Perspectives on Risks – Both Economic and Cyber

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One Area of Risk: Economic

- Heightened concerns over China and Europe
- Volatile foreign and domestic markets
- Federal funds rate futures fell significantly, reflecting market expectations for only a very gradual increase in short-term interest rates
- My assessment – economy continuing to improve despite headwinds from abroad
  - May imply more increases in the federal funds rate than are currently priced into futures market
  - My outlook still calls for a *gradual* pace of increases
  - Path is uncertain and will depend on incoming economic data
Another Area of Risk: Cyber

- Banks of all sizes are already taking significant steps to mitigate
  - Active, strategic investment in mitigation
  - Active supervision by examiners to insure effective controls
- Like terrorism – need continued vigilance and continuous improvement of defenses
  - Bank robbery and fraud were localized problems
  - Cyber attacks can originate from anywhere in the world
    - Global population of attackers
    - Seek opportunities (softer targets) without geographic preference
- Today’s conference will discuss continued mitigation
The Economy

- Domestic economy continues to improve
  - Payroll employment grew by 215,000 jobs
  - Some measures of wages and prices are trending up

- Global headwinds
  - Trading partners continue to face challenges
  - Several foreign central banks have eased
  - Some financial markets have been volatile
Figure 1: Federal Funds Rate Projections Implied by the Federal Funds Futures Market on April 1, 2016
March 2016 - December 2018

Note: The March 2016 rate is the actual March 2016 federal funds effective rate.
Source: Bloomberg
Figure 2: Probability of Rate Increases At or Before the December 2016 FOMC Meeting Implied by the Federal Funds Futures Futures Market on April 1, 2016

Source: Bloomberg
Figure 3: Probability of Rate Increases At or Before the December 2016 FOMC Meeting Implied by the Federal Funds Futures Market

Source: Bloomberg
Figure 4: Global Stock Market Indices
December 16, 2015 - April 1, 2016

Source: FT, STOXX Limited, WSJ, Bloomberg, Haver Analytics
Figure 5: U.S. Stock Market Indices

December 16, 2015 - April 1, 2016

Source: S&P, NYT, WSJ, Haver Analytics
Figure 6: CBOE Market Volatility Index: VIX
December 16, 2015 - April 1, 2016

Source: WSJ, Haver Analytics
Figure 7: Nominal Broad Trade-Weighted Exchange Value of the U.S. Dollar

December 16, 2015 - April 1, 2016

Source: JP Morgan, Haver Analytics
Figure 8: Spread of Moody’s Seasoned Baa Corporate Bond Yield Over Ten-Year Treasury Yield

December 16, 2015 - March 31, 2016

Note: Based on corporate bonds with remaining maturities of at least 20 years.

Source: Federal Reserve Board, Haver Analytics
Figure 9: Unemployment Rate Projections of Federal Reserve Governors and Federal Reserve Bank Presidents, March 16, 2016

2016:Q4 - 2018:Q4

Source: FOMC, Summary of Economic Projections (SEP), March 16, 2016
Figure 10: Core Inflation Rate Projections of Federal Reserve Governors and Federal Reserve Bank Presidents, March 16, 2016

2016:Q4 - 2018:Q4

Source: FOMC, Summary of Economic Projections (SEP), March 16, 2016
Figure 11: Real GDP Growth Projections of Federal Reserve Governors and Federal Reserve Bank Presidents, March 16, 2016

2016:Q4 - 2018:Q4

Source: FOMC, Summary of Economic Projections (SEP), March 16, 2016
My Perspective on the Path of Monetary Policy

- Financial market volatility has subsided
- Most economic forecasts do not expect large spillovers to the domestic economy
- While problems could still arise, I would expect that the very slow removal of accommodation reflected in futures market pricing could prove too pessimistic
- If as I expect the incoming data continue to show a moderate recovery it will likely be appropriate to resume the path of gradual tightening sooner than is implied by financial-market futures
Cyber Risk, However, is not Abating

- Financial institutions invest heavily in technology, and in keeping that technology safe
- Competition from “fintech” – appeals to customers looking for convenience
  - Not burdened by brick and mortar
  - Not regulated
  - But may not be as focused on cybersecurity or economic downturns as banks
As Banks Innovate to Meet Competition, There Are New Risks

- Knowing customers through the branch network is much less prevalent
- Cyber crime can originate from anywhere there is a computer link
  - Hard to find – particularly with large volume of transactions
  - Large-scale attacks can occur suddenly
Mitigation is Critical

- Banks invest significant resources in personnel and software remaining up to date
- Important to share information and strategies – a topic for discussion today
- Having protocols ready, should a breach occur, is also important
  - Resiliency; quick recovery of operations
  - Plan for communication with stakeholders and regulators
Concluding Observations

- Some of the economic concerns from earlier this year seem to be receding
- Financial market expectations of a very slow removal of accommodation could, it seems to me, prove unduly pessimistic
- I expect a stronger economy which will lead to more tightening than is currently priced into futures market expectations over the next two years
- Cyber risks are not abating
- Banking organizations (and central banks) need to evolve with these risks and challenges