The shaded area encompasses less than a 70 percent confidence interval if the confidence interval has been truncated at zero.

Table 2. Average historical projection error ranges
Percentage points

Variable	2023	2024	2025	2026
Change in real GDP[1]	±0.8	±1.7	±2.1	±2.2
Unemployment rate[1]	±0.1	±1.1	±1.6	±2.0
Total consumer prices[2]	±0.3	±1.6	±1.6	±1.7
Short-term interest rates[3]	±0.1	±1.4	±1.9	±2.5

NOTE: Error ranges shown are measured as plus or minus the root mean squared error of projections for 2003 through 2022 that were released in the winter by various private and government forecasters. As described in the box "Forecast Uncertainty," under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, consumer prices, and the federal funds rate will be in ranges implied by the average size of projection errors made in the past. For more information, see David Reifschneider and Peter Tulip (2017), "Gauging the Uncertainty of the Economic Outlook Using Historical Forecasting Errors: The Federal Reserve's Approach," Finance and Economics Discussion Series 2017-020 (Washington: Board of Governors of the Federal Reserve System, February), https://dx.doi.org/10.17016/FEDS.2017.020.

1. Definitions of variables are in the general note to table 1.
2. Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projections are percent changes on a fourth quarter to fourth quarter basis
3. For Federal Reserve staff forecasts, measure is the federal funds rate. For other forecasts, measure is the rate on 3-month Treasury bills. Projection errors are calculated using average levels, in percent, in the fourth quarter.

Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks inform discussions of monetary policy among policymakers and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world, and the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past *Monetary Policy Reports* and those prepared by the Federal Reserve Board's staff in advance of meetings of the Federal Open Market Committee (FOMC). The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real gross domestic product (GDP) and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 would imply a probability of about 70 percent that actual GDP would expand within a range of 2.2 to 3.8 percent in the current year, 1.3 to 4.7 percent in the second year, 0.9 to 5.1 percent in the third year, and 0.8 to 5.2 percent in the fourth year. The corresponding 70 percent confidence intervals for overall inflation would be 1.7 to 2.3 percent in the current year, 0.4 to 3.6 percent in the second and third years, and 0.3 to 3.7 percent in the fourth year. Figures 4.A through 4.C illustrate these confidence bounds in "fan charts" that are symmetric and centered on the medians of FOMC participants' projections for GDP growth, the unemployment rate, and inflation. However, in some instances, the risks around the projections may not be symmetric. In particular, the unemployment rate cannot be negative; furthermore, the risks around a particular projection might be tilted to either the upside or the downside, in which case the corresponding fan chart would be asymmetrically positioned around the median projection.

Because current conditions may differ from those that prevailed, on average, over history, participants provide judgments as to whether the uncertainty attached to their projections of each economic variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty seen in the past 20 years, as presented in table 2 and reflected in the widths of the confidence intervals shown in the top panels of figures 4.A through 4.C. Participants' current assessments of the uncertainty surrounding their projections are summarized in the bottom-left panels

(continued)

of those figures. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, are weighted to the downside, or are broadly balanced. That is, while the symmetric historical fan charts shown in the top panels of figures 4.A through 4.C imply that the risks to participants' projections are balanced, participants may judge that there is a greater risk that a given variable will be above rather than below their projections. These judgments are summarized in the lower-right panels of figures 4.A through 4.C.

As with real activity and inflation, the outlook for the future path of the federal funds rate is subject to considerable uncertainty. This uncertainty arises primarily because each participant's assessment of the appropriate stance of monetary policy depends importantly on the evolution of real activity and inflation over time. If economic conditions evolve in an unexpected manner, then assessments of the appropriate setting of the federal funds rate would change from that point forward. The final line in table 2 shows the error ranges for forecasts of short-term interest rates. They suggest that the historical confidence intervals associated with projections of the federal funds rate are quite wide. It should be noted, however, that these confidence intervals are not strictly consistent with the projections for the federal funds rate, as these projections are not forecasts of the most likely quarterly outcomes but rather are projections of participants' individual assessments of appropriate monetary policy and are on an end-of-year basis. However, the forecast errors should provide a sense of the uncertainty around the future path of the federal funds rate generated by the uncertainty about the macroeconomic variables as well as additional adjustments to monetary policy that would be appropriate to offset the effects of shocks to the economy.

If at some point in the future the confidence interval around the federal funds rate were to extend below zero, it would be truncated at zero for purposes of the fan chart shown in figure 5; zero is the bottom of the lowest target range for the federal funds rate that has been adopted by the Committee in the past. This approach to the construction of the federal funds rate fan chart would be merely a convention; it would not have any implications for possible future policy decisions regarding the use of negative interest rates to provide additional monetary policy accommodation if doing so were appropriate. In such situations, the Committee could also employ other tools, including forward guidance and asset purchases, to provide additional accommodation.

While figures 4.A through 4.C provide information on the uncertainty around the economic projections, figure 1 provides information on the range of views across FOMC participants. A comparison of figure 1 with figures 4.A through 4.C shows that the dispersion of the projections across participants is much smaller than the average forecast errors over the past 20 years.

Abbreviations

AFE	advanced foreign economy
BTFP	Bank Term Funding Program
COVID-19	coronavirus disease 2019
CRE	commercial real estate
DI	depository institution
ELB	effective lower bound
EME	emerging market economy
EPOP ratio	employment-to-population ratio
FDIC	Federal Deposit Insurance Corporation
FOMC	Federal Open Market Committee; also, the Committee
GDI	gross domestic income
GDP	gross domestic product
JOLTS	Job Openings and Labor Turnover Survey
MBS	mortgage-backed securities
MMF	money market fund
ON RRP	overnight reverse repurchase agreement
OPEC	Organization of the Petroleum Exporting Countries
PCE	personal consumption expenditures
repo	repurchase agreement
SOMA	System Open Market Account
S&P	Standard & Poor's
VIX	implied volatility for the S&P 500 index

America's Credit Unions

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March 7, 2024

The Honorable Sherrod Brown
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Tim Scott
Ranking Member
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, DC 20510

Re: Today's Hearing: "The Semiannual Monetary Policy Report to the Congress"

Dear Chairman Brown and Ranking Member Scott:

On behalf of America's Credit Unions, I am writing regarding the Committee's hearing entitled, "The Semiannual Monetary Policy Report to the Congress." America's Credit Unions is the voice of consumers' best option for financial services: credit unions. We advocate for policies that allow the industry to effectively meet the needs of their nearly 140 million members nationwide.

Regulation II

America's Credit Unions strongly opposes the Federal Reserve Board's (the Board) recently proposed rule to drastically reduce the Regulation II (Reg II) debit interchange fee cap. First and foremost, the Board's contention that the statutory text of the Durbin Amendment mandates that they proceed with this rulemaking is false. There is no trigger that requires reconsideration of the cap; instead, the text directed the Board to establish a cap that was "reasonable and proportional" to the costs of the issuer. In 2011, the Board determined that the cap met this standard even though only 80 percent of covered debit card issuers would see cost recovery for their authorization, clearance, and settlement (ACS) costs—the largest banks. As of the Board's last data collection, only 77.4 percent of debit card issuers are experiencing full recovery of ACS costs—again leaving high-cost, low-volume issuers, including many credit unions, operating at a deficit. If anything, this data suggests the debit interchange cap should be raised, not lowered, to ensure community-based financial institutions are able to continue providing needed products and services to consumers.

Any Board action should be based on robust, thorough, and accurate data that reflects market realities for all covered issuers. The Board's proposal is based on data from 2021 that does not account for the far-reaching changes to Reg II requiring dual routing for card-not-present transactions that went into effect on July 1, 2023. This change has direct bearing on the data used to calculate the proposed interchange fee cap including the aforementioned ACS costs that are central to the justification for drastically reducing the cap. The impact of the new routing requirements is undetermined and must be quantified before proceeding with any additional rulemaking impacting this regulation. It is insufficient to simply review the Board's biennial

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survey of large debit card issuers to assess the impact of the new routing requirement because it applies to all issuers, not just covered issuers with $10 billion or more in total assets. That data, from 2021, was collected well before the rule was finalized in 2022, let alone became effective in July of 2023.

Regulation II has caused significant real-world economic harm to credit unions and their members—and its recent proposed expansion by the Board is only compounding that harm. The Durbin Amendment's "exemption" of smaller financial institutions has proven to be largely illusory, as the Federal Reserve's own data shows that regulatory thresholds in the interchange market do not insulate smaller issuers from harm. Specifically, Reg II data indicates that the average per transaction interchange fee for exempt single-message transactions has fallen by nearly 31 percent in inflation-adjusted dollars from 2011 to 2021.

We echo Governor Bowman's concerns raised at the Board's October 25th meeting regarding the unfair nature of this proposal and the Board's reluctance to consider the impacts that such a drastic reduction could have on smaller issuers, including community-based financial institutions like credit unions. The biggest impact is likely to be on low- and moderate-income (LMI) individuals and families, as this reduced interchange fee cap could lead to higher borrowing costs and limited availability or complete discontinuation of certain products and services that are designed to help these LMI borrowers and their families. A Government Accountability Office (GAO) study ranked the Durbin Amendment "among the top five laws and regulations most cited...as having significantly affected the cost and availability of basic banking services." It further concluded that the regulation was associated with increases in the costs of checking accounts and a decrease in the availability of noninterest checking accounts without monthly fees. The NCAAP raised concerns at the time of implementation that debit card interchange would disproportionately affect at-risk communities by limiting the availability of banking services, and we have seen that play out since enactment. The adoption of Regulation II in 2011 brought a significant decrease in the availability of free checking and an increase in other fees and costs by financial institutions to make up for lost revenue. These negative effects could only be amplified by a further reduction in the debit interchange fee cap that will once again force financial institutions to make up for this lost revenue in other areas. This impact is acute for credit unions as not-for-profit cooperatives that do not have the same opportunities to raise capital as banks. Studies estimate that as a result of the Durbin Amendment, there was a transfer of $1 to $3 billion annually from low-income households to large retailers and their shareholders, the primary beneficiaries of interchange regulations.

Additionally, the Board's Cost Benefit Analysis of the proposed rule is riddled with inaccuracies. The Board asserts that consumers will likely benefit from cost savings passed through by merchants as a result of lower prices. The Federal Reserve's own research shows that only about one percent of merchants passed their savings onto consumers through reduced prices following the adoption of the Durbin Amendment, and in fact, over 20 percent of merchants increased their prices. This behavior will not change with further cuts.

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There have been little to no consumer savings that the proponents of the Durbin Amendment promised would happen. This proposed rule from the Board would only further exacerbate the difficulties imposed by this misguided law. Most importantly, it is not just covered issuers that would feel the impacts of this proposal, but rather all financial institutions would face pricing pressures and be forced to make difficult decisions that could negatively impact the communities they serve.

Central Bank Digital Currency (CBDC)

We would also like the opportunity to express our opposition to the creation of a central bank digital currency (CBDC) The creation of a central bank digital currency (CBDC) would represent a fundamental transformation of banking and payments and poses serious risks to consumers and the financial system. The creation of a CBDC deserves serious and exacting consideration that includes a focused enunciation of the issues Congress and the Federal Reserve would intend to solve through a CBDC that are singular and unique to the digital currency, novel and not duplicative of current innovations in the marketplace, and that do not worsen the provision of financial services for consumers or credit unions.

The consideration of a CBDC must proceed with several cornerstone principles. First, implementation of a CBDC should not proceed without congressional authorization and a clear structure and novel purpose. Second, any CBDC must utilize an intermediated model that preserves the direct relationship between consumers and financial institutions. This intermediation is necessary to ensure effective implementation of Anti-Money Laundering/ Combatting the Financing of Terrorism standards. Third, deposit substitution and its cascading effects must be sufficiently mitigated as to prevent reduction of the credit supply, to maintain affordable credit, and to ensure the safety and soundness of the financial system and overall economy.

At this time, any potential advantages of a CBDC are not worth the risks including financial stability, consumer privacy, misallocation of Federal Reserve resources, and government intrusion into banking services traditionally provided by the private sector.

Operation of the Federal Reserve's Overnight Reverse Repo Facility (ON RRP)

America's Credit Unions is concerned that the current rate offered by the Federal Reserve's Overnight Reverse Repo Facility (ON RRP) is draining deposits from credit unions. While the ON RRP was created to solve a problem during the 2007-2009 financial crisis, the ON RRP interest rate continues to attract money market funds. This form of subsidization for uninsured depositors allows money market funds to offer higher rates than the market would ordinarily support and continues to place pressure on credit union liquidity.

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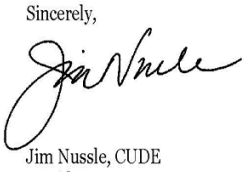
In Conclusion

On behalf of America's Credit Unions and their more than 140 million members, thank you for holding this important hearing. It is critical that the Committee understand the immense pressure credit unions—large and small—are under in terms of compliance and operational challenges.

Unlike other sectors of the financial services industry, credit unions embody the collaborative, people helping people philosophy. As such, we urge this Committee and regulators to work with the credit union industry to pursue an approach, both legislatively and regulatorily, aimed at ensuring credit unions can continue to serve their millions of members across the country.

Sincerely,



Jim Nussle, CUDE
President & CEO

cc: Members of the Committee on Banking, Housing, and Urban Affairs

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United States Senate

WASHINGTON, DC 20510

March 7, 2024

The Honorable Jerome Powell
Chair
Board of Governors of the Federal Reserve System
2051 Constitution Avenue NW
Washington, D.C. 20418

The Honorable Martin Gruenberg
Chair
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429

The Honorable Michael Hsu
Acting Comptroller
Office of the Comptroller of the Currency
400 7th St SW
Washington, D.C. 20219

Dear Chair Powell, Chair Gruenberg, and Acting Comptroller Hsu:

We write to express our concerns that the proposed rule issued jointly by the Federal Reserve, Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) to implement the Basel III Endgame (the "U.S. proposal") would significantly diverge from the international standards agreed upon by the Basel Committee in 2017 and the ongoing implementation of those standards in key non-U.S. jurisdictions. The U.S. proposal could lower credit availability for U.S. businesses and households, reduce market liquidity, and drive retail lending out of the banking system. Moreover, per the Federal Reserve's own findings, U.S. global systemically important banks (G-SIBs) are already sufficiently capitalized.[1] We fear the U.S. proposal could make U.S. banks less competitive and increased costs will be passed onto the consumer, without offsetting increases in consumer protection.

The U.S. proposal is the most complex and broadly impactful bank regulatory proposal we have seen in the last decade, affecting all bank products and services, and ultimately touching every household and business across the country. At a time when the Federal Reserve has indicated credit is tightening,[2] and economic and global conditions are volatile, we are concerned that the differing global implementation of Basel III will disincentivize and diminish lending in the United States by U.S. banks and reduce America's economic prosperity, while also promoting investment in foreign banks and in nonbank lenders where regulatory requirements are less stringent.

Unequal Capital Treatment of U.S. Banks

[1] *See* Federal Reserve, Financial Stability Report (May 2023), *available at* https://www.federalreserve.gov/publications/files/financial-stability-report-20230508.pdf

[2] *See* Federal Reserve, Senior Loan Officer Opinion Survey on Bank Lending Practices (July 31, 2023), *available at* https://www.federalreserve.gov/data/sloos/sloos-202307.htm.

The excessive requirements of the U.S. proposal could exacerbate the existing stringency of the U.S. bank capital framework relative to non-U.S. jurisdictions. As noted by Andrea Enria, Supervisory Chair of the European Central Bank (ECB), the current U.S. bank capital framework requirements are "significantly higher" than those required for equivalent European G-SIBs.[3] The U.S. proposal would further widen this gap between U.S. G-SIBs and non-U.S. G-SIBs. Enria explained:

> *The regulatory treatment [of G-SIBs] is, however, more demanding in the U.S., due to a host of gold plating choices . . . than is specified in the Basel standards. All this makes the overall capital requirements for G-SIBs higher, on average, in the U.S. than in the E.U.*[4]

U.S. implementation of the Basel III capital standards are already more stringent than those of the European Union, including higher capital standards and mandatory stress testing on capital payouts. As a result, U.S. banks already hold more capital currently than the European banks will likely hold after they have completed Basel III Endgame implementation. This unaligned capital treatment would only increase after the full implementation of the U.S. proposal, with U.S. banks required to hold significantly more capital than their European counterparts.

Loans Become More Expensive; Riskier Institutions May Benefit

In addition to the fact that the U.S. proposal will drive investment overseas, it could, concerningly, make it more expensive for American consumers and small businesses to obtain a loan from a bank. The U.S. proposal requires banks to hold more capital than what would be required by what was agreed to by the Basel Committee in 2017 for some mortgages. Banks will pass on the additional costs and expenses to borrowers, making it more affordable for some borrowers to obtain mortgages from lenders that are not banks.[5] The same is true for other products that Americans rely on to make large purchases, manage unexpected expenses, and grow their family farms and businesses. "Since the late 1990s, nearly 60 percent of total credit" has been extended by lenders outside the banking system that are not subject to the same regulation as banks.[6] While some non-bank lending institutions are regulated as closely as banks, others are not and consumers should not need to understand the differences in capital standards

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[3] *See* European Central Bank, "Banking supervision beyond capital," Speech by Andrea Enria, Chair of the Supervisory Board of the ECB, at the EUROFI 2023 Financial Forum organised in association with the Spanish Presidency of the Council of the EU, (Sept. 14, 2023), *available at* https://www.bankingsupervision.europa.eu/press/speeches/date/2023/html/ssm.sp230914~c6c0be0cc6.en.html.

[4] *See* European Central Bank, "The integration of the EU banking sector and the challenges of global competition," Contribution by Andrea Enria, Chair of the Supervisory Board of the ECB, for VIEWS, The EUROFI Magazine (Sept. 2023), *available at* https://www.bankingsupervision.europa.eu/press/interviews/date/2023/html/ssm.in230913~d990592ae3.en.html.

[5] *See* The Urban Institute, "Bank Capital Notice of Proposed Rulemaking: A Look at the Provisions Affecting Mortgage Loans in Bank Portfolios" by Laurie Goodman and Jun Zhu *available at* https://www.urban.org/sites/default/files/2023-09/Bank%20Capital%20Notice%20of%20Proposed%20Rulemaking.pdf

[6] *See* Federal Reserve, "Understanding Bank and Nonbank Credit Cycles: A Structural Exploration," report by C. Bora Durdu and Molin Zhong, (March 2019), *available at* https://www.federalreserve.gov/econres/feds/files/2019031pap.pdf.

and regulatory regimes to evaluate loan offers. Should the U.S. proposal be finalized as written, we fear credit will further migrate away from banks and consumers may end up relying more on less regulated or less transparent sources of financing.

Negative Impacts for Under-Represented Communities

Moreover, a flight to nonbank lending would only raise the barrier to entry for communities without generational wealth, particularly minority and immigrant communities, that want to open a small business or purchase their first homes. A March 2023 study by the National Association of Realtors showed that the rate of Black American homeownership was 29 percentage points less than White Americans, "the largest Black-White homeownership gap in a decade."[7]

In a letter to the Federal Reserve, FDIC, and OCC, the NAACP, National Association of Realtors, and other housing and civil rights groups relayed their concerns regarding the U.S. proposal's requirement to increase capital standards on certain mortgages with down payments of less than 20 percent. In their opinion, should the U.S. proposal be finalized, "they will have a devastating impact on our efforts to increase Black homeownership and disadvantage all first-time, and, in particular, first-generation homebuyers who do not have the benefit of multi-generational wealth or higher than average incomes."[8]

Conclusion

Due to the risk of significant negative effects on consumer lending in the United States, as well as the unequal capital treatment of U.S. banks that may push investment overseas, we urge you to consider these unintended consequences of proposed implementation of the Basel III Endgame. We look forward to engaging with you further on this issue in the future.

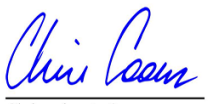
Sincerely,

Kirsten Gillibrand
United States Senator

Cynthia M. Lummis
United States Senator

[7] *See* National Association of Realtors, "More Americans Own Their Homes, but Black-White Homeownership Rate Gap is Biggest in a Decade, NAR Report Finds," (March 2, 2023), *available at* https://www.nar.realtor/newsroom/more-americans-own-their-homes-but-black-white-homeownership-rate-gap-is-biggest-in-a-decade-nar.

[8] *See* National Housing Conference, "Housing Groups Letter re Bank Capital 7.25.23," (July 2023) *available at* https://nhc.org/wp-content/uploads/2023/07/Housing-Groups-Letter-re-Bank-Capital-7.25.23.pdf.



Christopher A. Coons
United States Senator

Thom Tillis
United States Senator