

Record of Meeting
Federal Advisory Council and Board of Governors
Thursday, September 9, 2021

Item 1: Economic Activity

What is the Council’s assessment of the strength and sustainability of the recovery? Are there industries in which pent-up demand has now run its course, or in which demand is now ramping up?

Summary

The economic recovery from last year’s pandemic-driven recession remains robust. Second quarter GDP was about 1% above pre-pandemic levels, and the fundamentals of the U.S. economy appear solid, with consumer and business equipment spending already well above pre-pandemic levels. Despite labor shortages, supply chain constraints, and the continued proliferation of the Delta variant, excess personal savings and record-high household wealth—combined with near record-low interest rates and low debt-service burdens—are driving pent-up demand and sustained growth in consumer spending.

Strength and sustainability of the recovery

In general, Council members expect GDP to grow for at least the next few quarters, although at a slower pace, aided by household savings and wealth, increased government spending, vaccine effectiveness, and general economic reopening. The infrastructure bill recently passed by the Senate and currently awaiting House approval could provide an additional \$550 billion in new spending over the next five years, boosting industries and businesses that provide support services for power and water infrastructure, public transportation and ports, and highway and bridge improvements. According to The Brookings Institution, this new spending would be nearly enough to increase total federal infrastructure spending, as a percent of GDP, to average levels seen during the New Deal (~1.4% of GDP), though this would still be lower than the peak in the mid-1970s to early 1980s.

Households have about \$2 trillion in excess savings from government stimulus, and Council members confirmed average customer balances remained above pre-pandemic levels—despite an unemployment rate that was nearly two percentage points higher than before the pandemic. The higher savings rate can be attributed to several factors, including the lack of willingness (or lack of ability) to spend on services such as travel, vacations, and dining over the course of the pandemic.

One Council member suggested that the distribution of excess savings balances across household income levels will likely be a key factor in the magnitude and timing of spending going forward. This Council member’s data on savings accounts suggested an uneven concentration of balances. The data showed that accounts with average balances above \$5,000 have seen an almost 35% sustained balance increase since the end of 2019, while accounts with balances averaging less than \$2,500 have historically remained close to their pre-pandemic levels. Accounts with average balances between \$2,500 and \$5,000 have exhibited balance increases after stimulus payments but then revert to their longer-term lower averages over several months as stimulus payments are expended. The high concentration of savings in larger balance accounts could translate into consumer spending occurring over a longer time frame. However, with consumer spending making up about two-thirds of the domestic economy, growth in household purchases should provide continued economic support.

Inventories continued to be drawn down, with firms reducing their stocks at an accelerating pace due to both strong demand and supply chain constraints. Production bottlenecks that are restraining further sales should gradually ease, supporting the motor vehicle and housing sectors. It is expected that as supply chains normalize, inventory replenishment will be a key source of growth. Trade will be another positive for near-term U.S. growth: Demand is picking up from foreign economies, which will boost exports. At the same

time, the shift in consumer spending growth from goods to services should limit import growth, reducing trade deficits.

On the downside, there is mounting evidence of increased labor, input, and transportation costs, all of which could reduce the purchasing power of the consumer and potentially diminish the rate of recovery. As one Council member stated, these issues come down to three key things: labor shortages, increasing logistics costs, and supply chain issues.

Demand for physical consumer goods surged as high as 23% above pre-pandemic levels during the recession and the early stages of the recovery. Households purchased indoor and outdoor furnishings including appliances, decks, patios, and other home improvement products; sports and entertainment equipment; and groceries. Spending on services has increased this year but has yet to fully recover. Recent spending dynamics are driven by continuing normalization and the reopening of businesses, with spending shifting away from goods and toward services. But some recent spending changes may reflect the impacts of the Delta variant. One Council member noted that while their credit card data indicated growth in activity of 11% over the same period two years ago, it is down from a peak trend of just over 20% earlier this year. This Council member's data pertaining to the service sector indicated that spending on airfare, lodging, entertainment, restaurants, and bars slid in a recent week in late August from a peak in early July, with the biggest spending deceleration occurring in travel and lodging. It is expected that the recovery will be tested by the fading impacts of the government stimulus, the scheduled end of enhanced unemployment benefits in September, and the recent Supreme Court decision ending the renter eviction moratorium.

Despite business investment continuing to grow at a solid pace and the likelihood that government expenditures will be robust in the third quarter (as state and local governments continue to expend pandemic-related stimulus funds), some Council members expect that certain aspects of business investment will be weaker than the consumer sector, given the long-run decline in brick-and-mortar retail and what is likely to be reduced demand for office space in the wake of the pandemic.

Industries in which pent-up demand may have peaked

Council members noted that pent-up demand may have peaked in the housing, automobile, and consumer goods sectors, although many Council members believe that this could have been partly driven by continuing supply constraints.

Some Council members reported varying degrees of housing demand in their Districts, but the general consensus was that demand remained strong overall, with the latest reports indicating that home prices were up 15% year-over-year (YOY). One Council member discussed a homebuilder client who, during this period, instructed sales reps to increase prices by \$5,000 per week until no more orders were received. Despite the price increases, the homebuilder's orders did not diminish. Nevertheless, record-high prices seem to have finally begun to bring demand down to pre-pandemic levels. Overall, pending home sales fell about 2% per month in June and July. Lower home sales should allow for inventory accumulation, and the ongoing labor market recovery—combined with continued low mortgage rates—will help maintain housing demand.

Despite high demand for automobiles, sales have fallen every month since April due to supply constraints. Inventory shortages, exacerbated by the semiconductor shortage, will most likely cause new car sales to remain constrained for the remainder of 2021. Used car prices have also fallen somewhat recently as historically high prices have deterred some buyers. The Manheim index indicates that used vehicle prices have dropped for two consecutive months through July, while U.S. unit vehicle sales have declined for three consecutive months since peaking in April. One Council member noted that used car prices recently have started to rise again because buyers are concerned that low inventories will continue for an extended period.

Retail sales, which had been at elevated levels, have also been decelerating since April, including slowing growth of non-store internet-based sales. Amazon reported sales were below expectations in the second quarter, and the company lowered expectations for third quarter sales. Online orders also contributed little to

Walmart's U.S. comparable sales gain in the latest quarter. Overall, non-store sales stabilized near 14% of sales in recent months after rising to 19% earlier in the pandemic. Home Depot reported a decline in the number of transactions in its latest quarter, even as the average purchase size rose enough to increase the dollar amount of sales.

Industries in which demand is, or is expected to be, ramping up

Despite these trends, the service sector data indicated that demand remains robust as the economy continues to recover, with some businesses reporting difficulty catching up, given they intentionally reduced their supply earlier in the pandemic. Pent-up demand remains in the travel and transportation sectors, including airlines, hotels, and car rentals. Restaurants, which are enjoying strong demand, have raised prices—especially higher-end establishments in metropolitan areas. Some restaurants reported that they have reduced their hours and limited their menu selections due to difficulties recruiting staff. Council members generally expect this trend will continue into the fall and holiday season unless the Delta variant (or other variants) continue to significantly proliferate, thereby reducing consumer confidence.

Households with excess cash are likely to spend it on travel experiences that were not possible during the height of the pandemic. Tourism Economics, Inc. expects slow recovery in both leisure and corporate travel during the second half of this year and into 2022. TSA data indicated that more than 63 million passengers traveled through airports in July, an increase of about 11% compared to June, but still about 26% below July 2019 levels. While domestic travel has recently increased, international travel and cruise ship bookings remain muted. The travel sector could see improvement if consumer confidence is boosted by a rise in vaccination rates and a meaningful decline in COVID case counts.

In mid-July, U.S. hotels achieved occupancy rates of about 70%, which is comparable to levels seen in September 2019. However, occupancy rates have been declining since mid-July and were 61% at the end of August. One Council member reported that Florida has been experiencing higher occupancy rates in hotels and increased restaurant bookings. The city of Miami reported 72% hotel occupancy rates during June, and bookings are expected to remain elevated into the fall and winter.

Finally, the Wall Street Journal recently reported that two large institutions stated their business clients have ramped up credit line requests in anticipation of spending on inventory, labor, and expansions to meet demand. These institutions had seen a 20% increase in undrawn credit commitments from levels experienced in 2020, consistent with the experience of other Council members. Businesses requesting these line increases include those in the healthcare, industrial products, food products, and wholesale supply sectors. The eventual drawdown of these lines will support business investment and spending over the next several quarters.

Item 2: Labor Markets

How would the Council rate the overall strength of the labor market? Are there particular industries, occupations, or geographies in which shifts in demand or supply have created shortages or surpluses of labor? Are these shortages creating upward pressures on wages and benefits? Are upward wage and benefit pressures becoming price increases?

Overall strength of the labor market

The consensus among the Council members is that the overall labor market is improving but at a pace slower than would be expected given the underlying economic growth and high level of job openings. In general, the current labor market can be characterized as one where demand for labor has materially increased, but labor supply is weak and still a long way from full recovery. The higher level of nonfarm payroll additions through this past summer has helped bring the unemployment rate down to 5.2% in August 2021, off from a peak of 14.8% in April 2020, recovering approximately three-quarters of the job losses due to COVID shutdowns.

Across all Districts, Council members characterized the labor market as tight with significant labor shortages and noted that (1) employers in most industries have reported difficulty in recruiting and retaining workers and (2) competition for labor has increased as the economy continues to improve. While worker shortages are a challenge across categories, Council members specified that the shortage is most acute in entry-level positions and jobs that have fewer skill requirements.

Labor shortages continued to be reported amid record high job openings, and the National Federation of Independent Businesses reported a series high in the number of firms with unfilled positions. Factors contributing to the current labor market conditions include the strong economic recovery, higher “quit rates,” materially lower participation, and disincentives for individuals to seek employment, led by high average unemployment benefits, expanded tax credits, and foreclosure moratoriums. Expanded remote work has removed or reduced physical and geographic boundaries, further contributing to short-term labor inefficiencies and disparities. In the hospitality and restaurant industries, a lack of seasonal or migrant labor caused by COVID-related travel constraints has also impacted the availability of workers.

Further contributing to the shortages in the market is the increased competition for talent across various industries (retail sales and customer service, including restaurants) and for specific skills and experience (technology, cybersecurity, compliance). Also contributing to the shortage are fears associated with catching the coronavirus and difficulties surrounding childcare/family care arrangements. Some of these shortages could begin to ease over the next few months as (1) schools return to in-person instruction, thus resolving some childcare challenges and (2) expanded unemployment insurance benefits expire nationwide (which will occur in early September).

No District reported a surplus of labor in any industry, occupation, or geography.

Impacts of shifts in demand or supply on labor

As stated above, Council members uniformly reported that labor shortages have increased dramatically and broadly, impacting all industries, job categories, and geographies. The most acute shortages have been reported in entry-level positions in those industries that experienced the biggest job losses during the pandemic. These industries include general retail, restaurants, hotels and hospitality service companies, food service, and construction.

Most Council members also reported employment challenges within their own financial institutions. The biggest challenges related to filling branch, call center, and other retail and entry-level jobs. Council members also mentioned challenges in filling technology and other higher-level positions, as competition for talent has resulted in more attrition, and some professionals have chosen to shift careers entirely.

Pressures on wages and benefits

Overall, the current labor market has experienced an upward pressure on wages and benefits. Council members consistently reported that nearly all sectors are reporting labor-supply constraints, which have been limiting employers’ ability to take advantage of the increases in product and service demand. Fewer applicants for open positions and elevated “quit rates,” indicative of strong worker confidence, have contributed to wage pressure as workers leave for opportunities elsewhere. With some national businesses publicly announcing across the country that they are offering higher minimum wages and bonus incentives, the pressure to increase wages to attract talent for all job categories has increased. In addition, there is increasing pressure to raise base pay for existing employees to avoid a disparity among new versus current employees. Companies taking wage actions include Amazon, Walmart, UPS, Starbucks, Walt Disney, and several Council members’ institutions.

In addition to increased compensation, signing bonuses, and other incentives put in place to attract and retain talent, employers have been leveraging other benefits, including increased use of performance-based incentives and creative work arrangements—including indefinite work-from-home arrangements.

Many Council members reported that within their customer base and within their own institutions, filling jobs has remained extremely challenging despite material wage increases, unprecedented sign-on bonuses across all job categories, and the offer of workplace flexibility.

Impacts on prices

Along with rising wages and benefits, Council members consistently reported that prices have increased. However, it is unclear to what extent these labor cost increases have been the primary driver in the recent acceleration in consumer prices.

Council members reported that their business clients in the food service, retail, restaurant, travel, hospitality, and auto industries have already passed—or are beginning to pass—on higher labor costs to the consumer or business-to-business customer. While these observations and public reports indicate the pass-through of labor costs to the consumer, higher input and transportation costs and general supply chain disruption have also created upward pressure on prices.

One Council member observed the unique dynamic of rising prices in hotels and restaurants located in high-tourist-traffic regions (domestic and international), even as the quality of service has declined dramatically due to labor shortages.

Item 3: Inflation

Based on Council members' own experience and the experience of their clients, please comment on the following:

- a. Are the prices of products and services rising more quickly or less quickly than in the recent past? Are the prices for the products and services Council members purchase rising more quickly or less quickly?**
- b. Is there evidence that supply chains are reconnecting, or do persistent supply frictions remain? Are there industries or geographic areas in which expansion is impaired by supply constraints?**
- c. Has there been any significant trend to bring overseas activity “on-shore” or to “re-shore” this activity? Are these global-operation frictions generating any upward price pressures?**
- d. Have recent levels of inflation changed the inflation expectations of consumers and businesses? In the Council's view do inflation expectations remain well anchored?**

Are the prices of products and services rising more quickly or less quickly than in the recent past? Are the prices for the products and services Council members purchase rising more quickly or less quickly?

Prices are rising less quickly today than in the April to June time frame. The increases seem to be categorically related to industries most impacted by COVID and can be traced back to some form of workforce-related adjustment, finished good shortages, and disruptions within supply chains and distribution channels. Though these price increases have seemed to slow in August as compared to previous months, this trend may not necessarily continue into the near future because of the spread of the Delta variant and the cessation of unemployment payments. While Council members believe that prices may well normalize once supply and distribution frictions are removed, the workforce-related pricing pressures are likely here to stay. Below is a specific look at two industries, the food service/grocery industry and automobile/energy industry, which the BLS reported, and Council members stated experienced the most drastic increase in prices over the April to August time frame.

Food Service/Grocery

Rapid price increases in food service can be largely attributed to supply chain disruptions, which increase overhead costs. These costs are then passed on to the consumer via the local business. Restaurant owners and grocery stores alike have experienced notable price increases for wholesale food items. Restaurants are responding to the increases with fewer menu offerings and higher-than-average prices. For example, chicken processing plants around the country temporarily shut down or restricted the number of workers during the pandemic. With substantially decreased outputs, the wholesale cost of bone-in chicken wings was driven up to over \$5 per pound—more than double its normal cost. In this circumstance, restaurants are faced with a dilemma: charge customers \$24 for a serving of chicken wings or take the wings off their menu.

In addition to the rising cost of wholesale food components, some non-food items are also reflected in the recently trending higher consumer pricing within the grocery industry. For example, a critical raw material used in the glue that holds together paper ice cream containers is severely diminished due to the polar vortex that occurred in February. So, while ice cream is reaching levels of record-high demand, and the ingredients are accessible (albeit more expensive per the BLS CPI data), the containerization is not readily available. While we expect these price reflections to be transient once distribution and raw material availability normalize, increased labor costs in these industries will likely linger.

Most solvent restaurants follow the rule of thirds, which states that rent, food costs, and labor should each account for one-third of a business's total monthly overhead. As the discussion around working wages and labor shortages persists, business owners are left with two options: increase wages or remain understaffed. Businesses that cannot afford to increase their fixed costs are serving with skeleton staffs at rush hours, forcing employees into new roles such as working the grill and waiting tables. Conversely, some restaurants and grocery stores have offered signing bonuses to attract people back into the workforce. It will be interesting to watch this trend unfold, as the businesses opting to increase working wages to \$15+ per hour will play into the permanent nature of inflation within the industry, while the businesses offering a one-time signing bonus will seemingly be able to reduce their payroll expenses back to a normal level after the first year.

Automobile & Energy Industries

The new and used car markets also observed sizable price increases. These increases have been driven by both demand and supply side factors. Demand for automobiles surged as a result of the COVID environment. U.S. consumers' excess savings from lower leisure spending contributed to a higher demand for goods, including automobiles. In addition, public transportation ridership has declined more than 30 percent from pre-pandemic levels, partially driven by families migrating from higher-density metropolitan cities into suburbs and rural areas. This migration has also caused a small uptick in demand in the new and used car markets. Meanwhile, this higher level of demand came at a time when microchip and semiconductor production issues (1) impacted original equipment manufacturer (OEM) production and (2) limited the available supply. Dealerships across the U.S. lack available inventory, with inventory levels down approximately 65 percent relative to a 20-year average. Much of car dealerships' incoming inventory for the next four to five months is pre-sold. Customers have now begun to pay over the manufacturer's suggested retail selling price (MSRP) in some cases. One Council member that operates within auto lending cited prices exceeding, on average, 100 percent MSRP for the past two months. Many cars have currently turned into an appreciating asset, which is likely unsustainable over the long term. With higher input and labor costs, new-car prices are expected to continue to increase over time. The inflation in new-car prices should stabilize once chip production has caught up with demand; however, GM, Ford, foreign OEM producers, and Intel officials have stated that inventory issues may last into 2023. Council members did note that while used-car prices appear to have reached a peak earlier this year, it may take time for these factors to return to historical norms. In fact, trends over the past three to four weeks suggest that used-car values are once again rising slightly as consumers are more concerned about an extension of supply chains disruptions.

The BLS report for July 2021 confirmed a rapid rise in gas prices (41.8% increase in CPI) over this period. While there are a number of factors responsible for this price increase, a few issues in particular—such as fuel-additive production woes and the increasing costs and employability of truck drivers—fall outside the customary price-per-barrel conversations. Companies that produce fuel additives, including Afton Chemical, BASF, and Chevron, are allocating only about 50% of their normal volumes to major suppliers. This decreased allocation started in mid-2020 due to international pandemic-related plant shutdowns; the most recent issues largely stem from logistics management. Between the freeze in Texas and the current cost of freight carriers holding between \$23,000-\$27,000 (formerly \$3,000-\$4,000), some downstream suppliers are having trouble getting raw materials to the additive companies. These struggles are reflected in prices at the local level.

Similar to restaurant staff, licensed truck drivers are in high demand and are consequently seeing a 46% increase in YOY wages. With the increases in wages and leverage—which have helped to combat some of the driver-shortage issues—many drivers can forgo their previous weekend work and still make close to \$100,000. Given the market conditions, drivers are often given the option to pick their own routes. This option benefits truck drivers with a commercial driver’s license who do not want to drive through Mexico, for instance, as the inbound/outbound shipping lanes at the Mexican border are facing multi-hour delays. Meanwhile, Council members noted that some driver shortages are being caused by the legalization and usage of marijuana in parts of the country. There are able-bodied drivers who cannot pass an employment drug test. In desperation, some business owners are dropping the testing requirement altogether. While the truck-driving industry will likely benefit from the eventual normalization of freight and gas prices, some changes may need to be made to secure more drivers, including developing an industry-wide hiring process, modifying the driver qualification standards, and offering a prolonged period of premium pay.

Conclusion

Although these issues were discussed in detail above for only a small portion of the global economy, these problems are not unique to those industries. Council members have noted that labor shortages persist in agriculture and healthcare, and raw material deficits are affecting everything from surgical implants to vinyl and wood flooring. From an economic viewpoint, the U.S. and Europe would benefit from being more engaged in the effort to help vaccinate the world, as the global supply chain issues will not end if vital suppliers are continually forced into lockdown with the introduction of each new variant of the coronavirus.

Is there evidence that supply chains are reconnecting, or do persistent supply frictions remain? Are there industries or geographic areas in which expansion is impaired by supply constraints?

Global supply chains continue to face persistent friction due to a variety of COVID-related impacts, including shutdowns and the availability of skilled labor. While Council members are generally expecting these challenges to diminish toward the end of 2021 and in early 2022, most Council members report ongoing disruption within their Districts. The rise of the Delta variant has further complicated efforts in this space, as both the Yantian and Ninbo-Shoushan ports in China closed for several days over the past few months due to outbreaks. The impacts of these shutdowns have been further exacerbated by staffing shortages and backlogs at U.S. ports.

As of the end of August, the Ports of Los Angeles and Long Beach had 46 ships waiting to unload. This backlog was due to increased domestic demand, insufficient ground transportation, and rail congestion. Other U.S. ports, including the Port of Savannah, have also been reporting delays. Intermodal rail traffic has been metered or halted in some parts of the country to clear the congestion. These delays have caused significant increases in shipping costs and have been foreshadowing potential inventory shortages this holiday season. Adding to the shipping challenges is a strong trade imbalance, with many containers not only delayed upon arrival, but then leaving empty.

The downstream ramifications of these disruptions have been clear and consistent, with nearly all Districts reporting stress among clients. Council members noted that the industries most impacted have been

semiconductors and construction/heavy manufacturing—the downstream impacts of which have been readily observed in the automotive and construction spaces.

In the automotive industry, prices have risen for both new and used vehicles, with some dealers reporting that customers are willing to pay cash for luxury models not currently available or on significant backlog. The impact of this is similar to the sharp increase in competitive bidding in certain housing markets over the past year (including the Western U.S. metropolitan areas where many purchasers are paying significantly over list price). There is evidence of some recent easing, in particular in used car prices, though backlogs remain for many new vehicles.

In the construction space, the impact of the supply chain disruption has been twofold, with the importation of heavy equipment from Asia showing steep increases in prices—if the equipment is even available—and home manufacturers noting increases in component costs. One Council member reported a variety of increases, including the higher costs of piping to drilling equipment, and some homebuilders are no longer willing to contract up front for a new build, preferring to wait until a home has been completed to pass through the full cost. One offset, however, appears to be lumber prices, which spiked in early 2021 but are now below last year's levels.

Has there been any significant trend to bring overseas activity “on-shore” or to “re-shore” this activity? Are these global-operation frictions generating any upward price pressures?

While the U.S. market is witnessing widespread labor challenges, which are impacting the domestic contingent workforce, Council members are not reporting any significant trend in “on-shoring” or “re-shoring” economic activity to the United States.

However, many Council members have reported an increase in interest in “right-shoring” or “near-shoring,” which is further supported by a July 2021 Thomas report, which found that 83% of manufacturers indicated they are likely to “re-shore” over the next 12 months, up from 54% a year ago. Most of the reported focus has been on either diversifying operations out of China to other Southeast Asian countries, or moving operations to physically closer locations such as Mexico and Canada.

Though global supply chains are undergoing significant changes overseas, some of these changes appear to be for geopolitical reasons rather than in response to COVID-related supply chain issues. Industrial-product companies are dealing with these changes and added expenses by leaning more heavily on artificial intelligence and other technologies to improve the efficiency of production. While these adjustments to the global supply chain are likely adding some cost pressure up the production chain, increased pricing pressures have been minimal. In fact, one Council member reported “off-shore” rates in India had decreased YOY, despite India seemingly encountering increased labor market pressures similar to, if not greater than, those in the U.S. As such, while not currently being experienced, these pressures may have more impact on pricing in the future.

Have recent levels of inflation changed the inflation expectations of consumers and businesses? In the Council's view do inflation expectations remain well anchored?

Recent levels of inflation have changed near-term inflation expectations for both consumers and businesses alike. Consumers believe that inflation is well-anchored and will level out in the long term; in the near term, consumers are seemingly willing to spend more for the same goods and services. It is unclear how long this transitory period of elevated inflation will persist. Businesses and consumers will soon begin to feel the compounding effects of the Delta variant and the removal of the additional federal unemployment benefits. Consumers cannot continue to spend when (1) prices are too high, (2) income streams have been reduced, and (3) their savings have dried up. Ultimately, those three factors may contribute to ending the transitory inflation period. In short, if consumer spending is a key driver of recent inflation, having the aforementioned factors play out may bring about the expected near-term normalization.

On the supply side, issues surrounding wage increases and supply chain disruptions are dynamic. The consensus among Council members is that the resulting inflationary effects could last longer than originally expected. There are broadening and increasing pressures from the workforce to make wage increases across industries a sustainable change, and the premiums that employers are paying for generally unskilled labor will be passed down the chain and on to consumers. As the solutions to both supply chain disruptions and working-wage issues evolve, they will continue to manifest themselves in higher consumer prices.

Item 4: Fed Policy

What are the Council's views on the stance of monetary policy, including portfolio activities?

Monetary policy has been highly accommodative, and appropriately so in response to the sudden and severe economic fallout due to the COVID pandemic. In 2020, the Federal Reserve's fast, decisive monetary actions of reducing short-term rates to almost zero and purchasing \$120 billion in Treasuries and mortgage-backed securities on a monthly basis rescued the economy. As we emerge from the crisis, the Federal Reserve now has to pivot and adjust policy at the right time and cadence.

While GDP has recovered and the labor market is continuing to improve, unemployment remains above pre-pandemic levels. The recent surge caused by the Delta variant has not meaningfully impacted the economic recovery. As forecasted, inflation has been temporarily high, and it is expected to moderate over the coming months. Some Council members noted that certain high-growth equities and cryptocurrencies are exhibiting irrationally high valuations—an unfortunate risk that often comes with a highly accommodative policy. These Council members would advise the Federal Reserve to continue monitoring such bubble-like behavior.

Council members anticipate interest rates to stay near the zero bound until (1) there is sustained inflation above the 2% target and (2) the economy has reached full employment. All Council members have the expectation that this will not occur until sometime in 2023. With respect to asset purchases, market expectations are that the Federal Reserve will begin tapering asset purchases during the fourth quarter of 2021 and conclude by late 2022. The Council members are unanimously supportive of such a controlled tapering.

One risk that was raised by a Council member was the rate of FOMC member turnover. A heightened rate of turnover could create uncertainty and become disruptive in rolling out effective, timely, and measured policy changes.

Item 5: Changes in the Workplace

The COVID-19 pandemic has changed the workforce and the workplace in multiple ways, including decreasing labor force participation by women, increasing interest in and demand for remote work, and calling attention to health risks in the workplace. Specifically, what are Council members' views on:

- a. **Women in the Labor Force: Are there policies that Council members have observed, in either their or their clients' firms, that successfully increased labor force participation by women? What changes are needed in the "caregiving infrastructure" to help businesses employ more women?**
- b. **The Future of Remote Working: What have Council members' institutions learned from having employees work remotely? Do Council members believe a remote workplace is sustainable over the long run for some business activities? What changes in work behavior are needed to make remote working a viable business strategy? How do Council members see the nature of work evolving, given the experience with remote working during the pandemic?**
- c. **Vaccination and the Workplace: What are the Council's experiences with vaccine hesitancy during the pandemic at their own institutions and in their Districts? What requirements or**

guidelines, if any, have Council members adopted at their institutions regarding vaccination and the workforce? What has been the impact on workforce turnover and morale? What are banks doing to monitor and mitigate health risks as workers return to the office?

Women in the Labor Force

Background

Since the beginning of the pandemic, nearly 2 million women, or roughly 400,000 more women than men, have left the labor force. According to the BLS, as of July 2021, 56.2% of women were participating in the labor force compared to 57.8% in February 2020. Data show that women have borne more of the additional childcare responsibilities caused by the shift to remote schooling and closure of daycare facilities. In many instances, the choice for women to leave the workforce to take on childcare responsibilities was due to the disparity in women's annual earnings compared to men's. In 2020, the female-to-male earnings ratio was 82.3%. As a result of this disparity, more mothers than fathers left the workforce to care for their children during the pandemic.

Are there policies that Council members have observed, in either their or their clients' firms, that successfully increased labor force participation by women?

With the onset of the pandemic, Council members' organizations transitioned predominately all non-customer-facing branch positions to a remote environment. This transition allowed employees the flexibility to continue to complete their job duties while also handling childcare responsibilities. By being flexible regarding where and when their employees worked, Council members' institutions have not experienced significant losses of female employees during the pandemic. In regard to employees with jobs that are not suited for a remote environment, Council members noted instances where employees were provided flexibility to handle childcare issues. For example, some employees were given reduced hours—without reduced pay—as well as additional paid time off. Additionally, financial assistance was provided for childcare, tutoring, educational support, and online programs, benefitting many employees—especially those who had additional childcare responsibilities. One Council member had on-site childcare teachers run virtual programming. Employees' children could tune in each day for story time and other virtual activities, providing parents an educational outlet for their children, while providing the employee uninterrupted time to work.

Some Council members have also implemented programs empowering the managers in their organizations to work with employees to meet their individual needs through options to increase worker flexibility, such as compressed workweeks, remote working, flextime, and unpaid time off. Additionally, one Council member has partnered with a third-party service provider to offer employees, through a subsidized program, access to backup childcare, full- and part-time childcare, tutoring and homework assistance, pet care, household help, and senior care.

What changes are needed in the “caregiving infrastructure” to help businesses employ more women?

The primary challenge noted when it comes to women's participation in the labor force is access to quality, affordable childcare. Research has shown that childcare policies that reduce the cost and expand the availability of childcare services have positive effects on female labor force participation. Analysis in 2018 by the Center for American Progress found that nearly half of families with young children live in a childcare desert—areas where there are three or more kids for every available daycare spot. These “deserts” are disproportionately located in low-income areas. In areas with an undersupply of childcare options, women's labor force participation rates are an average three percentage points less.

The American Rescue Plan included several provisions aimed at addressing access to childcare, including tax relief through the temporary expansion of the Child Tax Credit and Child and Dependent Care Credit. Additionally, the budget reconciliation bill that recently passed the Senate would provide free universal

preschool for children aged three and four and continue the enhanced Child Tax Credit. (Some states currently offer free preschool options, though eligibility is typically income based.) There are several ways to increase access to affordable childcare, including (1) giving incentives to employers to provide childcare services or (2) offering subsidized programs to employees without taxing the employee for using the service.

Two ways to help all workers better manage their schedules when it comes to childcare and other responsibilities while also continuing to manage their career responsibilities are (1) allowing flexibility in when or where hours are worked for those not employed in the service industry and (2) providing more stable and predictable schedules for those in the service industry. Flexibility and more stable/predictable scheduling for all employees, regardless of gender, would also provide a greater ability for two-income households to stay in the workforce and share childcare responsibilities.

Finally, two policy items that were identified that could help with labor force participation for women are national paid parental leave and taxes. As a member of the Organization for Economic Cooperation and Development (OECD), the United States is the only country that does not offer national paid parental leave for at least 12 weeks. Notably, nearly one-third of working women leave the labor force when they have a child. Paid parental leave provides new parents time to choose a childcare provider. The paid leave also helps parents delay having to pay for expensive infant care. With respect to taxes, many OECD countries tax the income of married people as single taxpayers, whereas the United States taxes the income of married couples jointly. As a result of married couples filing taxes jointly, the spouse making less money—which historically has been the female—faces a higher marginal tax rate, which becomes a disincentive to returning to work. Certain developed countries that tax the income of married people as if they were single have experienced less disparity between the labor force participation rates of men and women.

The Future of Remote Working

What have Council members' institutions learned from having employees work remotely?

While many employees in frontline and critical operations roles were required to work in the office, the pandemic necessitated transitioning—for continuity and safety reasons—employees who were not frontline workers to working remotely. Pre-pandemic investments in technology and infrastructure were critical enablers to rapid and successful transitions to remote work. One lesson learned over the past 18 months is that employees do not always need to be physically on the premises to work effectively. Some roles and functions can be effectively performed regardless of employee location. However, some Council members found that innovating, collaborating, mentoring, training, and maintaining a strong company culture were not as easily attainable in a prolonged remote environment.

Many employees reported higher production and satisfaction from working remotely, due in part to a reduction in commute times and fewer office interruptions. Online collaboration tools and video conferencing were often used effectively, but “video call fatigue” and the perceived need to be continually accessible while not at the office presented challenges. At the same time, remote work allowed many employees to achieve a better sense of balance between their work and personal needs.

Finally, those employees who could not work from home because their jobs could not be easily or successfully performed from a remote location experienced lower levels of well-being. And both office-based and remote workers faced challenges with general mental health issues, including anxiety, depression, and disconnectedness.

Do Council members believe a remote workplace is sustainable over the long run for some business activities?

Council members believe that their industry is relationship-driven and, as a result, not all positions will be suitable for permanent full-time remote working. Many institutions had flexible work arrangements prior to the pandemic, and Council members expect that a hybrid working model will be part of the “new normal” for those who have jobs where there is not a requirement to be fully on-site. However, managers will need

to take an active role in helping to coordinate in-person interactions to help hybrid approaches be sustainable over the long term.

As companies have begun to develop and implement “returning to the office” plans, differences have arisen between employers and employees on the expectations of the future work environment. These expectations will require sustainable solutions to retain the best employees and successfully recruit external candidates. This is especially true in the technology, data, and analytics areas, where remote-only job postings are increasingly more common. One Council member reported a decline in candidates for roles that do not support remote work options or that require relocation. For many, remote work is now viewed as an expectation, rather than a perquisite.

What changes in work behavior are needed to make remote working a viable business strategy?

Establishing a clear and consistent framework for remote-work options is essential to success. Institutions will need to identify which roles support hybrid or remote work and also address other expectations surrounding customer engagement, onboarding, and training. To support a longer-term flexible-work-arrangement model, managers and employees must be more deliberate about which activities they are completing, as well as when and where they are completing them. To be viable, any flexible-work-arrangement plan must meet the collective needs of both the business and its employees.

Managers will need to think of additional ways to monitor organization culture, employee performance, productivity, and collaboration. Teams must make a deliberate effort to interact and collaborate in person on a regular basis, and employees at all levels must seek out these in-person interactions and not assume they will happen spontaneously. Face-to-face interactions will be critical for maintaining networks, developing employees, and driving innovation. Managers will need to shift their leadership strategy and behaviors to identify, support, and develop talent in a more dispersed work environment. In addition, performance management expectations and behaviors will need to be calibrated to ensure that managers focus on results and outcomes as opposed to the amount of time spent in the office.

Technology has played a significant role in meeting remote-work needs during the pandemic. Improvements in distributed meetings, the shift to paperless offices, the wider adoption of e-signatures, and improved ID authentication methods have all resulted in more effective and efficient operations. However, investments will need to continue in order to meet challenges with regard to high-speed internet access, distributed video conferencing and collaboration, data loss protection, and increased cybersecurity risks.

How do Council members see the nature of work evolving, given the experience with remote working during the pandemic?

It is premature to conclude which alternative work strategies will be viable over the long run. But it is clear that the pandemic has reinforced the notion that the nature of work is always evolving in response to the issues of the day. Council members will need to gather additional data to draw distinctions between short-term expectations and the long-term effects on employee health and well-being, risks to corporate culture, impacts to innovation, and the achievement—or not—of successful business outcomes.

Vaccination and the Workplace

What are the Council’s experiences with vaccine hesitancy during the pandemic at their own institutions and in their Districts?

The experience of the Council regarding vaccination rates and vaccine hesitancy broadly reflects that of the nation. Nationally, the Centers for Disease Control and Prevention (CDC) reports that as of September 1, 2021, 52.8% of the U.S. population is fully vaccinated. Council members reported, based on survey responses of employees, that vaccinated rates for their companies range from the mid-40th to the mid-70th percentiles (numbers that largely reflect the vaccination rates in their regions). Some Council members reported seeing varying vaccination rates based on compensation levels in their companies.

The Council reported that reasons for vaccination hesitancy for employees at their institutions are varied and personal—and reflect the concerns that have been expressed nationally. Council members shared some of the reasons for vaccine hesitancy that have been communicated by staff members:

- Lack of full FDA approval (rates may improve somewhat given final approval of some vaccines)
- Preexisting conditions
- Concerns with pregnancy or fertility
- Fear of long-term side effects
- Credibility concerns with policymakers
- Religious convictions

What requirements or guidelines, if any, have Council members adopted at their institutions regarding vaccination and the workforce? What has been the impact on workforce turnover and morale? What are banks doing to monitor and mitigate health risks as workers return to the office?

No Council member's institution has thus far required vaccinations, although the option remains open as Council members continue to evaluate the current situation. All Council members have strongly encouraged employees to be vaccinated and have undertaken efforts to educate their staff as well as provide time off for vaccinations. A few have offered a modest monetary reward for vaccinations. Some Council members have placed requirements, such as mandatory masking, on unvaccinated staff.

Overall, there appears to be no consistent approach to dealing with the unvaccinated. There is a general concern that more strict vaccination requirements may lead to turnover and vacancies, which will be difficult to fill in the current environment. Current efforts have so far not increased turnover or negatively impacted morale.

Regarding efforts around returning to the office, the majority of Council members have postponed previous plans to return in early September due to the impact of the Delta variant. Throughout the pandemic, Council members have followed CDC guidance or more stringent requirements to maintain the safety of staff and customers, and this diligence is expected to continue as staff return to the office.

Item 6: Cryptocurrencies

What levels and types of cryptocurrencies do Council members observe among their customers and clients at present? Are there any particular uses of cryptocurrencies that stand out? What do Council members foresee for the role of cryptocurrencies within investment portfolios and as media of exchange? What actions regarding cryptocurrencies would Council members advise to enhance and further strengthen the nation's financial supervision framework, particularly as it relates to banking?

Levels and types of cryptocurrencies

Council members have observed that consumer adoption of digital assets has accelerated dramatically in the past year, as has corporate adoption including by Microsoft, Home Depot, and Starbucks. Recent survey data indicate that 15% of U.S. consumers own digital assets and that a majority of them would like banks to offer more digital-asset products and services.¹ One Council member reported that monthly average ACH transactions to common cryptocurrency exchanges in 2020 was 8,000–10,000 per month. However, in recent months, cryptocurrency exchanges have seen upwards of 100,000 debits and credits.

Banks have historically been at the forefront of technological innovation, and Council members are evaluating ways to safely and responsibly allow their customers to buy, hold, and sell digital assets through their existing banking relationships. Banks have also seen clear customer demand for digital-asset

¹ Ron Shevlin, The Coming Bank-Bitcoin Boom, FORBES (Apr. 19, 2021), <https://www.forbes.com/sites/ronshevlin/2021/04/19/the-coming-bank-bitcoin-boom-americans-want-cryptocurrency-from-their-banks/?sh=c94d1c249086>.

management and custodial services as well as for prime brokerage, margin finance, and cross-border payment services in digital assets. Banks are exploring the provision of other traditional financial services to the asset class as well, including digital-asset investment products, agent or principal market support, structured notes and exchange-traded products referencing digital assets, payment platforms for digital-asset transactions, digital assets as a credit or debit card reward, and credit products secured by digital assets.

Uses of cryptocurrencies

Council members report that digital assets may have application in facilitating cross-border payments and peer-to-peer payments, as media of exchange for decentralized finance, and for speculative investment by clients. Digital assets, and Bitcoin in particular, also remain the payment method of choice for threat actors conducting ransomware attacks on U.S. companies. On behalf of customers, banks are providing digital-asset custody services, including by holding the unique cryptographic keys associated with cryptocurrencies, as part of their existing custody businesses.² Banks are well-suited to perform these custody services because they have the legal and compliance systems in place to address applicable anti-money-laundering (AML) requirements, as well as cybersecurity and other risk management issues.

As insured depositories, banks may also have a role as holders of stablecoin “reserves.” For example, stablecoin issuers may desire to place assets in an account with a bank to provide assurance that the issuer has sufficient assets to back the stablecoin. Similarly, banks—either alone or in a consortium with other insured depository institutions—could seek to issue stablecoins designed as a tokenized form of bank deposits.

Expected role of cryptocurrencies within investment portfolios and as media of exchange

Customers are increasingly seeking to obtain investment exposure to digital assets through their existing banking relationships. One Council member believes that digital assets will continue to emerge as an alternative investment opportunity and, while volatility may not make these assets a practical diversifier for direct investment risk, customers are interested in cryptocurrency exchange-traded funds and other proxy instruments. Other banks have offered customers access to cryptocurrencies through self-directed individual retirement accounts. One Council member noted that if digital-asset markets continue to mature, they could attract significant inflows from unstable national fiat currencies as a store of value.

An initial thesis held that digital assets would be used to facilitate payments transactions; however, digital assets’ high short-term volatility has impeded their usefulness as a commercial payment mechanism. Furthermore, many digital assets have limited use as media of exchange because their networks generally have a limited capability to handle large amounts of transaction data in a short span of time, unlike existing payment mechanisms. The high-energy use of distributed ledgers based on “proof of work” has also been a hindrance to the growth of digital assets as a payment system, but this issue may be mitigated by transitioning to more energy-efficient ledgers based on “proof of stake.” The rapidly increasing growth of stablecoins, however, may signal the broader acceptance of these digital assets as media of exchange and a payment mechanism.

Cryptocurrency financial supervision framework

Without action by the federal banking agencies to affirm the ability of banks to engage in digital-asset activities on behalf of customers, clients will increasingly look to nonbank financial service providers and limited-purpose banking institutions for digital-asset products and services. Because banks often have multiple regulators, it is important for regulators to take a coordinated approach that fosters innovation and gives banks clarity regarding the supervisory expectations for safe and responsible digital-asset activities. As regulators proceed, Council members think it is important to maintain a dual focus on (1) providing

² See, e.g., Authority of a National Bank to Provide Cryptocurrency Custody Services for Customers, OCC Interpretive Letter #1170 (July 2020) (providing that national banks have the authority to perform safekeeping and custody services for digital assets).

regulatory clarity to banks about offering these services to their customers and (2) ensuring that all other providers of these services are held to the same standards as depository institutions.

Specifically, Council members encourage banking regulators to do the following:

- Confirm banking organizations have the general authority to engage in digital-asset activities, so long as such activities fall within core or incidental banking activities.
- Clarify how banking organizations may adapt their existing risk and compliance management frameworks given the unique risks, such as KYC/BSA/AML, associated with cryptocurrencies.
- Along with the other financial regulators (i.e., the Securities and Exchange Commission and the Commodity Futures Trading Commission), develop a framework to assist banking organizations with categorizing the appropriate treatment of digital assets (e.g., as a security, commodity, or virtual currency) to provide more clarity on applicable regulatory treatment and supervision.
- Engage with international regulatory bodies to promote global uniformity in digital-asset regulation and classification.

The ability of nonbanks and limited-purpose banking institutions to offer digital-asset banking-type products outside of the federal banking regulatory framework undercuts the government's ability to ensure financial stability, protect consumers, and ensure the consistent application of national AML and national security priorities. Simply put, entities that serve as depositories of new types of money or that provide payment services similar to those offered by banks should be subject to the same type of cyber-security, AML/BSA/OFAC, consumer protection (e.g., Regulation E) and safety and soundness frameworks and supervision as banks.

Item 7: Bank Examinations

How would the Council recommend re-balancing onsite and offsite bank examinations, in light of the COVID-related shift in the mix of these two approaches? Considering both the quality and quantity of communication and information flow, is something lost when exams are conducted remotely?

Overall, the transition to off-site examinations since the onset of the COVID pandemic has been broadly effective. The enhanced use of communication platforms, security technologies, and remote access have allowed for the continued flow of information while maintaining the safety and soundness of institutions.

Council members agree that a good balance between on- and off-site examinations can be struck, especially when in-person communications with senior managers and directors are prioritized. Council members noted the benefits and efficiencies technology can create in the off-site process.

The shift to remote examinations enhanced efficiency for the examiners and financial institution staff, particularly for off-site data, loan files, and policy reviews. Some Council members expressed support for expanding the use of "self-service" approaches, in which examiners remotely access secure repositories through a direct connection to bank systems and data in order to conduct reviews with reduced reliance on management to collect, package, and deliver information.

While these technologies are effective, proper planning, communication, and security protocols are critical. There are challenges in uploading large amounts of data remotely, and there are security concerns for storing sensitive information. Having a dedicated IT support contact available to assist with access requests or technology issues would be beneficial.

From a communication perspective, some Council members found the remote process made exam coordination easier, as meeting requests were more formal and could be scheduled throughout the day through the use of remote video platforms, without the time constraints that are inherent in on-site examinations.

On the other hand, several Council members mentioned technology and communication challenges, as fully remote exams can become overly reliant on email communication, and differences in video conferencing services and capabilities can delay and disrupt virtual sessions.

A lack of coordination among examiners may also lead to the disruption of bank management teams through duplicate requests and follow-up meetings.

Overall, Council members appreciate the effectiveness of off-site examinations; however, some Council members noted inefficiencies with fully remote exams, with one of the major downsides being the reduction of frequent, informal, and face-to-face communication. In-person interactions have historically allowed institutions to deliver information in a more comprehensive manner, leading to more accurate examination findings.

An equally important function of the exam is understanding and reviewing strategic plans, key initiatives, and organizational culture. This process is best facilitated through on-site, in-person communication. Similarly, face-to-face interactions between bank personnel and examiners build relationships and trust.

As an example, in pre-pandemic on-site examinations, the increased frequency of informal conversations between bank staff and examiners ultimately led to a better flow of information and promoted a comprehensive understanding of key issues for both parties. On-site initial meetings along with frequent check-ins have allowed bank managers to offer perspective on issues and concerns that may arise during an examination.

The consensus among Council members is to create a hybrid approach for examinations going forward. This model would leverage the lessons learned from the COVID-related shift by maintaining efficiency improvements in technology and communication while continuing to foster and develop strong relationships with senior management and key bank staff. Some Council members noted that it may be premature to finalize the balance between on- and off-site examination activities until there is more clarity on the duration and long-term impact of remote work arrangements.

Under a hybrid model, much of the supervisory work and routine exams for lower-risk areas would continue to take place off-site. Several Council members noted that this approach would allow for a reduction in the on-site office space currently used to accommodate examiners and associated logistical support.

With the reduced on-site footprint, accommodations can be made to ensure continued communication between bank and supervisory staff and to help build relationships between new regulators and bank management. An example given was the creation of informal “office hours” used during examinations to discuss areas of concern and ensure all requests are being met.

When using a hybrid model, it is critical that key meetings between management and examiners take place in person. These meetings facilitate open dialogue and offer the opportunity for management to discuss strategic plans and emerging risks while giving examiners an opportunity to convey regulatory areas of emphasis or changing examination dynamics.

Overall, most Council members encourage the regulatory agencies to consider the adoption of a hybrid examination model, as efficiencies can be realized by maintaining flexibility between on- and off-site examinations. While the COVID pandemic has shown the effectiveness of remote examinations, it has also illustrated how in-person interactions between management and regulators are critical to the ongoing success of the supervisory process and for the continuing safety and soundness of institutions.