Recent Events and Questions for the Future

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The views expressed here do not necessarily reflect the views of the Federal Reserve Bank of Chicago or the Federal Reserve System.
Outline

- **Current environment**
  - Strong labor markets
  - High inflation

- **Recent banking events**

- **Updated outlook**
Labor markets still tight

Unemployment rate
(percent, SA)

Source: Bureau of Labor Statistics via Haver Analytics
Inflation still too high

Consumer Price Index
(seasonally adjusted percent change, year-over-year)

Source: Bureau of Labor Statistics via Haver Analytics
Banking stress is a new concern

- Silicon Valley Bank and Signature Bank failed in mid-March, triggering market volatility and concerns about the banking sector

- Credit Suisse forced sale to UBS also caused concern

- SVB and Signature had atypical business models

- Banking system overall appears to be strong

- Ongoing reviews, including that led by Vice Chair for Supervision Barr, will provide clearer picture of exactly what happened
Challenges concentrated in regional banks

Bank Stock Prices
(indexed March 2022 = 100)

Source: Yahoo! Finance
SVB and Signature Bank had unique circumstances

Impact of Unrealized Securities Losses on Capital Ratio (est.)

Uninsured Share of Domestic Deposits

Balance Sheet Growth, Q1 2019 to Q4 2022

*See appendix for methodological and source notes
Overall banking system in much better shape

**Core Capital (Leverage) Ratio**

(Percent)


8.0 8.5 9.0 9.5 10.0

Small banks (<$10B)

“Midsize” banks ($10B-$250B)

Big banks (>=$250B)

Note: Leverage is the ratio of Tier 1 capital to total assets. Tier 1 capital includes: common equity; noncumulative perpetual preferred stock; and minority interests in consolidated subsidiaries less goodwill and other ineligible intangible assets. “Small” banks is the simple average of the leverage ratio for banks with <$100M, $100M-$1B, and $1B-$10B in total assets, as reported in the FDIC’s Quarterly Banking profile tables.

Source: FDIC via Haver Analytics
Deposits have moved around in response

Note: Large banks are top 25 U.S. commercial banks by assets. Small banks are all others.
Source: Federal Reserve H.8 release

Source: Investment Company Institute
Government response helped ease concerns

<table>
<thead>
<tr>
<th>Credit Extended Through the Fed's Discount Window and BTFP</th>
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<tbody>
<tr>
<td>$ Billions</td>
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<td>-----------</td>
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<tr>
<td>Primary Credit</td>
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<tr>
<td>Bank Term Funding Program</td>
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<tr>
<td>Other Credit Extensions*</td>
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</table>

*Includes loans that were extended to depository institutions established by the Federal Deposit Insurance Corporation (FDIC). The Federal Reserve Banks' loans to these depository institutions are secured by collateral and the FDIC provides repayment guarantees.

Source: H.4.1 Factors Affecting Reserve Balances
Impact on monetary policy and the outlook

- Expect banking sector concerns to lead to tighter credit conditions

- Wide range of assumptions; most credible suggest equivalent to extra 25-50 bps of tightening

- March 2023 SEPs completed in the immediate aftermath of banking events

- Overall, median SEP outlook and funds rate path similar to December with funds rate reaching 5.1% this year
## Median SEP outlook

<table>
<thead>
<tr>
<th>Projection</th>
<th>2023</th>
<th>2024</th>
<th>2025</th>
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<tbody>
<tr>
<td>GDP</td>
<td>0.4</td>
<td>1.2</td>
<td>1.9</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>4.5</td>
<td>4.6</td>
<td>4.6</td>
</tr>
<tr>
<td>Total PCE</td>
<td>3.3</td>
<td>2.5</td>
<td>2.1</td>
</tr>
<tr>
<td>Core PCE</td>
<td>3.6</td>
<td>2.6</td>
<td>2.1</td>
</tr>
<tr>
<td>Federal Funds Rate</td>
<td>5.1</td>
<td>4.3</td>
<td>3.1</td>
</tr>
</tbody>
</table>

*Source: FOMC Summary of Economic Projections, March 2023*
Takeaways

• Current environment has strong labor market and inflation that is too high

• Financial conditions will tighten due to both monetary policy and banking sector adjustments

• Expect unemployment to increase, GDP growth to slow, and inflation to come down

• We will be watching financial developments very carefully
Top: All capital ratio data are from Federal Financial Institution Examination Council (FFIEC) call reports. Common equity tier 1 (CET1) ratio is the ratio of common equity tier 1 to risk-weighted assets (RWA). Adjustments for unrealized losses were made on a case-by-case basis. For globally systemic important banks (GSIBs) – Bank of America, Citi, JPMorgan, and Wells Fargo – unrealized losses were calculated as the difference between the value of these banks’ “held-to-maturity” (HTM) securities portfolios on an amortized cost basis and a fair value basis. This amount was then subtracted from CET1 and divided by RWA to produce an adjusted CET1 ratio.

Each of the non-GSIBs had the same adjustment plus a similar adjustment for “available-for-sale” (AFS) securities. The latter adjustment was necessary because each of these non-GSIBs had opted into the accumulated other comprehensive income (AOCI) election on their call report form. The AOCI election effectively allowed these banks to net out the impact of mark-to-market valuation changes to AFS securities on their capital ratios, which GSIBs are unable to do.

Bottom left: Bars show the percent change in total assets from Q1 2019 to Q4 2022 as reported on each institution’s financial report on the FDIC’s website.

Bottom right: Bars show the estimated share of uninsured deposits based on the estimated share of insured deposits reported on each institution’s financial report on the FDIC’s website. Notably, this estimate represents the share of domestic insured deposits. Deposits held at foreign branches were excluded from this analysis.