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Statement by Mr. Sobel and Mr. Hall on United States
Executive Board Meeting
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Sound fundamentals continue to push the U.S. economy forward at a solid overall pace. Though growth in the first quarter slowed to a 1.1 percent annual rate of increase, high-frequency data show growth has now picked up. Further, the outlook is buttressed by healthy underlying conditions. Ongoing job gains continue to support disposable income growth and consumer spending. Household balance sheets have been substantially strengthened, and consumer confidence is near levels that prevailed prior to the crisis. The housing sector continues its recovery. Fiscal policy is now supportive of economic activity. Monetary policy remains accommodative, and inflation low and stable.

Indeed, the U.S. recovery from the crisis has been remarkable.

- Overall economic activity stands 10.2 percent above its pre-crisis peak (15.0 percent above the post-crisis trough), propelled by strong domestic demand.
- Unemployment has declined from a peak of 10 percent to 4.7 percent today. A total of 14.5 million private sector jobs have been created since early 2010.
- The federal budget deficit has been cut from a peak near 10 percent of GDP in FY 2009 to 2.5 percent of GDP in FY 2015, representing the largest six-year decline since the demobilization from World War II.
- Relative to disposable income, household net worth has returned to its pre-crisis levels, while debt as a share of disposable income is at its lowest level since the early 2000s.
- Since 2009, the 33 bank holding companies with $50 billion or more in total consolidated assets have added more than $700 billion in common equity capital.

Going forward, these achievements provide a strong foundation for U.S. economic growth and for tackling the challenges outlined by staff. We thank the staff for their dialogue with our authorities and generally concur with much of their analysis and many policy recommendations. We also thank staff for their thoughtful working papers, which explore a number of issues relevant to the U.S. economy.

Fiscal policy: U.S. fiscal policy has been oriented at supporting near-term growth and job creation, while ensuring that the debt-to-GDP ratio continues to remain on a strongly sustainable track. Fiscal policy has been more supportive of growth over the last two years due to a broadly neutral fiscal stance alongside greater certainty about the direction of short-term policy. The Bipartisan Budget Act of 2015 established budgetary guidelines for the 2016 and 2017 fiscal years, lessened the burden of sequestration in those years, and suspended the debt ceiling through early 2017.

Looking forward, the Administration's FY 2017 Budget would lower the deficit to a sustainable level, steadily narrowing and then eliminating the primary deficit by FY 2021 and stabilizing the headline deficit and public debt in FY 2021-2026 at 2.6 percent of GDP and 75 percent of GDP, respectively.

Notwithstanding recent upgrades to near-term fiscal policy, we concur with staff that it is vital that we meet the medium-term fiscal challenges posed by entitlement spending. Social Security and Medicare have long served as our nation's most successful social insurance programs. While we have time to act – as these program's trust funds are projected to be depleted in 2028 (Medicare) and 2034 (Social Security) – Congress should not wait until the eleventh hour, given that they represent the cornerstone of economic security for seniors in our country. The challenge is to first ensure solvency, and at the same time, look at expanding and financing improved Social Security benefits, particularly for the most vulnerable.

Monetary policy: Since raising the target range for the federal funds rate to 0.25 to 0.5 percent in December last year, the FOMC has maintained the target range for the federal funds rate and kept the Federal Reserve's holdings of longer-term securities at an elevated level. These actions reflect a careful assessment of the appropriate setting for monetary policy, taking into account continuing below-target inflation and the mixed readings on the labor market and economic growth seen this year.

The FOMC has repeatedly emphasized that the path of monetary policy will remain data dependent. At present, the FOMC continues to anticipate that economic conditions will improve further and that the economy will evolve in a manner that will warrant only gradual increases in the federal funds rate. Despite uneven economic growth over recent quarters, available indicators point to a step-up in GDP growth in the second quarter, with real disposable income growing solidly, consumer spending picking up, and the housing market continuing its recovery. A cautious approach to rate increases will keep monetary support for growth in place while the FOMC assesses whether growth is returning to a moderate pace and further progress is being made towards the FOMC's inflation and labor market objectives. The proximity of the federal funds rate to its effective lower bound also supports caution.

At the same time, the economic outlook is uncertain, so monetary policy is by no means on a preset course and the 2 percent inflation objective is a symmetric one. The actual path of the federal funds rate will depend on economic and financial developments and their implications for the outlook and associated risks. Stronger growth or a more rapid increase in inflation than currently anticipated would likely make it appropriate to raise the federal funds rate more quickly. Conversely, if the economy were to disappoint, a lower path of the federal funds rate would be appropriate. The FOMC is also closely monitoring global economic and financial developments and their implications for domestic economic activity, labor markets, and inflation.

International context: The chief risks to the U.S. economic outlook stem from abroad. In the current environment of sluggish growth, low inflation, and already very accommodative monetary policy in many advanced economies, investor perceptions of and appetite for risk can change abruptly. Moreover, the outcome of the referendum in the United Kingdom will create new headwinds for the global economy. China's economic rebalancing toward domestic demand and consumption and away from export-led growth will also shape the global outlook.

Indeed, weak and unbalanced global demand has played a role in recent years in the relatively tepid recovery in the United States, particularly in the manufacturing sector. IMF staff projections show the U.S. current account deficit heading toward 4 percent of GDP, notwithstanding a more than 1.5 percent of GDP improvement in our petroleum balance. The projected current account increase is largely due to continued effects of dollar appreciation and weaker foreign growth. In our view, the first-best outcome for the global economy and the United States would be more concerted efforts to lift domestic demand, particularly in surplus economies. We support Managing Director Lagarde's call on all countries to implement balanced policy mixes and deploy all policy levers to support robust domestic demand growth. A modernized IMF that is more candid and forceful in its reviews of issues like exchange rates, current account balances, and shortfalls in global aggregate demand would help achieve this outcome.

The Administration is committed to deepening global engagement through upgrades to the trading system. Following passage by the U.S. Congress of trade promotion authority, negotiations were finalized on the 12-nation Trans-Pacific Partnership, and the Administration is committed to securing its Congressional approval this year. The TPP represents a "next-generation" trade agreement that opens global markets and deepens integration while ensuring a level playing field and robust protections. The United States also has ongoing negotiations on agreements for transatlantic trade and investment and trade in services, and a U.S.-China Bilateral Investment Treaty.

Medium-term challenges: We appreciate the significant focus that staff gives to issues that affect long-term growth and economic well-being. Ensuring that growth is strong, and the benefits of growth are widely shared, are concerns that touch all Americans. We are largely aligned with staff's priorities and proposals in these areas.

Our understanding of the slowdown in productivity remains incomplete. There is some evidence that the deep recession had a long-lasting effect in depressing investment, research and development spending, and the start-up of new firms. These effects should ease in a stronger economy. The global reach of declines in productivity also suggests common factors that are not yet fully understood. Nonetheless, many of the policy priorities are clear. Recent bipartisan legislative agreements took positive steps by making permanent the research and experimentation tax credit and providing funding certainty for surface transportation infrastructure planning and investment over the next four years. The Administration's FY 2017 Budget proposes stepping up spending for R&D and infrastructure, paying for this investment through other deficit reduction measures. The Administration also believes that reforming the corporate tax system has a role to play in making our economy more productive, and has put forward a detailed plan that would modernize the business tax code to make it fairer and more efficient.

Making sure that our economy works for everyone lies at the heart of many recent Administration actions and proposals. Addressing income inequality, reducing poverty, and bolstering labor force participation are all critical priorities. The tax legislation passed last year expanded and made permanent key tax credits, including for higher education, children, and the Earned Income Tax Credit (EITC). The Administration has put forward proposals that would further support working families and students by: raising the minimum wage and further expanding the EITC; increasing access to child care and early education; enhancing educational opportunities by partnering with states to make community college free for responsible students; expanding apprenticeship and technical training programs; encouraging states to establish paid family and medical leave programs; and making retirement plans more accessible and portable. The Administration has also taken action where it can, for example by updating overtime regulations to extend coverage to 4.2 million Americans.

Financial sector: We share staff's assessment that regulatory reforms and improved capital positions and risk management have strengthened the U.S. banking system. The 33 large banking organizations participating in this year's stress tests had an aggregate common equity tier 1 capital ratio – which compares high-quality capital to risk-weighted assets – of 12.3 percent in the fourth quarter of 2015, more than double the level in early 2009. Moreover, this ratio fell to a minimum level of 8.4 percent in the hypothetical stress scenario featured in this year's stress tests, highlighting the increased resilience of these firms even under a severely adverse scenario.

U.S. regulators are also vigilant regarding risks in the nonbank sector. We appreciated staff's focus on asset managers and the life insurance industry, but several additional initiatives should have received greater attention, including: initiation of a rulemaking process on a framework for capital standards for systemically important insurance companies; agreement among most states that standardized principle-based valuation for life insurers will become operative next year; SEC proposals to strengthen money market funds and the asset management industry; and efforts at OFR and SEC to enhance data collection in the asset management industry. More broadly, the Financial Stability Oversight Council continues to analyze whether and how the nonbank sector could pose risks to U.S. financial stability.

Recognizing that the public awareness and momentum around financial sector reform may flag as the crisis recedes further from view, the Administration remains fully determined to complete implementation of the Dodd-Frank Act and preserve hard-won gains in financial stability. The Administration also remains fully committed to advancing the international financial regulatory reform agenda globally, working closely with the FSB, international standard-setting bodies, and other international fora.

We welcome staff's ongoing efforts to assess the drivers and impacts of the withdrawal of correspondent bank relationships. Staff usefully acknowledge the broad and complex set of factors that may be playing a role in the changes witnessed to date. More rigorous and systematic data collection efforts in affected jurisdictions would help further our understanding of the drivers. The U.S. authorities have shown and continue to demonstrate their commitment to data-driven analysis of the scope and drivers of the reduction of correspondent banking relationships; clarifying regulatory expectations, as appropriate; and outreach to financial institutions and jurisdictions on the issue, including through hosting public-private dialogues with a number of affected regions, and providing technical assistance to help countries improve their compliance with global anti-money laundering and countering the financing of terrorism (AML/CFT) standards. The IMF and World Bank play an important role in providing technical assistance and we encourage both to ensure that their work in this area is adequately resourced. The U.S. authorities will continue to work bilaterally and multilaterally to encourage the robust implementation of global standards, which must be the foundation for maintaining a secure and inclusive financial system.