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U.S. needs higher rates; banks need more capital: FDIC's Hoenig

Patrick Rucker

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The Federal Reserve should demand more capital from Wall Street while the central bank slowly increases interest rates, a leading U.S. regulator said on Thursday as he outlined a formula for future economic growth.

Thomas Hoenig, vice-chairman of the Federal Deposit Insurance Corporation, said the financial system could be rattled if the Fed continued to hold rates low while the largest banks did nothing to increase capital reserves.

"The challenge is to find a path that enables central banks to rebalance monetary policy without shock overwhelming the financial system," said Hoenig, a leading voice for tough banking regulations.

That shock could come if the Fed were to suddenly increase rates while banks lacked capital, said Hoenig.

Banks retain profits or issue stock as a cushion against future losses. Global banking regulators are debating how much of a cushion - or 'capital' - leading banks should have.

A global watchdog for banking standards, the Basel Committee on Banking Supervision, is writing new capital rules.

European Union regulators and other officials expect those standards will ease some capital standards.

The Basel Committee meets in Chile on Nov. 28-29 to finalize the rules.

On Thursday, Hoenig said regulators were misguided if they expected banks to extend credit once they had lower capital standards.

"Allowing financial firms to operate at minimum capital levels fails to accelerate economic growth and leaves the system more vulnerable to shock," he told a meeting at the Cato Institute, a libertarian think tank in Washington.