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FEDERAL RESERVE GOVERNOR MICHAEL BARR: BOOMS, BUSTS, AND FINANCIAL REGULATION

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WELCOME AND MODERATOR:

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WESSEL: Good morning and welcome. I'm David Wessel, director of the Hutchins Center on Fiscal and Monetary Policy. We're very pleased to host Michael Barr here today. Michael Barr has been on the Federal Reserve Board since July 2022, and he has been a persistent advocate for tougher regulation of the financial system, and I do mean persistent. His proposal to implement the Basel III capital rules was shut down by his colleagues on the Reserve Board. He resigned as vice chair for bank supervision in February 2025 to avoid a showdown with the Trump administration over its power to remove him from that post. Yet he continues his quest. He recently dissented from the Fed board's decision to relax the enhanced supplemental leverage ratio, which if you know what it is, fine. And if you don't know what it is, don't bother. But he dissented because he said it was unnecessarily, it unnecessarily and significantly reduced bank capital levels. And today he draws from history to caution about undoing too many of the rules put in place after the global financial crisis to prevent a repeat. Michael Barr currently chairs the Fed's committee on consumer and community affairs which we'll try and talk about if we have time. A lawyer by training, Barr worked in both the Clinton and the Obama administrations, was a key player in drafting the Dodd-Frank Act of 2010, and when he was not in Washington, he was dean of the Gerald R. Ford School of Public Policy at the University of Michigan. Michael has some remarks, and then I'll join him on stage, ask some questions, and I'm happy to take questions from the audience. So with that, the podium is yours, Michael.

BARR: Thanks very much, David, and thanks to all of you for being here and those of you who are watching online. I'm here to discuss one of the most important resources that policymakers have, the lessons of history. In discharging my responsibilities at the Federal Reserve, I've been thinking a lot about history. Its study provides the opportunity to step out of the particular circumstances of today to inform our understanding of the core issues at the heart of financial regulation. While we must be attentive to new and even unprecedented challenges, experience shows that understanding the lessons of history gives policymakers a great advantage. Many of the decisions we face today have, in some form, been confronted by previous generations of policymakers. In these remarks, I want to discuss a particular pattern in the history of the financial system, which is the relationship between regulatory weakening and the economic financial cycle of booms and busts. My intent is not to rehash well-examined facts or to go over past historical episodes chapter and verse. Rather, I aim to offer perspective on this historical through line that focuses on the regulatory cycle.

It's widely accepted that the economy and financial system experience cyclical booms and busts. Booms have historically been characterized by a multitude of good things. These can include faster economic growth, workers who had been sidelined entering the workforce and improving their lives, and financial innovations that often make credit or investment more readily available. At the same time, some of the characteristics of a boom economy, such as rapid increases in credit and in financial market activity, as well as greater risk taking and leverage, can sow the seeds of busts In busts, economic activity and lending contract and asset prices decline. This can lead to rapid deleveraging and dislocation throughout the financial system, which worsen the downturn, causing job losses and business closures, homes lost, and lives upended. There are usual multiple causes that drive booms and make busts so terrible, some unique to each individual episode. But one factor that is common to many past cycles of boom and bust is weakening financial regulation. Weakening regulation often drives risk-taking and increases bank fragility during the boom, making the ensuing bust more painful. Indeed, economic research suggests that weaker regulation leads to more bank failures, setting the stage for worse recessions. Moreover, because the financial system evolves so rapidly, regulation may also continually adjust. Much financial regulatory weakening occurs simply when regulators fail to keep pace, while at other times there is a deliberate action to lower regulatory burden that ends up miscalculating the risk involved.

Let me be clear here that when I refer to regulatory weaking, I mean not only direct deregulatory actions by regulators or legislators, but also failure of the regulatory framework to keep up with changing circumstances. In principle, financial regulation should incentivize banks to engage in responsible risk-taking and build up resources in good times so that they can deal with times of financial stress and continue their vital role in the economy in bad times. The prosperity that accompanies a healthy economy should allow banks to invest in improved risk management and strong financial resources. However, a healthy economy can also reduce the effectiveness of regulatory constraints on bank risk-taking. This can occur for a host of reasons, including behavioral biases, political pressure, market dynamics, and the tendency for innovation to move more quickly than regulators. These dynamics can result in regulatory weakening during boom times. When actively pursued, this weakening often appears justified at the time and may be implemented by well-meaning policymakers, who simply miscalculate the long-run effects of their actions.

My purpose in these remarks is to recount several boom and bust episodes in American history and identify some lessons that can guide policymakers entrusted with the responsibility of promoting a strong and stable banking system. This history demonstrates the connection between regulatory weakening and cycles of boom and bust. I don't mean to suggest that more regulation is always better, or that repealing and reforming regulation isn't sometimes appropriate to remove obsolete rules and relieve unnecessary burden. But if we can at least agree that regulation should seek to limit devastating financial crises, then the history that I will describe today offers some lessons for anyone thinking about regulatory policy. There are, of course, lots of examples to choose from, both in the United States and abroad. But I'll focus on the Great Depression, the savings and loan or S&L crisis, and the global financial crisis. I'll then discuss some possible reasons that similar episodes could recur and conclude with some thoughts and the lessons we can learn.

Let's start with the biggest and most widely studied bust in U.S. history, the Great Depression. Scholars continue to debate its causes, which were multiple and complex. One compelling argument focuses on the failure of regulation to keep pace with the innovations of the Roaring '20s. As I said, I view such regulatory stagnation as a form of weakening. This weakened regulatory environment played a role in setting the stage for and then exacerbating the bust. Weakened regulation that had failed to keep up with the times left banks unable to weather shocks to the economy. The banking sector's collapse was a significant factor in making the Great Depression the most severe economic crisis that this country has ever experienced. The Roaring '20s expansion was powered by the post-war recovery and technological advances in transportation, manufacturing, and communication. Stock markets grew quickly to help finance this innovation, while residential and commercial real estate investments surged and swelling demand for consumer durables led in turn to increased demand for financing. As credit needs escalated, there was intensifying competition among banks, S&Ls, and rapidly growing non-bank finance companies, trust companies, and other financial vehicles. The 1920s were also characterized by high levels of financial speculation, both inside and outside the banking sector. Banks engaged in speculation through non-banks affiliates and supported speculation by lending. At the same time, many banks were relatively thinly capitalized. And overly concentrated especially given the lack of federal deposit insurance at the time. In addition, many states had prohibitions on branching that prevented banks from diversifying their portfolios and inhibited local competition, keeping many struggling banks alive. The stock market boomed, margin lending grew dramatically, and insider trading and market manipulation were rampant. As the financialization of the economy increased, the regulatory framework failed to keep up. Outdated branching restrictions remained, failing to reflect the size and dynamism of the modern economy. Banks gained permission to engage in new activities such as real estate lending and certain activities in the securities markets. However, capital requirements and other rules were not adjusted to reflect potential increased risks from these new activities. The cumulative effect of these events was a significantly weakened regulatory environment and a substantial buildup in risk without a commensurate increase in resources to allow the sector to withstand the risks posed. Looking back, we know now that when the economic shock hit, the banking system magnified that shock. The boom of the Roaring '20s started to go bust in 1929 when the fast growth of the past decade turned to contraction, followed by a series of financial and banking crises. In all, approximately 9,000 of the nation's 23,000 banks failed, resulting in major losses to depositors, given the lack of federal deposit insurance, and a significant contraction in credit that deepened and lengthened the economic downturn. Notably, banks and states that had more robust regulatory frameworks – for example, those that applied higher capital requirements – had lower rates of failure. In response to the financial collapse in the Great Depression, Congress adopted reforms aimed at addressing risks that had driven those panics. Among these steps, Congress established the Federal Deposit Insurance Corporation and federal deposit insurance to reduce the risk of bank runs and protect retail depositors. Congress increased regulatory oversight of banks and separated commercial and investment banking. Congress also enacted strong securities laws and created the Securities and Exchange Commission. Overall, these steps have stabilized the financial sector and ushered in a long period of quiescence in banking.

My second example today is the S&L crisis of the 1980s and early 1990s, which did substantial harm to millions of Americans and the financial system and was extremely expensive to resolve. In this episode, in contrast to the Great Depression, affirmative deregulation led to excessive risk-taking by S&Ls, as well as banks during a boom period. As circumstances soured, revealing weaknesses, Congress attempted to bolster the S&L sector by loosening the regulatory framework further. This failed to resolve the underlying stress and instead further fueled the buildup in risk-taking, worsening the losses in the subsequent bust. Let me first set the stage. The years leading up to the S&L crisis were characterized by dramatic growth in business credit in the course of the economic expansion that began in 1982. At the beginning of this period, the S&L sector primarily served the residential real estate market because of restrictions on S&L activities. These restrictions eased over the 1980s, allowing S&Ls to get significantly larger and engage in new kinds of lending. However, these changes were not accompanied by sufficient regulatory enhancements to account for the increased risks. The expansion in S&L activity also presented new competition with commercial banks, which had themselves built up significant risks as they expanded into new activities. At the same time, both S&Ls and banks were increasingly under pressure due to both high inflation and high interest rates, which disrupted their funding needs. Competition for customer funds increased dramatically, especially because of the rise of money market mutual funds, which had grown rapidly. When Congress removed outdated deposit rate caps to allow banks and S&Ls to more effectively compete for funds, it did so without implementing adequate safeguards against these new institutions taking on excessive risk. This led many S&Ls to engage in increasingly risky projects to compensate for escalating funding costs. Banks also increased their deposit rates and tools and took on more risk. As vulnerabilities at S&Ls became evident, Congress, federal regulators, and the states attempted to bolster both sectors with the hope of allowing them to outgrow those weaknesses. For instance, Congress and the states reduced restrictions on S&L's ability to invest in commercial and consumer loans. These changes contributed to the boom in commercial real estate lending, which became a key source of vulnerability. In addition, Congress and the Federal Home Loan Bank Board, the federal S&L regulator at the time, weakened capital requirements and the enforcement of those requirements for the S&L sector. This allowed institutions to become weaker and poorly capitalized entities to stay afloat, leaving S&Ls as a whole badly positioned to weather adverse circumstances. The bust, when it came, was severe. S&L losses continued to amount throughout the 1980s. Many banks also experienced severe stress. These difficulties were amplified by an eventual decline in real estate values and problems in the agricultural and energy sectors. In 1980, there were just under 4,000 S&Ls. By 1989, that number had fallen below 3,000, with over 500 of the remaining institutions insolvent, as judged by book value. And over 1,600 banks failed between 1980 and 1994. Regulatory weakening had propped up tottering institutions, allowing zombie institutions to persist, accumulating much greater losses than they otherwise would have. The process of cleaning up the sector began in earnest in the late 1980s and continued into the mid-1990s with a final cost of 160 billion, roughly 5% of gross domestic product at the time. And the cost of resolving insured banks that failed during this period was $36 billion. Congress implemented significant reforms in response to the S&L crisis, including stricter capital and accounting requirements, limits on insured depository institutions, investment powers, and expansion of regulatory enforcement authority. These changes paved the way for stability in the banking sector for some time.

I'll turn now to my final example, the global financial crisis, which had devastating effects for the millions of people who lost their livelihoods, their homes, and their businesses. In the decade leading up to the crisis, America experienced rapid credit growth and a housing boom. There was optimism about the benefits of financial innovation, such as securitization of home loans and belief in the power of market discipline as a form of self-regulation. Home prices and mortgage debt accelerated in tandem, driven by a mutually reinforcing cycle of optimism, with home prices roughly doubling between 1997 and 2006, and even larger increases in mortgage debt. Amid this boom, lending standards dropped, driven by investor demand for mortgage-backed securities, which were increasingly opaque and risky in their design, but still highly rated by the rating agencies. There was substantial growth in the over-the-counter derivatives market, including new forms of credit derivatives. Money market funds boomed, becoming increasingly linked to the off-balance sheet businesses of banks. These developments led to the emergence of large, short-funded, and interconnected financial entities, both banks and non-banks. The regulatory environment failed to keep up with these changes in activity and the increasing complexity of financial institutions and markets. And regulatory weakening heightened vulnerabilities. The Gramm-Leach-Bliley Act, enacted in 1999, permitted the creation of financial holding companies that could engage in the full range of financial activities. However, the act did not put in place a regulatory framework commensurate with a full range of financial risks and permitted non-bank firms, such as investment banks and insurance conglomerates, to compete with banks wholly outside its framework. The Commodity Futures Modernization Act of 2000 exempted OTC derivative transactions from virtually all regulation and oversight by the Commodities Futures Trading Commission and SEC. In the lead up to the crisis, regulators cut regulations further. A striking image from the time featured the head of one financial regulatory agency wielding a chainsaw to demonstrate his commitment to slashing regulations. The competitive landscape and regulatory lacuna led to a race to the bottom in standards for underwriting and issuing mortgage loans and securities, and transactions became increasingly funded by opaque and unstable short-term wholesale funding. Consumers were left unprotected as the subprime crisis grew. In addition, the largest investment banks, which were overseen by the SEC, increased their leverage with heavy reliance on short-term funding, leaving them increasingly vulnerable to any losses. These are just a few of the examples of the widespread failures in financial regulation and supervision that occurred in both the banking and non-banking sectors in the leadup to the crisis. The resulting recession and financial crisis saw the deepest and longest contraction in economic activity since the second World War, the collapse of large financial institutions, and significant government support to keep the financial system afloat, followed by a prolonged period of slow growth. In response to this crisis, Congress passed the Dodd-Frank Act, a reform package that, among other things, strengthened bank capital, addressed all balance sheet exposures and provided for stress testing. Consumer protections were strengthened, and a new Consumer Financial Protection Bureau was created. Supervisors ramped up forward-looking supervision, and in addition, banking regulators adopted capital and liquidity reform, which substantially improved the resilience of the banking sector. Setting the role that regulatory weakening played in the crisis provides a powerful reminder of the importance of preserving these regulatory gains. Reviewing these three examples together, it's striking to see the pattern of regulatory weaking during a boom, including the failure of the regulatory environment to keep pace with the evolving financial sector and how this weakening lays the foundation for a subsequent bust.

Why do we continue to see these cycles? Some reasons are psychological, others political. Humans have short memories, especially for experiences we might like to forget. The further we get from a crisis, the more its causes fade from memory and the less likely a recurrence seems. We become more likely to view regulations as unduly burdensome and place less value on the protection they offer from downside risk. The financial sector itself lobbies hard to weaken regulation, which is often effective when the last crisis seems far away. Credit cycles, financial innovation, and evolving needs of the economy are also significant contributors. As the economy changes, so do financing needs. This makes it harder to recognize when things are running too hot. In addition, regulators are understandably cautious about restraining innovations that have societal benefits, which may hinder their ability to reduce associated risks. Longstanding regulations can be subject to regulatory arbitrage, making them less effective as activities migrate outside the regulatory system. These dynamics make the financial sector unstable, feeding the boom and bust cycle. How can we do better? The first lesson is to approach the financial system through the cycle perspective and avoid thinking this time is different. In each of the booms I have covered, there was a heady confidence that market discipline would control risk-taking, that downside risks were so implausible as not to merit attention, and that easing regulation was justified. With such confidence, insufficient thought was given to how regulatory weakening might create new vulnerabilities. A bit of humility would have helped. While it is true that regulation must evolve with the economy and financial system, we need to recognize that relaxing rules can create vulnerabilities. Changes in the markets themselves can also weaken the effectiveness of regulation.

The second lesson is that policymakers should resist the pressure to loosen regulations or to refrain from imposing regulation on new activities during the boom times. With past economic downturns in the rearview mirror, regulations start to be seen as a limitation on growth rather than necessary protection against vulnerabilities. As became evident in past episodes, vigilant supervision and prudent rules on risk-taking are important to prevent future crises. While there is a trade-off, it is important to have appropriate protections in place to reduce the risks and costs of resolving busts.

Third, regulation cannot be static. If regulation fails to keep up with the evolution of the financial sector, it can create new risks or hinder growth. To conclude, an important lesson we can draw from U.S. financial crises is the role that ill-advised weakening of the bank regulatory framework played in those crises. It is well within our ability, and it is our duty as regulators, to learn from these episodes to avoid making the same mistakes. In doing so, we can help to ensure that the financial system is prepared to weather downturns and continue to serve households and businesses. Thank you very much.

WESSEL: Thank you, Governor Barr, for that interesting history lesson. I want to talk about today. So you said that when actively pursued, this regulatory weakening often appears justified at the time and may be implemented by well-meaning policymakers who simply miscalculate the long-run effects of their actions. Is that what you think's going on right now?

BARR: You know, David, I certainly worry about that. I mean, you've seen me dissent in a couple examples of recent action by the Federal Reserve Board. One area, for example, I'm quite worried about is stress testing. Stress testing was a really important innovation coming out of the global financial crisis to have a forward-looking perspective on the risks facing the largest financial institutions in the country. And that stress testing worked. It's been very, very effective. And one of the things that I'm seeing happening right now is the board is responding to the current environment by agreeing to go through a process for the stress testing that I think is likely to ossify the stress tests, make it easier for the banks to game those stress tests and make those stress tests less effective over time. So I am quite worried about this. Again, people are doing this for good, well-meaning reasons. But I'm really worried that over time, stress testing will become much less effective.

WESSEL: So one of the issues recently at the board was about how you decided whether a bank was well-managed or not, and you had some reservations about the changes that the board, your colleagues on the board voted for or voted to put out for comment. But one of things that I think is sometimes puzzling to people who are observers and not well versed in bank regulation, is on one hand, you and all your colleagues always say the banking system is safe and sound. And then we learned from this thing that you consider two-thirds of the banks with assets over $100 billion not being well managed. So it seems like there's a bit of tension there. What is this all about?

BARR: So, you know, our expectations of firms are not that they're just on the other side of avoiding failure. We want firms to be well managed. We want to firms to actually conduct their operations to the standards that are required to be a well-managed institution. That means capital and capital planning, liquidity, and it also means their governance and controls are effective across the range of risk that they face. Because we need to be forward-looking in supervision. So we're not just worried about the risks that a bank faces today, we also want to make sure they have the risk-management practices that can address risks in the future. And so we want firms to be well managed and changing the grading, having a grade inflation for banks is not the way to make them safer. And I'm again really worried that the proposal that was put out is basically just grade inflation. If you call a bank well-managed and it has a serious deficiency in governance and controls or capital liquidity that's not a well-managed firm. That's a firm that has a problem that it needs to address; that it can address in the ordinary course of its business. It needs focused attention on and the way to get that focused attention is to call it out for the deficiency it is.

WESSEL: So when you look across the financial system, the banking system, the non-bank financial system the financial markets, are there one or two risks that are particularly salient in your mind right now?

BARR: Well, I'm always worried about all the risks in the system. I'd say some emerging risks, for example, are in the crypto sector, where there's a lot of enthusiasm about new forms of financial intermediation. And it's good to have innovation in the financial system. But that innovation needs to come with clear guardrails. And we don't really, you know, we're at risk of not having the right guardrails in place, so that's an example of concern. In the private credit markets, private credit has grown dramatically. Lots of aspects of that are terrific innovations that provide credit to firms and reach them in new ways, but we haven't seen a through-the-cycle experience with private credit at this size yet. And so there are risks as that market starts to change, as it starts to be more exposed to retail investors, more exposed to short-term funding that it might get over its skis. So that's another example. And a third one -- and then I'll stop, because I could list a lot of concerns -- but a third area we've all been watching closely is the presence of the hedge fund basis trade. So this is hedge funds' participation in the treasury market, which in good time provides an enormous amount of liquidity to the Treasury markets and is really good at making sure there's matching efficiency between the futures market and the cash market and Treasury market. That's all really good in good times. But that's done with very, very high amounts of borrowed money and very little protection. So if things go wrong in the trade, those hedge funds might be in a position to rapidly pull back from the Treasury market and that could cause risks in the future.

WESSEL: Let's talk a little bit about crypto, and particularly stablecoins. So what role do you think stablecoins could and should play in our financial system? And what do you about the legislation, the Genius Act, that's now on its way through Congress?

BARR: Well, you know, right now, stablecoins largely play a role of helping people who are interested in investing in the crypto asset space transfer from one crypto asset to another crypto asset. And that's probably in the near term, the biggest use case. People talk about stablecoins being used for other purposes, for cross-border trade, for example, or for faster payments. Those use cases haven't been really proven out yet, but you know, that's for the financial sector and the private market to decide. The key thing is that stablecoins are a form of private money. And that private money, because it's based on the dollar, borrows from the trust of the central bank. And we need to be very careful as new forms of private are created. We've seen lots of examples in history where that money can become very unstable. If you're an owner of a stablecoin and you're treating it like cash you're thinking it like money like a dollar bill and you have some doubt that enters your mind, just a question, you raise a question, is this dollar really worth a dollar, you're gonna run. And those runs can be really destabilizing to the financial system and certainly to the stablecoin owners so you have to be really careful with this form of money. We had periods of time, for example, in the 1800s when we had lots of competing forms of private money in the form of bank notes, those ended up trading below par because people had these kinds of concerns. We didn't have an efficient system for the transmission of money in our economy. And that was really only fixed with the creation of the National Bank Act in a uniform currency in 1863. So we overcame the problems of fractured private money systems. We established a national currency. We established uniform currency at par. And there's a tendency now to kind of want to go back to this era of the 1830s that has some difficulties.

WESSEL: So I suppose there's one view that we ought to just ban stablecoins, but that seems impractical. It's a big market, and it's trading quite a bit both in and outside the United States. So what kind of guardrails would you like to see on stablecoins to make you less worried that they're going to be the seeds of the next financial crisis?

BARR: I think we need to have strong federal oversight, a unified approach around the country to stablecoin regulation. We need to more restrictions than we currently have now on the kinds of assets that can back stablecoins. Congress is taking steps in this direction right now, but the steps that they're taking, my belief is, my judgment is, are not going to be sufficiently strong to have a stablecoin market that you can count on. And so that presents real concerns.

WESSEL: So the stablecoin issuers have to have reserves, dollar for dollar, that's what the Genius Act says. And the question is, what can those reserves be in? And some reserves are pretty straightforward, insured deposits in banks or whatever, but the bill is somewhat --

BARR: Short-term treasury securities.

WESSEL: Short-terms treasury securities, the bill was substantially broader than that.

BARR: Right, it includes, for example, uninsured deposits at banks. It includes certain kinds of repurchase and reverse repurchased transactions. And the definitions of those are quite broad, so they could potentially include involvement of cash that's not really cash. So there's a range of concerns about that. There are concerns about, again, the lack of coherent, consistent, unified federal oversight of the sector. We could see states competing to attract issuers of stablecoins, and that could result in lowering standards over time. So there are serious issues here. I think it's better to have a framework than not to have the framework. But my best intuition is that in a couple years, Congress is going to have to come back and revisit this question, because there's going to have been some significant problem in the sector.

WESSEL: Full employment for staff and lobbyists, right? So, Michael, the Dodd-Frank Act set up the vice chair for bank supervision, a position you had for a while, and I think the idea was that somebody on the Federal Reserve Board should be accountable for supervision. Famously, during the run-up to the global financial crisis, it was pretty clear that Alan Greenspan worried a lot about monetary policy and not very much about bank regulation and we suffered the consequences. But it doesn't seem to have provided much stability. It's become rather a pendulum that swings from one administration to another. So is there some, A, do you agree that's a problem? And B, if you do, what's the solution?

BARR: I think you're exactly right about the origins of the provision. Congress wanted accountability at the Federal Reserve Board for banking regulation and supervision, and I personally think that's a really important value. It's important for Congress to understand and be able to hold the board accountable. When I was vice chair for supervision, I regularly testified on Capitol Hill. People knew what the Federal Reserve was doing and why it was doing it. And I think that's an important value to maintain. It does mean that there have been shifts in regulatory philosophy across administrations. That's really been true across the banking regulators for a very long period of time. We've seen swings in history back and forth, and I've recounted just some of them here today, but that's a longstanding issue. Bank regulation involves tradeoffs and those tradeoffs involve decisions about how much to worry about risk in the financial system as compared to efficiency gains that you might have in the shorter term and I think that's appropriate for people to debate and to disagree about

WESSEL: So is one of the issues here that the vice chair for supervision is accountable, and Congress says you shall come tell us what's going on, but you don't have the authority? You're subject to the vote of the other six governors.

BARR: That's right. I mean, the position is not a position that on rules or on major supervisory actions, enforcement actions, the vice chair can't act on her own or his own. They need the support of the majority of the board. And that also provides some checks and balances in the system.

WESSEL: Was there anything you'd change in this structure to make it work better?

BARR: Well, you know, obviously that's up to Congress to decide and I have really tried to stay out of the business of advising Congress.

WESSEL: In your current life. In my current life, in my current life. Let me ask you one question about yourself, and then I want to turn to monetary policy before I turn to the audience. Your term as a Fed governor extends to 2035.

BARR: 32.

WESSEL: 32, I'm sorry. 2032, long enough. You going to stay for that whole time?

BARR: I don't have any plans to leave.

WESSEL: That's all you're going to say.

BARR: I can't say how long I'm going to stay, but I don't have any plans to leave.

WESSEL: Okay, so this is kind of an interesting time in monetary policy. There are times when, frankly, decisions are fairly straightforward. You know, when COVID hits and the economy shuts down, it's pretty clear that the Fed has to jump in to support the economy with lower rates. And on the other hand, when inflation turns out to be worse, that's a recipe for raising interest rates. This seems like a tougher call now. We have, on one hand, the labor market's pretty good, some signs of cracks. Inflation has come down, but it seems a little stubborn. And then as you look ahead, there's the effects of the tariffs. So when you think about the economy, employment, inflation, the impact of tariffs, how are you reading things right now?

BARR: David, look, it's a great question. So the number one word we hear when I go around the country talking to businesses and to households, the number word that I hear is uncertainty. And that's what I hear around the table with my colleagues as well. That's what they're hearing from people around the county. So it is a very difficult time to make these kinds of judgments. If you look over the last few years, inflation went from a very highly elevated place to a somewhat elevated place. We've made substantial progress on inflation. That is starting to trend the other way. So we don't want to make too much out of one or two months' data, but recent data coming in suggests that inflation may be coming back up a bit. The labor market is solid, but as you said, there are some cracks, so we want to make sure we're attentive to making sure that unemployment doesn't rise excessively. We're in a place right now where the board, the FOMC, as you've heard Chair Powell say, believes we're in position where we can wait and see. And I think that's right. Our policy is probably moderately restrictive right now. We can watch and see as tariffs come in. We're beginning to see some imprint on inflation prints. If you look over the last couple of months, services inflation continues to moderate, but goods inflation, which had been basically zero or negative, is now positive, and this month very positive, positive meaning high. Durables went up quite a bit, if you look at, cars seem to, the tariff effect on cars seems to not be in printing yet, but if you look at other durables, they shot up quite a lot last month. Again, you don't want to make too much of one month's data, but it is something we're watching and we need to look over the next bit of time to really understand how tariffs are going to pass through to prices, whether that price effect might continue for some time or be a one-time effect. What is it going to do or not to inflation expectations? Long-term inflation expectations so far are very well anchored. So we really need to wait and see how the data come in, how that data affect our evolving outlook, our forecast for the next period of time, and how to weigh the balance of risk in this period. And so I do think we're in a period where it's appropriate, given that level of uncertainty, changes in policy, uncertainty about how that policy translates into the economy, for us to wait and see.

WESSEL: So the thing you're waiting to see, it sounds like, is a lot on the inflation side. What happens with tariffs and inflation? You seem less worried that the labor market's weakening.

BARR: Well, you know, right now I would say the labor market is solid, but as tariffs come to have a greater effect in the economy, they will push up prices, but also will lower growth. So in the first half of this year, we're likely to have seen a moderation in growth from last year. And I expect in the next half of the year, were going to see a further moderation in growth over the second half of 2025. So we are also going to need to be quite attentive to the labor market. And if there's too much weakening in the labor market, we also might need to take steps for that reason. So it really is a question of being attentive to the ways that tariffs are having an effect on the economy. And obviously, it's not just tariffs. So dollar depreciation has an effect on inflation, immigration policy has an effect on potential growth and on growth, we're seeing much lower levels of immigration, net immigration in the economy. That means there are fewer workers. It means there's lower demand, but also fewer workers, so supply and demand are going down. Potential growth goes down, growth goes down, so that has an effect on economic output we have to be attentive to. Fiscal policy, obviously, is another area where we're quite attentive to the ways in which fiscal policy has an effect, both in the short-term and on longer-term interest rates. So we're looking at the whole picture, the policy picture, what's going on in the economy, what the data are telling us, what that data coming in tell us about how we should adjust our forecast and then balancing those risks. I think we're in a wait and see mode.

WESSEL: Your turn. I'm going to take two or three questions, wait for a mic because there are a lot of people online, tell us who you are, and remember a question ends with a question mark. So someone up there is taking the oath of office, can you give him the mic?

AUDIENCE QUESTION: Hi, Alan Loeb, Washington attorney. I have a compound question, and the first part of it is, regarding crypto, whatever happened to Gresham's law? And secondly, thank you for reviewing the history, because I think the history has lessons, and you have brought out a great many about risks in financial markets. But you have stated them in such general principle, I wonder if you would say that those same dynamics from the history that you have identified also apply beyond financial markets, for example, to environmental regulation where there is a risk due to under regulation that the social cost will greatly exceed the social benefit or the private benefit. Thank you.

WESSEL: Thank you. Can you pass the mic behind you?

AUDIENCE QUESTION: Do you want me to ask it now, David?

WESSEL: Yes.

AUDIENCE QUESTION: Ryan Tracy with Capital Count. I wanted to ask you about the separation of banking and commerce. There's obviously a longstanding principle, but you talked about what's happening with stablecoins. In that bill, non-financial companies would be allowed to issue one. The FDIC has a number of ILC charter applications from non-financial companies. The OCC has a numbers of trust bank applications from crypto and fintech firms. And it feels like this isn't being talked about very much. What's your perspective on whether that concept is relevant and whether the right approach is being taken at the moment?

WESSEL: Thanks. Is there another one? There's a woman on the aisle here.

AUDIENCE QUESTION: Hi, I'm Jessica Heckel with UBS Financial Services. You talked about private credit being an area of risk. Can you elaborate on that a little bit more? Oftentimes, asset managers talk about the loans being first lien, senior secured, they're backed by private equity sponsors. So is it something you see as being pockets or just overall, especially since we haven't seen it play out over a cycle?

WESSEL: Three good questions. Why don't we start with, do you see an analogy to environmental regulation?

BARR: So I'm very careful in my current role to stay in the lane that I have, which is a big enough lane talking about the macro economy and the financial system. So I kind of going to pass on providing commentary on environmental regulation.

WESSEL: What about, Ryan Tracy asked the question about, are we eroding the notion that we should separate banking and commerce? And I wonder if maybe you could start with a little historical perspective there. Why do we have this idea and are we eroding it?

BARR: So lots of countries do financial regulation differently. Many countries permit commercial firms and banking firms to connect with each other in a variety of ways. In the U.S., since the Great

Depression, we've historically separated those, and I think that's provided some meaningful benefits to our economy. One of them is efficiency. So when financial firms connect with commercial firms, it can lower the competition for the provision of commercial loans in the economy. There's less competition for commercial loans. You can get less availability. You can higher pricing for commercial loan activities. So part of it is it's more efficient for the financial sector to be separated from the commercial sector in terms of benefits to the real economy. A second risk when you blend these together is that you're bringing in risk from the commercial sector into the banking system or into the financial system and that can cause risk to the the financial companies. So for example in the global financial crisis, we had major auto lenders that were connected to the automobile companies fail and were eventually bailed out by the federal government because of risks in the automobile sector that came from the Great Recession. So there's a little bit of additional protection to the financial sector that comes from separating those two things out. And you can also get, if you combine those things, institutions that have enormous economic power over broad sections of the economy, also able to bring that power to bear in the financial sectors. So that's a third reason historically we've separated those out. In the stablecoin bill, there is the possibility for a very large technology company, for example, or a very larger merchant to offer their own stablecoin. And so you could get some of this blending of commercial and financial activity that I described before that might skew power in the system, reduce deficiency in the system, and create some additional risk to the financial sector.

WESSEL: And do you see some erosion? He mentioned industrial loan corporation applications, some changes in trust companies.

BARR: Yeah. I do think that you're going to see the ILC charter kind of take off again. That seems to be the zeitgeist of the moment. And that reintroduces that same kind of difficulty that we've seen in the past.

WESSEL: And then private credit. Maybe we should define our terms. Private credit are loans that are often made by firms that are not banks, that don't necessarily have the same capital requirements and definitely don't have the regulation. Often they raise money from sometimes from institutional investors, sometimes now more from retail investors to lend outside the banking system. So what's the problem here and what's the opportunity? I think one question is, if the banks were doing a good job, why did this grow up? Some of the argument is that you guys overregulated the banks and made it too hard for them to make loans, so it became easier for Apollo and BlackRock to step in.

BARR: So let me start with the upside of private credit. So one of the upsides is the structure of, historically, the structure private credit funds involve substantial equity and also the borrowing from those institutions historically came from outside the banking sector. The loans that were being made were made to institutions that had a lot of leverage themselves and not necessarily loans that the banking sector would want to make, but sometimes loans that were in direct competition with banks in the leverage loan market, in the syndicated loan market. More competition for provision of commercial loans, generally that's a good thing. It can reduce pricing. So what are the risks in that sectore? So one risk is a private credit sector of this size hasn't been through the cycle. So we don't know what kind of performance we're gonna see. A lot of --

WESSEL: You mean, if we have a recession, they might not look so good.

BARR: Exactly, exactly. And the spreads that are in that sector suggest that the loans are riskier than their reported performance. And one of the things that happens with many of these loans is they have what's called a payment-in-kind feature. And the payment- in-kind feature, if the firm gets in trouble and can't an interest payment, the firm is allowed to basically either put that interest payment into the final payment or to raise more debt to pay off the interest payment or raise more equity to pay off the interest payments. And that payment in kind feature thus masks delinquencies that are occurring in the sector, so we can't see them. There's not a lot of public information about the private credit sector, so it's relatively opaque and that raises some concern. Then there's some additional features of private credit that are starting to develop, that have not been historically part of the model, but are now becoming more part of a model. So one of those is raising money from retail investors, rather than from institutional investors or accredited investors; going retail. The second is using short-term funding as part of the model. If you have long-term funding and a long-term asset, that works really well. If you've got short-term funding and a long-term asset, a liquid asset, that maturity transformation can be risky. And so there's more short-term borrowing in the market. There's much more reliance on bank liquidity in that market than there was a decade ago. So the private credit market is not a separate thing. It is deeply connected to the banking system. You have banking firms themselves having affiliates that are doing private credit. So the connections between the banking sector and private credit have grown significantly. And you can't just treat it as something that might happen over here with no effect on the banking system. So those are the kinds of risks. I'd say we're also seeing some types of related risks in connection with the insurance sector. So we have in the life insurance sector a number of very large firms are now owned by private equity. Private equity-owned life insurance firms are much more likely than other life insurance firms to have significant alternative assets in the private equity space. Private credit are also funding those same arrangements. Those same life insurance firms are more likely to have short-term funding, basically forms of securities that provide short-term funding, use of the federal home loan banks to provide short-term funding. Short-term finding is not historically part of the life insurance market. You have long-term assets and long-term liabilities and so the introduction of that short-term funding model to the life-insurance sector connected to private credit and private equity is a related source of risk.

WESSEL: I meant to ask you, you now have this role as chairman of the consumer committee on the board. What's your priority there?

BARR: So I think there's enormous work that we can do at the Federal Reserve Board and around the country to foster financial inclusion. It's an area that I've been working on for 30 years of my career. And the Federal reserve has an important role to play in doing that. We just had a financial inclusion conference yesterday to bring people from around the country together to talk about innovative ideas, whether that's things like promoting access to safe and affordable bank accounts. Using alternative data like cash flow underwriting to access the market. Things like FedNow and faster payments to make it easier for low-income people to control the payment flow, their income and their payment out. So financial inclusion is a really critical area that I think will be really important going forward that I'd like to foster.

WESSEL: There's a question here on the front. The mic's coming to you.

AUDIENCE QUESTION: Thank you, Nagara, from New York City. Thanks, David. I was here almost 10 years, 15 years, when we had a conversation with Ben Bernanke and also Jay Powell here. My question is, as a Fed governor, it's been close to 20 years that we had a last financial crisis. Do you see something is brewing in the sense that the Fed is already thinking in the lines of creating the helicopter money or something like in the lines OLA orderly creating the authority? In a sense, what are your thoughts in that, because you're raising the concern that ease of regulations might cause another collapse. So thank you.

WESSEL: Is there another question in the back? There's two in the back. There's one behind you, two Tristan after you.

AUDIENCE QUESTION: Yes, Thomas Ward. I'm an economist. I was at the World Bank for 10 years and so forth. My concern is we talk about regulations, regulations, regulations. You look at the Dodd-Frank Act, all that it does is consolidate banking. How does that help consumers when they have less choices? You look the result when Frank then was a board member of a bank that failed. So clearly there's issues and how is that really making a difference? And when you look at what Jamie Dimon are saying about the banking situation and so forth. Your thoughts.

WESSEL: There's one behind there, somewhere in the back I saw.

AUDIENCE QUESTION: Hi, Luke Dillingham, FINREG lab. In a past Brookings event, Peter Conti-Brown and Sean Vanatta had argued that there's this overuse and abuse of confidentiality in the bank supervision space. And I was wondering about your thoughts on that and potentially if more transparency would help us move towards a system where we have fewer of this cyclical cycle of regulatory weakening.

WESSEL: So why don't you start with the last one? At least I understood that question.

BARR: Let me just say that I think that the confidentiality of bank exams is actually an affirmative value, a really important thing. For one, we need to have a banking system that has the trust and confidence of the American people, and having the ability to have confidential communications I think is important for that. And second, you can think of the supervisory relationship with a bank as, in part, providing frank and useful exchanges between the employees of the bank, the managers of the banks, and supervisors. And if that were all public, I worry about the reduction in useful exchange of views that would happen. And I think it would likely reduce the ability of supervisors to make a difference in the conduct of the management of the bank over time.

WESSEL: So the question was, do you see a financial crisis brewing? Can you tell us when it's going to arrive and what's going cause it?

BARR: Well, let me start, as I did in the remarks, by reflecting a little bit on history, and in this case, very recent history. So we had a stress in March of 2023 in the banking sector with the failure of Silicon Valley Bank and First Republic Bank and Signature Bank. And that was in part, not in full, but in part caused by the deregulation that had happened in the period before that. The Federal Reserve and other banking agencies reduced our supervision of regional banks. And we reduced the requirements, for example, that they had to be stress tested. And that contributed to the financial stress in March 2023. People have already forgotten about that episode, even though it was just about two years ago, because the federal government intervened. The Federal Reserve, with our colleagues at the FDIC and the Treasury Department, intervened, created an emergency lending program, the bank term funding program, that was widely used in the banking sector by institutions of all sizes as we wanted. And we put in place an emergency exception to least-cost resolution so that the FDIC could protect uninsured depositors. Because the fear was that if those uninsure depositors couldn't make payroll, on Monday morning, there'd be widespread panic in the banking system among uninsured depositors that would particularly harm regional and community banks. So we had to step in in a really quite massive way to prevent that stress from becoming a financial panic. And the intervention worked. And it worked so well that nobody remembers that we had stress in the banking system just two years ago, so. The lessons from history are not lessons that only apply to periods in the long past. They're here with us now. And so when you think going forward, we're looking at, you don't know. I've said many times, you have to have a lot of humility about the ability to predict the cause of financial crisis. You can look at the underlying vulnerabilities in the financial system, and trying to assess where there's are, where there might be too much leverage in the system, not enough liquidity in the systems, risk-taking in the system that doesn't peer match with risk management of those risks. And then you'll see where the shock comes from. Nobody predicted in 2019 that we'd have significant financial stress and an economic downturn from a global pandemic. We had people in the financial sector using epidemiological models to understand the propagation of risk in the financial system and they didn't say epidemiology itself is going to be the issue. So you have to be humble about the ability to predict these shocks and what you need to focus on is making the system less vulnerable when those shocks hit.

WESSEL: Let me reframe the question about Dodd-Frank for the final question. So I think the criticism is that A, we limited some ability of, the CFPB and others limited some products that were available to consumers. And then the Jamie Dimon critique is, you guys just overdid it. There's Basel III, there's the SLR, there are all these things. They don't, they weren't coherent, and essentially -- I know this is a bit much coming from Jamie Dimon -- you weren't humble enough.

BARR: Yeah, yeah, so I would I would take that under-over.

WESSEL: So I mean, really, do you look back on what we did in Dodd-Frank, what you did in Dodd Frank, and said maybe we did some things that were too much because we were so panicked and that we really should be rethinking some of those things?

BARR: Look, I think it's important to rethink regulation on a periodic basis, not in one direction or another. Not to say there's more regulation or less regulation, but do we have the right mix of regulation? I think its totally appropriate to look at that over time. When I look at the Dodd-Frank Act, the areas that I think of are not the areas where we didn't do enough. I mean, where we did too much, but where we didn't do enough. And I don't think there's any evidence that the Consumer Financial Protection Bureau reduced choice in the market. The evidence is that prices came down in the consumer financial space, defaults came down, we saw better redress for consumers when they were harmed. It made the system safer and fairer and I think increased trust in the banking system. It was to the benefit of banks by showing consumers that you could have a fair marketplace. And I am worried that as there are significant cuts to that agency, we're going to see consumer harm go up and trust go down.

WESSEL: Well, please join me in thanking Michael Barr for his remarks and candor. Thank all of you for coming and for such good questions. And for those who want, the Fed has posted Governor Barr's remarks and we'll have them on our website as well. So thank you.