Financial Sector Advisory Council

Meeting Minutes

Federal Reserve Bank of Dallas

2:00 p.m., February 28, 2024

Financial Sector Advisory Council Meeting

Committee Attendees:

Dawn Fitzpatrick, Soros Fund Management (Council Chair)
Hayley Boesky, BofA Securities
Frank Brosens, Taconic Capital Advisors
Gabriel Casillas, Barclays Capital
Chris Edmonds, Intercontinental Exchange
David Finkelstein, Annaly Capital Management
Britt Harris, Texas Permanent School Fund
Jarvis Hollingsworth, Irradiant Partners
Travis Machen, Morgan Stanley
Henry McVey, KKR
Purnima Puri, HPS Investment Partners
Mark Seidner, PIMCO

Federal Reserve attendees: Lorie Logan, Robert Triplett, Tom Falk, Claudia Aguirre, Sam Schulhofer-Wohl, Mike Schetzel, Karel Mertens, David Teeples, Mark Wynne, Emily Greenwald, Seth Searls, Daron Peschel, Roberto Coronado, Alessio Saretto, Jim Dolmas, Anthony Murphy, Tyler Atkinson, Kunal Patel, Haoyang Liu, Ali Ozdagli, Chris Otrok, Matthew McCormick, Pon Sagnanert, Hugo De Vere, Elizabeth Delaire, Amy Chapel, Paul Wheeler, Gina Gadson-Richards, Heidi Mitchell, Lorenzo Garza, Amy McGregor, Ben Munyan, Tim Stearns

Discussion of economic and policy outlook:

Council members suggested that the resilience of the labor market and consumption, and lack of stress in household and corporate balance sheets, should permit the FOMC to be slow and methodical in determining the timing of an initial rate cut. They acknowledged that some measures of consumer health had deteriorated, but said these indicators generally remained stronger than pre-pandemic levels.

Members discussed risks to the inflation outlook. The possibility of inflation reaccelerating was viewed as a low risk, but not a negligible one. Members specifically noted that an end to the inventory destocking cycle could attenuate downward pressure on core goods prices and that constrained housing supply could be a source of upward pressure on shelter prices starting in 2025 or 2026, after a large volume of multi-family residential units is expected to come online this year.

Members also discussed easing in financial conditions over recent months, including narrowing in credit spreads for both investment-grade and high-yield bonds to historically low levels; declines were attributed both to resilient corporate fundamentals and to a favorable supply-demand backdrop for these bonds.

On balance sheet policy, members thought that the FOMC would choose to slow asset runoff to a pace closer to that of the prior episode of runoff. They also projected that this slowing would coincide with a low level of balances in the overnight reverse repo (ON RRP) facility, where eligible institutions, mainly money market mutual funds, invest overnight with the Fed. Council members believed the FOMC would not want to risk an episode of money market volatility similar to the one that occurred in September 2019. A few members discussed the outlook for the ON RRP facility, including the possibility that balances could stabilize at a positive level.

Discussion of residential and commercial real estate sectors:

Members discussed the current state and outlook for the residential and commercial real estate sectors. On the residential side, a few factors were identified as supporting the resilience of the market, including the “lock-in” effect, in which homeowners avoid moving to preserve their low-rate mortgages. This effect has limited increases in interest costs, depressed the supply of homes for sale, and supported prices. It was also noted that mortgage underwriting standards have remained strong, residential housing leverage is not elevated, and mortgage delinquencies remain below pre-pandemic levels. However, members also noted that measures of housing affordability are at historically low levels. Finally, they discussed risks facing non-bank mortgage servicers, including liquidity needs arising from increased delinquencies on certain types of mortgages as well as potential challenges sourcing liquidity.

Members also discussed the outlook for the commercial real estate (CRE) market, with a focus on risks in the office sector. Members expected the volume of maturing CRE loans this year to be well above 2023 levels, though a few members suggested that many lenders would continue to extend maturities in return for better terms. Some members drew an analogy to the previous episode of slow, prolonged stress in the retail CRE sector in the half-decade preceding the pandemic. Members also noted that some banks have recently increased loan loss provisions for their CRE portfolios. Members observed that smaller banks had generally reserved less than larger banks. This was viewed as potentially making smaller banks more vulnerable to defaults, though it was also observed that higher reserves at larger banks could partly reflect greater exposures to more distressed urban office loans.

Discussion of other risks in the financial system:

Members highlighted a broad range of economic, regulatory, and geopolitical risks. Sticky services inflation, a rising U.S. debt burden, and the potential for stagnant growth in Europe and China were cited as key economic risks. Members also highlighted the challenges posed by bank regulatory uncertainty and the costs of regulatory compliance, especially to smaller banks.