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Federal Reserve Bank of Boston®

"The Importance of Examining the Risks of High Leverage to the Real Economy"

Kenneth C. Montgomery
Interim President & Chief Executive Officer
Federal Reserve Bank of Boston

Welcoming Remarks and Conference Overview
at the Federal Reserve Bank of Boston's
65th Economic Conference, entitled
"The Implications of High Leverage for Financial Instability Risk, Real Economic Activity, and Appropriate Policy Responses"

November 8, 2021

The views expressed today are my own, not necessarily those of my colleagues on the Federal Reserve Board of Governors or the Federal Open Market Committee.

Good morning, and thank you for joining us for the Boston Fed's 65th annual economic conference – the second of two economic conferences hosted by the Bank this fall. We are pleased to have our speakers, participants, and audience members join us this week to discuss and analyze a very important topic – the implications of high leverage. As noted in the title of the conference, we want to explore the implications of high leverage for financial instability risk, for real economic activity, and for policy responses.

I am grateful to my colleagues in the Boston Fed's Research Department for putting together another in a long line of rigorous and relevant economic conferences. Our intention with these conferences has always been to convene experts who can explore important economic issues and contribute to improving policy and outcomes. So I appreciate the opportunity to say a few words of introduction and overview as we open the 65th such gathering.

I'll begin by saying the Federal Reserve Bank of Boston has long been engaged in studying financial instability risks, specifically the implications of these risks for the real economy. Eric Rosengren, who recently retired as president of the Bank, studied and spoke about these issues, first as a researcher and later as a policymaker, often working alongside Joe Peek and his colleagues. All told, the Bank has, for some time, emphasized the important role of credit in the economy and the importance of financial stability considerations in monetary policy deliberations.

This focus at the Boston Fed has allowed us to contribute in significant ways to policy discussions and decisions at some critical moments for the U.S. economy. Two such examples, about which I will touch on only very briefly, are the 2008 financial crisis, and the COVID-19 pandemic. Indeed, in both cases, we had the opportunity to play key roles in implementing and administering Federal Reserve System programs intended to help provide liquidity to markets and support credit availability to the private sector.

The first example I'll point to – the Great Recession of 2008 and 2009, which was triggered and exacerbated by a financial crisis – drove home the critical importance of having a stable and resilient financial system. Policymakers have since taken many actions to strengthen regulation of financial institutions in order to minimize the risk of a repeat financial crisis and resulting disastrous collapse in economic activity of the sort we experienced during the Great Recession. Take, for instance, the introduction of stress testing for large banks and a number of other regulatory measures that led to a relatively well-capitalized banking system.

In contrast, over the past decade, we have seen other sectors' indebtedness climbing – to potentially concerning levels. In particular, by some measures, nonfinancial business leverage is historically high – perhaps due, in part, to extremely low interest rates globally. Our conference aims to analyze the risks of such high leverage for the broader economy – and also provide a forum for discussion of appropriate policy responses targeted at mitigating those risks.

I'll turn now to the second example – focused on the Fed's response to the economic emergency brought on by the COVID-19 pandemic. The COVID-19 outbreak in the U.S., starting in March 2020, had a devastating impact on many households and businesses, especially small businesses. Many business owners lost revenue streams overnight, as they had to substantially curtail or even shut down operations. Millions of workers lost their jobs. The abrupt and drastic disruptions, along with extremely elevated uncertainty, caused widespread turmoil in financial markets.

Confronted with such unprecedented disruptions to the U.S. economy, public policymakers – both monetary and fiscal – took decisive actions to support households, businesses, and markets in order to stabilize the financial sector and ultimately help minimize damage to the real economy. The Federal Reserve, with support from the Treasury Department, introduced a number of liquidity and credit facilities to ensure businesses, as well as consumers, could readily access the credit they needed in order to weather the pandemic-induced interruptions. The Main Street Lending Program,[1] one such facility that was administered by the Boston Fed on behalf of the Federal Reserve System, supported continued operations of small and medium sized businesses, despite the pandemic disruptions.

The Bank's 65th annual research conference is intended to contribute to our understanding of how *leverage* affects financial stability risks, and ultimately the resilience of the real economy – in particular the effect of leverage on key macroeconomic variables such as employment and investment. In addition to a focus on the business sector, the conference will also include analysis of the effects of household leverage on the severity of the Great Recession, as well as analysis of how the commercial real estate sector can best recover after the pandemic. Another particularly timely topic to be considered is the likely difficult trade-off for policymakers going forward – stemming from the unfortunate side effects of some of the policy measures taken to combat the pandemic, given that they added more debt to businesses' already debt-laden balance sheets.

I am confident the insights we take from the discussions and presentations during the next three days can contribute to improving the formulation of public policy going forward. Again, I want to thank our organizers, presenters, discussants, and audience members for taking part.

At this point, it is my pleasure to introduce the moderator of the first day of the conference, Benjamin Friedman. Professor Friedman is the William Joseph Maier Professor of Political Economy at Harvard University.

Professor Friedman's work has focused on monetary policy – including the optimal conduct of policy and the transmission of policy through the financial system to the real economy – as well as the role of central banks in maintaining financial stability and formulating appropriate policy responses to various crises.

More recently, Professor Friedman has broadened even further his distinguished portfolio of work, with his newest book, *Religion and the Rise of Capitalism*, which provides a fundamental reassessment of the foundations of current-day economics and shows how religious thinking has shaped economic thinking.

Please join me in welcoming Professor Friedman – truly an expert on many of the topics that will be central to this conference.

Thank you.

[1] For more information, see: Main Street Lending Program - Federal Reserve Bank of Boston (bostonfed.org)