

## Michelle W Bowman: The economy and bank supervision

Remarks by Ms Michelle W Bowman, Member of the Board of Governors of the Federal Reserve System, at the Florida Bankers Association Leadership Luncheon events, Miami, Florida, 10 January 2023.

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Thank you, Bill, and I'd also like to thank Alex Sanchez and the Florida Bankers Association for the invitation to be with you today. It is a pleasure to be here in person to discuss issues that are top of mind for all of us as we begin the new year. I will start with some thoughts about the Federal Reserve's ongoing effort to lower inflation, which continues to be much too high. I will then touch on other issues in the Fed's purview, including bank supervision and regulation.<sup>1</sup>

While the Fed has access to a staff of expert economists and a seemingly infinite flow of economic data to inform our decision-making, I often find that the most valuable data comes directly from the experiences and perspectives of those who are engaged in and supporting the economy through the financial system. In my more than four years as a member of the Board of Governors and the Federal Open Market Committee (FOMC), I have learned that there are few who understand the economy more directly than bankers, business owners and the customers you serve.

### Monetary Policy

Let me begin by discussing the Fed's efforts to lower inflation. Inflation is much too high, and I am focused on bringing it down toward our 2 percent goal. Inflation affects everyone, but it is especially harmful to lower- and middle-income Americans, who spend a greater share of their income on necessities like food and housing. Stable prices are the bedrock of a healthy economy and are necessary to support a labor market that works for all Americans.

Over the past year, I have supported the FOMC's policy actions to address high inflation, and I am committed to taking further actions to bring inflation back down to our goal. Since last March, the FOMC has been tightening monetary policy through a combination of increasing the federal funds rate by 4-1/4 percentage points and reducing our balance sheet holdings.

In recent months, we've seen a decline in some measures of inflation but we have a lot more work to do, so I expect the FOMC will continue raising interest rates to tighten monetary policy, as we stated after our December meeting.<sup>2</sup> My views on the appropriate size of future rate increases and on the ultimate level of the federal funds rate will continue to be guided by the incoming data and its implications for the outlook for inflation and economic activity.

I will be looking for compelling signs that inflation has peaked and for more consistent indications that inflation is on a downward path, in determining both the appropriate size of future rate increases and the level at which the federal funds rate is sufficiently restrictive. I expect that once we achieve a sufficiently restrictive federal funds rate, it

will need to remain at that level for some time in order to restore price stability, which will in turn help to create conditions that support a sustainably strong labor market. Maintaining a steadfast commitment to restoring price stability is essential to support a sustainably strong labor market.

To this point, unemployment has remained low as we have tightened monetary policy and made progress in lowering inflation. I take this as a hopeful sign that we can succeed in lowering inflation without a significant economic downturn. It is likely that as a part of this process, labor markets will soften somewhat before we bring inflation back to our 2 percent goal. While the effects of monetary policy tightening on the job market have generally been limited so far, slowing the economy will likely mean that job creation also slows. And if there are unforeseen shocks to the economy, growth may slow further. It's important to keep in mind that there are costs and risks to tightening policy to lower inflation, but I see the costs and risks of allowing inflation to persist as far greater. These dynamics make the difficult decisions facing the FOMC even more challenging, but it is absolutely necessary that the Committee achieves our goal of price stability.

From the late 1960s through the mid-1980s, the U.S. economy experienced high inflation, high unemployment, and declining living standards. During that time, policymakers prematurely eased monetary policy when the economy weakened, and inflation remained high. The FOMC was forced to return to tightening monetary policy, causing a deep recession in 1981 and 1982. This is an important lesson that guides my thinking about monetary policy and my continued support for policy actions that will continue to lower inflation.

It is also important to remember that today's inflation is a global concern. This is because some of the factors driving inflation in the United States are global, including the disruption to goods production and trade during the pandemic, the shutdown and reopening of large economies, and the more recent disruption of food and energy supplies due to conflicts abroad. Monetary policy can do very little to improve supply disruptions, but it can help bring supply and demand into better alignment.

While the path ahead looks uncertain, I am encouraged by three specific developments. The first is the ongoing strength of the labor market, which was further supported with last Friday's jobs report. So far, the job market has remained resilient despite higher interest rates and slower growth. The second development is that the balance sheets of households have remained strong, with low debt levels. Low debt and strong balance sheets together with the strong labor market mean that consumers and businesses can continue to spend even as economic growth slows. The third point is the strength of the U.S. banking system, with high levels of capital and liquidity, due in large part to the reforms adopted after the last financial crisis.

I will turn now to the banking and payments issues on the Fed's agenda, which include crypto and digital assets, innovation in payments, climate change and banking supervision, and likely changes to the rules implementing the Community Reinvestment Act (CRA).

## **Cryptocurrency**

The dysfunction in cryptocurrency markets has been well-documented, with some crypto firms misrepresenting that they have deposit insurance, the collapse of certain stablecoins, and, most recently, the bankruptcy of the FTX cryptocurrency exchange. These events have made it clear that cryptocurrency activities can pose significant risks to consumers, businesses, and potentially the larger financial system.

While the traditional financial system has limited exposure to cryptocurrencies, I expect that some banks will continue to explore how to engage in crypto-related activities. The Fed and other banking agencies will continue to focus in this area, in light of the significant risks these activities may pose. But the bottom line is that we do not want to hinder innovation. As regulators, we should support innovation and recognize that the banking industry must evolve to meet consumer demand. By inhibiting innovation, we could be pushing growth in this space into the non-bank sector, leading to much less transparency and potential financial stability risk. We are thinking through some of these issues and what a regulatory approach could look like.

## **Payments**

The Fed plays an important role in fostering the safety and efficiency of the U.S. payments, clearing, and settlement systems. There have been a number of interesting developments on payments that continue to be top of mind for policymakers. One of these is the push for real-time payments. Since 2019, the Fed has been working to launch FedNow, a new faster payments system that will be available in the first half of 2023. FedNow will help transform the way payments are made through new direct services that enable consumers and businesses to make payments conveniently, in real time, on any day, and with immediate availability of funds for receivers. FedNow will enable depository institutions of every size, and in every community across America, to provide safe and efficient instant payment services.

We have also been studying the concept of a central bank digital currency (CBDC). Several foreign governments and central banks are exploring digital currency, and there are many competing proposals suggesting a need to create a digital currency. The common theme underlying the need in these proposals is the desire to increase the speed and reduce the cost of financial transactions. Last January, the Fed published a paper soliciting comment on possible forms and uses of a CBDC in the United States. The Fed continues to study the idea, although much of what supporters hope to achieve with a central bank digital currency may be provided through FedNow and existing private payment services. In any case, initiatives to make payments faster and more efficient will continue to be an area of focus.

## **Climate Supervision**

Climate has also been a recent focus for Fed supervision, but our narrow interest in this area is limited to the largest banks. Last fall, the Fed announced an exploratory pilot study with six of the GSIBs that is narrowly focused on the goal of enhancing the ability of supervisors and firms to measure and manage climate-related financial risks, not credit allocation. The Fed has also published a climate guidance proposal for banks over \$100 billion in assets. These climate efforts do not apply to smaller and community banks. Smaller and community banks already integrate and comply with robust risk management expectations. The Fed views its role on climate as a narrow focus on

supervisory responsibilities and limited to our role in promoting a safe, sound and stable financial system. While this climate supervision effort is a new area of focus, it has been a longstanding supervisory requirement that banks manage their risks related to extreme weather events and other natural disasters that could disrupt operations or impact business lines.

## **Community Reinvestment Act**

The last item on our regulatory agenda that I will note in my remarks today is the proposal to update the Community Reinvestment Act. The CRA requires the Fed and other banking agencies to encourage banks to help meet the credit needs of their communities, including low- and moderate-income communities. This rule was last updated 25 years ago, and the banking industry has changed dramatically since the 1990s. The proposal reflects these industry changes, including recognizing internet and mobile banking services, it also attempts to provide clarity and consistency, and it could enhance access to credit for these low- and moderate-income communities. I am fully supportive of these efforts, but I also share the concern noted in public comments that have suggested that some of the elements included in this overhaul of the CRA framework result in significant new regulatory burden, particularly for the smallest and community banks. As we continue this important rulemaking process, it will be critical for the Fed to carefully weigh the costs and benefits of any changes before finalizing a proposal.

I will stop there so we can move on to our conversation. Thank you again, for the opportunity to be with you today. I look forward to the discussion.

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<sup>1</sup> These views are my own and do not necessarily reflect those of my colleagues on the Federal Reserve Board or the Federal Open Market Committee.

<sup>2</sup> See Board of Governors of the Federal Reserve System (2022), "[Federal Reserve Issues FOMC Statement](#)," press release, December 14.