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Remarks by
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Member
Board of Governors of the Federal Reserve System
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Thank you for inviting me to speak here today.¹ I will begin by looking back at the global financial crisis and the great recession, which were arriving on the horizon at about this time 10 years ago. For the United States and many other countries, this would turn out to be the most painful economic crisis since the Great Depression. The fact that we had a severe recession but not another depression is a tribute to the aggressive response of those who were in a position to act at that time.²

In the event, the financial system avoided collapse but incurred severe damage and proved incapable, for a time, of performing its key functions. That was true of the largest investment and commercial banks, several of which either failed or required taxpayer support to survive. It was also true of the many pieces of the financial market infrastructure whose structural weaknesses contributed to the crisis, such as the triparty repurchase agreement (repo) market, the over-the-counter derivative market, and prime money market funds.

The financial turmoil caused heavy damage to the real economy. Payroll employment declined by almost 9 million; over 7 million people lost their homes.³ Many young people entered a terrible job market; research shows that this may adversely affect their careers for many years. Many experienced workers who lost their jobs may suffer permanently lower income prospects.⁴

The nation faced two big tasks after the crisis. We had to get the economy growing again so people could get back to work and rebuild their financial lives. And we had to return the

¹ The views I express here are my own and not those of the Federal Reserve.

² Ben S. Bernanke, *The Courage to Act: A Memoir of a Crisis and Its Aftermath* (New York: Norton, 2015).

³ Source: CoreLogic, completed foreclosures.

⁴ See, for example, Lisa B. Kahn, "The Long-Term Labor Market Consequences of Graduating from College in a Bad Economy," *Labour Economics* 17(2) (April 2010): 303–16.

financial system to good health and address the many structural weaknesses that had become apparent.

Today, the first of those tasks is well along. We have gone eight years without a subsequent recession--one of the longest recoveries on record. Employment is now almost 7 million jobs higher than its pre-crisis peak, with all of the net gains coming from the private sector. And with unemployment at 4.5 percent, we are at or close to full employment.

But all is not well. Although job growth has been strong, gross domestic product has increased only about 2 percent annually since the crisis, held down by the weakest sustained period of labor productivity growth since World War II. Labor productivity--the increase in output per hour--has increased only ½ percent per year since 2011, about a quarter of its post-war average. The productivity slowdown has profound implications for our national well-being. This slowdown is a worldwide phenomenon, so it is likely that there are global forces at work. The slowdown has been associated with weak investment and a decline in output gains from technological innovation.

We need a national focus on increasing the sustainable growth rate of our economy.⁵ That means investing in our workforce to give them the skills and aptitudes they need to compete in the global economy. It means policies that reward work, and policies that support investment and research. For the most part, these policies are not in the purview of the Federal Reserve.

What about the second goal? As with the economy, we have made great progress toward our goals. Today, our financial system is without a doubt far stronger than it was before the crisis. The largest financial institutions now hold much higher levels of higher-quality capital.

⁵ Jerome H. Powell, "Recent Economic Developments and Longer-Run Challenges" (speech delivered at the Economic Club of Indiana, Indianapolis, November 29, 2016), www.federalreserve.gov/newsevents/speech/powell20161129a.htm.

They hold higher levels of liquidity as well and are much less reliant on runnable short-term funding. They are subject to rigorous, forward-looking capital stress tests that recognize the dynamic nature of financial risks. And they have submitted several rounds of resolution plans that are helping to ensure that they could be safely reorganized should all these other safeguards prove insufficient.

Our financial market infrastructures are also much stronger. The amount of intraday credit extended in the triparty repo market has been drastically reduced. Last year, the Securities and Exchange Commission implemented reforms that address weaknesses in the structure of prime money funds. And about 75 percent of interest rate and credit default swaps are now centrally cleared, which allows for greater transparency and more consistent risk management.⁶ While the move to central clearing has made the system safer, we need to make sure that the central counterparties have the resources and risk-management practices to withstand plausible but severe shocks.⁷

Many of the statutory provisions and regulations put in place to effect these changes were novel; it is not likely that we would have gotten everything exactly right on the first attempt. This is a good time to step back and ask what changes have worked and where adjustments should be made. Indeed, along with the other financial regulatory agencies, the Federal Reserve is contributing to just such an exercise by the Treasury Department. As I share some of my views on these issues, I should emphasize that I speak for myself and not for my Board colleagues or for the new colleagues who will soon join us.

⁶ Timothy Massad, "Remarks before the 2016 P.R.I.M.E. Finance Annual Conference" (The Hague, the Netherlands, January 25, 2016), www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-38.

⁷ The Alternative Reference Rates Committee is working to strengthen another key segment of the financial infrastructure. The Committee will select its preferred alternative to U.S. dollar London Interbank Offered Rate (or, LIBOR) and is expected to complete its plans to promote the use of this rate this year.

A few themes can guide us in this next phase. First, after years of raising capital and liquidity standards, and of stress tests and living wills, our financial system is much stronger now. We should protect these core reforms and avoid a return to the highly vulnerable system that existed before the crisis. Second, in too many cases new regulation has been inappropriately applied to small and medium-sized institutions. We need to go back and broadly raise thresholds of applicability and look for other ways to reduce burden on smaller firms. Third, the new rule book is excessively complex. We need to look for ways to simplify the rules so that they support our goals but also improve the efficiency of regulation. For example, we need to allow boards of directors and management to spend a smaller portion of their time on technical compliance exercises and more time focusing on the activities that support sustainable economic growth. Fourth, we need to continue to strive to provide an appropriate level of transparency to supervised firms and the public regarding our expectations.

Some aspects of the new regulatory program are proving unnecessarily burdensome and should be better tailored to meet our objectives. Some provisions may not be needed at all given the broad scope of what we have put in place. I support adjustments designed to enhance the efficiency and effectiveness of regulation without sacrificing safety and soundness or undermining macroprudential goals.

One example where some adjustments are warranted is our supervisory relationship with the boards of directors of banking firms. After the crisis, there was a broad increase in supervisory expectations for these boards. But it is important to acknowledge that the board's role is one of oversight, not management. We need to ensure that directors are not distracted from conducting their key functions by an overly detailed checklist of supervisory process requirements. Rather, boards of directors need to be able to focus on setting the overall strategic

direction of the firm, while overseeing and holding senior management accountable for operating the business profitably, but also safely, soundly, and in compliance with applicable laws. We are currently reassessing whether our supervisory expectations for boards need to change to ensure that these principles, and not an ever-increasing checklist, are the basis of our supervisory work related to boards.

I am sure that there are other areas where laws, regulations, and supervisory practices could be adjusted in a way that preserves the gains in safety and soundness but helps financial institutions devote as much of their resources as possible to supporting economic growth. I look forward to our discussion.