

## Record of Meeting

### Federal Advisory Council and Board of Governors

Thursday, February 5, 2026

#### Item #1: Economic Activity

**How would Council members characterize their clients' and contacts' assessments of their near-term economic prospects? How are businesses' assessments affecting their production, investment, and inventory management strategies? Are consumers' assessments causing them to alter the level or composition of their spending or saving? What is the Council's outlook for the pace of business and consumer spending in 2026?**

Despite softer job and income growth and higher costs stemming from tariffs, the economy remained surprisingly resilient throughout 2025, with clients expressing cautious optimism about the near-term outlook for 2026. Although optimism around AI-driven innovation and robust equity market performance has supported consumer spending and business capital expenditures, many remain mindful of risks associated with elevated equity markets and continued domestic and geopolitical policy volatility and uncertainty. Overall, assessments of near-term economic prospects were characterized by cautious optimism, tempered by uncertainty.

Businesses generally view the economy as resilient, even as they acknowledge pressures from trade policy shifts, a cooling labor market, and broader geopolitical uncertainty. Many firms appear prepared to move forward but are doing so with heightened awareness of potential risks and a greater focus on efficiency and adaptability in production and inventory management. Businesses have generally adapted to an environment of persistent uncertainty and are now operating with a clearer sense of what constitutes a “normal” operating environment. Firms serving low- to middle-income consumers reported greater pressure, while those catering to higher-income households continued to experience relatively steady demand. Outside of AI-driven spending, businesses are advancing investment spending selectively, continuing to invest where demand is solid or strategic priorities warrant it.

Consumer spending has held up better than expected, despite muted labor income growth and a softening labor market. Spending patterns were generally described as stable but increasingly bifurcated. There is little evidence of broad pullbacks in overall spending—particularly in higher-income markets—though consumers remain discerning and price sensitive. Consumers continue to express pessimism, driven by concerns about job security, the overall cost of living (for example, insurance, energy, and food prices) and housing affordability; however, this sentiment has not yet translated into weaker spending. Consumer sentiment is at record lows, highlighting a disconnect between financial-market resilience and broader public perception. Overall, the economic tone is one of resilience accompanied by underlying skepticism, rather than robust expansion.

Looking ahead in 2026, the Council members generally anticipate slow but stable growth, broadly comparable to 2025, with limited expectations of a sharp acceleration or a contraction. Although weaker job and income gains will undoubtedly remain a headwind for consumer spending, the anticipated fiscal boost from the One Big Beautiful Bill Act is projected to help sustain the expansion and keep consumer spending elevated, particularly in the first half of the year. Additionally, favorable depreciation provisions and corporate tax cuts in the legislation are expected to support non-AI-related business investment, which has contracted over the past year. While the near-term outlook has improved, downside risks remain elevated, particularly in the second half of 2026.

## **Item #2: Labor Markets**

**How strong is businesses' demand for labor at this point, relative to the available supply? Are there significant geographical or occupational areas of stress or slack in the market? How does the Council see the levels of employment and compensation evolving in 2026?**

Some Council members reported signs of cooling in the labor market, while others described a more balanced or normalized labor market, with sector-specific differences persisting. Although business demand for labor is not as elevated as in recent years, it continues to exceed available supply in several key occupational areas. Hiring behavior has shifted toward retention and internal optimization, with most businesses focused on retaining current employees rather than expanding headcount.

Council members observed that labor supply constraints persist in skilled trades, healthcare, engineering, technology, and revenue-generating roles, while availability has improved for white-collar support functions. These shortages are particularly acute in rural areas and regions facing housing affordability constraints, which continue to limit worker mobility and labor force participation. Meanwhile, the supply side remains challenged by an aging workforce and reduced immigration.

Geographically, labor market stress remains concentrated in sectors and regions reliant on skilled workers—particularly construction, healthcare, and advanced manufacturing. Some coastal and metropolitan areas are also experiencing constraints due to housing affordability and immigration-related effects on labor availability. By contrast, greater slack is evident in administrative and white-collar support roles, where labor supply and demand have largely come back into balance.

Looking ahead in 2026, employment levels are expected to remain broadly stable, with companies moderating hiring rather than cutting jobs. Firms are generally adapting by investing in cross-training, automation, and selective restructuring instead of broad-based hiring. Compensation growth is forecasted to normalize in the 3 to 3.5 percent range, though wage pressures are likely to remain elevated in high-demand technical and skilled positions. Despite ongoing efforts to improve productivity and implement operational efficiencies, compensation expectations remain elevated and relatively sticky across industries.

## **Item #3 Inflation**

**Are businesses reporting pressures to their input and labor costs, or concerns about how such pressures might evolve across sectors in 2026? Are Council members observing or foreseeing any trend in business' pricing power or pricing behavior?**

While moderating to some extent in 2025, progress on reducing inflation appears to have stalled, with core personal consumption expenditure readings remaining stubbornly closer to 3 percent rather than the Federal Reserve's 2 percent target. Labor market costs have moderated, and rental rates are easing in several regions, but tariff-related expenses—particularly for construction materials, transportation equipment, and other industrial goods—remain key drivers of elevated inflation. Additional pressures come from rising property and casualty and health insurance costs, as well as growing demand from AI data centers, which is pushing up electricity prices. Farmers are reporting notable increases in costs for fertilizer, phosphate, feed, and fuel, while restaurants and hospitality firms continue to face pressure from these same input costs, as well as labor expenses. Overall, wage growth has slowed but remains above historical norms, as competition for highly skilled and specialized labor continues to force upward adjustments for hiring and retention—especially in healthcare, where a shortage of nurses, technicians, and other roles persist.

Despite this, inflationary conditions were generally described as having stabilized at elevated levels rather than continuing to accelerate. Many businesses reported that the sharpest increases in labor and input costs appear to have passed, particularly compared with 2024 and early 2025. Council members highlighted that organizations have adapted to the current inflation environment through efficiency measures such as automation and AI adoption, capital investments to reduce labor dependence, optimization of physical

footprints, and more disciplined budgeting. Ample capital availability has enabled many firms to pursue these strategies, supporting margin preservation even as costs remain elevated. Several businesses also cited merger and acquisition (M&A) activity as a strategic response to inflation, allowing firms to achieve greater economies of scale, reduce unit costs, and enhance pricing leverage.

Council members reported that most businesses indicated they have largely passed higher costs on to customers and that consumer resistance has so far been limited—especially among higher-end consumers. Professional services firms, notably accounting and insurance agencies, generally reported strong pricing power, achieving higher billings and profits without proportional increases in labor costs. Confidence in price stability has improved, and pricing behavior has shifted materially as businesses report fewer reactive price increases, shifting away from frequent adjustments toward longer pricing intervals, and choosing to absorb modest cost increases rather than risk reducing demand. Some reported that certain firms have regained a degree of pricing power, in part because customers are prioritizing reliability, execution, and trusted relationships over lowest-cost bids. As earlier low-margin or aggressively priced contracts expire, companies are increasingly resetting prices upward, improving projected profitability with limited customer pushback thus far. Businesses are implementing strategies such as cost pass-throughs, strategic pricing, margin negotiations, contract escalators, and proactive supply chain adjustments.

Across commercial real estate development, input cost pressures have largely stabilized. Developers report that both material prices and labor costs have leveled off, reducing uncertainty around project budgets. Pricing practices have increasingly moved toward cost-plus and open-ended contract structures, with widespread use of escalation clauses, tariff contingencies, and short-duration quotes to manage ongoing volatility in labor, materials, and insurance costs. Most construction material costs are reportedly passed directly through to project owners without additional markup. High overall costs have led to project delays, rescoping, or cancellations, though fewer projects are being postponed than in prior years. Combined with lower interest rates, this improved cost visibility is enabling more projects to move forward in 2026, even as pro forma debt service coverage ratios remain tight. Conversely, other parts of the construction market—particularly residential—show signs of competitive pricing pressure, with larger contractors bidding aggressively or below historical margins to maintain backlog and keep crews deployed. This has placed downward pressure on margins and signals softer demand, even as headline construction costs remain high. Sectors such as retail, healthcare, agriculture, and service-based businesses have less pricing flexibility and are experiencing rising credit stress.

Although Council members noted that there do not appear to be outsized inflation concerns for 2026, uncertainty remains around potential increases to input costs—particularly related to tariffs—as lower-cost inventory purchased prior to trade policy changes is replaced at higher prices. Additional pressures could arise from energy, geopolitical, or regulatory changes. Overall, Council members expect inflation in 2026 to remain manageable but structurally embedded, with current pricing increases largely accepted as “the new normal.” This has resulted in more conservative pricing strategies, reduced product offerings, and a heightened focus on cash flow stability, which is restraining investment amid increased margin pressure.

Many businesses expect to raise the prices they charge customers over the coming year; however, these increases are likely to be driven more by cost pressures than by pricing power. Consumers are expected to remain price sensitive, prompting firms to be cautious about passing through additional cost increases. With labor demand moderating and lower-income households facing increasing financial strain—as reflected in the first declines in the savings rate since 2022 in October and November—overall pricing power is unlikely to strengthen in 2026.

Council members also noted longer-term risks to the inflation outlook. Persistent underinvestment and affordability challenges in the housing market are likely to exert upward pressure on rents over time. Similarly, insufficient investment in global energy infrastructure may drive higher energy and utility costs in the next few years, with electricity demand increasing to support AI and data center growth. Additional

factors, including higher costs associated with reshoring, rising trade barriers, lower immigration, and expansionary fiscal policies, may further contribute to cost pressures.

#### **Item #4: Federal Reserve Policy**

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

Council members support the recent decision to maintain a stable rate stance. Inflation remains above target, and the current rate does not appear to be putting pressure on growth or economic activity. Council members support a data-dependent approach to guide the timing of future rate cuts. The case for maintaining the current rate is further supported given the stable unemployment numbers. Council members remain cautious about the labor market and feel close monitoring is warranted to assess potential downside risks in consideration of a move to a more accommodative stance.

Council members support the Federal Reserve's continued limited purchases of short-term Treasuries in amounts sufficient to ensure that liquidity remains ample for financial market participants. These purchases appear to have had the desired effect of easing liquidity conditions in the money markets and the broader banking system. Council members believe that maintaining these purchases is important to keep reserves at sufficient levels within the banking system.

#### **Item #5: AI-Related Investment**

**How would Council members characterize the pace of AI-related investment spending by their business customers and business contacts at this point? On what investment categories are they spending: buildings and infrastructure; equipment; software? What sources of funds are they tapping into? Are their projects proceeding smoothly, or are they encountering bottlenecks, supply-side constraints, or other frictions? How satisfied are they with the results of their AI investments thus far? How would Council members characterize their investment plans for the next several years?**

AI adoption is increasing steadily, though the pace varies widely by firm size and technological maturity. Large enterprises are moving quickly, shifting from early experimentation to broader, enterprise-level deployment and treating AI as a central component of ongoing modernization efforts. Smaller and mid-sized businesses (SMBs) are adopting AI more gradually, integrating capabilities into existing platforms and as practical use cases become clearer and easier to implement. Most businesses now view AI as an essential component of long-term competitiveness. Many SMBs report that their AI investments largely consist of upgraded enterprise resource planning, customer relationship management, and human resource information system platforms with embedded AI copilots, rather than custom-built solutions. There is little evidence of firms developing proprietary models or standalone AI platforms, particularly among companies with revenues between \$10 million and \$100 million. Overall, AI adoption continues to gain momentum, with organizations across sectors advancing along the adoption curve at a steady, upward pace. At present, the technology appears to be used mainly to increase productivity and limit new hiring, rather than to fully replace workers.

AI-related investment is concentrated in a few key areas. The largest technology-focused organizations continue to direct significant resources toward expanding data center capacity, acquiring land, and upgrading power and utility infrastructure to support scaled AI model deployment. These firms are also investing in advanced computing, specialized networking equipment, and automation technologies. In several asset-heavy sectors—including manufacturing, logistics, and healthcare—firms are making incremental investments in equipment and edge technologies that enable real-time AI decisionmaking, though these deployments still account for a relatively small share of total spending. For most other

businesses, investment is primarily focused on software and related services, including AI-enabled capabilities delivered through existing platforms and the integration and support needed to put those capabilities into practice.

AI initiatives are being funded through a combination of internal and external sources, which vary by firm size. Large organizations typically draw on capital expenditure programs and technology budgets, and some supplement these with bank credit facilities. Capital-intensive projects, such as data center development, increasingly rely on bank loans, insurance and private capital markets, and asset-backed or corporate bond issuances. Smaller firms continue to rely primarily on internal cash flow and subscription-based software spending, with selective use of bank credit for incremental equipment or facility upgrades.

Large data center projects are moving forward, though in some cases construction is outpacing the installation of project-specific power generation equipment or general grid availability. Small and mid-sized business AI projects underway today are focused on practical, operational use cases—such as workflow automation, document processing, and customer interaction tools—most of which are delivered through embedded features in existing platforms rather than through custom model development. Council members highlighted a range of practical, operational use cases, including a professional services firm using AI for document review, research, and workflow automation; a commercial real estate developer using AI to improve project management, scheduling, and construction timelines; a physician group piloting AI-enabled scheduling and revenue cycle management tools; and a wholesale distributor leveraging AI-assisted demand forecasting to improve inventory turnover.

Early outcomes are directionally positive, with many firms reporting improvements in efficiency, accuracy, and cycle times, but results remain uneven and highly dependent on the maturity of underlying data foundations. Organizations with strong data governance and unified, well-managed data environments are achieving faster deployment and more meaningful gains, while those with fragmented or low-quality data continue to experience limited benefits and slower progress. In addition, the employee learning curve for AI represents a cultural shift that is likely to impact the pace of adoption across most firms.

Banks expect AI investment to expand steadily over the next several years, with larger institutions planning to increase spending on enterprise-grade data environments, model development platforms, core system modernization, and increasingly automated, agent-driven workflows. These firms view AI as a structural component of long-term competitiveness and expect it to remain a protected investment priority even in variable economic conditions. SMBs anticipate a more gradual path, advancing adoption as core providers and fintech partners deliver more mature, supervisory-aligned capabilities, and as proven use cases accumulate. Across the industry, AI is becoming embedded in multiyear strategic plans, with spending expected to rise as tools become more reliable and as data governance and operational readiness improve.

The widening gap in AI between large and small financial institutions mirrors the early digital transformation era, when firms with the resources to modernize first gained advantages in scale, efficiency, and data maturity. A similar pattern is emerging today: larger financial institutions are advancing rapidly in AI, while smaller firms are progressing more gradually. However, this divergence is not predetermined. Smaller organizations can still succeed as fast followers by building strong data foundations, focusing on practical use cases, and partnering with trusted technology providers.

As AI advances, financial institutions face rapidly evolving fraud risks. Deepfakes are increasingly being used to impersonate executives, creating the potential to disrupt operations, while AI-driven social engineering schemes are making fraud more difficult for employees to detect. Threat actors are also using AI to generate false identities, fabricate documents, and scale phishing attempts, underscoring the need for stronger controls, updated employee training, and modern fraud mitigation strategies.

For AI adoption to be safe, sound, and fair across established financial institutions, the regulatory environment must keep pace with innovation. Clear and consistent expectations for both established and emerging institutions are essential to maintaining fairness, enabling responsible adoption, and ensuring that

smaller banks are not placed at a competitive disadvantage. When regulatory guidance evolves in alignment with technological capabilities and is applied consistently, financial institutions of all sizes can adopt AI confidently and responsibly.

#### **Item #6: Outlook for Banking in 2026**

**What is the outlook for loan volumes, deposit flows, and credit quality in 2026? What will be the primary drivers of revenues, costs, and profitability? What sorts of risks and contingencies warrant particular attention?**

The 2026 banking outlook reflects modest improvement in loan volumes, deposit growth, and credit quality, supported by easing interest rate pressures and gradually stabilizing economic conditions. Council members generally expect low- to-mid-single-digit loan growth, with commercial and industrial lending benefitting from lower rates, increased mergers and acquisitions, and capex activity. One district reported robust commercial real estate activity, with double-digit growth but for project refinancings. Other districts noted strong lending activity tied to data centers and power generation. Council members also anticipate growth in consumer lending as declining rates support improved mortgage and home equity activity, alongside continued steady growth in credit card balances.

Council members anticipate modest deposit growth as corporate customers rebuild cash buffers and liquidity to support increased M&A activity and capital expenditures. Retail deposits are expected to grow modestly, as the employment outlook remains stable and inflation pressures ease. Credit quality is generally expected to remain steady in 2026 as borrowers benefit from lower debt service burdens. The most noted area of weakness continues to be Class B and Class C office buildings.

Council members noted that the primary driver of revenue in 2026 is expected to be margin expansion, supported by higher volumes, declining funding costs, and asset repricing. They also cited modest fee growth from payments, treasury services, and wealth management, while larger banks reported robust capital markets and trading revenues. The most significant drivers of costs continue to be wages and technology investments, including AI.

Several risks and contingencies were noted by Council members, including the following:

- geopolitical and policy uncertainties, including trade policy shifts and potential regulatory changes (e.g., credit card rate caps),
- uncertainty surrounding the path of interest rates, particularly if policy significantly differs from expectations,
- significant negative trends in employment conditions that could impact consumer behavior, and
- potential disintermediation of bank deposit bases by interest-bearing stablecoins.

#### **Item #7: Digital Assets**

**Technology and digital asset companies are increasingly competing with regulated banking organizations in providing payment services and lending. Should the Federal Reserve foster a two-way street by clarifying that the following activities are financial in nature or incidental to a financial activity under section 4(k) of the BHC Act: (1) acting as a custodian, agent or principal with respect to digital assets and/or (2) developing, using and selling general-purpose technology services for purposes of providing financial services in a way that enhances the customer experience. If so, what guardrails should be established to protect the safety and soundness and stability of the U.S. financial system?**

Council members unanimously support the Federal Reserve clarifying that acting as a custodian, agent, or principal with respect to digital assets as well as developing, using, and selling general-purpose technology services for purposes of providing financial services to enhance the customer experience are financial in

nature or incidental to a financial activity under section 4(k) of the BHC Act. As regulated institutions, banks and bank holding companies are best positioned to provide digital asset services to financial markets and customers, given their established financial stability and risk management programs. This clarification would modernize the permissible activities framework while ensuring banks can innovate and compete on equal footing with nonbank competitors.

Clarity from the Federal Reserve regarding this financial activity under section 4(k) of the BHC Act is an important first step. However, all federal banking agencies should participate in the establishment of appropriate guardrails to protect the overall safety and soundness of the U.S. financial system by applying equal regulatory treatment to the same activity, regardless of where it occurs. The promise of new and emerging technologies must be balanced with the core goals of safety and soundness.

As such, the Council members support the establishment of consistent guardrails grounded in existing supervisory frameworks, including the following:

- applying clear, risk-based capital, leverage, and liquidity requirements to digital-asset exposures on a consolidated basis;
- mandating bank-equivalent standards to ensure clear segmentation of customer and custodial assets in compliance with UCC Article 8;
- reinforcing strong governance oversight, including internal approval processes commensurate with risk;
- extending all applicable consumer protection laws, privacy and fair lending rules, and applicable anti-money laundering and countering the financing of terrorism (AML/CFT) and sanction requirements;
- establishing exposure limits by asset class, complexity, and counterparty risk, and requiring concentration limits by client and activity type;
- applying cybersecurity, data governance, and third-party risk management standards to fintech and technology partnerships; and
- requiring supervisory accountability and resolution planning for systemically significant platforms.

Allowing greater bank participation in digital-asset markets promotes the overall safety and soundness of the U.S. financial system because of the high level of focus on the management of financial and non-financial risks within the bank regulatory perimeter. Without this clarification, nonbanks may offer banking services without commensurate protections and supervisory standards, undermining the banking system, increasing risks to U.S. financial stability, and fueling regulatory arbitrage. Moreover, continued inaction could dampen innovation and inhibit competition.

### **Item #8: Stablecoins & Skinny Master Accounts**

**Congress recently enacted the GENIUS Act, which includes a prohibition on permitted payment stablecoin issuers (PPSIs) paying interest or yield on payment stablecoins. Should the Federal Reserve interpret the prohibition to apply to payments made directly or indirectly by PPSIs? Should the same prohibition apply to the payment of interest or yield on tokenized deposits? The Federal Reserve has issued an RFI on a “skinny” master account. One use of such an account would be to hold reserves backing payment stablecoins in the form of deposit claims against a Federal Reserve Bank. What guardrails should the Federal Reserve impose on access to “skinny” master accounts?**

#### **The Payment Stablecoins and Interest or Yield**

Congress enacted the GENIUS Act to provide regulatory clarity to foster the responsible use of payment stablecoins—not stablecoins generally. The statute specifically defined a “payment stablecoin” as a digital asset used or designed to be used “as a means of payment or settlement.” Accordingly, payment stablecoins are intended to function as payment instruments, not as investments or substitutes for interest-bearing deposits.

Stablecoins that directly or indirectly pay interest, yield, or the economic equivalent do not function as payment instruments. Rather, they more closely resemble money market funds or other investment vehicles and should be regulated accordingly. Permitting payment stablecoins to offer interest or yield without being subject to the regulatory framework applicable to investment products may incentivize market participants to shift funds from regulated bank deposits into more lightly regulated stablecoins. Such migration could trigger deposit flight and reduce banks' capacity to engage in the credit intermediation that is critical to driving economic growth.

These concerns apply equally whether interest or yield is paid directly by PPSIs or indirectly through affiliates or third-party intermediaries. Although the GENIUS Act is not yet effective, most interest or functionally equivalent returns on stablecoins are already provided indirectly by digital asset intermediaries rather than by issuers themselves. As a result, a prohibition limited solely to direct payments by PPSIs would be easily circumvented and would undermine congressional intent. Therefore, the Federal Reserve should interpret the GENIUS Act's prohibition on interest and yield to encompass both direct and indirect payments. As Governor Waller has observed, a payment stablecoin "is not supposed to pay interest," and payments framed as "rewards" constitute "skirting the spirit of the law."<sup>1</sup>

No prohibition on interest or yield should apply to tokenized deposits. Unlike payment stablecoins, tokenized deposits are not a new form of financial instrument requiring a new regulatory framework. Instead, they function like traditional deposits, with balances recorded on a distributed ledger. These deposits—tokenized or otherwise—are channeled into credit-creation activities that are critical to a well-functioning economy. Any restrictions imposed on tokenized deposit interest would impede technological innovation given that interest would be permitted on traditional deposits but restricted once those deposits are tokenized.

The Federal Reserve should coordinate closely with the U.S. Department of the Treasury and other federal banking agencies to ensure a consistent interpretation and application of the GENIUS Act's prohibition on interest and yield. Absent such coordination, stablecoin issuers could seek regulatory arbitrage by structuring issuance through entities overseen by different regulators, undermining the law's intent.

### **Stablecoin Reserve and "Skinny" Master Accounts**

The Federal Reserve's request for information on Payment Accounts, commonly referred to as "skinny" master accounts, states that such accounts should be used "for the express purpose of clearing and settling the institution's payment activity." An entity that uses a Payment Account to hold stablecoin reserves would be treating these accounts more like investment vehicles, contrary to the Federal Reserve's intent. To prevent these and other non-payment uses of Payment Accounts, the Federal Reserve should finalize its proposed restrictions on such accounts, including the following:

1. Payment Account holders do not receive interest on balances held at a Reserve Bank, and
2. Payment Accounts would be subject to an overnight balance limit, potentially at the lesser of \$500 million or 10 percent of the accountholder's assets.

Other proposed Payment Account guardrails—such as limiting available payment services to those that cannot trigger overdrafts—are necessary to mitigate risk to the Reserve Banks and the broader financial system. It is particularly important that banking institutions without consolidated supervision do not obtain Payment Accounts to provide payment system access to affiliates or third-party partners that conduct bank-like activities, such as extending credit, but are themselves ineligible for a Payment Account. Without such safeguards, entities could circumvent legal eligibility requirements by establishing or using an affiliate, or using an unaffiliated third party, that establishes a Federal Reserve account operated primarily for that entity's benefit, while the entity itself evades appropriate federal oversight. Additional guardrails should

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<sup>1</sup> Crypto America, Interview with Federal Reserve Governor Christopher Waller, Oct. 22, 2025, available at <https://www.youtube.com/watch?v=ymVnO6YL6NI>.

include regular federal supervision around BSA/AML, sanctions adherence, and operational and cyber risk management.

Finally, the Federal Reserve should impose limits on account balances and payment activity for new Payment Account holders during an initial trial period, until there is sufficient evidence that these accounts do not introduce unforeseen risks to the Reserve Banks, other Payment Account or master account holders, or the financial system as a whole.