Recipe for a Thriving US Economy:
Strong Banks, Patient Policy, and an Independent yet Accountable Central Bank

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Introduction

My thanks to the Ohio Bankers League for the invitation to speak with you today. Being in this room is a big deal to me. You might think of yourselves as unassuming bankers, but let me tell you why I think you're super stars.

Not long ago, on a beautiful fall day, I was walking along Main Street with a local banker in the town of Wooster, Ohio. Everyone knew him, lit up when they saw him, and shared stories about how he'd helped them with their business, their mortgage, or their personal finances. It was like being in the presence of a celebrity: LeBron James or Donovan Mitchell greeting fans and shaking hands. While the usual Fed disclaimer applies[1], *I* know how important you are to the communities you serve.[2]

In fact, I've understood the value of American banks for a long time. Before becoming a Federal Reserve policymaker, I worked in financial markets as a market maker and, for an eventful period, as a corporate treasurer. Like probably all of you, I vividly remember the first few months of the pandemic in 2020. As consumer spending fell rapidly across the globe, markets buckled, and firms drew down their lines of credit, creating a severe cash shortfall. I worked firsthand with bankers under these challenging circumstances to make credit and resource allocation decisions.

Fortunately, banks were in a good position to serve as a bridge between the financial system and the real economy. Community banks in particular punched above their weight. They made nearly half of the Paycheck Protection Program loans that were extended during the first six months of the pandemic.[3] This

[1] As always, the views I express today are my own and not necessarily those of the Federal Reserve System or my colleagues on the Federal Open Market Committee.

[2] I'm grateful to Doug Campbell, Joe D'Agostino, Edward Knotek, Edward Prescott, and Grant Rosenberger for assistance with these remarks.

[3] "Paycheck Protection Program Report," US Small Business Administration, August 12, 2020. home.treasury.gov/system/files/136/SBA-Paycheck-Protection-Program-Loan-Report-Round2.pdf.

support along with fiscal actions and the Fed's emergency measures allowed the economy to get back on its feet relatively quickly.

Five years on, that experience continues to reinforce that banks are a crucial source of strength for the economy. I'll take that a step further: In good times and bad, the large and diverse US banking system is our economy's "secret sauce," and like any great recipe, our banking sector blends a variety of ingredients to create a flavor profile with balance and harmony, one which is uniquely American.

Strong banks are not only important for the economy, they're also essential for effective implementation of monetary policy. Banks must be safe and sound in order to propagate monetary policy decisions throughout the economy. Tailoring regulation and supervision is one way we can ensure the banking system endures as a lasting source of economic strength. At the same time, we should be mindful that loosening the rules too much could result in less resilient banks that don't serve the country well in times of stress.

Just as we balance safety with economic growth in the supervisory arena, Federal Reserve policymakers also have to balance both sides of our dual mandate for price stability and maximum employment. So this will be a speech in two parts: banking and monetary policy.

Banking in the USA

I said before that our banking system is uniquely American, and here's what I mean by that. First, we have more than 4,000 commercial banks and thrifts in the US, offering depositors, investors, and borrowers a broad range of choices. No other developed country has close to the number of banks and thrifts that we have.

Second, the banking system is diffuse, limiting the concentration of financial power in New York or Washington. We have both state and federal charters in the US, which affords banks the opportunity to select their regulatory framework, tap local or national capital supplies as needed, and provide more pathways for new banks to enter the market.

The US banking sector, like Ohio's, has three main segments. The Buckeye State is home to a number of G-SIB (global systemically important bank) branches; regional banks, including three of the country's largest, sometimes called "super" regionals; and many smaller entities, 150 community banks and thrifts and 34 mutuals, more than any state other than Massachusetts.[4] Together, this mix of financial institutions makes the economy more resilient, breeds innovation, and offers a wealth of options to consumers and businesses.

Community Banks

Consider what flavor community banks bring to the sauce. Community banks excel at relationship lending, mainly to small businesses and in the local commercial real estate sector. This might sound like a niche, but supporting small-business growth is immensely important to the health of the overall economy. While large public companies get the most attention, small businesses with fewer than 500 workers are their own force. In 2022, there were more than 6 million small businesses in the US. That's more than 99 percent of the total number of firms in our economy, and they accounted for a little under half of payroll employment.[5]

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[4] For the purposes of these remarks, I'm defining community banks as those with less than $10 billion in assets, large and regional banks as those between $10 billion and $750 billion in assets that are not G-SIBs, and G-SIBs as those classified as global systemically important banks by the Financial Stability Board. There are eight G-SIBs in the US, including each of the six US banks with more than $750 billion in total assets. fsb.org/2024/11/2024-list-of-global-systemically-important-banks-g-sibs/

[5] Based on 2022 Statistics of US Businesses (SUSB), available at census.gov/data/tables/2022/econ/susb/2022-susb-annual.html.

In my conversations with small-business owners, I often hear how they rely on community banks that know and understand them. During that visit to Wooster I mentioned earlier, a bridal shop owner told me that her thriving business wouldn't have been able to open without a loan from a community bank. This tracks with results from the Fed's Small Business Credit Survey, which is managed by the Cleveland Fed: In the most recent report, small firms that applied for financing at community banks were more likely to be fully approved than firms that applied at large banks. It's perhaps no surprise, then, that small businesses consistently rate their interactions with community banks higher than with the largest banks.[6]

Regional Banks

If community banks stand out in relationship lending, while G-SIBs cater to large corporate customers, what kind of flavor do regional banks bring to the sauce?

Despite the significant outflows of uninsured deposits that we saw during the spring of 2023, regional banks overall are faring well. Within the regional banking segment are many different business models.

Regional banks make loans to small and middle-market firms that may be too large for community banks and are likely unprofitable for G-SIBs. Here, they blend community bank-style relationship lending with their larger balance sheets to make impactful investments. I heard a great example of this from the owner of a hotel chain in Cincinnati. He had originally financed construction of a new, high-end hotel through a family office. But as interest rates started rising, he turned to the regional bank he'd known for nearly 20 years to refinance the debt at a lower rate. Today, this hotel is making a positive local economic impact thanks in part to the more favorable terms the regional bank was able to arrange.

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[6] Here, large banks include online lenders. *2025 Report on Employer Firms: Findings from the 2024 Small Business Credit Survey*. Federal Reserve Banks. 2025, pg. 20. fedsmallbusiness.org/reports/survey/2025/2025-report-on-employer-firms.

Finally, regional banks are high-profile backers of the communities they serve. You can see this in their Community Reinvestment Act projects and in the logos that adorn everything from little league team ballfields to professional sports arenas. And, overall, they are doing good business: their returns on assets are higher on average than for the largest firms.[7]

So our sauce is simmering along nicely, with each banking segment bringing its own distinct and complementary flavor. Community banks add a dash of local knowledge and personalized service, regional banks introduce depth, and the very largest banks provide national and international service at scale.

But as any good cook will tell you, monitoring the sauce is required to keep things from burning. This is where bank supervision can exert an important and positive influence in maintaining the sauce's flavor and consistency.

Bank supervision is one of the five main responsibilities of the Federal Reserve, the others being financial stability, running the payments system, consumer protection and community development, and, of course, monetary policy. Just as community and regional bankers know their clients, the Federal Reserve's teams of examiners know their banking institutions. Under the Fed's decentralized Reserve Bank structure, examiners live and work in the same communities as the institutions they supervise. The Cleveland Fed represents the Fourth Federal Reserve District, which comprises all of Ohio and parts of Pennsylvania, Kentucky, and West Virginia. Every day, our supervisors are on the ground to ensure banks' safety and soundness. These relationships are long-lasting. Supervisors develop a deep understanding of their

[7] Cleveland Fed staff analysis based on Call Report and FR Y-9C data. From 2015 to 2024, return on assets (ROA) among regional banks was higher than among the G-SIBs. Size-weighted average ROA for regional banks during this period was 0.75 percent, while for G-SIBs it was 0.62 percent. This calculation adjusts earnings for unrealized losses and gains on securities, and it adjusts assets for off-balance-sheet activities like unused lines of credit by using the regulatory capital adjustments. We define regional banks as those with between $10 billion and $750 billion in total assets that are not classified as G-SIBs by the Financial Stability Board.

institutions' strategies and thus can tailor their oversight to match the risks each bank faces. There is no "one-size-fits-all" formula.

Risks and Challenges

Through these relationships, the Fed is monitoring the risks and challenges facing the banking industry, with a particular eye on financial stability.

The big risks are well-known: nonbank financial institutions are growing at double the pace of the banking sector,[8] offering many of the same services without the same regulatory oversight. These services include private credit, whose speed, flexibility, limited disclosure, and customization often make it an appealing alternative to traditional bank loans. In light of this growth, it's worth considering whether overly stringent rules in the wake of the Global Financial Crisis moved too much financial activity out of the banking sector. As I noted earlier, it's important to balance the benefits from safety and soundness with overall economic growth.

Stablecoins are another relatively new development. There are interesting cross-border applications for this new technology, though their use-case as a domestic payments instrument is unproven. And the potential competition that stablecoins may eventually pose to bank deposits bears watching.

Operational risks are always top of mind, increasingly in the form of fraud. And not just because of the ever-evolving cyber-threat landscape. Practically every conversation I have with a community banker these days features an anecdote about the rise in old-school fraud. You see this in crimes like check washing, with paper checks being stolen from mailboxes and then altered. Social engineering scams that

[8] Financial Stability Board. 2024. *Global Monitoring Report on Non-Bank Financial Intermediation*. fsb.org/uploads/P161224.pdf.

rob customers of their savings have also escalated, and banks are often caught in the middle. This adds another costly layer to banks' risk-management activities.

A less well-known but no less serious challenge to the banking sector is the lack of new traditional bank entrants.[9] Before the GFC, new commercial banks opened at an average pace of more than 100 per year.[10] But since then, *de novo* entry has collapsed to roughly seven new banks per year. While there are multiple factors behind this decline, a significant one is the increase in fixed compliance costs.

In response to the decline in entry, bank regulators are presently working on easing application standards and speeding up the process for startup banks. Done properly, this is a sensible and welcome effort that holds the promise of increasing competition and keeping the pool of community banks strong. It's also consistent with a tailored approach to bank regulation and supervision, with the largest institutions subject to the strictest rules given the risks they pose to the wider financial system.

Seasoning the Secret Sauce for the Long Term

In sum, when it comes to regulatory oversight, balancing costs and benefits should be our guiding principle. It's appropriate to ease rules that have unnecessarily curtailed *de novo* entry. But it's also worth taking stock of the economic gains we reap from rules that have made the banking system more resilient.

We rebounded quickly from the pandemic recession in large part because well-capitalized banks were positioned to continue lending when businesses and households needed it the most. Let's not water down the sauce to the point that the banking system can't support the US economy as strongly as it does today.

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[9] McCord, Roisin, and Edward Simpson Prescott. 2014. "The Financial Crisis, the Collapse of Bank Entry, and Changes in the Size Distribution of Banks," *Economic Quarterly*, Federal Reserve Bank of Richmond, issue 1Q, pgs. 23–50.
[10] McCord, Roisin, Edward Simpson Prescott, and Timothy Sablik. 2015. "Explaining the Decline in the Number of Banks since the Great Recession," *Richmond Fed Economic Brief*, Federal Reserve Bank of Richmond, issue March.

A healthy banking system is also critical to effective monetary policy implementation. Banks through their lending help transmit Federal Reserve policy changes to businesses and households. So, let me transition to my outlook for the economy.

The Outlook for the Economy and Monetary Policy

The past year has been a challenging one for monetary policy. Both sides of the Fed's dual mandate have been under pressure as the labor market softened and inflation stayed elevated. That's a tough mix because higher rates of both unemployment and inflation hurt everyday Americans.

The good news is that the outlook is brightening. Recent readings on economic growth have been encouraging, and the labor market appears to have stabilized. Many forecasts, including my own, call for some easing in inflation over the course of this year. At this point, I believe monetary policy is in a good place to stay on hold as we assess the incoming data and weigh if, and how, policy may need to adjust further.

Last year started on the weak side with meaningful uncertainty, but the economy picked up speed in the second and third quarters. Toward the end of 2025, the federal government shutdown likely slowed growth while disrupting the release of some key economic data. Consumer spending—the primary engine of the US economy—held up well all year long. Though spending in the aggregate has been resilient, it hasn't been uniform. For example, a visitors bureau in our District said the gap between bookings at luxury hotels and budget chains has widened. This is consistent with reports from a range of business and community contacts that there's strength among higher-income consumers and more cautious spending by lower-income consumers—what some refer to as "the K-shaped economy."

In the labor market, job growth slowed and unemployment ticked up over the course of last year. Both official data and what we're hearing from businesses point to a "low-hire, low-fire" environment where companies aren't adding many workers, but they're not laying off a lot either. And workers are staying put more than usual.

While slowing job growth and rising unemployment often signal bigger troubles ahead, recent signs point to stabilizing conditions. In December, the unemployment rate stood at 4.4 percent, similar to where it was in September.[11] While not as low as it had been, it's close to what I and many economists think of as a long-run equilibrium. Initial claims for unemployment insurance have stayed low. Companies' WARN notices of mass layoffs,[12] which we track at the Cleveland Fed, were about in line with their historic average through December, although some large companies have recently announced job reductions. Labor demand eased last year, but labor supply has also been limited by the aging population and reduced immigration. Overall, the labor market appears to be roughly balanced.

Turning to the other side of the Fed's dual mandate, inflation is still too high. Our goal is 2 percent PCE inflation over the longer run. The latest reading was 2.8 percent last November. That's much better than in 2022, when headline PCE inflation topped 7 percent. But inflation has largely moved sideways for more than two years. We feel the costs of elevated inflation with every shopping trip. The longer that inflation remains at these levels, the greater the risk that it becomes entrenched in the economy.

One notable development over the last year has been the rise in goods inflation, especially for items that are more exposed to global trade. Businesses in the Fourth District say increases in tariff rates have

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[11] The January employment situation report was delayed by the partial government shutdown, according to the Bureau of Labor Statistics.
[12] Cleveland Fed researchers collect and analyze advance notices filed under the Worker Adjustment and Retraining Notification (WARN) Act. Updates on WARN notices are available at clevelandfed.org/research/additional-research-resources. See Krolikowski, Pawel M., and Kurt G. Lunsford. 2024. "Advance Layoff Notices and Aggregate job Loss." *Journal of Applied Econometrics*. 39(3): 462–480. doi.org/10.1002/jae.3032.

pushed up costs. While some firms have already passed these costs along, others say that more price increases are coming. A northwest Ohio-based maker of farming equipment told us they are starting to see the full effect of tariffs hitting their bottom line, and it's only now that they're getting ready to raise prices for their own customers.

Tariffs are top of mind for many businesses, but they aren't the only source of inflationary pressures. Rising prices for health insurance and electricity are also pushing up costs. At this point, it's too soon to say if these broad cost pressures have peaked.

Looking ahead, I'm cautiously optimistic. Growth this year should get a boost from easier financial conditions, recent interest rate reductions, and fiscal support, among other factors. Businesses tell us they are expecting some firming in activity, and bankers in our District say projects that were on hold last year are starting to move forward. Brighter growth prospects should translate into stronger demand in the labor market, helping to reduce the unemployment rate over the course of this year. Inflationary pressures should start to ease as tariff rates stabilize.

Of course, there are no guarantees when it comes to forecasts, and there are considerable uncertainties around mine. Ultimately, I want to see evidence that inflation is, indeed, coming down. There's a risk that inflation could persist near 3 percent through this year, as it has for the past two years. Or inflation expectations could show signs of becoming unanchored if the public sees the elevated readings of the last five years as a sign that policy is not committed to achieving our 2 percent goal. On the other side, stabilization in the labor market could give way to additional softening if economic growth disappoints.

Two weeks ago, the FOMC kept the target range for the federal funds rate steady at 3-1/2 to 3-3/4 percent, a decision I voted to support. I believe we are in a good position to keep the funds rate at this level and see how things play out. By many estimates, including my own, the funds rate is now in the vicinity of neutral, meaning it's not meaningfully restraining the economy.

If we see progress on both sides of our mandate, that tells me that our policy rate is already at the right setting and that we should hold it there. Rather than trying to fine tune the funds rate, I'd prefer to err on the side of patience as we assess the impact of recent rate reductions and monitor how the economy performs. Based on my forecast, we could be on hold for quite some time.

To me, a steady funds rate would reflect positive economic developments, though holding rates near neutral might slow the return of inflation all the way to 2 percent. If my forecast doesn't materialize, then policy would need to respond accordingly. Right now, I see the risks of a higher or lower path for the funds rate as about balanced.

History shows us flexibility has benefits. Setting policy to support a long economic expansion helps us to achieve the "maximum" in our maximum employment mandate. Long expansions provide broad benefits to American workers. But inflation needs to be low and stable to ensure that workers can fully enjoy the strong labor market conditions. I'll be keeping an open mind about the best policy path to achieve and sustain those outcomes. The long expansion of the 1990s saw a series of decreases <u>and</u> increases in the funds rate in response to the incoming data and risks to the outlook. During the long 2010s expansion, the Fed held the funds rate steady for an extended period. Just as tailoring supervision has benefits for banks of different sizes, monetary policy needs to be tailored to the conditions appropriate for each business cycle.

During those lengthy expansions, both of which had low inflation, monetary policy operated independently from short-term political influence. That's very different from in the 1970s, when political pressure on US monetary policy was stronger, inflation was much higher, and expansions were shorter.[13]

International evidence shows that countries with less independent central banks usually face higher inflation.[14] This is because reducing inflation often entails tough tradeoffs of short-term economic weakness in exchange for a future with lower inflation and stronger growth. In the US, former Fed Chair Paul Volcker took the unpopular step of sharply raising interest rates, which created a painful recession but finally tamed the high inflation of the 1970s.

Then, as now, the Fed's independence goes hand in hand with its accountability to Congress and the American people. The Fed chair regularly testifies before Congress and holds press conferences after every FOMC meeting. We strive to be transparent about our decisions and the framework we base them on so the public can anticipate our actions. My colleagues and I on the FOMC frequently share our perspectives on how the economy is performing relative to our goals in media interviews, town hall meetings, and speeches at conferences, like this one today.

So to draw a parallel to the secret sauce of the US banking system from earlier, let me conclude with the key ingredients of the Federal Reserve's time-tested design. It's independent and accountable so that policymakers can focus squarely on achieving the dual mandate. It's decentralized to ensure unique regional perspectives are considered in national monetary policy decisions. And it's structured to keep the banking system safe and strong by balancing regulatory oversight by the Board of Governors in Washington with relationship-driven supervision by the regional Reserve Banks across the country.

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[13] For example, see Weise, Charles L. 2012. "Political Pressures on Monetary Policy During the US Great Inflation." *American Economic Journal: Macroeconomics* 4(2): 33–64. jstor.org/stable/41426400.

[14] For an overview of the research, see, for example, Congressional Research Service. "Central Bank Independence and Economic Performance: What Does the Evidence Show?" Updated June 6, 2007. congress.gov/crs_external_products/RL/PDF/RL31955/RL31955.6.pdf.

I'm proud to be part of this institution, one that supports our unique banking sector. And I'm committed to achieving our maximum employment and price stability objectives on behalf of the American public.