

Record of Meeting
Federal Advisory Council and Board of Governors
Thursday, September 17, 2020

Item 1: Households

What observations does the Council have about households' current economic and financial situations and their near-term prospects?

General Outlook

Council members believe that the financial condition of households generally improved over the past quarter; however, the current situation remains mixed. Some households are still experiencing job loss, while other households have benefitted from increases in financial asset values and higher savings. Millions of households remain dependent on government support and are impacted by business and school closures, uncertainty regarding whether government and employer benefit programs will continue, and the continued increase in health-care costs. Other households have maintained employment income, with many taking advantage of low interest rates to buy, refinance and improve houses and to buy new and used vehicles. Council members discussed strengthening in consumer spending rates, which may be a sign of emerging confidence. The near-term prospects for a more fulsome improvement remain dependent on progress in containing the virus and adjusting to its effects, as well as additional government stimulus; therefore, Council members agree that uncertainty remains high.

(a) Labor

Labor market conditions have improved since April, when the unemployment rate peaked at 14.7%. August's nonfarm payroll reported a 180-basis-point reduction in the unemployment rate from July, to 8.4%. While the employment picture is trending positive, Council members discussed that state-reported and nationally reported data may not be entirely aligned. Racial minorities, women, and adults with less education have also been less likely to be able to work from home, disproportionately increasing their unemployment rate. Fortunately, in August 2020, unemployment rates decreased across all reported ethnicities. Still, initial unemployment insurance claims remain above 2009's peak despite the loss of \$600-per-week supplemental benefits, which some Council members believe may have been a disincentive for many workers to seek employment and so diminished labor force participation rates. Nonfarm payrolls are recovering, but remain down almost 11.5 million workers from their February peak. All Districts reported that near-term prospects are consistent with a gradual recovery in the labor market; to date, the northwestern United States appears to have fared better than most.

(b) Labor Sectors

Job losses during the pandemic have been largely concentrated in service industries, with travel and leisure/hospitality generally being the most negatively impacted. Longer-term structural changes are likely, turning temporary job losses into permanent ones, but with new industries emerging to provide socially distant services. Goods-producing employment declined less than during the 2008-2009 recession and has rebounded faster. Prospects for state and local government employment remain challenged by budget shortfalls, and a lack of federal support could lead to yet another wave of layoffs. Overall, a spike in COVID-19 cases this fall could also have more serious consequences, delaying a return to the full-employment conditions that were experienced pre-pandemic. Council members noted some dislocation between job losses and income loss. Specifically, because much of the loss in employment appears to be more concentrated in the lower-earning jobs, a shock to income has not been as pronounced.

(c) Income

The U.S. Census Bureau's Household Pulse Survey for data collected in mid-July revealed that 51.1% of adults were in households in which someone had a loss in employment income since mid-March. The prospects for personal income growth are limited by the end of one-time stimulus payments and the expiration of weekly \$600 supplemental unemployment benefits in all states. Prospects for compensation growth are also hurt by an elevated unemployment rate, though additional stimulus could improve households' economic prospects and reduce income inequality. The Household Pulse Survey indicated that fewer than 5% of households with incomes of \$50K or less reported using their first stimulus checks to add to savings, compared to 15% of households with incomes over \$100K.

(d) Spending

Consumption has shifted amid the pandemic, away from services and towards goods and away from in-person towards online channels. High-frequency retail-store traffic data from Google Mobility suggest that activity is down by more than 14% since the pandemic began, even as the level of retail sales has passed its previous peak. Goods consumption has been helped by one-time stimulus payments, low interest rates, and at-home consumers. Spending on home improvement has been robust, while used and new retail auto and home sales have recovered strongly. Services consumption is recovering more slowly than goods spending. Data from online restaurant reservation service OpenTable show that restaurant bookings are still more than 40% below their pre-pandemic levels, consistent with social-distancing requirements. Spending on air travel also remains severely depressed, with the latest TSA screenings near 40% of normal activity. As of July, goods spending was over 2% above that of a year earlier, while services spending was down nearly 5% from a year ago. Council members believe spending on discretionary travel, eating out, and other similar services will likely remain challenged until there is an effective virus treatment.

(e) Credit & Debt

Households have been helped by the reduction of debt-service costs during the pandemic. Debt-service costs have fallen not only due to lower interest rates and mortgage refinancing, but also forbearance and deferral programs proactively initiated by most U.S. banks. Council members noted a risk that delinquencies, while modest to date, could rise for most categories of household debt, should the federal government not provide additional stimulus for unemployed workers or should employment conditions fail to strengthen. Council members noted that credit losses to date in all major U.S. consumer-lending categories were trending better than initial expectations, and that banks were more than appropriately reserved for these conditions. Council members discussed lending conditions and are now seeing an uptick in loan demand. While the most recent Federal Reserve Senior Loan Officer Opinion Survey indicated tighter lending conditions, banks represented within the Council reported that credit remains available for new loans and that banks are willing to lend to both consumer and commercial customers.

(f) Savings

Financial conditions have been marked by an accumulation of savings during the pandemic due to government stimulus payments, precautionary savings, and reduced opportunities to spend amid business closures. The savings rate was at its highest in 61 years of data in April and bank deposit balances have surged: total deposits at commercial banks exceeded \$15.5 trillion in mid-August, up over 21% from a year ago. Digital banks had also experienced outsize percentage growth, as consumer preferences continued to shift more toward digital channels.

(g) Wealth

Financial asset appreciation has improved the condition of households, following the early stages of the pandemic. Other assets on consumer balance sheets have been mixed, with household real estate appreciating and the value of noncorporate businesses likely adversely impacted by mandated business closures. The distribution of wealth gains has likely been most beneficial for affluent households, as the wealthiest 10% of households own 84% of stocks, and only 65% of households own their homes.

(h) Sentiment

Households remain concerned about the outlook. The latest readings on consumer confidence and consumer sentiment remain near their recent lows set in March-April. Not only is the pandemic weighing on sentiment, but so are the political impasse over additional fiscal stimulus, social unrest, and an upcoming election cycle. Consumer sentiment will be helped by positive news about progress with vaccines and treatments, which is more likely to occur in early 2021.

(i) Health Care

Household economic conditions have been further stressed by the loss of employer-provided health-care coverage for those who have lost their jobs. Families USA estimates that 5.4 million American workers lost their health insurance between February and May of this year, further worsening household financial stress. Additional workers may lose health-care coverage as furloughs turn into layoffs: permanent job losses were higher, at 3.4 million, in August. In addition, those who retain coverage may find that the pandemic has made health care more expensive.

(j) Schools

Millions of households are being impacted by widespread school closures. With schools closed, 22 million students who receive free and reduced-price meals at school may be going hungry. In addition, according to Care.com, 73% of parents say they plan to make major changes to their professional lives to accommodate the lack of childcare. The overall costs of work and school from home are worsening the economic situation of some families. Further, the lack of widespread internet access, including Wi-Fi, may have a disproportionate effect on lower-income households.

(k) Housing

Many households are also being pressured by their housing situation. The Census estimated that 27% of adults in the U.S. missed their rent or mortgage payment for July. Eviction moratoriums are expiring, and evictions are only being limited in some municipalities by the capacity to process them. This is leading to increased homelessness and more crowded housing conditions amid a contagious pandemic. Other households, that have the flexibility of remote work, are migrating from dense urban areas. Several Council members noted changes in customer living patterns – specifically families leaving cities for the suburbs and more remote locations. Near-term prospects for homebuying activity are helped by low mortgage rates, which have led to a surge in both new and existing home sales. However, support will be needed for many households with job losses and reduced income as the forbearance programs and eviction moratoriums expire.

Conclusion

Due to high savings, rising net worth from housing and financial assets, and limited credit deterioration at this time, Council members believe the outlook for households in aggregate is surprisingly positive given the severity of the recent shock. Therefore, a faster economic recovery may be possible. However, there are a range of experiences among households at this time and there is a risk of a two-speed economy, with recovery in sectors able to adapt to social distancing but weakness in those that cannot. These experiences could lead to structural changes in the economy, including the labor market, where participation may remain depressed and the natural rate of unemployment may move higher through time. The near-term prospects for improvement in household economic and financial conditions remain dependent on adjusting to the pandemic's effects, and additional fiscal stimulus is needed to facilitate this adjustment.

Item 2: Businesses

What observations does the Council have about the current situation and near-term prospects for businesses in various sectors, including the not-for-profit (NFP) sector?

For-Profit Sectors

- While the overall economy is in a recession, Council members have observed a very mixed story at the sector level. Generally, businesses largely dependent on the physical participation of the consumer are facing significant near-term challenges due to reduced foot traffic and higher expenditures to maintain appropriate sanitization and social-distancing protocols. Small businesses continue to be particularly vulnerable. Others, however, are doing quite well, and the third quarter will see a substantial recovery overall. The Council noted that the Paycheck Protection Program (PPP) was successful in providing short-term relief to these small businesses. Several Council members also noted that businesses that have been able to pivot and adapt their operating model to deliver their products and services leveraging technology have seen the same if not increased demand.
- Council members also have observed that across all industries, companies have embraced and accelerated their digital strategies. This is expected to have broader implications, including increased efficiencies and productivity and lower inflation. Council members have also observed ongoing disruptions in global supply chains that continue to impact a variety of industries.
- Below is commentary on selected sectors that have been impacted more than others (both negatively and positively) by the pandemic.

(a) Retail

- The Council observes that the retail sector remains under pressure, especially for those businesses that have relied more heavily on in-store transactions versus e-commerce. Over 40 large retailers have filed for bankruptcy during the pandemic, and it remains to be seen how many more will file before the economy normalizes. This is expected to have a downstream effect on retail commercial real estate.
- The Council also observes that there are retailers that have fared the same if not better during the pandemic. Essential big-box retailers such as Costco, Target, and Walmart, have become the main shopping destination for consumers and have also been able to successfully leverage their e-commerce capabilities. Fully online retailers have also outperformed as consumers have purchased more heavily through digital channels.

(b) Accommodation and Food Services (Including Groceries, Restaurants, and Bars)

- This industry has been severely impacted during their mandated shutdowns, and consumers have preferred to dine at home. Grocery stores and wine and liquor stores have performed well, especially with an increased demand of delivery of foods and drinks to homes. Groceries experienced an almost 11% year-over-year increase in sales during the month of July. On the other hand, sit-down restaurants and bars have remained severely impacted, with low customer turnout and capacity constraints.
- Within the restaurant sector, the quick-service restaurant (QSR) industry has been doing relatively better than sit-down restaurants, although the winners are those that have been able to offer takeout and delivery models leveraging technology and contactless capabilities. Bars will still remain severely stressed, as the model is heavily dependent on customer foot traffic. One Council member stated that while many restaurants have been able to adapt to curbside pick-up or outdoor dining along with to-go cocktails, their sales are still only at around 40% of pre-pandemic levels. Many participated in PPP for short-term relief, which proved to be helpful. One Council member noted that further impact to full-service restaurants will depend on geography, with winter months jeopardizing the ability of those that have been dependent on outdoor seating to remain at break-even.

Travel, Hospitality, and Entertainment

- Travel has remained soft as international and corporate travel has remained grounded and leisure travel has only modestly picked up during a season that is traditionally active. TSA traveler throughput rates show improvement. Airlines are creating more incentives for consumers to fly, including no-change fees, heightened safety protocols, and semi-full flights to ensure proper social distancing. However, research from Kayak indicates that domestic flight searches are still down between 50-60% from a year ago, while international flight searches are down between 60-75%. Car and RV travel have increased substantially, with households choosing to expend their pent-up demand for travel through domestic road trips.
- Following the travel trend, with fewer people traveling, hotels are still experiencing high vacancy rates (remaining under 50% across the county). Hotels catering to corporate and luxury travel are the hardest hit, while properties catering to budget or longer stays and leisure travel are faring better.
- Full-service hotels with meeting and banquet space continue to lag the market, in part due to the lack of conventions and conferences, as well as special large-crowd events such as weddings. Some of this is offset by special contracts for blocks of rooms for essential workers. Additionally, hotel operators continue to face higher operating costs due to increased cleaning protocols and have taken to cost control measures including furloughs to reduce expense loads. One Council member noted that resort properties are faring better than luxury or hotel properties primarily utilized for corporate travel, although they are only at about 40% of pre-pandemic levels. This improved trend began during Memorial Day weekend. Another Council member noted that about 50% of bookings are made within three days of stay, indicating the ample inventory of rooms that remain available. Geographies typically experiencing high season during the winter should experience more bookings, although still lower than pre-pandemic levels.
- The sector that remains hardest hit is the entertainment sector, as it is largely dependent on customer foot traffic and large gatherings. While large theme parks in certain geographies have re-opened with limited capacity and social-distancing guidelines in place, most venues that support this sector have remained closed. Live events in particular, ranging from sports to live shows, are severely impacted by deferred ticket sales and sponsorships. These developments are impacting the near-term profitability of this sector for all of 2020 and are expected to continue into 2021 until a vaccine is in the market.

(c) Real Estate

- The pandemic has affected the residential real estate market and the commercial real estate market in different ways, but it has similarly and negatively impacted them in densely populated cities.
- In the residential real estate market, against the backdrop of low interest rates, many households have migrated out of densely populated cities into neighboring suburbs due to extended work-from-home protocols and the desire for more square footage. As a result, home sales have been robust during the pandemic. The National Association of Realtors reports an 8.7% increase in home sales year-over-year, and almost 25% growth in home sales month-over-month during July. With an exit from densely populated cities, prices and rents for residential properties in these cities have softened and are anticipated to remain softer through 2021.
- The commercial real estate sector has a different narrative. In the office sector, physical occupancy levels remain low, especially in the metro cities, hovering between 10-35%. Densely populated cities such as New York City and San Francisco have been the most severely impacted. Large corporate offices are developing post-pandemic plans, which include determining the right square footage per worker and which roles can remain fully remote while staying productive, and redesigning the new work of the future. In the near term, as work-from-home policies have been extended for most companies, the office sector remains challenged. The long-term health of this sector will depend on post-COVID-19 office environments and, as such, remains unclear.

- In multifamily real estate, occupancy levels are in the mid-90% range, but collections are beginning to show some deterioration in some geographies (particularly in cities that were densely populated pre-pandemic) as the stimulus and enhanced unemployment benefits begin to expire. One Council member noted that property owners have not yet offered large, widespread rent concessions, but the frequency and amounts of rent concessions are increasing. Developers and lenders are closely watching supply, especially given the short- to medium-term economic uncertainty from COVID-19 and the potential longer-term shift to a reduced appetite for higher-density living. Policy decisions by government with respect to eviction moratoriums could have a material impact on asset valuations and eventual loan delinquencies.

(d) Health Care

- The health-care sector has experienced a substantial rebound compared to March, when non-essential providers were in large part closed and dealing with cancellations and postponements of elective procedures. Several Council members observed that while non-essential services have resumed since March, this segment has only reached about 60-80% of pre-pandemic levels. Even as appointment volume has increased to satiate pent-up demand, it is expected that many offices will continue performing at an operating loss into 2021, due to capacity limitations coupled with an overall slowdown in demand for elective procedures. Within the various provider types, the pandemic has hit certain specialties differently. Operators of assisted-living facilities, long-term care facilities and nursing homes, for example, are coping and reacting to the higher propensity for cases, the need to test staff and patients weekly, and higher overhead costs. One Council member noted that, in the dentistry sector, more practices are going up for sale or contemplating strategic acquisitions to scale their patient base to support ongoing operating expenses.
- The pharmaceutical sector is stable as firms remain actively engaged in the R&D effort – with private-enterprise and government dollars invested – to release a safe COVID-19 vaccine.

(e) Energy

- The energy sector broadly has been focused on cost control measures, including furloughs and pressuring oilfield service vendors to reduce their prices. Restructuring and workout activity has increased, especially for those with high pre-pandemic leverage. Equity for new and existing transactions has been limited, though a number of investors are evaluating purchases of distressed assets – similar to what happened in previous down cycles. Certain lenders are accelerating their exits from energy financing by transitioning their industry-dedicated staff to the workout department and selling individual loans in the secondary market at a discount.
- Two Council members pointed to some very early signs of a recovery in the sector but overall remain cautious, given continued weakness in global energy prices.

(f) Technology

- Technology companies have done extremely well during this time, as enterprise-operating models have largely shifted towards digital first. Business health in other sectors has largely correlated with how well firms have used technology to enable their product and service offerings and delivery. Companies have accelerated their digital strategies end-to-end, which has created increased demand for delivery of technology solutions. This has led to increased valuations for the technology sector.
- This sector has demonstrated a strong demand for debt capital and stands out as an outlier in an otherwise weak lending-demand market.

(g) Auto

- The automobile sector has experienced a rebound since April/May lows. Production levels have increased significantly but are still meaningfully impacted by global supply chain disruptions. Manufacturers have not been able to keep up with the upswing in demand, resulting in abnormally low inventory levels. Used car sales are holding steady.

Nonprofit Sector

In view of more than 1.4 million 501(c)(3) nonprofits in the country, the nonprofit sector contributes more than \$1 trillion to the U.S. economy, or approximately 5.6% of the nation's GDP. Nonprofits employ more than 10% of the country's private workforce. While very challenged, the nonprofit community has shown resiliency and innovation as it has adapted to the pandemic environment and downturn. Much like the for-profit sector, there are winners and losers based on how these organizations have pivoted their strategies. Early industry surveys predict that between 10-25% of nonprofits, by number, may be forced to close as a result of COVID-19, versus an average of 4% per year under normal circumstances.

On a positive note, supporters (new and existing) continue to show up in new ways, nonprofits have quickly adapted their programs, and most government funding of nonprofits has continued to be disbursed so far. Many organizations that rely on some level of fundraising have noted the ability to successfully raise supplemental, "emergency" monies from their donor base, including funding coming from people who had never given previously. PPP was very effective for the non-profit sector: the funding took short-term pressure off many organizations as it provided a buffer for them to operate at mostly normal levels, while they developed extraordinary funding and fundraising models to supplement the loss of program or other revenue sources. Social service agencies have not yet seen a decrease in government funding, although they are preparing for some program funding cuts in the future.

The largest factor that has put stress on the nonprofit sector is the increased need for services juxtaposed with fewer resources. As fall fundraisers are canceled or moved to virtual forums, event revenue projections are down for the year and are likely to remain at low levels. In addition, the lack of sophisticated technology and automation systems for many of these nonprofits makes it more challenging to take full advantage of a virtual platform. While the need for many direct services expands at the community level, nonprofits have had to cut expenses by furloughing staff or eliminating roles entirely. True membership organizations that rely on "in-person" experiences are also struggling. YMCAs, museums, performing arts, and Goodwill organizations are examples of these. Furloughs and lease payment deferrals are common issues facing these organizations. Organizations that are heavily reliant upon fundraising could be principally at risk, especially if they do not possess the resources to fund the minimum expense to operate.

Many nonprofits are worried that if states do not receive some level of government funding assistance through a new stimulus package, further cuts will be forthcoming. Such cuts could be more severe if local and state governments go for a prolonged period of time without supplemental aid in the face of their own decreased revenue sources. It is not known if this ability to pivot and develop alternative pathways for survival and success is sustainable for the long term, but early indications of constituent communities supporting causes and, to date, of government agencies continuing to fund their constituents are hopeful. The question is how long this will be possible if donor bases, or agency funding sources, are to focus attention elsewhere, or simply diminish over time.

Item 3: State and Local Governments

What observations does the Council have about the current situation of state and local governments and near-term prospects?

Economic impacts from the coronavirus pandemic have resulted in revenue shortfalls and increased spending for state and local governments. This strain on their finances is significant, as state and local governments are important drivers of employment and economic growth across the nation. Although many states had been able to build reserve funds over an extended period of growth, reduced revenues and higher expenses are consuming many of these resources. CARES Act funding has been adequate to cover additional COVID-19-related expenses in many regions, but concerns about additional shortfalls remain if the pandemic further impacts revenue streams. Additionally, continued confusion over additional federal stimulus has resulted in challenges in developing budget strategies at the state and local level.

In general, Council members' state and local government clients have maintained strong credit profiles, with access to both capital markets and banks. Sales tax collections, under significant stress during this period, have seen some rebound in July and August. Usage taxes, including hotel, airport, and mass transit, remain depressed, or even non-existent in some parts of the country. The decline of toll-road revenue peaked in April but has improved sharply through August, as travelers generally feel safer travelling in their own vehicles. Income tax collections, although collected later in the year, have been stable as have real estate tax collections. All told, 34 states experienced over a 20% decline in revenues from March to May 2020, compared with the same period last year (Urban Institute), and the Center on Budget and Policy Priorities estimates an overall state budget shortfall of 10% for FY 2020. Regionally and locally, there are greater pockets of stress, as shifting workforces, college closures, and continued depressed tourism and discretionary entertainment have created winners and losers. At the municipal level, cities most at risk are those that rely heavily on tourism, high sales taxes and state assistance.

Near-term prospects suggest severe budget shortfalls, service and employment cuts, and higher taxes, unless sizeable federal assistance is provided. Moody's Analytics estimates that without additional federal assistance, state and local budget shortfalls will total roughly \$500 billion over the next two fiscal years, subtracting 3 percentage points from GDP and costing more than 4.0 million jobs. However, in the absence of a federal response, individual states can be expected to examine an array of proposals designed to raise revenue that could impact businesses. Debt-related avenues to mitigating budget impacts, including securitizing revenue streams, debt service "scoop and toss" financings, deficit financing, and asset sales/leaseback structures, will likely continue to be explored at both the state and local level. Accessing the Municipal Liquidity Facility may become more palatable for many eligible governments the longer the pandemic continues, particularly given the recent rate reduction.

On the expense side, it has been evident that many states and larger cities have taken a proactive approach in addressing projected budget shortfalls by seeking immediate cuts in spending with employee furloughs and expense reductions. However, state and local governments are experiencing an increased need to spend more on unemployment benefits, complicated school reopening plans, health-care and housing services, responses to prolonged social unrest, and soaring election administration costs. Some of these issues have been growing for years, while others have been created or exacerbated by the pandemic.

Expected increases in foreclosures and evictions may burden public services, with an estimated 27% of adults in the U.S. missing their rent or mortgage payment for July, according to a nationwide survey conducted by the Census Bureau. The CARES Act protected renters living in properties with government-backed mortgages from eviction, but those provisions expired on July 25, 2020. Although many states are considering bills that would aid workers and prevent evictions, this could further stress state and local budgets.

While the CARES Act also allocated \$400 million for elections, researchers at New York University estimate that states will need an additional \$4 billion to prepare for the election cycle, with increased costs for mail-in voting and personal protective equipment for poll workers.

Health-care services and education are notable areas of strain. A hospital in Tennessee closed in August, with the owner citing severe staffing shortages and the inability to secure funding or grants from the state. In Florida, 39 hospitals have requested help from the state for respiratory therapists, nurses, and nursing assistants. The Center for American Progress expects that K-12 public education will be especially vulnerable to big budget cuts this coming year and likely for years to come because of COVID-19, unless federal assistance is given.

Congress continues to debate additional funding for states and localities. The CARES Act provided support for state and local governments in March, but that funding was earmarked solely for virus relief, and Treasury Department guidance precludes the use of those funds for offsetting revenue losses. Negotiations continue for another round of fiscal stimulus, though lawmakers have been unable to find common ground and are particularly at odds over funding for state and local governments.

The long-term economic effects of COVID-19 on state and local governments may take some time to fully materialize and may persist even as health risks dissipate. State and local tax collections tend to lag business cycles. Ultimately, a return to fiscal health will depend on an easing of the virus, increased consumer demand, vibrant tourism and more predictable revenues.

Item 4: Disparate Impact of the Pandemic

The pandemic has had a disparate and more severe impact on low-income people and particularly on people of color. How has this disparity manifested itself among banks and their retail and commercial customers? How have banks responded?

The disparate impact of the COVID-19 pandemic on diverse and low- to moderate-income (LMI) communities has been broadly documented, and banks are responding to these impacts, as well as broader calls for racial justice, through a variety of means in both the short and long term.

(a) Effect on Customers

- Council members agree that diverse and LMI communities throughout the country have experienced a greater impact from the pandemic with regard to higher numbers of COVID-19 cases,¹ less access to reliable education and childcare, and higher job losses. Low-income individuals and families and people of color are often more likely to experience loss of employment or reduced income during such economic times and are typically less likely to have emergency savings to meet the unexpected financial needs that result. Low-wage workers have suffered disproportionate job losses and are six times less likely to be able to work from home than high-income individuals. Examples of research documenting the disparate impact of the pandemic on minority populations and businesses include the following:
 - A Pew Research survey found that Blacks and Hispanics were more likely to have been personally impacted by COVID-19; to have lost jobs due to the virus; and to be unable to pay bills, make partial payments, or cover three months' worth of expenses.
 - The Census Bureau reported that 15% of Black and 15% of Hispanic homeowners missed or deferred their latest mortgage payment as of the end of July 2020, compared to 7% of Caucasians.
 - Research by the Federal Reserve Bank of New York found that, nationally, there were significant Paycheck Protection Program (PPP) coverage gaps for Black-owned small businesses, and that these businesses generally have less access to credit and fewer existing relationships with banks.
- While Council members have not yet seen a distinct financial impact of the pandemic on minority and LMI individuals with bank accounts, they expect that trend to change in the near term. Over the first half of 2020, there has been an overall increase in checking account and savings account balances across retail banks. This appears to be due to three factors. First, households that stopped payroll deposits – presumably in response to pandemic-related job losses – were able to replace that income with unemployment benefits, which were greater than previous payroll deposits for many lower-income workers. Second, overall spending was significantly reduced as people stopped spending money on things other than necessities, such as travel, dining, and entertainment. Third, in response to the pandemic, banks granted loan forbearance and waived fees for financially impacted customers.
- Council members recognize, though, that they have limited insight into the financial health of LMI and minority individuals that remain outside the banking sector. Moreover, Council members do not expect the favorable trend for banking industry customers to continue for a number of reasons.

¹ For example, a community health center in Buffalo has tested about 7,500 people evenly distributed across race. The positivity rates are 3% for white Americans, 15 % for black Americans, and 26% for refugees.

First, the lapse in federal unemployment benefits in July will quickly begin to affect checking and savings deposits. Second, as local and state lock-down and quarantine regulations are lifted, consumer spending has begun to increase, which will likely lead to increases in other types of spending and credit card balances. Finally, bank forbearance and fee waiver programs are temporary in nature. Council members expect the impact of these developments to be more pronounced for individuals in diverse and LMI communities.

(b) Banks' Response

- Council members, as well as banks generally, have offered proactive assistance to customers experiencing financial hardship due to the pandemic – including those low-income and minority customers who have been hit the hardest. Examples of customer assistance measures include:
 - Forbearance on mortgage payments, both for federally backed mortgages (as mandated by the CARES Act) and other mortgages;
 - Payment deferrals (extensions) for auto loan and credit card payments;
 - Suspension of negative furnishing to credit reporting agencies during the deferral/forbearance period (mandated by the CARES Act);
 - Account modifications for longer-term payment assistance;
 - Moratorium on mortgage foreclosures and auto repossessions;
 - Suspension of assessment of late payment fees;
 - Waived or refunded fees related to deposit accounts (e.g., insufficient funds, overdraft);
 - Forgiveness or temporary suspension of negative deposit account balances (e.g., to provide customers full access to Treasury stimulus payments);
 - Close monitoring of complaints citing COVID-19;
 - Increased outreach efforts to customers, community organizations, educational and religious facilities, municipalities, and other not-for-profit entities;
 - Virtual resources for customers, including financial education programming and multilingual websites with information to address pandemic-related concerns;
 - Collaboration with Community Development Financial Institutions (CDFIs) and other community partners by providing funding and technical assistance, which in turn support many minority and women-owned businesses.
- In addition to consumer assistance programs, many banks have been engaged in the administration of key loan programs to assist commercial customers, including the PPP and the Main Street Lending Program (MSLP). Understanding and navigating the PPP process was a complicated task that involved up-to-date knowledge of program requirements and resources to process the loans. Realizing the challenges associated with it, many banks took special efforts to ensure small businesses knew that they were ready and able to assist. Some of these efforts targeted businesses owned by low- and moderate-income individuals.
- Poor access to capital is not a new problem for minority-owned businesses, but it has been greatly exacerbated by the pandemic. In response, some Council members are rethinking the way that they approach these customers to increase lending and access to capital. For example, some banks are developing plans to encourage frontline employees to understand all avenues available to help existing and potential customers in LMI communities, such as special business credit cards and loan offerings and certain Small Business Administration (SBA) programs that are intended to assist LMI communities. In addition, banks are evaluating new product offerings and tailoring existing products to better serve minority-owned businesses. This includes borrowing programs geared towards minority- or women-owned businesses, programs for budgeting and saving towards the purchase of a home, and new-supplier diversity programs that reduce the barrier to entry for minority-owned small businesses. Finally, some banks are exploring ways they can provide additional equity or equity-like financing to minority-owned businesses.

(c) Social Justice Response

- Finally, in addition to specific responses to the disparate impact of the COVID-19 pandemic, Council members reported that banks are addressing the current national reckoning on racial injustice. While this continues to be an ongoing dialogue, financial institutions are pledging money and other resources to address racial inequality, which the pandemic and other events of 2020 have brought to the forefront of the national conscience.² Examples of bank efforts in this area include:
 - Expanding diversity and inclusion measures, such as strengthening efforts in the areas of recruiting, hiring, and talent management to develop and promote people of color;
 - Expanding community development banking programs;
 - Direct charitable contributions to organizations that focus primarily on social justice and racial equity issues (e.g., Lawyers Committee for Civil Rights Under the Law); and
 - Supporting, either financially or through other means, programs that focus on eliminating inequality in diverse and LMI communities (e.g., one Council member reported allowing employees to use paid time off to work with qualifying social justice and economic empowerment nonprofits).
- Nevertheless, there is a tremendous amount of work that remains to be done to eliminate the disparity that has become much more visible during the pandemic, and banks are responding to this call with long-term commitments and plans to work towards reducing the gap.

Item 5: Financial Institutions

How have practices changed within Council members’ institutions and between institutions and their customers as 2020 has progressed? To what extent do Council members regard these changes as temporary versus permanent? What challenges do these changes present to business practices? What potential gains and costs might be expected from an acceleration of evolutionary changes resulting from the pandemic?

General Outlook

Six months into the new operating environment, and consistent with Council members’ views in May, banks have continued to deliver products and services to both businesses and individuals with little to no disruption during the pandemic. The industry has accomplished this while focusing heavily on employee and customer safety protocols. Strategic investments in technology, digitally enabled applications, by-appointment and drive-through branch banking, and robust remote-work capabilities have enabled banks to continue meeting customer needs through all channels, particularly mobile and online channels.

(a) Institutional Practices

- In providing “essential” services, branch and other frontline bank employees continued to work on-location to deliver for customers. The most significant change noted by all Council members was the transition of non-branch employees to a remote working environment. The vast majority of office workers quickly transitioned to an alternative work environment, while banks invested significantly in new social-distancing, cleaning, and work environment protocols in order to best protect the bankers continuing to work on-site. At present, most banks are continuing to see the majority of their non-branch employee base working remotely.
- Digital transformation has accelerated to meet changing customer preferences and behaviors, which increasingly require remote, digital, and “mobile-first” banking capabilities. The PPP program also reinforced the need for technology-enabled processes, as banks deployed Application Programming

² For example, one Council member announced a commitment of more than \$1 billion to help end systemic racism and support economic empowerment of African Americans and LMI communities.

Interfaces, business process automation, and electronic signatures to facilitate loan fulfillment, or leveraged third-party fintech capabilities to meet loan demand.

- Many Council members reported higher call volumes in the customer call centers, handled largely by remote operators working from home. Some Council members see the “remote agent” or hybrid model continuing on a permanent basis in a post-pandemic environment.
- During the pandemic, banks modified branch operations, including by emphasizing drive-through services only or by-appointment in-person branch banking. Safety protocols to protect employees and customers include mandatory wearing of masks, density limitations, glass partitions, and other health-related modifications. Many of the Council members reported some restoration of “pre-pandemic operating models,” with a continued emphasis on employee and customer safety.

(b) Practices Between Institutions and Customers

- Consistent with what was reported in May, banks continue to support customers through debt payment relief and waiver of certain deposit fees. Banks also have served as the primary conduit for government lending programs, including PPP and the Main Street Lending Program.
- Customer preferences continue to change at an accelerated rate due to the pandemic, with more transactions and customer interactions moving through digital channels (mobile, online, and videoconference) and away from branches, offices, and ATMs. As banks continue to transition back to pre-pandemic commercial and retail operations, branch and ATM volumes are increasing, but remain well below levels experienced prior to March. Commercial banking activities, including transactions, banker meetings, and closings, largely remain virtual. Council members believe that a portion of the movement away from physical, in-person transactions and customer interaction is permanent.

(c) Temporary vs. Permanent Changes

- Council members uniformly believe that some of the changes in work practices will be permanent. While most employees will return to the office, some will either work permanently from home or participate in some sort of flexible or hybrid work schedule based on job category and activity. While the pace of the transition is still uncertain, Council members believe that the net result will be a reduction in bank-owned and -operated real-estate square footage over the medium to long term, even when considering modified density limitations that may remain in place in the post pandemic work environment.
- The lower volume of branch and ATM transactions during the peak of the pandemic shutdown has reversed to some extent, as parts of the country see increasing economic activity and business openings. However, Council members generally believe that there will not be a return to pre-pandemic branch traffic or in-person banking activity. Trends in digital delivery and customer preferences toward mobile, call center, and online banking channels will continue and result in a more permanent shift away from physical delivery of banking products and services.

(d) Challenges Resulting from Changing Business Practices

- Council members note that maintaining strong customer relationships and loyalty will be based on how well financial institutions can evolve and enhance and deploy digital capabilities to provide a better and more efficient customer experience. As banking services become more commoditized, service and cost to deliver will be a primary differentiator. Redefining the concept of outstanding customer service will be critical as customer interactions move away from in-person interactions to increasingly digital and remote channels.
- Banks will need to evaluate branch sizing, location, and overall footprint, as transaction volumes and sales activities continue to trend away from the branch. Council members feel that there will be an overall acceleration of branch consolidation and reduction in square footage. Given thinner branch footprints, banks will need to continue to refine the way in which they support local communities, both from a banking-services and economic/philanthropic perspective.

- The move to more remote working environments increases cyber risk and fraud risk across the industry. The acceleration of digital transformation brought on by the pandemic has increased the industry's potential attack surface, exposing organizations to increased levels of cyber threat and fraud activity.
- The remote working environment can also create challenges for bank employees, as employee engagement, collaboration, career development, mentorship, new idea generation, team-building, and project execution can all be negatively impacted in a "work-from-home" environment.
- New-customer diligence, loan underwriting, and risk assessment (including quality of management) become more challenging in an environment that eliminates or limits in-person meetings, particularly in the commercial banking space. Additional care must be taken to ensure solid underwriting and diligence processes and to mitigate heightened fraud risk.

(e) Potential Gains and Costs

- Increased investment in technology and digital capabilities will be needed across the industry, particularly in smaller and mid-sized banks, in order to meet changing customer behaviors as noted above. Council members also noted that the acceleration of digital capabilities will result in more banks seeking fintech partnerships in payments and other product areas.
- Investment in the control environment will be critical to offset increased risks associated with expanded use of technology and digital channels, as well as a more robust remote work environment.
- Increased costs will be offset, to some extent, by efficiencies created through technology investments resulting in more digitized internal processes and the lower cost of product and service delivery through digital channels. Further branch consolidation and a reduction in office square footage driven by some level of permanent remote work should also reduce overall expenses for financial institutions.

Item 6: Financial Markets

How does the Council assess the financial markets' current and prospective performance with respect to overall functioning and other trends or developments worthy of note?

The overall functioning of the financial markets has improved significantly since the disruptions caused by the COVID-19 pandemic in March. Stabilization in volatility and valuations can be attributed to the announcement of Federal Reserve facilities to restore liquidity to the markets, its ultra-accommodative policy that has driven interest rates to historic lows, and its outright securities purchases. As a result, spreads have tightened, financial markets are operating with reduced uncertainty, and liquidity and cash are no longer being acquired at premiums. Markets now operate without the liquidity strains and resultant slippage that characterized the early months of the pandemic.

Another reason the severe market turmoil in March did not result in a broader financial crisis is that banks were well capitalized and highly liquid and, therefore, able to provide massive amounts of credit to the nonfinancial sector rapidly. Between February 12 and April 1, 2020, bank loans increased by over \$700 billion, in large part because banks were funding draws on lines of credit, as large and small businesses sought to stockpile cash. (For comparison, Federal Reserve lending peaked at about \$130 billion at the beginning of April.) Despite these massive draws, banks faced no material liquidity challenges, and counterparty concerns remained largely subdued.

Equity markets have rebounded sharply, as evidenced by a 50% rise in the S&P 500 since its lows in March, bringing it to an all-time high. While the recovery reflects the brightening economic outlook and optimism around unprecedented liquidity injections by the Federal Reserve, many Council members voiced concerns about the pace of increase in equity prices, especially given the severe economic downturn and the expectation for increasing credit losses.

Additionally, there are growing concerns about high growth technology and new economy stocks, which are exhibiting signs of speculative excess and have contributed to the bolstering of equity markets. The PE ratios for the Russell 2000 growth index are trading roughly 50% higher than their trailing five-year averages and are currently at their highest levels since the technology bubble in the late 1990s. In addition, the breadth of the market has been declining, with market gains the result of increases in a handful of large cap stocks rather than broad advances across the majority of stocks. For instance, the NASDAQ 2000 index, which is dominated by large cap technology stocks, is up 28% for the year while the NYSE composite index, which includes all common stocks listed on the NYSE, is down 6.5% YTD.

The overall functioning of U.S. Treasury markets has improved with Federal Reserve purchases. However, markets may be strained by increased issuance due to fiscal stimulus. For example, the bid-to-cover ratio at the 30-year auction in August was a 13-month low, as the auction size had risen to a record \$26 billion. Federal Reserve purchases have helped absorb some of the Treasury supply. The value of Treasuries held by the Federal Reserve has risen by \$2.3 trillion over the past year, leading the balance sheet to exceed \$7.0 trillion for the first time.

Corporate debt markets are functioning without incident, helped by limited Federal Reserve purchases of corporate debt, including high-yield. Through mid-August, \$2.3 trillion of corporate debt had been issued in 2020, on pace to exceed the previous record of \$2.6 trillion in full-year 2019. This increased issuance has been driven by low yields, as the effective yield for junk-rated borrowers fell to 5.6% in mid-August from a 2020 high of 11.4% in March. However, the pandemic has caused many bankruptcies, and the Bloomberg Bankruptcy Index rose to a decade high in early August. Both Moody's Corp. and S&P Global Inc. forecast that the default rate for junk-rated U.S. corporate borrowers will exceed 12% early next year. Risk premiums across corporate bonds and a wide variety of other fixed income asset classes appear especially low considering the severe economic downturn and sharp increases in Treasury and corporate supply.

Mortgage markets are functioning well, helped by government payments to consumers, liquidity support to servicers from the GSEs, and Federal Reserve purchases of agency MBS, which have narrowed mortgage market spreads since March. Yet, spreads remain wider than in February, largely driven by elevated prepayment risk. The Federal Reserve's purchases of agency CMBS have also led CMBS spreads to tighten from their March peaks. However, non-GSE CMBS in certain sectors remain challenged, with expectations that maturing CMBS will have difficulty refinancing, especially for coronavirus-impacted sectors like hotels. GSE reform also may pose a risk to mortgage market function.

The overall functioning of ABS markets has improved since March, despite only limited direct support from the Federal Reserve through the Term Asset-Backed Securities Loan Facility. The recovery in auto ABS and non-Agency MBS has been supported by a recovery in collateral values given rising home and used vehicle prices. It is too early to determine the impact of loan forbearance programs and the PPP. There have been positive trends so far, though these conditions remain dependent on debt prioritization, employment data, and fiscal support.

The functioning of municipal markets has been good despite increased credit risk. Although the Municipal Liquidity Facility had only loaned to Illinois and the New York Metropolitan Transportation Authority through late August, the facility's existence has helped provide a funding backstop. The Bond Buyer index of 20-year general obligation bonds fell to a 68-year series low in early August, even amid elevated default risk, especially for debt related to sectors disproportionately hurt by the pandemic, such as hotels, stadiums, airports, and public transit systems.

Despite the success of monetary and fiscal stimulus measures in reviving financial markets, these actions are not without risk. U.S. national debt and related Treasury bond issuance continues to expand, and there are the beginnings of market movements reflecting outsized issuance of new debt and growth in money supply. These effects can be partially observed in the decline of the U.S. dollar against other currencies, although the trend of many trading partners to engage in quantitative easing and heavy sovereign debt issuance partially obscures these trends. More clearly seen is the decline in the value of the dollar against

precious metals such as gold and silver. With dollar weakness, gold rallied to a record, above \$2,000 an ounce, acting as a hedge against economic uncertainty and concerns of currency debasement from fiscal and monetary stimulus. In addition, U.S. sovereign credit default swap pricing (while low overall) has increased since the start of 2020.

Longer term, Council members are concerned about market distortion and moral hazard arising from the Federal Reserve's support for credit, municipal, and Treasury markets. A lack of market depth and consequent lack of market liquidity that many market participants had identified as a potential problem over the past few years required the Federal Reserve to become a market participant to an unprecedented extent, as non-bank-affiliated traders retreated from the market. A review of the causes of that illiquidity, including regulations that discourage principal-at-risk market making at banks and their affiliates, appears warranted, lest the Federal Reserve's current role become a semi-regular one.

Additionally, while U.S. government and Federal Reserve intervention reduced the impact of the initial tightening phase of the credit cycle by providing ample credit availability, Council members note concerns about the potential for credit deterioration in a second phase of the pandemic, which could rapidly tighten credit availability again. Federal Reserve tools to address a second phase are unlikely to work as well as the initial liquidity injections. The valuations of risk assets and overall credit spreads do not appear to reflect a second tightening of credit markets as defaults rise.

Item 7: Federal Reserve and Other Government Pandemic Support

What are the Council's views on the efficacy and continuing utility of various programs mandated or envisioned under the CARES Act, including liquidity facilities, targeted lending programs that have grant elements, and the Main Street Lending Program?

General Outlook

Council members are unified in their belief that government programs mandated or envisioned under the CARES Act have been very effective to this point in helping limit the economic impact of the COVID-19 pandemic. Questions remain as to how long this impact will endure and whether programs initially envisioned for a shorter duration will have to be extended in order to address continued economic dislocations.

(a) Liquidity Facilities

- Council members agreed that liquidity facilities implemented by the Federal Reserve provided support for a smooth functioning of the credit markets even though the actual utilization of the facilities was relatively low, suggesting that the Federal Reserve's commitment alone was enough to stabilize credit markets. In particular, the Primary Market Corporate Credit Facility and the Secondary Market Corporate Credit Facility, with their ability to purchase the debt of companies downgraded to a sub-investment-grade rating, have helped provide support to the corporate bond markets. For instance, at the height of the crisis, investors demanded new debt issuance premiums of more than 75 basis points over comparable secondary trading levels, a difference normally measured in single digits. Since the introduction of these facilities, in addition to generally positive economic trends and developments, credit spread indications and credit curves have returned to pre-pandemic levels or better.
- The Municipal Lending Facility (MLF) also appears to have been effective, as yields on high-grade municipal securities have fallen below pre-pandemic levels, although spreads on riskier debt have remained elevated.
- The Term Asset-Backed Securities Loan Facility (TALF) similarly narrowed spreads on high-quality ABS debt, although spreads on less liquid ABS assets remain elevated. One Council member pointed out that, although utilization has been low, the TALF continues to grow at a slow

pace, reflecting the facility's effectiveness amid uncertainty around the performance of assets backing the securities, particularly for commercial real estate and small business loans.

- The Paycheck Protection Program Liquidity Facility (PPPLF) was supported by Council members, although some members felt the attestation requirement was overly broad and limited bank usage. The Council believes the Commercial Paper Funding Facility, Primary Dealer Credit Facility, and Money Market Mutual Fund Liquidity Facility introduced before the CARES Act were also important and effective at improving market functioning.
- In addition, Council members agreed that the liquidity facilities should continue in place due to the uncertainty of the ultimate impact of the current pandemic.

(b) Targeted Lending Programs with Grant Elements

- The Council believes the Paycheck Protection Program (PPP) was very successful in supporting small and midsize businesses and employment during the early stages of the pandemic. Through the effective execution by the SBA and the banking industry, the program provided essential support to more than 5 million small businesses, allowing them to preserve millions of jobs. The SBA's Economic Injury Disaster Loan (EIDL) program also provided important liquidity. One Council member pointed out that more than half of businesses that received a loan through EIDL also received funding through PPP. Some Council members believe that an extension of the PPP program would be appropriate, as it would allow access to additional PPP funding for companies that had previously accessed a PPP loan but continue to face financial stress due to the pandemic.
- Some Council members expressed concern about how much the liquidity and lending facilities are masking the underlying condition of businesses in the pandemic, which may become apparent once these programs have ended.

(c) Main Street Lending Program

- As they previously reported, Council members continued to see very limited demand for loans under the MSLP, by either for-profit or nonprofit entities. Some Council members believe that funding provided through PPP, as well as through the Federal Reserve's financial market facilities, which has contributed to the availability of liquidity and credit for small and large businesses, may help explain the more muted level of initial interest in the MSLP.
- The most frequently cited factors for the tepid customer interest to date continue to include (i) credit currently available from existing lenders, (ii) MSLP leverage limitations, (iii) four-year maximum terms, (iv) dividend distribution and compensation limits, and (v) uncertainty of workout dynamics. Notwithstanding these issues, Council members agreed the program should continue in place in case there is increased demand in the future.

Item 8: Supervisory and Regulatory Practices

What are the Council's views on the effectiveness of regulatory and supervisory adjustments and accommodations enacted to address problems and concerns resulting from the pandemic?

General Outlook

Regulatory and supervisory adjustments and accommodations enacted to address the significant economic damage and human hardship caused by the pandemic have been effective and remain an important contributor to households and businesses accessing low-cost funding and maintaining adequate cash flow to meet their financial obligations. The Federal Reserve's actions have promoted the resilience of financial institutions and a sustainable supply of credit during the economic uncertainty. These actions have assisted banking organizations to serve as a source of strength to affected borrowers and communities and to quickly react to the changing environment.

(a) Swift Agency Action

- As the pandemic began domestically in March, the financial agencies took swift action, issuing a significant number of guidelines and actions over the next few months to refocus supervisory and industry priorities. These actions constituted a robust and comprehensive response by the agencies and were helpful to institutions of all sizes and in all geographic regions. The actions included support for institutions in meeting the needs of customers, in making adjustments to capital and liquidity requirements, and in providing guidance on operational issues. In addition, the Federal Reserve implemented numerous liquidity facilities, which have been instrumental in promoting and maintaining smooth market functioning.
- Much of the interagency guidance encouraged banks to meet the financial needs of customers affected by the pandemic. The agencies provided support for expediting requests to provide more convenient availability of services in affected communities; also, the Federal Reserve reiterated its policy of using available flexibility, consistent with regulatory requirements, to facilitate efforts to meet borrowers' needs and protect public health and safety. The changes to supervisory approach and related accommodations have assisted financial firms in responding. Institutions have offered various forms of customer assistance, such as waiving insufficient funds fees, offering low-interest-rate loans, and curing negative account balances, so that customers could receive the full benefit of stimulus payments.
- The interagency guidance, clarifying that loan modifications to borrowers temporarily affected by the pandemic are not considered troubled debt restructurings, has been a particularly important tool. It has allowed financial institutions to extend flexibility to commercial borrowers such as real estate owners, enabling these owners to provide rent relief to commercial and residential tenants. In turn, commercial tenants are better able to serve their customers, and residential tenants are better able to meet their obligations. These measures minimize the likelihood of banks' taking ownership of large numbers of properties through foreclosure and are crucial to the overall economic recovery. The financial and economic benefits of these adjustments will likely reach their maturity in the fourth quarter and may not be available going forward.
- The Federal Reserve also issued statements curtailing most non-critical examinations, extending time periods for remediating supervisory findings, and delaying regulatory report-filing deadlines. These accommodations allowed the industry to focus on critical pandemic-specific issues, including monitoring capital, liquidity, asset quality, operational preparedness, and consumer impacts.
- With the reduction in non-critical examination activity, Council members reported an increase in informal interactions with, and requests from, the agencies. In recent weeks, the industry has undergone a number of special exams related to the current environment. As examination work resumes, it will be important to retain capacity in the system to manage critical areas most impacted by the pandemic. Given the unique sharpness and severity of the pandemic-related downturn, there will likely be opportunity to accumulate lessons learned that could serve to strengthen practices after the current cycle.

(b) Additional Regulatory Actions

- The agencies implemented several other actions that have had broad positive effects across the economy and the industry, facilitating the ability of financial institutions to continue to meet customer needs while preserving capital and liquidity. For instance, the transition period for incorporating Current Expected Credit Loss (CECL) estimates into regulatory capital was increased to five years from three years, which will help mitigate a sharp procyclical reduction in lending and help banks meet customer credit needs during the pandemic. Also, with respect to Regulation D, the Federal Reserve removed limits on monthly withdrawals by savings depositors, better enabling their access to funds during the pandemic.
- Other actions have had differing benefits for banking organizations based on their size, complexity, and business model. For example, the temporary exclusion of U.S. Treasury securities and deposits

held by the Federal Reserve from the supplementary leverage ratio (SLR) benefited global systemically important banks (G-SIBs) and has mitigated unintended consequences of the SLR reducing credit availability by allowing these firms to lend with capital that would have otherwise been held against risk-free assets. These actions have promoted smooth market functioning and intermediation.

- Community banking organizations, on the other hand, have been predominate users of the Federal Reserve’s Paycheck Protection Program (PPP) Liquidity Facility and have benefited significantly from the interim rules designed to negate the regulatory capital effect of PPP loans pledged to the facility. Actions such as this have facilitated banks’ participation in the CARES Act programs, allowing them to serve as a source of economic strength to their borrowers and communities.

Conclusion

As financial institutions and their customers continue to be affected by COVID-19, the Council recommends supervisors remain cognizant of the effects of the pandemic and maintain a balanced and flexible approach, recognizing that a return to pre-pandemic conditions will likely be a gradual process. During this period, the Council encourages the agencies to continue enabling firms to prioritize their customers’ needs and to target coordinated supervisory activity to critical issues related to the pandemic and the safety and soundness of institutions. The adjustments and accommodations enacted earlier this year continue to be crucial in aiding the overall economic recovery.

Item 9: Economic Outlooks & Associated Risks

All things considered, including monetary and fiscal policy actions taken thus far, what is the Council’s expected path for overall economic performance with respect to real growth, employment/unemployment, and inflation? What are the greatest risks the Council sees to this outlook?

General Outlook

A recovery from the effects of the pandemic is underway in the United States, but the strength of that recovery remains highly uncertain. After a V-shaped rebound in May and June, the economy started to slow again in July and August as the “re-opening” phase of the recovery came to an end. The strength and trajectory of the recovery is dependent on efforts to contain the spread of the virus, the speed at which a vaccine can be developed combined with the population’s comfort in receiving the vaccine, and the continuation of fiscal stimulus until an effective vaccine is developed. As a result, the range of future outcomes is unusually wide. While a reasonable base case is for growth and job gains to continue as the nation finds ways to either contain or adapt to the virus, the recovery is likely to be uneven due to flare-ups and continued uncertainty.

(a) Real Growth

- The consensus of Council members is for real Gross Domestic Product (GDP) to contract between 5% and 6% for 2020 as strong second-half growth is not able to offset the impact of the shutdowns earlier in the year. Real GDP is expected to grow between 3% and 4% in 2021 and not return to its pre-pandemic level until the first half of 2022. The Bureau of Labor Statistics projects growth in real Gross Domestic Product to be slower from 2019 to 2029, at 1.8% annually, than it was in the previous decade, which was 2.3%. Meanwhile, labor productivity growth is projected to increase from 1.1% annually for the period 2009 to 2019 to 1.8% annually for the period 2019 to 2029, due to continued advances in technology. While there is consensus among Council members on the general path of growth going forward, the pace and timing of growth will vary by geographic region, based on any spikes in COVID-19 cases and how reliant the region is on industries most impacted by the virus.
- The outlook for consumer spending is crucial to GDP outlook, as it accounts for roughly 70% of GDP. May and June consumer spending was resilient, despite elevated levels of unemployment,

and can be attributed to the unprecedented magnitude of fiscal support via direct stimulus checks and the unemployment supplement provided under the CARES Act. The level of stimulus more than offset the loss in employment income, as evidenced by deposit balance growth. Spending on goods increased to slightly above pre-pandemic levels, fueled by the stimulus payments and pent-up demand from March and April. These boosts to spending are likely to diminish in coming months, particularly as the \$600 weekly unemployment insurance benefit has expired. Spending on services remains approximately 11% below pre-pandemic levels, as social-distancing requirements and lingering concerns about the virus dampen activity in sectors with high personal contact, such as travel, leisure, and hospitality.

(b) Employment & Unemployment

- The consensus of Council members is that unemployment will likely end the year below 9%, with employment improving over the next few years as an effective vaccine is developed and widely distributed. However, the consensus of Council members also is that full employment is years away. The Bureau of Labor Statistics projects slower annual job growth over the next ten years, with annual job growth at 0.4% for the ten-year period from 2019 to 2029. Additionally, the labor force participation rate is projected to decline from 63.1% in 2019 to 61.2% in 2029. The longer the virus hampers the full return of demand, particularly in industries like retail, travel, leisure, restaurants, and hospitality, the larger the risk of businesses closing permanently, resulting in temporary job losses becoming permanent and requiring a reallocation of workers to different industries.

(c) Inflation

- Inflation is expected to remain low for many years. While near-term inflation could continue to creep higher as prices rebound from the initial demand shock and as supply chain disruptions impact the economy, Council members expect this to be temporary. Over the next one to two years, the weak economy is likely to push inflation lower, given the ongoing slack in demand due to the slow recovery and high levels of unemployment. Additionally, longer-term dynamics of slower population and employment growth over the next ten years, as noted previously, combined with forecasted increases in labor productivity as a result of advances in and increased adoption of technology, will likely continue to exert downward pressures on inflation.

What are the greatest risks the Council sees to this outlook?

(a) Timing and Effectiveness of a Vaccine

The greatest risk to the outlook is the uncertainty surrounding the timing and effectiveness of a vaccine combined with the willingness of the population to get vaccinated. The longer the development of an effective vaccine takes, the longer it will be until a full recovery can begin and certain impacted industries return to normal operations. Additionally, the longer it takes for the development of an effective vaccine, the greater risk that certain businesses will be forced to close permanently, resulting in permanent job losses. Finally, the population's discomfort with receiving a vaccine developed faster than any in history could slow the potential recovery further.

(b) Risk of a Second Wave

A second wave of the virus, causing further shutdowns of businesses and/or stay-at-home orders to be re-instituted, would have a significant impact on the economic recovery. Businesses that have stayed open could close permanently, resulting in further permanent job losses impacting consumer spending and GDP growth.

(c) Additional Fiscal Stimulus

There is risk that fiscal stimulus does not continue or continues at an insufficient level. Early in the crisis, Congress passed legislation providing one-time stimulus payments to most households, made more people eligible for unemployment insurance, and increased benefits for all unemployment insurance recipients by a flat \$600 per week, on top of regular state payments. This provided a huge boost to household income, allowing consumers to increase their spending or savings as households saved \$1.2 trillion in the second quarter (not annualized), which equates to the amount saved over the prior twelve-month period, despite record unemployment. This resulted in the first recession on record in which personal income rose, as unemployment insurance replaced greater than 100% of wages for many workers. However, the boost from the stimulus payments is fading. The extra \$600 in unemployment benefits expired on July 31, and talks to reauthorize these payments have stalled, costing households about \$70 billion a month. Without additional stimulus, slower spending growth is likely, weighing on the recovery.

(d) November Elections

Uncertainty surrounding the outcome of the November elections may create additional risk, as significantly delayed or contested results could potentially weigh on business hiring and investment decisions, further slowing the recovery.

Item 10: Federal Reserve Policy

What are the Council's views on the stance of monetary policy?

Council members view the accommodative stance of Federal Reserve monetary policy as appropriate in the current economic environment. The Council commends the Federal Reserve for the continuing use of all of its tools to stimulate the economy during these challenging and unprecedented times.

The Federal Reserve lowered the federal funds rate to a target range of near zero in early March, provided ample liquidity, implemented large purchases of Treasury and mortgage-backed securities, instituted emergency lending facilities, and communicated a transparent view on the level of short-term rates well into the future. These actions, along with fiscal stimulus, have kept the economy afloat and provided confidence that the Federal Reserve is pulling the appropriate monetary levers to foster an economic recovery. The scale and speed of these actions have prevented a major financial crisis from occurring as a result of effects directly attributable to the pandemic.

At the Kansas City FRB Jackson Hole symposium in August, the Federal Reserve announced a major monetary policy shift to a flexible average inflation target. This will allow inflation to run above 2% for a period of time, after running below the 2% level, before the FOMC raises the federal funds rate. In addition to the inflation change, the Federal Reserve also shifted its approach to employment in a way that will focus on those individuals at the lower end of the income spectrum. The Federal Reserve will be less inclined to raise interest rates when the unemployment rate falls as long as inflation does not increase. The Council views this change in policy as appropriate at this time.

The Council appreciates the Federal Reserve's communications indicating that negative interest rates do not appear to be an attractive policy option and it supports this view. The Council also appreciates the clarity in the forward guidance the Federal Reserve has communicated regarding the direction of monetary policy.