2:00 pm, February 19, 2025

Financial Sector Advisory Council Meeting

Council Attendees

Hayley Boesky, BofA Securities
Gabriel Casillas, Barclays Capital
David Finkelstein, Annaly Capital Management
Dawn Fitzpatrick, Soros Fund Management
Britt Harris, On Eagles Wings
Aasem Khalil, Goldman Sachs
Travis Machen, The Bank of Nova Scotia
Henry McVey, KKR
Karen Karniol-Tambour, Bridgewater Associates
Purnima Puri, HPS Investment Partners
Marc Seidner, PIMCO
Matthew Zames, Zames Group

Federal Reserve Bank of Dallas Staff in Attendance:

Lorie Logan, Sam Schulhofer-Wohl, Seth Searls, Mike Schetzel, Karel Mertens, Emily Greenwald, Rebecca Zarutskie, Roberto Coronado, Jody Stanley, Amy Chapel, Lorenzo Garza, Mark Wynne, Enrique Martinez-Garcia, Saikrishna Nori, Tyler Atkinson, Ali Ozdagli, Haoyang Liu, Timothy Stearns, Ben Munyan, Rosie Levy, Hugo De Vere

Discussion of Recent Drivers and Impacts of Changes in Long-Term Interest Rates

Council members discussed the increase in longer-term interest rates that had occurred since the September FOMC meeting, as well as the potential implications for real estate and other rate-sensitive sectors. It was observed that the increase in longer-term rates, which occurred despite 100 basis points of reductions in the federal funds rate, reflected a combination of higher real term premiums amid expectations of continued expansionary fiscal policy, as well as reduced expectations for further rate cuts. Members questioned whether the sharp reduction in the market-implied probability for further rate cuts this year was justified given elevated policy uncertainty. However, most members thought the low option-implied probability on rate increases was appropriate and consistent with a perceived high bar for the FOMC to hike, despite the possibility of near-term tariff-driven inflation pressures.

Council members then discussed the impact of higher longer-term rates on other markets. It was noted that spillovers to the residential real estate market were fairly limited, as households have become increasingly accustomed to higher mortgage rates, and the recent increase in Treasury yields hadn't fully passed through to mortgage rates. It was observed that mortgage delinquencies remain below long-term averages, though they are higher for mortgages guaranteed by Ginnie Mae, reflecting greater strains among lower income households. Members also discussed corporate credit markets, noting that limited issuance volumes have helped to compress spreads of corporate debt to Treasury yields. The limited overall supply of corporate debt has similarly meant that companies seeking to borrow or refinance have not struggled to find investors willing to lend.

Discussion of Expectations for Productivity Growth

Council members highlighted how the country's robust capital markets, flexible labor markets, and entrepreneurial spirit were likely to foster growth, particularly in comparison to other countries. They also thought the U.S. response to the pandemic had been relatively more helpful for productivity growth. While other countries emphasized paying employers to keep people in their jobs, the U.S. in many industries allowed unemployment to spike and more directly supported laid-off workers. That approach allowed workers to move to new jobs or start businesses as the recovery began, spurring productivity growth. Council members also suggested that productivity gains from generative artificial intelligence (AI) were still in early stages but had the potential to boost growth down the road. Overall, council members thought markets were priced for continued economic outperformance in the United States.

Discussion of Other Risks in the Financial System

Members cited a range of domestic and global risks. The elevated level of uncertainty around U.S. government policies, especially trade, was top of mind for participants. With regard to trade policy, the impact of uncertainty on investment and activity, the possible inflationary impact of tariffs, and their effect on the outlooks of foreign jurisdictions were all cited. It was noted that the degree of flexibility in exchange rate regimes would influence both inflationary and growth effects of tariffs.

Members also cited risks associated with technology, including cryptocurrency and AI, in the wake of equity price declines associated with recent AI news. The speed of technology innovation and shifts was also discussed, including the increasing reliance of the banking sector on technology provided by a small number of firms. Following discussion at the prior meeting of the potential exit of Fannie Mae and Freddie Mac from government conservatorship, some members viewed the risk of a rapid privatization as less likely.