Welcome and Opening Remarks

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“What Are the Consequences of Long Spells of Low Interest Rates?”
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bostonfed.org
Why Focus on the Consequences of Long Spells of Low Interest Rates?

- The likelihood of rates being low for long has increased
  - Low rates are a global phenomenon
  - We see low productivity growth, low inflation, and low population growth in many developed countries
- The recent extended period of low rates makes it important to be evaluating potential costs
- The potential costs of low rates could impact how policy should prepare for, and react to, a recession
Figure 1: Overnight/Policy Rates for the Euro Area, Japan, and the U.S.
January 2000 - August 2018

Note: Rates are as of end of period. U.S. target rate is the midpoint of the target range, beginning in December 2008.
Source: Bank of Japan, European Central Bank, Federal Reserve Board, Haver Analytics
“Reach for Yield”

- The prevalence and cost of potential “reach for yield” behavior may be important:
  - Do households alter savings, spending, and investing decisions in a low rate environment?
  - Do firms behave differently in a low interest rate environment?
  - Do regulated firms face different incentives in a low interest rate environment?
Figure 2: Estimated Global Hedge Fund Industry Assets Under Management
1990 - 2018:Q2

Note: Data are as of December 31 for 1990 - 2017 and as of June 30 for 2018:Q2.
Source: Hedge Fund Research, Inc. – www.HedgeFundResearch.com
Figure 3: Global Private Equity Assets Under Management

2000 - 2017

Note: Private equity refers to the core asset class centered on the buyout and venture capital industry. Data are as of December 31.

Source: Preqin
Growth in Alternative Assets

- Alternative asset classes have grown rapidly during the recent period of low rates
- “Reach for yield” and institutional constraints may interact to generate more risk for the economy
  - Example: College endowments
  - Example: Pension funds
- Has growth been due to financial innovation, or rather due to the potential to obtain higher returns through less traditional and riskier asset allocations?
Figure 4: Average Annual Effective Spending Rate for U.S. College and University Endowments and Affiliated Foundations 1998 - 2017

Note: Data are for fiscal years ending June 30.
Figure 5: Asset Allocation for U.S. College and University Endowments and Affiliated Foundations
2003 - 2017

Note: Data are for fiscal years ending June 30. Asset Allocations are dollar-weighted. Alternative strategies include private equity and hedge funds among other investments.

Figure 6: Ratio of U.S. Public Pension Fund Assets to Projected Liabilities
2001 - 2016

Note: For most public pension funds, the data are for fiscal years ending June 30; some have other fiscal years.
Figure 7: U.S. Public Pension Fund Portfolio Allocation
2001 - 2016

Note: For most public pension funds, the data are for fiscal years ending June 30; some have other fiscal years. Alternatives include private equity and hedge funds among other investments.

Implications for Micro Risk Management

- If institutions take on too much risk, what are the implications for institutions and their stakeholders?
- Will there be political pressures to mitigate the costs, if they are realized?
- Could risk-taking by households, firms, and regulated institutions manifest itself in financial stability problems?
Implications for Macro Risk Management

- Should we think differently about monetary policy goals and tools if the costs are large?
  - If we are likely to hit the effective lower bound frequently
    - Are inflation goals too low?
    - Should monetary policy implementation be different?
- Do we need additional financial stability tools?
- Should fiscal policies – at the national or state level – be different if the costs are great?
- Do we have sufficient policy buffers to mitigate the adverse effects of economic downturns?