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THE ECONOMIC OUTLOOK

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BEFORE THE

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CONGRESS OF THE UNITED STATES

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SECOND SESSION

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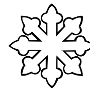

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CONTENTS

Members

Hon. Carolyn B. Maloney, Chair, a U.S. Representative from New York 1
Hon. Kevin Brady, U.S. Representative from Texas 3
Hon. Sam Brownback, Ranking Minority, a U.S. Senator from Kansas 4

Witnesses

Hon. Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System 6

Submissions for the Record

Prepared statement of Representative Carolyn B. Maloney, Chair 48
Prepared statement of Representative Kevin Brady 49
Prepared statement of Senator Sam Brownback 50
Prepared statement of Chairman Ben S. Bernanke 51
Prepared statement of Representative Elijah E. Cummings 54
Letter from Representative Elijah E. Cummings Dated April 21, 2010, Transmitting Questions to Chairman Ben S. Bernanke 56
Letter from Chairman Ben S. Bernanke Dated May 27, 2010, Transmitting Responses to Representative Elijah E. Cummings 62
Letter from Senator Robert P. Casey, Jr., Dated April 21, 2010, Transmitting Questions to Chairman Ben S. Bernanke 68
Letter from Chairman Ben S. Bernanke Dated May 27, 2010, Transmitting Responses to Senator Robert P. Casey, Jr. 69

THE ECONOMIC OUTLOOK

WEDNESDAY, APRIL 14, 2010

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met, pursuant to call, at 10:00 a.m. in Room 106 of the Dirksen Senate Office Building, The Honorable Carolyn B. Maloney (Chair) presiding.

Representatives present: Maloney, Hinchey, Sanchez, Cummings, Snyder, Brady, Paul, and Burgess.

Senators present: Schumer, Klobuchar, Casey, Brownback, and Risch.

Staff present: Andrea Camp, Gail Cohen, Colleen Healy, Jessica Knowles, Andrew Wilson, Rachel Greszler, Lydia Mashburn, Jane McCullough, Jeff Schlagenhauf, Ted Boll, and Robert O'Quinn.

OPENING STATEMENT OF THE HONORABLE CAROLYN B. MALONEY, CHAIR, A U.S. REPRESENTATIVE FROM NEW YORK

Chair Maloney. The Committee will come to order. In order to have time for questions, I am limiting opening statements to the Ranking Member, Senator Brownback, for five minutes, and the Vice Chair and Mr. Brady for three minutes. And I would also like to ask for unanimous consent to accept written statements of Members into the record.

America is on a path toward economic recovery. A large part of the credit for this turnaround is due not only to President Barack Obama but also to Ben Bernanke, the Chairman of the Federal Reserve, a respected scholar on the Great Depression.

Under this guidance the Fed took creative and effective actions to inject liquidity into our financial system, which saved our nation from economic catastrophe.

I am confident that you will continue to steer monetary policy at the Fed carefully through the next set of obstacles, balancing the creation of robust economic growth with the prevention of inflation.

Our hearing today on the economic outlook is timely for many reasons. Just this week, the committee of economists responsible for dating the end of the recession announced that the recovery is still too fragile to announce that the recession is over. But there are indications that we are indeed well on our way to economic recovery.

After four straight quarters of negative growth, the economy grew during the last two quarters of 2009. There is a consensus that when the latest GDP numbers are announced on April 30th,

we will see that our economy continued to expand during the first quarter of 2010.

The most recent employment report showed that 162,000 jobs were created in March, with three-fourths of those jobs in the private sector.

Manufacturing employment was up for three straight months.

The stock market is at its highest in almost 15 months.

Temporary help, a leading indicator of the health of the labor market, has added 313,000 jobs since October of 2009.

Sales of cars and light trucks were up in March.

And many surveys of the economy are optimistic about growth in both the service and manufacturing sectors.

These improvements in our economy are proof that actions taken by Congress, the Fed, and the Administration have started to have a positive impact.

In the last year, Congress enacted policies that supported struggling families and encouraged job creation. The Recovery Act provided tax relief for 95 percent of American families and created jobs while investing in clean energy, infrastructure, and education.

Last year we extended the $8,000 first-time homebuyers' credit that will spur construction jobs. We extended a host of safety net programs that will help struggling families weather the economic storm.

We extended the net operating loss carry-back provision that will help small businesses hire new employees. And we are boosting funding for small business loans via the Small Business Administration.

We passed the HIRE Act to give tax breaks to businesses that hire unemployed workers. Without these measures, the depth of the contraction would have been much deeper and far longer.

Although the recent estimates of the cost of the bailout of the financial system are much lower than initially expected, the true cost of the financial system failure in terms of lost employment and pain to working families is immeasurable.

Much of the budget deficit over the next 10 years should be attributed to the financial crisis. Economists have estimated that the budget deficit has increased by $3.1 trillion due to the decline in tax revenues from the long line of workers who have lost their jobs.

While we have come far in stabilizing the financial system, we would like to hear your thoughts on various reform proposals that have been introduced and are being considered before Congress to make sure that financial institutions do not take on excessive risk and have appropriate capital requirements.

We also look forward to hearing your take on upcoming challenges, including the recovery of the housing market. One important factor in the housing market's current recovery is the low mortgage interest rates that were sustained by the Fed's purchases of mortgage-backed securities and Fannie and Freddie debt. Now that the Fed has completed those purchases, we would like to hear your assessment of the housing market and the impact of the Fed's exit on mortgage rates.

On another note, I am grateful for your leadership in ushering in new rules to prevent unfair or deceptive practices with respect

to credit card accounts and the rules the Fed put in place to curb excessive overdraft fees.

We thank you for your testimony today, Chairman Bernanke, and look forward to working with you as the Committee continues to focus on helping our economy recover and expand.

[The prepared statement of Representative Maloney appears in the Submissions for the Record on page 48.]

Chair Maloney. Thank you, and the Chair recognizes Mr. Brady.

OPENING STATEMENT OF THE HONORABLE KEVIN BRADY, A U.S. REPRESENTATIVE FROM TEXAS

Representative Brady. Thank you, Madam Chairman. I am pleased to join in welcoming Chairman Bernanke before the Committee.

The Federal Reserve's injection of $1.3 trillion of liquidity in the fall of 2008 quelled the panic in financial markets. Although I disagree with the Fed's participation in the "bailouts" of AIG and Bear Stearns because these institutions were insolvent, the Fed's timely actions as lender of last resort to solvent but illiquid financial institutions and markets prevented the financial panic from becoming a depression.

During the spring of 2009 the "stress test" and subsequent capital increases by large banks restored confidence in financial institutions and markets. Largely because of these decisive actions, the U.S. economy is now beginning to recover.

However, the recovery will continue to be subpar as businesses delay critical hiring and investment decisions due to the uncertainty generated by President Obama and Congressional Democrats to increase taxes, raise energy prices, enact job-killing regulations, and generate a dangerous level of federal debt.

Despite recent guidance from Washington to bank examiners about commercial mortgage loans, I am concerned that bank examiners are exacerbating real estate problems through their inflexibility.

Pressed by regulators, community and regional banks are not renewing performing commercial mortgage loans even though their underlying cash flow can easily service the debt.

That said, I would like to share with you my concerns about monetary policy going forward. We are in danger of repeating the mistakes that produced stagflation in the 1970s. Because of the lag time between monetary policy decisions and their effects, the Federal Reserve must act to prevent inflation well before the public perceives that prices are rising.

Yet there are voices demanding that the Federal Reserve delay action. Recently economist Lawrence Ball advocated keeping the federal funds rate extraordinarily low even as prices rise to reduce the unemployment rate, notwithstanding the fact that the so-called Phillips Curve trade-off between inflation and unemployment had been thoroughly discredited three decades ago.

Price stability contributes to economic growth, and only the Federal Reserve can maintain price stability. My concern is that Administration officials may press the Federal Reserve to delay rais-

ing interest rates and unwinding the expansion of its balance sheet to cover for the Obama Administration's anti-growth policies.

Taxes, especially on small businesses and investment, are about to soar as the 2001 and 2003 rate reductions expire and $569 billion of new taxes to fund the President's new health care plan are implemented. Additional costs are lurking in the form of regulations to control greenhouse gas emissions and complex cap and trade legislation.

Despite these tax increases, the CBO projects that higher spending under the President's budget would create deficits of $9.8 trillion over the next 10 fiscal years, spiking publicly held federal debt to 90 percent of GDP by 2020. Unless Congress controls federal spending, these deficits will crowd out private investment and slow our economic growth.

Chairman Bernanke, I urge you to resist any attempts to delay raising interest rates in order to offset these anti-growth policies.

Regarding financial services legislation, I am concerned about weakening the Fed's independence, institutionalizing too-big-to-fail, and perpetuating the status of Fannie and Freddie as zombie banks.

Making the President of the Federal Reserve Bank of New York a political appointee and stripping the supervision of smaller banks and their holding companies from the Fed would weaken the regional Reserve Banks and undermine the Fed's independence.

Moreover, diverting the Fed's profits from the Treasury to pay for the Consumer Financial Protection Bureau would set a dangerous precedent that would open the floodgates for other off-budget federal spending.

The perverse incentives arising from the presumption of government backing caused large financial institutions, especially Fannie and Freddie, to take excessive risks and inflate a huge bubble in the housing market.

Instead of ending too-big-to-fail, the Senate bill would establish a permanent bailout fund for large financial institutions that may exacerbate this problem by identifying who the government regards as too big to fail.

Incredibly, the Senate bill does not provide for final resolution of Fannie and Freddie, despite costing taxpayers $128 billion so far with no prospect for any recovery. Like walking zombies, Fannie and Freddie with their explicit government backing are frightening most private capital away from re-entering housing finance.

We have a lot of challenges before us, Chairman Bernanke, and I look forward to your testimony.

[The prepared statement of Representative Brady appears in the Submissions for the Record on page 49.]

Chair Maloney. Thank you.

Senator Brownback.

OPENING STATEMENT OF THE HONORABLE SAM BROWNBACK, RANKING MINORITY, A U.S. SENATOR FROM KANSAS

Senator Brownback. Thank you very much, Madam Chairman. I appreciate it.

Chairman Bernanke, welcome. It's good to have you here. I would ask that my full statement be put into the record as if presented.

Mr. Chairman, I really do look forward to your testimony today. It seems like to me that we have some giant issues. You are used to dealing with large problems and we continue to have them.

It strikes me that the fiscal policy in the country is one that just must be commented on with its impact and its possibilities and problems down the road.

I get very concerned about the very real prospect of a government bubble being created. We have come through the dot-com bubble, the housing bubble, and I am very concerned about us having a government bubble. And how is it that we can ease through this period of time, which is something I am certain you and the staff at the Federal Reserve must be talking a great deal about.

One of the issues I would hope you would consider moving forward is the makeup of the FOMC Committee on Monetary Policy. A lot of us from all over the country are impacted by monetary policy. The Federal Reserve in New York has a permanent seat on that. Is that truly reflective of the diversity of views across the country? That is one of the issues I have been looking at and researching: should that committee be broadened out on its representation of Federal Bank chairmen on the FOMC Committee. And it is something that we will be presenting.

Several of us in the Congress have joined on to a bill to press on China to allow its exchange rate to float. A number of us feel that artificially holding down the exchange rate has had a major impact on the U.S. economy. It does not reflect current economic realities and adds to the permanent feel of the imbalance between us and China on trade.

And one of the things that should happen when you have a trade imbalance is the currencies should be adjusting to reflect that, under basic economic theory, and yet the Chinese Government doesn't allow that to happen.

That has a big impact on the prices of goods coming into this country. It has a big impact on us exporting to China. It has a big impact on other countries around China that are exporters, as well. And it seems to a number of us that if the Chinese are not going to allow this float to take place, that we should be forcing this through trade policy, through the possibility of sanctions. This would be something I am sure you probably do not want to be dragged into, but it is going to be something that will probably land on your doorsteps as well.

Those are the big issues. Plus, I would hope in looking at interest rates down the road that it seems to me it shows strength in our economy if we are able to start saying we should allow these interest rates to move up a little bit; that we think the recovery is moving forward; that we are getting to a stabilized point; that it would show some strength and resiliency if you allow those interest rates to start edging upward.

That is something that obviously is on your plate, and you guys have to decide, but looking at it as an outside observer it seems like we might be at a point at which that would be a wise move,

and one that would show strength, and get maybe some of the fear out of what may happen in the future.

It seems like we think things are moving forward—and they're starting to—and we want to get away from this government bubble, fiscal and monetary policy, and start to ease off the pressure on that in a slow and prudent fashion.

Madam Chairman, I thank you for the hearing and I look forward very much to your testimony, Chairman Bernanke.

[The prepared statement of Senator Brownback appears in the Submissions for the Record on page 50.]

Chair Maloney. Thank you very much. We expect Senator Schumer to join us. He has a conflict with his committee work. When he comes, we will recognize him.

I would now like to introduce Chairman Bernanke. Dr. Ben Bernanke began a second term as Chairman of the Board of Governors of the Federal Reserve System on February 1, 2010. Dr. Bernanke also serves as Chairman of the Federal Open Market Committee, the System's principal monetary policy-making body.

He originally took office as Chairman on February 1, 2006, when he also began a 14-year term as a member of the Board. Dr. Bernanke was Chairman of the President's Council of Economic Advisers from June 2005 to January of 2006.

Prior to beginning public service, Dr. Bernanke was the Class of 1926 Professor of Economics and Public Affairs at Princeton University. Dr. Bernanke had been a Professor of Economics and Public Affairs at Princeton since 1985.

Welcome. We look forward to your testimony.

STATEMENT OF THE HONORABLE BEN BERNANKE, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Chairman Bernanke. Thank you, Madam Chair.

Chair Maloney, Vice Chairman Schumer, Ranking Members Brownback and Brady, and other Members of the Committee, I am pleased to be here today to discuss economic and financial developments. I would also like to make a few remarks on the fiscal situation.

Supported by stimulative monetary and fiscal policies and the concerted efforts of policymakers to stabilize the financial system, a recovery in economic activity appears to have begun in the second half of last year.

An important impetus to the expansion was firms' success in working down the excess inventories that had built up during the contraction, which left companies more willing to expand production.

Indeed, the boost from the slower drawdown in inventories accounted for the majority of the sharp rise in real gross domestic product in the fourth quarter of last year, during which read GDP increased at an annual rate of 5.6 percent.

With inventories now much better aligned with final sales, however, and with support from fiscal policy set to diminish in the coming year, further economic expansion will depend on continued growth in private final demand.

On balance, the incoming data suggest that growth in private final demand will be sufficient to promote a moderate economic recovery in coming quarters. Consumer spending continued to increase in the first two months of this year, and has now risen at an annual rate of about 2½ percent in real terms since the middle of 2009.

In particular, after slowing in January and February, sales of new light motor vehicles bounced back in March as manufacturers offered a new round of incentives. Going forward, consumer spending should be aided by a gradual pickup in jobs and earnings, the recovery in household wealth from recent lows, and some improvement in credit availability.

In the business sector, capital spending on equipment and software appears to have increased at a solid pace again in the first quarter. U.S. manufacturing output, which is benefitting from stronger export demand as well as the inventory adjustment I noted earlier, rose at an annual rate of 8 percent during the 8 months ending in February. Also, as I will discuss further in a moment, financial conditions continue to strengthen, thus reducing an important headwind for the economy.

To be sure, significant restraints on the pace of the recovery remain, including weakness in both residential and nonresidential construction and the poor fiscal condition of many state and local governments.

Sales of new and existing homes dropped back in January and February, and the pace of new single-family housing starts has changed little since the middle of last year.

Outlays for nonresidential construction continue to contract amid rising vacancy rates, falling property prices, and difficulties in obtaining financing. Pressures on state and local budgets, though tempered by ongoing federal support, have led to continuing declines in employment and construction spending by state and local governments.

As you know, the labor market was particularly hard hit by the Recession. Recently we have seen some encouraging signs that layoffs are slowing and that employment has turned up.

Manufacturing employment increased for a third month in March, and the number of temporary jobs—often a precursor of more permanent employment—has been rising since last October.

New claims for unemployment insurance continue on a generally downward trend. However, if the pace of recovery is moderate, as I expect, a significant amount of time will be required to restore the 8½ million jobs that were lost during the past two years.

I am particularly concerned about the fact that in March 44 percent of the unemployed had been without a job for 6 months or more. Long periods without work erode individuals' skills and hurt future employment prospects.

Younger workers may be particularly adversely affected if a weak labor market prevents them from finding a first job or from gaining important work experience.

On the inflation front, recent data continue to show a subdued rate of increase in consumer prices. For the three months ended in February, prices for personal consumption expenditures rose at an

annual rate of 1¼ percent despite a further steep run-up in energy prices.

Core inflation, which excludes prices of food and energy, slowed to an annual rate of ½ percent. The moderation in inflation has been broadly based, affecting most categories of goods and services with the principal exception of some globally traded commodities and materials, including crude oil.

Long-run inflation expectations appear stable. For example, expected inflation over the next 5 to 10 years as measured by the Thompson Reuters/University of Michigan Surveys of Consumers was 2¾ percent in March, which is at the lower end of the narrow range that has prevailed for the past few years.

Financial markets have improved considerably since I last testified before this Committee in May of last year. Conditions in short-term credit markets have continued to normalize. Spreads in bank funding markets and the commercial paper market have returned to near pre-crisis levels.

In light of these improvements, the Federal Reserve has largely wound down the extraordinary liquidity programs that it created to support financial markets during the crisis.

The only remaining program, apart from the discount window, is the Term Asset-Backed Securities Loan Facility, or TABSLF, for loans backed by new-issue commercial mortgage-backed securities, and that facility is scheduled to close at the end of June.

Overall, the Federal Reserve's liquidity programs appear to have made a significant contribution to the stabilization of the financial system, and they did so at no cost to taxpayers and with no credit losses.

The Federal Reserve also recently completed its purchases of $1.25 trillion of federal agency mortgage-backed securities and about $175 billion of agency debt. Purchases under these programs were phased down gradually, and to date the transition in markets has been relatively smooth.

The Federal Reserve's asset-purchase program appears to have improved market functioning and reduced interest-rate spreads not only in the mortgage market but in other longer term debt markets as well.

On net, the financial condition of banking firms has strengthened markedly during recent quarters. Last spring, the Federal Reserve and other banking regulators evaluated the Nation's largest bank holding companies under the Supervisory Capital Assessment Program, popularly known as the stress test, to ensure that they would have sufficient capital to remain viable and to lend to creditworthy borrowers even in a worse-than-expected economic scenario.

The release of the stress test results significantly increased market confidence in the banking system. Greater investor confidence in turn allowed the banks to raise substantial amounts of new equity capital and, in many cases, to repay government capital.

The Federal Reserve and other bank regulators continue to encourage the banks to build up their capital, ensure that they have adequate liquidity, improve their risk management, and restructure their employee compensation programs to better align risk and reward.

Despite their stronger financial positions, banks' lending to both households and businesses has continued to fall. The decline in large part reflects sluggish loan demand and the fact that many potential borrowers no longer qualify for credit, both results of a weak economy.

The high rate of write-downs has also reduced the quantity of loans on banks' books. But banks have also been conservative in their lending policies, imposing tough lending standards and terms. This caution reflects bankers' concerns about the economic outlook and uncertainty about their own future losses and capital positions.

The Federal Reserve has been working to ensure that our bank supervision does not inadvertently impede sound lending and thus slow the recovery.

Achieving the appropriate balance between necessary prudence and the need to continue making sound loans to creditworthy borrowers is in the interest of banks, borrowers, and the economy as a whole.

Toward this end, in cooperation with the other banking regulators, we have issued policy statements to bankers and examiners emphasizing the importance of lending to creditworthy customers, working with troubled borrowers to restructure loans, managing commercial real estate exposures appropriately, and taking a careful but balanced approach to small business lending.

We have accompanied our guidance with training programs for both Federal Reserve and state examiners, and with outreach to bankers throughout the industry.

For example, we just completed a training initiative that reached about 1,000 examiners. We are also conducting a series of meetings across the country with private- and public-sector partners to gather information about the credit needs of small businesses and how those needs can best be met.

We have also stepped up our information gathering so that we can better understand factors that may be inhibiting bank lending. These efforts include a survey by examiners of banks' practices in working out loans, the results of which will serve as a baseline against which we will assess the effectiveness of our supervisory guidance.

We are also obtaining additional information on small business credit conditions. For example, we assisted the National Federation of Independent Business in developing a survey to assess barriers to credit access by small businesses. And we are using our own Senior Loan Officer Opinion Survey on Bank Lending Practices to monitor changes in bank lending to small businesses.

In addition to the near-term challenge of fostering improved economic performance and stronger labor markets, we as a Nation face the difficult but essential task of achieving longer-term sustainability of the Nation's fiscal position.

The federal budget deficit is on track this year to be nearly as wide as the $1.4 trillion gap recorded in fiscal 2009. To an important extent, these extremely large deficits are the result of the effects of the weak economy on revenues and outlays, along with the necessary actions that were taken to counter the Recession and restore financial stability.

But an important part of the deficit appears to be structural. That is, it is expected to remain even after economic and financial conditions have returned to normal.

In particular, the Administration and the Congressional Budget Office project that the deficit will recede somewhat over the next two years as the temporary stimulus measures wind down and as economic recovery leads to higher revenues.

Thereafter, however, the annual deficit is expected to remain high through 2020, in the neighborhood of 4 to 5 percent of GDP.

Deficits at that level would lead the ratio of federal debt held by the public to the GDP—already expected to be greater than 70 percent at the end of fiscal 2012—to rise considerably further.

This baseline projection assumes that most discretionary spending grows more slowly than nominal GDP, that no expiring tax cuts are extended, and that current provisions that provide taxpayers' relief from the alternative minimum tax are also not further extended.

Under an alternative scenario that drops those assumptions, the deficit at the end of 2020 would be 9 percent of GDP, and the federal debt would balloon to more than 100 percent of GDP.

Although sizable deficits are unavoidable in the near term, maintaining the confidence of the public and financial markets requires that policymakers move decisively to set the federal budget on a trajectory toward sustainable fiscal balance.

A credible plan for fiscal sustainability could yield substantial near-term benefits in terms of lower long-term interest rates and increased consumer and business confidence.

Timely attention to these issues is important, not only for maintaining credibility but because budgetary changes are less likely to create hardship or dislocations when the individuals affected are given adequate time to plan and to adjust.

In other words, addressing the country's fiscal problems will require difficult choices, but postponing them will only make them more difficult.

Thank you. I would be pleased to take your questions.

[The prepared statement of Chairman Ben Bernanke appears in the Submissions for the Record on page 51.]

Chair Maloney. Thank you very much.

The Fed's stance has been that it plans on, and I quote, "maintaining exceptionally low levels of the federal funds rate for an extended period of time," end quote.

Since there has been a great deal of speculation about the possibility that you might change your mind, let me simply ask you: Do you still hold that opinion?

Chairman Bernanke. Well the Federal Open Market Committee has stated clearly that they currently anticipate that very low, extremely low rates will be needed for an extended period.

They have emphasized, however, that that projection, that forecast, is conditional on three sets of conditions:

One, very low resource utilization, high unemployment, low capacity utilization.

Second, subdued inflation trends—low inflation.

And third, stable inflation expectations.

So if those conditions cease to hold and we anticipate changes in the outlook, then of course we will respond to that. But the committee at its last meeting issued a statement reiterating that expectation about interest rates.

Chair Maloney. And you mentioned certain criteria. Are there any other particular measures that the Fed will be using to determine when to raise the federal funds rate?

Chairman Bernanke. Well we will certainly be looking at a broad range of economic indicators to try to assess where the economy is going. As was mentioned earlier, our policies take a while to work and therefore we have to look at the outlook as well as the current situation. And so I tried today to give you some sense of our outlook, which is for moderate economic recovery going forward.

In addition of course we will continue to look at inflation, and look at inflation expectations. We will also look at what is happening in financial markets. And that was also mentioned earlier. We want to be sure that financial imbalances are not building. And to the best that we can tell, we have been trying to evaluate that criterion. And to the best we can tell, of course it's very difficult, we're not seeing obvious imbalances at this point.

But certainly it is an issue, and recent experience suggests that we need to be very cautious about that, and we are paying attention to those issues.

Chair Maloney. Thank you.

Mr. Brownback.

Senator Brownback. Thank you, Madam Chairman.

Mr. Chairman, in your last statement on fiscal policy, we were running a deficit of 4 to 5 percent of GDP, but the more likely scenario is 9 percent of GDP if I interpreted you correctly, that if you don't make any of these adjustments and yet the Congress generally goes on alternative minimum tax and things like that, and if we keep delaying action, you're saying we are on track to be at 9 percent of GDP debt by 2020. Are we on a sustainable path right now on our fiscal policy?

Chairman Bernanke. Well, Senator, first let me just say that those numbers are based on CBO analysis, and assume, as you say, that AMT fixes continue to be extended, as they have been, and that expiring tax cuts are extended, and that nonmilitary spending grows as fast as GDP. So there are some assumptions about policy.

I think it is fair to say that deficit, structural deficit, longer term deficits of anywhere between 4 and 9 percent, anywhere in that range, is not sustainable because it leads to a debt-to-GDP ratio, which grows essentially indefinitely; it does not stabilize. It leads to higher interest payments, which then feed back into the deficit. So I think it is very important that we consider how looking forward, not this year—because many economic conditions that are moving towards higher spending and lower revenues—but over the medium term as we try to plan our fiscal policy going forward, we need to find a sustainable path, and that would require lower deficits than we currently are projecting, or at least the CBO is projecting.

Senator Brownback. Are we on track to have the same sorts of problems that Ireland and some other European countries have presently?

Chairman Bernanke. Well, we are a much larger, diversified, advanced economy than Greece and some of the other countries, but clearly at some point we need to address those balances. We need to make sure that we have a sustainable fiscal program that will not lead to indefinite growth in the debt, relative to the GDP.

Senator Brownback. At what point does the global financial community determine that the United States is not being serious enough about its fiscal policy, so that it starts raising the cost of capital for the United States?

Chairman Bernanke. Senator, that's inherently very hard to know. At some point the markets will make a judgment about, really not our economic capacity, but our political ability, our political will to achieve longer term sustainability. And at that point, interest rates could go up, and that would be of course a negative for economic growth and recovery.

So we don't know when that point would be reached. And for that reason, I think it is important, even if we cannot balance the budget immediately, that we begin to think about how in the medium- to long-term we can put the federal budget on a sustainable trajectory.

Senator Brownback. But it is clear that the markets could anticipate that happening even now.

Chairman Bernanke. It is absolutely possible, certainly.

Senator Brownback. Chairman Bernanke, we have a financial regulatory reform bill out of the Senate Banking Committee. I want to ask you about a specific issue concerning the Fed in this legislation.

My concern is the placement of an independent Consumer Financial Protection Bureau within the Federal Reserve, funded by the Fed's ability primarily to print money. Do you have views on this stand-alone agency being placed within the Fed?

Chairman Bernanke. Well I would like to understand better how it would work. My current understanding is that the agency would not be within the Fed in any kind of accountability sense; that the agency would not be reporting to the Board, or to the Chairman; it would essentially be free-standing.

So that means that "being within the Fed" is kind of a vague idea at this point. It is true that the current proposal would involve the Federal Reserve financing this agency. That of course does not make it any less costly to the taxpayer; it just means that there would be less revenue remitted from the Federal Reserve to the Treasury.

So it is really up to Congress how you want to account for and finance the agency. But that particular way of doing it would lead to less seniorage, or revenue, being remitted from the Fed to the treasury because some would be used to support the agency.

Senator Brownback. Mr. Chairman, I want to urge you to continue to speak out about the fiscal condition of the country. I think we are in a path that is not a good one, and that at any point in time the markets could start to react negatively to our fiscal prob-

lems. And I think the sooner we start to react to that and to show the ability to address it, the better for the country.

Thank you very much, Madam Chairman.

Chair Maloney. Senator Schumer for as much time as he may consume.

Vice Chairman Schumer. Thank you. Mr. Chairman, I very much appreciate your being here.

You have often spoken about imbalances in the global economy and the role that they played leading up to the financial crisis. Vice Chairman Kohn noted in a speech last week that deficit countries like the U.S. need to rely less on consumption, but surplus countries like China must increase their domestic demand, if the global economy is going to thrive.

Which brings me to my first question: It is clear to me, and many experts agree, that China's policy of keeping its currency pegged to the U.S. dollar helps to perpetuate the imbalances in the global economy by subsidizing even more Chinese exports at the cost of increasing American exports.

It makes us too much of a consumption country, and China too much of an exporting country and not enough of a consumption country. This has a direct impact on American jobs. Now just about everyone I speak to admits that that is the case.

When Lindsey Graham and I started out on this five years ago, everyone was saying, oh, please, just go away; we're not.

So if China appreciated its currency and moved to a free floating exchange rate, it would do more for jobs here in the U.S. than any single stimulus program we could pass into law. And now Senator Stabenow and I have combined our currency reform bills into one and we intend to push for action on it in Congress.

First question: Do you agree that China's currency policies contribute to harmful global imbalances, and was one of the causes of the worldwide Recession?

Chairman Bernanke. Yes, I broadly agree with that. I think most economists agree that their currency is undervalued and has been used to promote a more export-oriented economy.

I think it would be good for the Chinese to allow more flexibility in their exchange rate. It would give them more autonomy in their monetary policy so they could address inflation and bubbles within their own economy. It would be in their interests also to combine a more flexible exchange rate with other efforts to increase domestic demand, domestic consumption, and achieve a more balanced economy.

So I don't think the exchange rate is the only factor, but it is a contributing factor to these——

Vice Chairman Schumer. Isn't it a large contributing factor?

Chairman Bernanke [continuing]. It's——

Vice Chairman Schumer [continuing]. 30 percent?

Chairman Bernanke [continuing]. I don't know what——

Vice Chairman Schumer. It's 30 percent. Let's just assume that for the sake of argument right now. That is huge.

Chairman Bernanke [continuing]. I don't know what share of the imbalances can be attributed to the exchange rate and how much to just the other policies that lead to an imbalance of domestic versus foreign demand, but it clearly is a contributing factor.

Vice Chairman Schumer. Okay. Now if it is in China's interest to do it, why don't they do it?

Chairman Bernanke. Well because, like us, they have a variety of political considerations and concerns. They are being conservative, first of all, because I think they are concerned about the effects of any large changes, given what they still perceive as the fragile state of the global economy.

Like we do, they have political factors such as the influence of exporters who are interested in maintaining that strong export orientation. And so they have a variety of both intellectual, if you will, and political rationales.

Vice Chairman Schumer. Okay. And don't we lose thousands and thousands of jobs because of this? And don't billions and billions of dollars flow out of the American economy that wouldn't if just, arguendo, their exchange rate floated?

Chairman Bernanke. I would like to qualify that and say that, besides floating the exchange rate, they would also need to take action such as creating a stronger safety net that would increase consumption and create a more domestic orientation towards spending.

I don't think the exchange rate by itself in the short term would have a major impact. But over time it would have an impact.

Vice Chairman Schumer. Of course it would. Okay, why don't they move—you mentioned political forces. So, you're me. Or one of us here. And we hear our manufacturers, for instance, saying they cannot compete.

I have been to manufacturers in Upstate New York that make great products. They are selling them in China. The Chinese are now copying their products, not letting them sell them in China anymore for all kinds of reasons—but then going to sell them here. And this firm is worried it is going to go out of business.

I hear this story over and over again. This is a high-end product. It's a ceramic that deals with pollution in coal-producing electricity plants. What do you do, if you are us? I have been talking about this for five years. Talking gets you nowhere. And we are ready to act.

What do you suggest we do? What do I tell all those workers who have lost their jobs? What do I tell good New York manufacturers who are being put out of business, they believe, by unfair competition?

Chairman Bernanke. Senator, it is an important issue and I think we should continue to press for a more flexible exchange rate——

Vice Chairman Schumer. Don't you think stronger—we should take stronger action than we have so far? It has produced virtually nothing.

Chairman Bernanke [continuing]. Well there has been some appreciation, as you know.

Vice Chairman Schumer. I know, but that was made up for. We are now still about 30 percent out of balance, which is where we were five years ago.

Chairman Bernanke. Senator, I am not disagreeing with your economic premise at all. But of course the relationship between the

United States and China is a very complex one and covers many, many, many different issues.

Vice Chairman Schumer. Well, you know it is about time we put jobs and American wealth first, and we're not, and I worry about the future of the country for that reason.

Let me go to one final question, Madam Chair. This relates to consumer protection, one substantive and one theoretical.

It is clear that nonbank mortgage companies and others outside the mainstream banking system played a major role in the financial crisis, committed some of the worst consumer abuses. The new consumer bureau proposed in the Senate Financial Reform Bill will also have enforcement power over large nonbanks. And that power will have to be exercised through a rulemaking process.

Now I filed an amendment in committee to pursue—and I will pursue it on the Floor—that would make the new consumer bureau able to enforce its rules against nonbank financial companies, large or small, payday lenders, rent-to-own debt collectors. These are some of the most rapacious people. They prey on the poor. And under our bill they are not regulated because they are small, nonfinancial.

Do you agree they should be regulated?

Chairman Bernanke. I think they should be regulated. I think it should be an even playing field, if you wish, between say banks and nonbanks in terms of the rules that they face.

Vice Chairman Schumer. Yes.

Chairman Bernanke. The only complexity is that of course there are many states involved in regulating. Some do a better job than others, and I think working with the states would be an important part of trying to do this effectively.

Vice Chairman Schumer. Yes, but to just exempt small, nonfinancial companies does not make any sense, right?

Chairman Bernanke. I think there should be an even playing field.

Vice Chairman Schumer. Okay. And a final question that is following up on Senator Brownback. The CFPA. Why would you want it in the Fed? I mean, it would seem to me that the whole mission of the Fed is not consumer protection; it is safety and soundness.

In my experience—and as you know, I think the Fed has done a good job in many areas; it's done a poor job in consumer protection—why would you want it in any form in the Fed? Wouldn't it be better to have it be an independent agency?

Now if there are safety and soundness considerations, the Fed can always—they have lots of external events that affect safety and soundness. Why wouldn't it be better to be independent?

Chairman Bernanke. We haven't asserted anything on this issue——

Vice Chairman Schumer. I understand. I'm asking you, as the head of the Fed, why would you want this?

Chairman Bernanke [continuing]. Well the one thing I would like——

Vice Chairman Schumer. Or are you saying you don't? You don't want it, or not want it?

Chairman Bernanke [continuing]. I understand why people would be concerned, given that we were late in taking some important steps. I can understand why some advocates would want to have a purely independent agency that would have this as the top priority. I understand that. It's perfectly sensible.

Vice Chairman Schumer. I think I want to cut you off right there.

Chairman Bernanke. All right, but may I just say——

Vice Chairman Schumer. I'm joking.

Chairman Bernanke [continuing]. Just say, though, that while we have acknowledged, again, being late on these issues, I do believe that we should receive credit for a much better performance in recent years. And note that there are advantages, and I know that Congress has been grappling with the issue of whether or not the agency should be separated completely from the safety and soundness regulatory function, for example. There are issues there I think which are worth——

Vice Chairman Schumer. But if your number one goal were consumer protection, you would want it independent? Isn't that correct?

Chairman Bernanke [continuing]. I would want it to have——

Vice Chairman Schumer. I'm not saying it should be or it shouldn't be. I'm just saying, if.

Chairman Bernanke [continuing]. Well I think we all should be concerned about issues like credit availability, for example, and there may be benefits to having some strong interaction between this agency, or this set of rulemakings and the bank regulators.

Vice Chairman Schumer. Thank you.

Thank you, Madam Chair. Thank you, Mr. Chairman.

Chair Maloney. Thank you, very much.

Representative Brady.

Representative Brady. Thank you, Madam Chairman.

I think we all agree that China's currency is undervalued. There is some real question about its impact on the U.S. trade deficit, and real concerns about the impact of raising prices on U.S. consumers.

It is also important to note that it is equally important that we not allow that one single issue to overshadow concerns we have with intellectual property rights' protection in China, subsidies, and other issues such as protecting investment and Chinese barriers to U.S. exports, especially in light of the view that this Congress and White House has not pursued pending trade agreements that could create over 250,000 new jobs in America by ratifying agreements with Panama, Colombia, and South Korea.

A couple of thoughts. One, I appreciate in your testimony your reference to the commercial real estate market. I still am convinced that there is not a real differentiation in the Fed and the other banking regulators between growth markets and contracting regions.

I am concerned that there is not an understanding that community and regional banks have picked up the demand left unmet by the fall of the CMBS, and of the inflexibility of bank examiners. I am convinced today in the real world among banks there is a clear view that commercial real estate loans are problem loans. The

sooner you get them off your books, the sooner you contract that portfolio, the better for us.

The result of that I believe is that we are going to exacerbate a problem with more than a trillion dollars of those loans coming up for renewal. I do appreciate the effort that you are making. In fact, you had representatives at a recent roundtable this week with some of our most sound banks and real estate leaders in the Houston region. I appreciated the fact that you are listening to those concerns.

Two thoughts. Independence and monetizing debt. You referenced the deficit today in your remarks. It's so critical. Will you—you know, it's reasonable to expect the Administration to press for easy money in the hope of artificially lifting output and unemployment in the short run.

Will you resist the pressure to monetize the debt as rising borrowing costs intensify our federal budget problems?

Chairman Bernanke. Well, Congressman, first absolutely we will. Our holdings of Treasury Securities today are about the same as they were before the crisis. We have not monetized the debt. And we will not. And we will of course continue to make sure that price stability is central to our objectives. So let me just assure you on that point.

Let me just add parenthetically that, given the structure of our debt it wouldn't even help. It wouldn't even help reduce the debt. Given that so many of our obligations are either short-term, or indexed, or real obligations such as medical obligations or Social Security obligations, which are indexed, it wouldn't have a substantial effect even if there were willingness to do that, which of course there is not.

So there really is no alternative but to try to find real solutions. Inflation is just not an answer either, for economic reasons, and just because it wouldn't even affect the balance very much.

Representative Brady. Well the reason, I noticed OMB's projections on Treasury Note yields for the next few years is much lower than what is already occurring today, so I think that pressure will increase, not just from the White House but from Members of Congress.

I worry about the independence of the Fed, and I wanted to ask you. Obviously we're all aware of the Senate bill dealing with making major changes to the Federal Reserve such as making the president of the Reserve Bank of New York a Presidential appointee, removing certain voting rights, and transferring your jurisdiction of certain banks.

Do you have any concerns about making the president of the Federal Reserve Bank of New York a Presidential appointee?

Chairman Bernanke. Yes. I don't think that is the right way to go. I think we want to maintain accountability through the Board of Governors, which then oversees the system. And that is really the appropriate way for us to be accountable to the Congress, which we will be.

We want to be completely open and transparent to the Congress on all financial matters, but we do need to maintain our independence in our policy decisions.

Representative Brady. Do you feel like some of the changes such as voting rights at the Regional Reserve Banks, do you think those changes—do you have concerns that they could weaken the Regional Reserve Banks and could undermine the independence of the Fed in dealing with monetary policy?

Chairman Bernanke. Well I think that our FOMC structure, which was created in the late 1930s, has worked pretty well. It's got a good combination of Presidentially appointed, Senate-confirmed governors here in Washington, and Reserve Bank presidents around the country.

There are 19 people on the FOMC, 7 governors and 12 Reserve Bank presidents. We all come of course to every meeting, and everyone's views are heard. So, not withstanding the voting arrangements, it really is a collective decision, a consensus decision.

So I think we get both the Washington perspective and the Washington accountability, but we also get very important information and input from around the country. And you mentioned this earlier, Congressman, that one of the sources of that information is our oversight of state member banks, which are very well informed about their local economies, and therefore are a very important source of information for us.

And so that is also a concern that we have, that we would lose that oversight. So the independence is very important, and I think the main issue here is just to make sure that we are allowed to take actions in pursuit of our mandate without intervention by either the Congress or the Administration.

Representative Brady. Thank you, Mr. Chairman.

Chair Maloney. Congresswoman Sanchez.

Representative Sanchez. Thank you, Madam Chair.

Thank you again, Mr. Chairman, for being before us today. Mr. Chairman, I think that I am having the same problem that a lot of other people are having with respect to what's going on in our country. And that is, that we continue to say that small businesses in particular create the jobs, but we know that employment lags behind when the economy is turning around.

So let's just say for a minute that maybe we're turning around. Maybe we have gotten to the break-even point, or we might be growing a little bit; or we may not; and we're not going to see employment pick up for awhile. I think everybody is sort of coming to that realization.

But here is the problem I have. Most of the small businesses, that went into business because it was good times, and the money was flowing, and there was lots of excess fat, the people who got into business for those reasons are gone.

Now you have your businesses that have been around for awhile. A lot of them took good precautions in a normal period and are financially pretty sound, they can't get working capital. They just can't get loans to buy inventory, or to upgrade the technology that they need, and banks are not lending still.

We are at almost a zero percent interest rate. I mean, money is pretty cheap. But even those credits that before were good credits, and today are still pretty good credits, can't get to the money.

So what do you suggest? I mean, what is happening out there? What are we missing? What do we need to do? Getting a loan

through the SBA Administration involves a lot of paperwork and it is a long and difficult process.

So these businesses today are saying, we've made it through. We're still around, but we still can't get the working capital to really move forward. And I have seen a lot of businesses like that who are actually good credits but they do not have equity in their homes, which is where they used to go before to borrow against their own personal wealth. What are we going to do about that?

I mean, what do you suggest? Or what can the Congress do? Or what can we do in conjunction to get that moving?

Chairman Bernanke. Well let me first agree with your premise that small businesses do create a lot of jobs, particularly in economic recoveries. To the extent that they can't get credit, that is going to slow or prevent their expansion. That is very important. And so that is a top priority for the Federal Reserve.

I don't want to take too much time, but the issues really are complicated. There are some firms that got easy credit earlier and now they can't qualify for tougher credit terms.

There are some firms that are not demanding credit. If you look at the surveys, their number one problem is lack of demand, lack of customers. And the surveys also suggest that some firms are able to get credit, though not all. So it is a complicated picture.

That being said, one creditworthy small business that can't get credit, that's too many. We want to fix that. And we have approached this from a long list of policy actions, including strengthening the banking system, including our interest rate policy, as you mentioned. But I mentioned specifically that in our supervisory role, as I discussed briefly in my remarks, we have issued very strong guidance to banks and to examiners, and very explicitly to examiners, that small businesses are to be evaluated based on their ability to pay, not based on their industry, not based on their geography.

And we encourage, for example, second-round reviews, if the first one doesn't pass. We are very explicit that decline in the value of the collateral, of the home or the store, is not in itself a reason to mark down or deny the loan.

We have been working very hard to get feedback. And one of the problems we get, frankly, is that bankers tell their Congressmen that they're having a problem, but they won't tell us, for one reason or another, and we are trying to make sure we get as much feedback as possible.

So we have been having meetings around the country at all the Reserve Banks in the different districts with bankers, with small businesses, with community activists, to try to understand what are the barriers. What can we specifically do?

So we are working very hard to improve that situation. Unfortunately, credit is somewhat tighter and will be somewhat tighter, and that is probably unavoidable. But we do want to make sure that creditworthy borrowers are able to access credit, and we are working very hard on that.

In terms of what Congress can do, there are some proposals. The Administration has a proposal to use some leftover TARP funds to essentially incentivize small banks, because small banks are more likely to be lenders to small businesses.

Representative Sanchez. Sure. They know they're closer to——

Chairman Bernanke. And they know them better, and they have longer term relationships. We have been doing a lot to try and increase our data information about those loans.

Now it would take another lengthy discussion to talk about the pros and cons of a specific proposal, but there may be different ways to incentivize or support, either through the SBA or directly, small banks which know those customers to increase their lending, and I would encourage you to look at that.

Representative Sanchez [continuing]. Well, Mr. Chairman, I would like to discuss with you or your people how we might get to that point. We have information from our bankers. Maybe they're not telling you. Maybe we need to bring them in and talk to you. It just seems like there is a disconnect, and we need to get beyond this barrier to really get at what seems to me to be—I mean, I used to be in the financial industry—pretty creditworthy businesses when they come and they talk to me, and I look at their balance sheets. And yet, it is almost like the money is right here, but they can't get to it.

Chairman Bernanke. I encourage anyone around the table there who would like to bring in folks, we can work out ways to have those conversations. It would be very helpful to us.

Representative Sanchez. Thank you, Chairman. I appreciate it.

Thank you, Madam Chair.

Chair Maloney. Thank you.

Representative Paul.

Representative Paul. Thank you, Madam Chairman, and welcome, Chairman Bernanke.

I want to make a brief comment, and then I want to ask a question about the IMF.

My brief comment is a comment about the answer you gave to Mr. Brady about monetizing debt. Because your balance sheet remains relatively stable with Treasury Bills, it doesn't mean that the Fed can't monetize debt.

You mentioned in your statement that you bought securities, mortgage-backed securities, and agency debt, and that's over $1.2 trillion. Well where did you get the money? You created this money. So you did monetize debt. That went into the banking system. The banking system can buy Treasury Bills. And they can borrow money at zero percent, and that's why they're making a lot of money right now, because they can buy other debt and make a little bit more, and it looks magic except for the mortgage—the people who are losing their mortgages and losing their houses right now.

But one other quick question. Are the thousand examiners that you're training, are any of those new? Or are these people already on the payroll?

Chairman Bernanke. On the payroll, and they include both Federal Reserve and State examiners.

Representative Paul. Okay. Because my comment there is: Probably 10,000 won't do much good. Because it isn't a lack of ex-

amination, if you don't deal with the problem, and the problem really comes from a monetary policy of low interest rates.

As long as low interest rates rig the market and gives bad information to the investor, all the examiners in the world can't compensate for this. And this whole idea that capital can come from a printing press rather than savings, I still have a terrible time trying to understand how an economy can thrive on that. Because it rejects every notion of free-market capitalism.

But the question I have on the IMF is, this week the IMF has announced that they are going to open up that new arrangement to borrow, or expand. There's a commitment of $50 billion there now, and it's going to go up to about $560 billion, and it coincides, you know, with the crisis going on in Greece and Europe and how they're going to be bailed out.

The irony of this promise is that in the new arrangement, this increase, Greece is going to put $2.5 billion in there. I think this is—only a fiat monetary system worldwide could come up and have Greece help bail out Greece, and be prepared to bail out even other countries.

We are going to go from fifty up—no, we are going from ten up to a hundred and five. So that is $105 billion we're going to commit to bailing out the various countries of the world, and who knows what, but I think this does two things I want to get your comments on.

One, why does it coincide with Greece? What are they anticipating? Why do they need $560 billion? Do we have a lot more trouble?

And, when it comes to that time where we have to make this commitment, who pays for this? Where does it come from? Will this all come out of the printing press once again, and we expect to bail out the world?

Are you in favor of this increase in the IMF funding and our additional commitment to $105 billion?

Chairman Bernanke. Well the source of this was going back in the G–20 meetings in the crisis. And I think one of the agreements that the G–20 leaders came up with was sort of a mutual commitment to put more money into the IMF as a way of addressing the financial crisis around the world. And that's why it happened.

The Federal Reserve wasn't involved in those meetings. So that was before Greece. If money is put out to any country, it will be done first of all with specific approval from the executive board, which includes of course the U.S. in a veto position, and with conditionality. That is, the country has to meet certain conditions.

So the G–20 leadership apparently has agreed that this is a way to provide credit to avoid fiscal or exchange rate crises in countries around the world.

Representative Paul. Yes, but do you think this is a good idea? Do you agree that we should make this commitment?

Chairman Bernanke. I think in general that having the IMF available to try to avoid crises is a good idea, yes.

Representative Paul. And again, where will the money come from? This is our problem in this country. We're bankrupt, too. And also, along this line, do you feel like, you know, you go along with

this commitment, what are we going to do when a state gets under the gun, like California and others?

I mean, they are approaching the state that Greece is in. We can't turn down California. I mean, if we can pay out all these banks, and they get off the hook, and now they're making billions, and their executive officers are cleaning up, do you think we would ever turn down California, or any other State that gets in the same situation?

Chairman Bernanke. Well that is Congress' decision.

Representative Paul. Well you bailed out a lot of people from the IMF. You know, you have the capability of buying up some debt and doing all these kinds of things. We can't even audit you to find out what you do. So you can do anything you want, and you can create as much money as you want. So——

Chairman Bernanke. You can see any transaction or loan we make. We're happy to provide that information to you. And we are not involved with lending to the IMF. The IMF is a separate institution, which has American executives, part of the executive board——

Representative Paul [continuing]. But where would the money come from?

Chairman Bernanke. It's a loan, but it would come from the U.S. Government.

Representative Paul. Eventually we would create out of thin air, because we don't have——

Chairman Bernanke. Well, it's a loan. If it's not paid back, then we would take our share of the loss.

Representative Paul [continuing]. I yield back.

Chair Maloney. Thank you.

Congressman Snyder.

Representative Snyder. Thank you, Madam Chair.

Thank you, Mr. Bernanke—Dr. Bernanke, for being here. I don't often agree with things that my friend from Texas, Mr. Brady, says, but at the beginning of the hearing he said that you had quelled the panic at the end of 2008 and 2009, and I think that may be a phrase you want to remember. "He quelled the panic." That could be tombstone material. So you might want to save that and tell your heirs to remember that phrase——

Chairman Bernanke. A long time from now, I hope.

Representative Snyder [continuing]. Decades from now when you're looking for something.

On page 4 of your statement, you said ". . . , the financial condition of banking firms has strengthened markedly . . . ."

What I want to ask about is the more amorphous of ethics in banking. What concerns me is this: If I want to buy a car, I will study who puts out the best car. And the manufacturers, and the dealers, they stand by their service, they stand by their product.

If I'm looking for someone to paint my house, I ask around about who does the best job of painting houses. And I'll get references, and I'll go talk to people about, yes, this person did the best job of painting my house. And the providers of a product, the providers of services, they work to put out a product that satisfies me.

It seems to me that we've got a situation with major players in the financial services industry that they work for ways that their customers will be unsuccessful. Now what do I mean by that?

Well, the one that we're probably most familiar with now is that I'm a Bank of America customer—and they're probably tired of me talking about them at these hearings—but the computer program. This happened to me. I didn't go into late fees or anything, but I just look at it on line. Banks closed on Good Friday, Saturday, Sunday, Monday, and I look and all the debit card purchases I did through the weekend, regardless of when I did them, are processed in the order with the largest first, from the $300 down to the $3.65 coffee at Starbucks, or something, and we all know what that's about.

The goal is to drive people unknowingly into overdraft fees. They want me to fail as a customer. Now if that's how they're treating—I think the study showed they make most of their money on overdraft fees from 14 percent of their customers—but they're preying on people, hoping that we don't succeed at managing our money.

And then we've had this history over the last several years that led into this problem of loans that should never have been made, but they made them, and then sell them, so that then they can walk away from their mistakes and they then don't care about whether they succeed or not.

So my question is, you have done a great job of quelling the panic, and I think that history is going to treat you well, but my question is on the more vague one. What about the ethics, the morality of the financial services industry?

I have asked this question of many people, and they say: Well, they're responsible to their shareholders. But so are my painters. So are my car dealers. What about the issue of responsibility to customers, where you actually want your customers to succeed, where you actually want to put out a product which will help them meet the financial needs of their family?

Where does that come into all these discussions?

Chairman Bernanke. I think it is incredibly important. I think the heart of any good business is ethical treatment of your employees, and your customers, and so on.

And my experience is that among bankers, like in any other group of people, there are some who are very ethical, and some who are not. And in the cases of those who are not, we need to make sure there's adequate protection. It's like a Better Business Bureau, if you will.

In the case of the overdraft protections, the Fed recently put out rules requiring opt-in on debit card ATM transactions. You have to opt-in in order to be allowed to overdraw and receive an overdraft fee.

Representative Snyder. But you did not do anything about this computer program that processes them from larger to smaller, did you?

Chairman Bernanke. We did not in that particular rulemaking because it was part of the Electronic Funds Transfer Act and did not have a place to put that in, so to speak, but we are in fact looking at those practices and we will try to address them.

They are not completely straightforward because there are arguments for the big one first because people want to make sure that their mortgage gets paid before their coffee gets paid, but——

Representative Snyder. Well I've heard that from local bankers many a time——

Chairman Bernanke [continuing]. Well in any case, we're looking at that very seriously and we will try to come up with a solution that will address the problem you are talking about.

Representative Snyder [continuing]. Because, you know, it is—I mean, I have had the personal experience of going in and checking a balance before I get some cash out on a Saturday, and it says I've got $130, and I take out $100, and then because of the reprocessing, in fact—this was actually an experience several years ago where it did push me into an overdraft, but it was one that they had formally said to me, yes, you have enough money.

I mean, that is how nefarious it is, and most people do not do online. Most people don't follow it like I do, because I am so intrigued by what they're doing. They are just preying on people. I just think it is very, very difficult to deal with all of the issues that the Chairwoman wants to deal with, what Ms. Sanchez was talking about, if there is a morality in the industry that says ultimately our goal is to get money from people, not necessarily to see them have a successful commercial real estate venture, or a successful home loan, but to package, and sell, and move on. And I don't know how we get at that in this industry very well.

Thank you.

Chair Maloney. Thank you. Congressman Burgess.

Representative Burgess. Thank you.

Chairman Bernanke, welcome to our Committee. Let me—Dr. Paul made an observation that is so important it just bears repeating. The concept that the banks that got into trouble were able to get money at a very, very low interest rate, and now are turning around and loaning it back to you at a much higher interest rate. And there is no reason for them to make loans to the entrepreneur or the small business person. They are actually making money just working off this system that it appears to me that the Fed has provided for them.

So I do urge you to look at that. You talked about the creditworthy business who is being given an appraisal that then makes them appear non-creditworthy, and this is a real problem. I heard from people all over my District during the break that this is going on today in almost any Congressional District in which you look in the country.

To the extent that you offer help in that, I intend to take you up on that offer. I will have several of these individuals visiting me here in Washington next week, and I would like for them to be able to tell someone at the Fed just what they told me last week. And part of it is mark-to-market but part of it is the very slow rate of getting appraisals back, and the appraisals are so slow in coming back that they in fact do not reflect rapidly changing market conditions, and people in the real world cannot function in the system that we have created for them.

So I think Representative Sanchez had some very good points, and I will also take you up on that offer because I think it needs

to—I think there needs to be more, there needs to be more hands-on from the Fed about what are the actual effects of the monetary policy that you are pursuing.

You also made a comment that the Fed is open. I know Dr. Paul talks a lot about auditing the Fed and knowing what's in there. Is there a way for me to know what the Fed holds as far as real holdings in my Congressional District?

You hear stories on the radio about the Fed owning a shopping center in Oklahoma City, for example. I didn't know you guys were into that. But what do you own in my Congressional District? So if I have a constituent ask me that question, am I going to be able to get that information?

Chairman Bernanke. So the answer is: Yes. The only kind of strange assets like that that you're referring to, basically what we own is Treasuries and the liabilities of Fannie and Freddie. That's basically what we own.

We do have some assets that were involved in the bailouts of Bear Stearns and AIG which are still on our balance sheet. That's about 5 percent of our balance sheet. Again, this is not something we wanted to do, but we didn't have an option at the time.

That not withstanding, we have released all the information about what's in that group of assets, and includes information about, you know, who the loan is to, et cetera. So, yes, you can find that out.

Representative Burgess. All right, I appreciate that. And I will have someone from my office follow up with you on that.

Now you mentioned, again in response to Senator Brownback's question of the concern about the structural deficit and about the tax provisions that are due to expire and assumptions made that all of those expire. Here's a report from the Joint Committee on Taxation. I won't question you about it because it's not fair to do that, but it has 50 pages of tax cuts that are expiring in the next 10 years. Some of them are quite obscure. It appears to me some of them should expire. But have people at the Fed gone through this and really put pencil to paper about which of these—I doubt very much that Congress is going to let the Alternative Minimum Tax kick in. I don't know quite what we're going to do about that, or how we're going to pay for that before the end of the year, but we always do something. So I expect you are correct in that assumption.

But has someone at the Fed gone through this entire report from the Joint Committee on Taxation looking at the expiring tax provisions over the next ten years so that we have some idea of what we're dealing with as far as what you term the structural deficit going forward?

Chairman Bernanke. Well again we were using the publicly available CBO projections there. And on the tax side, I am not advocating any policy or anything like that; I am just telling you how the CBO has done these projections.

That particular projection is one where all the expiring tax cuts are extended and quantitatively, by far, the two biggest are the 2001–2003 tax cuts, and the AMT. And those dominate in terms of the dollar amount. Then there are a whole bunch of other ones like

the research and development credit, and other things like that which are often extended, but of course may not be.

Representative Burgess. But all of that of course directly affects the policy that we all talk about that we should be concentrating on in job creation and job growth.

Just one final thought to leave you with. And I heard from so many people over the break. And you referenced this in your testimony. The young person getting out of college today who is having terrible difficulty finding a job, and may set a tone for their productive years that is forever tainted by their experience because of this Recession. And then you have the person my age, what I like to refer to as the late boomer, who also is having difficulty, the person 45 to 60. Those jobs do not exist. And that is really where we've got to look at both the beginning and the latter end of the employment years because they are both in serious trouble———

Chair Maloney. The gentleman's time has expired, but Chairman Bernanke may answer.

Chairman Bernanke. No, I would certainly agree with that. Both ends, including people near retirement, are having difficulty, and there are different ways to address those different parts, but it is clear that very long-term unemployment is not just a short-term effect, it has a long-term implication for the person's ability to earn a living in the labor market.

Chair Maloney. Thank you.

Congressman Hinchey.

Representative Hinchey. Thank you, Madam Chair.

Chairman Bernanke, thank you very much. You have a very interesting job, and it is fascinating because of the set of circumstances that you have to deal with. Among all the things you have to deal with, the organization of the monetary policy of this country is the critical issue.

One of the things we are all confronting, of course, is this huge national debt. It is important to recognize what occasions caused that huge national debt—primarily, the illicit, unjustified invasion into Iraq and the hundreds of billions of dollars that have been spent there, and now continue to be spent there, and hopefully will end shortly.

The tax reduction for the wealthiest people in this country, which has now brought about the greatest concentration of wealth in the hands of 1 percent of the population we've seen since 1929.

And of course the dramatic drop in the income of virtually everyone else across this country—mostly among the working people.

And other things like the inability to negotiate the price of prescription drugs in the context of Medicare, which is jeopardizing the future of Medicare.

All of these things are critically important. The tax cut expires the end of this year, but all these other things that we have to deal with are critically important. And one of the most important aspects of them is just to understand what they are all about, and how they came about.

The engagement of investment in commercial banks now continues, in spite of the fact that the economy now is beginning to get a little bit better. There are ways in which this is being attempted to be addressed.

One of the ways in which it's being attempted to be addressed is in the context of the financial reform bill of Chairman Dodd. One of the things that he is trying to do is to introduce the elements of the Volcker Rule to deal essentially with what happened with the elimination of the Glass-Steagall Act, the interaction of commercial and investment banks.

Now that aspect of his legislation is not solid by any means. There is a study that is going on apparently that is going to make a determination as to whether or not the provisions of the Volcker Rule, which are only partly effective in the context of dealing with the commercial and investment bank interaction/interrelationship/inter-investments, manipulation of investments, all of those things.

So what do you expect will come out of that study with regard to the inclusion of the Volcker Rule? And if it comes out positively with the inclusion of that in the Dodd bill, how effective is it going to be?

Chairman Bernanke. Well first, I think we all agree that we don't want to have banks or investment banks taking speculative positions with the U.S. safety net behind it. So clearly we have to draw that line.

I think inevitably what the study will find is that drawing a sharp line is not easy because there are various activities such as hedging other positions, or making markets, that involve perhaps temporary proprietary holdings, and so on.

So it may not be quite as easy to say this is proprietary, this is not. And so we will need to have a set of rules, or a criteria that helps us distinguish which is applicable under the Volcker Rule and which is not. And I think that is going to be the big challenge. So we will have to see what the results are.

Representative Hinchey. And there's going to be opposition to making that clear decision. There's no question about that. And that opposition is going to come as a result of the huge amount of income that is generated in the process of the interaction of this situation.

So this is something that's got to be brought about effectively. Now, you know, we could do something simple like bringing back something like the Glass-Steagall Act and separating those banks, and eliminating the conflict of this kind of investment. And it would seem to me that that would be something that would be very effective.

Back in 1933 when that was put into place, it had a very effective means to deal with the Great Depression. But there is a great resistance now to doing that, and that resistance is coming from a handful of people who are effectively engaged in this kind of manipulation of investment.

So I wonder if you can tell us a little bit more about what you think should happen here? And if there's any way in which your operation and this Congress can be engaged more effectively in bringing about a more open and honest way in which this banking situation is engaged, and the elimination of this manipulation that has been one of the major causes of this deep recession that we're experiencing.

Chairman Bernanke. Certainly. I don't think Glass-Steagall by itself would solve our problems, because we had commercial banks

losing money on regular loans, and we had investment banks losing money on speculative securities trades.

So separating that, you know, wouldn't have saved Lehman Brothers, and it wouldn't have protected a number of the banks that had problems——

Representative Hinchey. But if I could interrupt you just a second, I mean some of that elimination had occurred prior to the elimination of that complete legislation in 1999. There were interactions in the Glass-Steagall Act. There were interventions in it. There was some manipulation of it, all of which brought about some of the declines.

Chairman Bernanke [continuing]. I don't think it's just the separation. I'm trying to say, I think we do need to take important steps. They would include, for example, stronger capital requirements to make sure that the institutions who are taking risks are bearing those risks themselves.

It would include making sure that every large financial firm has a strong consolidated supervisor. We don't have the GAAPs that we had, where some kinds of firms were able to sort of sneak by without being overseen.

And I think it is also very important to have this resolution regime that allows us to wind up a failing firm, which means basically that the creditors and the shareholders would bear the costs, and that creates another set of incentives to keep banks and other financial firms away from excessively risky investments.

So I think there are a bunch of things we can do. I don't think Glass-Steagall by itself would solve this complex problem.

Chair Maloney. The gentleman's time has expired.

Senator Klobuchar.

Senator Klobuchar. Thank you very much, Madam Chairman.

Thank you, Mr. Bernanke, for being here. Chairman Bernanke, I will tell you, I just was in my State last week and we have about a 7.3 percent unemployment rate, so it's a little better than the national average. And despite all the struggles, there are some glimmers of hope there, which I know you see with all of your number crunching. Digi-Key in Thief River Falls, Minnesota, population 7,500, has 2,500 employees, and they're hiring 400. So anyone that wants to come there, should see me.

So we have some glimmers of hope. And what I wanted to talk to you about where I see as a potential limitation on our recovery, and that is the debt. And I appreciate you speaking out on that.

A number of us actually held out our votes on the budget and lifting the debt cap. We wouldn't do it without a promise that we were going to get an up and down vote on the Debt Commission. I was very distraught that some of our colleagues changed their votes, didn't do it, and then the President appointed one.

Could you talk about the importance of getting something done on the debt in the long term for our markets and for our economy? And why something like this Debt Commission, if we can get some practical recommendations that we can have an up and down vote on, is so important?

Chairman Bernanke. Well it has direct implications for the health of our economy, and maybe not even just in the long run. I mean, in the long run of course if we have higher interest rates

that's going to reduce investment, and that's going to reduce capital formation growth, and job creation.

It's going to mean we're going to have to borrow more from abroad, which also means a heavier burden on our children to pay back. So those are the classic problems. But I think worse than that is that right now the markets are essentially signaling a lot of confidence that our political system will deliver a sustainable trajectory of fiscal policy going into the next few decades, and I think it's very encouraging in a sense that we can borrow at 30 years at 4 percent, or 4 percent plus.

Senator Klobuchar. And part of that you believe is because they believe we're actually going to do something about it?

Chairman Bernanke. And they believe we're going to do it, and I think——

Senator Klobuchar. And if we don't do something about it?

Chairman Bernanke [continuing]. If we don't do it, or we give a strong indication that we're not going to be able to do it——

Senator Klobuchar. Okay.

Chairman Bernanke [continuing]. Then it would not be something that we'd have to worry about in 2040, it could be something we have to worry about on Wednesday——

Senator Klobuchar. Exactly.

Chairman Bernanke [continuing]. Because it could happen that markets would lose confidence. And again, I want to draw a strong distinction between the United States economy and our fiscal position and that of some other countries. But we've seen around the world just recently, a number of countries who have come under pressure because of loss of confidence in their resolve or ability to address these problems.

Now that does not mean we have to balance the budget tomorrow, but it does mean we have to have a plan and a credible process of some kind to, in the medium term to show that we can manage these difficult problems. And they are very, very difficult. You have all my sympathy, because they are extremely hard politically and intellectually to solve.

How to do it? I think the commission will be interesting to see what they come up with. It's actually a very good commission——

Senator Klobuchar. It is. It is.

Chairman Bernanke [continuing]. A lot of very good people on that.

Senator Klobuchar. Right. And that's why—I want to move on to one other question, but I think this idea that we just put our heads in the sand is just not going to work in the long term is your point. And that is why I hope my colleagues take seriously, on both sides of the aisle, the recommendations of this commission and it does not just become a study on a shelf.

My second focus here—and you and I have discussed small business lending, and I know some of my colleagues have discussed that with you and how important I believe—I have been working with Mark Warner on that proposal.

The second thing is just these latest proposals by Chairman Dodd to look at taking back some of the power from the Regional Federal Reserves. We have one in Minneapolis, very close to my

State Office, and we have found it actually to be helpful. What you think of that proposal?

And then second, the other concern I've heard a lot is from our small community banks, the proposal to limit your supervision to banks that have more than $50 billion in assets. Again, our community banks are not big fans of that proposal either; and I would like to hear your perceptions of this proposal to limit—to consolidate the Fed power away from Regionals and then also to take the community banks out from under the Federal Reserve.

Chairman Bernanke. We are very concerned. We understand we need to play a role with the large institutions as part of a process of trying to keep our financial system stable, but it would be I think a very bad outcome if we were to lose all connection with the small- and medium-sized banks where we currently supervise state member banks and bank holding companies around the country.

First of all, that provides us a great deal of useful information about what's happening out there in the country about small business loans, about credit, about the local economy.

It gives us a perspective on the whole financial system and the whole economy. We don't want to just be looking at Wall Street. We need to look at the whole economy. And not only for monetary policy purposes, but also for financial stability purposes.

Small banks, medium-sized banks can be part of a financial crisis, too, as they were for example during the thrift crisis, or during the Great Depression, or Penn Square in 1982, and there are many other examples.

So both, because we want to have that connection with the rest of the economy, and because both monetary policy and financial stability require we have a broad view of the entire banking system. We think it is very important that we maintain that connection.

We are not asking for new powers. We are asking just that the status quo be maintained so that the Fed has the ability to supervise and have a strong connection with small- and medium-sized banks, as well as the very largest banks.

Senator Klobuchar. And the idea of the Regional Federal Reserves, the same thing?

Chairman Bernanke. The Regional Federal Reserves are in fact our ears to the ground. They are where the actual supervisors reside, and they do the operational work, and they have those local connections, as you well know. And Washington is where the policy is set and where the overall accountability flows from, but we rely very heavily on those eyes and ears around the country to get that feedback.

Senator Klobuchar. Excellent. Thank you very much.

Chairman Bernanke. Thank you.

Chair Maloney. Senator Casey.

Senator Casey. Madam Chair, thank you very much.

Chairman Bernanke, thank you for being here. We appreciate your testimony and your insights, but also your public service at this time. I know it is not easy to be in the position you are in.

I wanted to explore two general areas, if we can get to both. One is jobs, and the other is currency.

First of all with regard to both the data that is out there, as well as your testimony, there is a good bit to be positive about. I have said a number of times that the actions that were taken in the Fall of 2008 when you came to us and presented the gravity of the financial situation, plus the Recovery bill in 2009, and more recent job creation bills, have had a positive impact, and even more so the next couple of months.

But we still face a situation, for example, in our State, where even though if you look at the rate, we are at about 8.9 percent unemployment which in a relative sense is lower than a lot of big states, but it still means 577,000 people out of work. If it's not a record, it is very close to a record.

Then I look at it in terms of individual regions. We have had this unfortunate confluence of misery in places as large as Philadelphia where the unemployment rate has been at 10 for a long time, and it just bumped up more recently to over 11. But next to Philadelphia you have numbers higher than that in very small, and often rural counties where the loss of one employer means an unemployment rate of 12 or 13 or 14 percent.

Having said all of that, in the midst of all that misery for a lot of people we keep hearing that small businesses have trouble accessing credit. We hear that over and over again. The dichotomy between that difficulty that folks are having, especially small business owners, and then you see the headline in the New York Times saying, and I'll read it, "J.P. Morgan is upbeat on economy as it posts profit." For a lot of people out there there are two words in that headline that are at variance with where they are.

One is "upbeat." A lot of people are not upbeat for the reasons I cited, those numbers. And the other words is "profit." A lot of people are not seeing profit in the bottom lines of their small businesses.

So as a long predicate, I know that you have highlighted in addition your concerns about fiscal matters like the deficit. You said, and I quote, "The decline in large part" meaning the decline in credit to small business, "reflects sluggish loan demand and the fact that many potential borrowers no longer qualify for credit, both results of the weak economy."

And that is kind of the diagnosis of the problem. What do you think are steps we could take in the short run, meaning the next six months to the next year, that would have a positive impact on the jobs climate as it relates in very particular way on small business?

Chairman Bernanke. Well again, the small business problem is a very difficult one because we want small business to have credit, but we want to make good loans. We don't want to go back to the weak lending standards of before the crisis.

And so, as I've discussed earlier today as well, it's a very high priority of the Federal Reserve to work with our banks and our examiners to make sure that there's an appropriate balance. That is, loans have to be appropriately underwritten. They have to be sufficiently likely to be repaid, prudent. We don't want banks to be losing money on bad loans.

But on the other hand, we certainly don't want a modern equivalent of red-lining. We don't want to say that the whole category of

small business is not to receive credit, or all retailers are not to receive credit, or nobody in the State of Florida is to receive credit, because of just the general category.

And I think part of this is a cooperation between the banks and the examiners working together, understanding each other to make sure that every loan is evaluated on its own two feet, so to speak, so that you could very well have a situation where the value of property has gone down, but the company has a stable business and it has been able to repay for many years. In which case, we have provided guidance to our examiners in training and asking for feedback, in which case that loan should be made, or at least it should be given a very careful assessment.

This is something that goes back to a point that Senator Klobuchar raised, which is the Fed's involvement with the banking system. We are of course bank examiners, and safety and soundness examiners, so we are obviously very concerned about making sure the banks are safe and sound and making good loans, not taking undue risks, et cetera; but on the other hand, as the central bank of the United States we are also very concerned about the overall health of our financial system in our economy.

Therefore, perhaps more than others, we are really focused on getting that balance right. We really want to make sure that good loans do get made; that they are very much in everyone's interest.

So I have talked about some of our programs and our information gathering, and we have had meetings around the country, and conferences, and we are collecting extra data that we didn't used to collect before about small business lending. We have put extra questions into the NFIB Survey to try and get more insight.

And as I've said earlier, I invite direct feedback from Members of Congress and their constituents who have suggestions and ideas about how we can better meet this need.

From Congress's point of view, it is again a difficult problem, but we discussed earlier just some proposals to use TARP money, $30 billion in TARP money, to provide additional capital, or reserves, to incent small banks to make more small business loans. And there are a lot of issues in how to do that, but that is one direction that could be constructive.

Senator Casey. Thanks very much.

Chair Maloney. Thank you.

Thank you. Chairman Bernanke, you testified earlier that in financial regulatory reform we should have stronger capital requirements. Many believe that we should also limit leverage. Some of these financial institutions were highly leveraged, 60 percent, 35 percent.

Do you believe that the leverage should also be limited? And, if so, what would you recommend? And do you think we should have a specific number put in the legislation, a cap on leverage?

Chairman Bernanke. So in the United States we have, as a first line of defense, a risk-weighted capital ratio, which is not a straight leverage ratio; it's amount of capital we have to hold against assets, where we have to hold more capital against riskier assets, which makes sense. The riskier the asset, the more capital you want to hold.

And we, the Federal Reserve and the other bank regulators, are working very actively with other regulators around the world to strengthen the capital requirements. We have already made proposals to do that. We are going to get assessments from the banks about how big an impact that would have. And it is our intention to move forward with more conservative higher capital requirements. So that's the first thing.

The leverage ratio is kind of a backstop, a failsafe, if you will, because that's a very simple ratio. It's just a ratio of capital against total assets without making much or any distinction between Treasuries versus loans to small businesses, for example.

And the United States has long had a leverage ratio as a backstop to our capital rules. One of the interesting things that appears to be coming out of the international negotiations is that the U.S. leverage ratio, which never was used abroad, now looks like it will be adopted by other countries as well, which is good for us because it will create a more even playing field and create greater safety in the global banking system as well as here.

So the leverage ratio is part of these negotiations and discussions we're having internationally, and there are proposals on the table. We haven't yet gone through the whole process of doing the quantitative analysis to figure out exactly what the right number is, so I can't tell you offhand what the final number will be. But we are certainly looking to make the leverage ratio part of the more conservative approach to making sure that banks have enough capital that they can absorb, even in a severe crisis like the one we've had, they can absorb their losses.

So, yes, that will be part of our proposal.

Chair Maloney. Well, I think you should reach your conclusion by the time we pass this bill. We should have something definite in the legislation on leverage.

I would like to ask your assessment on international banking, your comments on what's been happening in Greece. At the Senate Banking Committee hearing in February, you testified that the Fed was going to look into credit default swaps on sovereign debt.

Can you tell us what you found?

Chairman Bernanke. The Goldman Sachs arrangement with Greece is where we put most of our focus. On that, we found that there was in 2000 and 2001 a contract between the Greek Government and Goldman Sachs which, by using exchange rates that were different from the market rates, had the effect of modestly changing the reported debt and deficit ratios that Greece reported to the European Eurostate, their statistical agency.

Goldman Sachs sold this position in 2005 to a Greek bank. A couple of comments. One, as I mentioned the effects—they did have the effect of distorting the numbers—were relatively modest, about 1 percentage point. The debt to GDP ratio changed from about 101 percent to 100 percent. So it wasn't a large effect, but it was an effect.

At that time, this of course was well before the Federal Reserve was supervising Goldman Sachs, and it was also before the Enron episode where following which, the Fed and other bank supervisors greatly strengthened our rules against arrangements which are ba-

sically intended to have accounting impacts, essentially to affect the accounting valuations.

So we have discussed the issue with Goldman, and they have, as they are required to do, a much more elaborate procedure now to evaluate such possible deals to make sure that they are not being motivated by accounting and other kinds of appearance issues.

So we believe that that situation is now well under control. And as I said, they divested that position in 2005.

On the credit default swaps, we haven't found large positions in U.S. banks vis-à-vis European governments, but we have not addressed the question specifically of using CDS to manipulate prices, which of course would be illegal and inappropriate. That would be more an SEC responsibility. I know they are looking at that issue.

But again, exposures of U.S. banks via credit default swaps or direct holdings to European governments are relatively limited.

Chair Maloney. Are you satisfied with the solution Europe has reached? Do you see the problems plaguing Greece spilling over into other adjacent countries, or possibly having an impact on the United States?

Chairman Bernanke. Well it's a work in progress. They've made, I think, a good bit of progress, but it's politically difficult because on the one hand the Europeans don't want to assist Greece unless they are persuaded that the Greeks have made a very good-faith effort on their own to reduce their deficit and improve their own fiscal position; and at the same time the Europeans themselves have to agree how they're going to share the burdens and how they're going to set up the arrangements.

I think there's a broad understanding that it's very important for them to come to a solution, and they've made a good bit of progress there. But I think there will still be further discussions going forward.

The United States is not directly involved in these negotiations, but I've been informed that they've made good progress and that they are quite confident that a solution will be forthcoming.

Chair Maloney. Thank you very much.

Mr. Brady.

Representative Brady. Thank you, Madam Chairman.

I do believe in the importance of small business credit. It's not an issue of more capital; it's an over-correction on behalf of the regulators at the banks. I really believe—and again I'm not a banker, I'm not an expert in the area—but especially in commercial real estate, even though they're told these are guidelines, repeatedly these are guidelines, banks know, community and regional banks know if they go over, a dime over the concentration thresholds, they're going to enjoy a visit, a special visitation from their friendly banking regulator.

Plus, you know, the requirement of setting aside capital reserves for commercial real estate that are far in excess of the real risk of that loan is really creating—I can't overstate the problems it is creating among creditworthy projects, not just inhibiting growth, but I think creating again a much more severe commercial real estate crisis where we already know there are real challenges anyway.

I really do appreciate your focus on that area, among all the other things you're doing. It's critical that the Fed be listening and injecting common sense wherever possible in that process.

Can I ask you about two things. One about sort of the tradeoff between inflation and unemployment, and also a question about the balance sheet and exit strategy.

We have had a couple of people testify before Congress here recently. Professor Lawrence Ball advocated raising the Fed's inflation target to 4 percent. His argument was that higher inflation would alleviate unemployment and give the Federal Reserve more room to reduce nominal interest rates in the future, sort of that tradeoff again, inflation/unemployment.

How do you respond to Professor Ball's argument that unemployment is so dire that we should inflate our way to a more rapid recovery?

Chairman Bernanke. Well his argument is that at a higher inflation rate, nominal interest rates would also be higher on average, and that would give more space to cut during a recession and perhaps more ability to create impetus. So that's not an illogical argument, but it has substantial risks.

Which are: The Federal Reserve over a long period of time has established a great deal of credibility in terms of keeping inflation low, around 2 percent roughly speaking, and you can see that for example in Inflation Index Treasury Debt, which shows that people expect over the next 10 years about 2.2 percent inflation on average over that 10-year period.

If we were to go to 4 percent, and say we're going to 4 percent, we would risk I think losing a lot of that hard-won credibility because folks would say, well, if we go to 4, why not go to 6, and if you go to 6, why not go to 8. It would be very difficult to tie down credible expectations at 4, beyond which of course in the longer term low inflation is good for the economy, and 4 percent is already getting up there a bit and would probably have detrimental effects on the functioning of our markets, and so on.

So I understand the argument, but that is not a direction that we are interested in pursuing. We are going to keep our inflation objectives about where they are. We think about 2 percent is about appropriate, given biases and measurement of inflation, and given the need to have a little bit of space between the average inflation rate and the risk of having deflation, or falling prices.

So that is where we are going to be. That is the path we are going to be following.

Representative Brady. You have raised the issue of expectations, and there are, I believe, in this economic recovery rational expectations that businesses will see higher tax rates, higher energy prices, more regulation, I do think that has an impact, and individuals as well, the high debt, someone has to pay that back, is it going to land on them, and does it affect our economy. That's all part of the psyche and confidence of business and consumers.

One of those areas of uncertainty is the extraordinary balance sheet expansion of the Fed. Recently testifying before the House Financial Services Committee, Professor John Taylor stressed how important it would be for the Fed to provide an exit strategy with explicit decision rules, so as to allay fears of surging inflation, and

here in Congress, that the Fed will not continue to exceed its traditional purview of monetary policy.

Are you prepared to lay out a definitive roadmap to normalization?

Chairman Bernanke. Yes, we haven't determined all of the details. We're obviously going to see how things evolve. But I have recently testified before the House Financial Services Committee, and also released separately a document, another testimony which has laid out our proposed exit strategy.

We are developing the tools to do that. This has been an ongoing campaign on my part and on the Fed's part going back to last summer when I published a Wall Street Journal Op Ed——

Representative Brady. I saw that.

Chairman Bernanke [continuing]. That laid out the strategy.

My impression is that early on there was a lot of concern in the markets about this large balance sheet, and the large amount of reserves in the banking system. Now I'm not saying that the concerns have completely evaporated, but I think that over time that we have provided a lot of information about our exit strategy, and my sense is that it has had a good effect; that for the most part there's a lot of confidence in the financial markets that we do know how to exit effectively, and we will exit effectively, and that we will do so in a way that doesn't lead to any increase in inflation. And again, one piece of evidence is the long-term break-evens in the inflation indexed bond market. So we are doing that.

I don't think we can give quantitative rules at this moment on exactly how to do that because I don't think we have enough knowledge. But we do know that we have all the tools we need to drain those reserves and to reduce the balance sheet over time, and to raise interest rates when it becomes necessary to do so to avoid inflation.

Representative Brady. Right. Thank you, Mr. Chairman.

Representative Hinchey [presiding]. Mr. Chairman, thank you very much. I deeply appreciate the position that you have, and how critically important it is, particularly right now. And frankly, the relatively candid responses that you give, which is in many ways revolutionary from this particular responsibility.

I wanted to ask you a question about the housing market and the circumstances that we're dealing with there. This economy is still very, very rough. It's not secure by any means. And there are a whole host of things that really need to be done, and an awful lot of attention needs to continue to be paid to it.

One aspect of that of course is the housing market. As you mentioned, the Federal Reserve under your leadership has worked with the Administration and Congress to create an environment to encourage responsible home ownership. And that was something that was very positive, and it stepped in in a very positive way to deal with this economic situation.

The conditions are about to change. And one of the ways in which they change is the fact that in March the Federal Reserve stopped purchasing mortgage-backed securities, which had kept interest rates low and helped to stabilize the housing market.

Can you give us the justification for that, and what you think the aspects of that are going to be?

Chairman Bernanke. Well, to go back to the comments of Mr. Brady, we have already expanded our balance sheet quite considerably and we didn't want to create such a large balance sheet that it would create uncertainty, or concern about our ability to normalize policy at an appropriate time.

We were concerned about the potential impact of the cessation of MBS purchases on mortgage interest rates, and for that reason we announced well in advance our proposal, and we reduced our purchases very gradually. We tapered off our purchases. And I am pleased to say that so far we see very little effect on mortgage rates. There's been essentially no effect on mortgage-backed security yields, and so at this point I don't anticipate any significant impact on mortgage rates.

Of course if——

Representative Hinchey. For how long? I mean, there's been some—there have been a number of announcements just over the course of the last week or so about the interest rates for mortgages going up, and specific elements talking about how they're about to do it.

Chairman Bernanke [continuing]. In the last couple of days it has gone the other direction. I think the net change since we stopped purchasing is pretty close to zero.

So we will continue to watch that. There's nothing that says if the economy weakens and the issue is housing and mortgage rates, there's nothing that says we couldn't resume those purchases if necessary, and we will certainly keep that option open. But again at this point the main effect seems to be that we are still holding $1.4 trillion in agency MBS and debt, and that amount being taken off the market seems to be having the ongoing effect of keeping mortgage rates pretty low.

Representative Hinchey. Well no question about it, it has had a very positive effect. But my concern is, frankly, that now that positive effect is being eliminated. And we already see issues that indicate that these interest rates are going to go up. These interest rates go up, as they go up, that is going to reduce the housing market, particularly in the context of the ongoing economic circumstances that most working people are having to confront.

So I am deeply worried about this, and I thank you for saying that you will be looking at it and considering it and maybe making some changes, hopefully, if it seems to be necessary.

There are other aspects of the housing market, however, also that are also about to cause some serious problems, it seems to me at least. Among those, the first-time homebuyer tax credit is due to expire April 30th, and the FHA has recently tightened its restrictions on loan eligibility.

So the housing market is not yet stabilized. So I wonder what you think about all three of these issues that are essentially being eliminated now, which were put into play to deal with the economic circumstances, and which caused a positive effect on the housing market. But now, those effects are being eliminated.

And it seems to me that this situation is likely to get progressively worse, and maybe rapidly worse.

Chairman Bernanke. Well the number of starts of housing has been very low, and unfortunately all the efforts, including the low

mortgage rates, have not really rejuvenated new construction very much. So that remains a concern.

I think one other important aspect here is the foreclosure mitigation issues. One of the most important aspects of the housing market is not even just the amount of construction, but what happens to house prices. Because if house prices stabilize, that will help consumer confidence—because people will feel that the value of their home is not falling anymore—and it will help probably improve, reduce mortgage delinquencies as well.

So one concern we have is that foreclosures will continue to put houses on the market and cause house prices to fall further. So we are watching that very carefully and we are hopeful that some of the programs that the government has put in place will help mitigate that foreclosure rate.

Representative Hinchey. Well I am deeply concerned about the effect of elimination of these three issues, which had had a positive effect, and the elimination of these three issues prior to the moment when the housing market is improving significantly.

So I think that this is something that needs a lot of attention.

Chair Maloney [presiding]. That is an excellent point, and the gentleman's time has expired, and we look forward to the Chairman's response.

Chairman Bernanke. I agree, the housing market has been a big part of this whole cycle, absolutely, and we are going to have to watch that sector very carefully, not just in terms of construction but in terms of prices and in terms of foreclosures. Those are all big issues for people in this economy.

Chair Maloney. Congressman Burgess.

Representative Burgess. Thank you, Mr. Chairman.

Let's just close the loop on what we were talking about on jobs when my time ran out before and talking about the problems people have in the beginning of their earning years, midlife crisis, and then pre-retirement. It seems like some of the things we have done recently in the past 14 or 15 months, the health care bill being a big one, and I heard from several people back home, a couple who had an assortment of small businesses and provided roughly 320–350 entry-level jobs, minimum wage jobs, if you will, for which they do not provide health benefits. Generally they are looking at the second wage earner in a home being the holder of this job, or someone just entering the job market who might in fact now be carried on their parents' insurance, but they're looking at the $2,000 fine that they will now have for each full-time equivalent, and at their level of employment they just simply can't continue.

They are either going to have to stop what they're doing, sell their businesses and retire and go to Reno, or something different, but they cannot continue to do—as they outlined to me, they will not be able to continue to do what they're doing.

And here's again a couple through various entrepreneurial activities providing 300 to 350 entry-level jobs for these people at the beginning of the job market. And you know that that scenario is replicated across the broader economy over, and over, and over again.

We have also frightened people with what we're doing with cap-and-trade and possible energy tax. We've also frightened people

with financial regulatory reform where people just don't know what to expect around the next corner.

And then the 50 pages of tax cuts that are going to expire that also add to the uncertainty.

So where do we begin to ratchet back the uncertainty that we are providing to the small business person that prevents them from adding a job right now, or worse yet, may make them look at, hey, I may have to have my workforce by 2014 because I can't do what you've asked me to do?

Chairman Bernanke. No, we have heard around the country that uncertainty, both economic uncertainty, where's the recovery going, and policy uncertainty; uncertainty about what the regulatory environment is going to look like, has had some adverse effects on businesses because they don't know how to plan. They don't know exactly what the environment is going to look like.

And so, while it is very important of course that on these very important issues of health care, and environment, and regulatory reform and so on that Congress do a deliberative process and come up with the best possible outcomes. Obviously earlier resolution and clarity is better than delay. So that is certainly an issue to try to reduce that overhang of uncertainty.

Representative Burgess. Although many more people were asking us to look at the problems with jobs and joblessness than there were asking us to deal with a problem with global warming, and health care inequities. I mean, the numbers are stark.

My time is going to run out again. You were talking with Senator Klobuchar about the commission, the deficit commission, or as I like to call them, the debt panels, that have been created. And of course Congress, the House in particular, we do control the purse strings.

You talked when you were in Dallas, and in fact your comments were, nothing prevents us from beginning now to develop a credible plan for meeting our long-run fiscal challenges. I agree with you. I just think that ought to come from the legislative body and not from an Executive Order on a death—I mean a debt commission.

So are you familiar with Ranking Member Paul Ryan on the Budget Committee has what he describes as a Roadmap for America's future? It's a big lift, but he tackles Tax Code, Medicare, Social Security, as sort of one single entity and tries to deal with our long-term fiscal future from that standpoint.

Wouldn't that be a better way of going about looking at this, rather than the targeted reductions that a commission is going to come back with?

Chairman Bernanke. Well just in general I think the entitlements—Social Security, and especially Medicare—are quantitatively a very big part of the fiscal issue going forward, and I think creative thinking in general about how to control those costs is extremely important.

To go back to your question about health care costs for the small business, it's not just the fiscal issue but anything we can do to reduce the costs of health care to make it more effective and efficient is going to help not only the federal budget, but it's going to help the functioning of the economy.

So I can only agree and encourage any kind of creative thinking about bringing forth proposals. And as they come from Congress, as you say, all the better. The trouble is that, you know, obviously by its nature, you know, Congress is often very focused on the near term and it is hard to get the attention on the very long-term issues.

Representative Burgess. Yes. Unfortunately this bill that we passed in health care, 4,000 pages that did nothing, nothing to reduce the long-term cost of health care other than provide for rationing in the very near future.

Thank you, Madam Chairwoman, I will yield back my time.

Chair Maloney. I thank the gentleman. And CBO estimates that over the 20 years it will save the economy a trillion dollars with that health care bill.

Mr. Chairman, may I ask you, in your opinion what is the primary source of risk to the recovery at this time? And what is your assessment of the risk of a double-dip recession?

Chairman Bernanke. I was always fairly humble about forecasting. In the last few years, I have become extremely humble about forecasting, so I have to be very cautious.

But having said that, I think there's a pretty broad view that we are seeing some building momentum in final demand. Consumer spending looks to be picking up. At least equipment and software investment looks healthy. The broader global economy is stronger, which implies more exports.

So it looks like we are on a path to moderate recovery, and that the risk of a double-dip, while certainly not negligible, is certainly less than it was a few months ago.

That being said, there are any number of possible things that could derail it. If for whatever reason consumers under the pressure of a weak labor market and tough balance sheets decided to become more conservative and slow their spending, a financial problem emanating from, I don't know, Greece or whatever so-far unknown source that could cause more problems in the financial markets. There are all kinds of scenarios you could imagine. Oil prices being driven up by a geopolitical problem.

So one could certainly imagine, and one thing we do in our Federal Open Market Committee meetings is look at alternative simulations and alternative scenarios that look at alternative possibilities that could occur. But right now, again as I said at the beginning, it looks like the financial markets are more stable.

Banks are still working their way out of a period of high losses and financial stress, but they are making progress. The consumer looks to be doing better. So for all those reasons I think the best bet is that we'll see a moderate recovery.

But of course again forecasting is not a precise business.

Chair Maloney. So we are making progress, but have not achieved total success.

What happens, Chairman Bernanke, if the unemployment rate does not decline as the economy improves?

Chairman Bernanke. Well that is a possible risk. So we anticipate the unemployment rate is likely to decline relatively slowly, and there are a couple of factors that will affect that.

One is the pace of overall growth. Obviously if growth is only moderate, that will not quickly lower the unemployment rate. That is the first observation.

The second observation has to do with the rate of productivity. Following the 2001 recession, productivity gains were quite significant, which is a good thing generally, but meant that firms were relatively slow in bringing workers back because they didn't need to. They had productivity gains in order to meet demand.

We've seen remarkable productivity gains in the last year or so in the U.S. economy. We don't anticipate productivity growth will continue at that rate going forward, but if it does then that may reduce the number of workers that firms need to bring back in order to meet demand.

So there is a possibility. I wouldn't consider it the leading possibility, but there is a possibility that unemployment will stay stubbornly high, around 10 percent. If that were to happen, that would be one of the risks that we were just discussing because that would reduce consumer confidence and make them concerned about their ability to sustain their spending.

Chair Maloney. You took some creative steps in creating new lending facilities. I believe the only funding facility still operating is TALF, and when does the Federal Reserve plan to close TALF, or do you plan to make this facility permanent?

And also, a prime concern from the District that I represent in New York is the commercial real estate crisis. I would like to know, are there any additional actions that can be taken by Congress or others to protect against the crisis in commercial real estate? And where do you see this going forward?

Chairman Bernanke. So the only remaining facility is in fact the TALF for commercial real estate, and we left it in longer because of the extra needs there and because it takes longer to bring the commercial mortgage-backed security deals to market.

However, we're planning to close that on June 30th because we we're only making those loans on an emergency basis, and we do have to justify having this emergency program. And we have in fact seen improvements in the commercial mortgage-back security market. So our current plan is to close that at the end of June.

On commercial real estate, that is for many banks, particularly small- and medium-sized banks, that is a very big challenge. And we're seeing a few glimmers of improvement, but it's still going to be perhaps a few more quarters before banks have worked through their commercial real estate book and have gotten to the point where they have complete control and understanding of their losses and risks in that area.

So once again, as in our capacity as bank supervisor the Fed has, along with the other supervisors, has issued new guidance on commercial real estate. Among other things, we want to encourage workouts in the same way that government policy has been to help residential mortgages, to help residential borrowers work out troubled mortgages, we'd like to see the same thing happen for commercial real estate mortgages.

In fact, we believe that is happening in many cases, and we want to promote that. And again we have instructed our examiners to

work with banks to try to work out problem loans, and in general to maintain the flow of credit wherever possible.

So it is a difficult problem. And in part now it's not just a financing issue, it's just fundamentals, prices of commercial real estate have fallen by 40 percent in many places. Vacancy rates are up. Rents are down. And so it is understandable that there are going to be some stresses in this market. So we are going to continue to work with banks to try to help work through that.

There have been periods in the past where commercial real estate has created a lot of banking problems, as you know, and eventually we do work through it. But it is going to cause a problem for a number of banks in the near-term.

Frankly, I don't know what to suggest to Congress. I think ultimately that the banking system and the borrowers are going to have to find solutions and work through this as quickly as possible.

Chair Maloney. Mr. Brady.

Representative Brady. Madam, I have about a thousand questions, but in the interest of time, two proposals have been floated to increase banking taxes and enact a transaction fee on trades. One purportedly to pay back the TARP, although the banking sector is going to be repaying plus some. The transaction fee I think is simply a way to raise revenue.

Your views on those taxes? And the banking one seems to be almost a global effort to increase taxes on banks that have international relationships and connections. Your view?

Chairman Bernanke. Well first on the tax on transactions, the Treasury has rejected that idea, which came up in other jurisdictions, and I think I agree with the Treasury's judgment on that.

The problem is that, by taxing transactions, you would greatly reduce liquidity in markets. And people who are just ordinary investors transacting in those markets would find that bid-ask spreads had gotten much wider and much more costly for them to buy and sell assets and to hedge their portfolios and so on.

And indeed what would probably happen is that, so long as there was any jurisdiction in the world that didn't have those transaction taxes, everything would go offshore and you probably wouldn't collect very much in terms of taxes. In the current world, I don't think that's a very good way to raise revenue.

The fee on financial institutions, it is basically a tax and as such it is up to the Congress to decide whether it wants to raise revenue through taxing large financial institutions.

I think the only observation I would make there is that it should be structured, if you do do it, it should be structured in a way that doesn't create unnecessary problems.

So, for example, one of the original ideas was to tax based on leverage, but some further investigation and discussion sort of revealed that that would cause very severe problems in the repo market that would essentially disrupt some very important markets because it would create essentially a tax on certain kinds of transactions.

So there are other ways to create the tax base, if that's the way you want to go, and so my only advice there is, if Congress decides that you want to raise revenue through that particular method, and you can justify it just as a general revenue measure as well

as a repayment, if you wish, that you do it in a way that minimizes the disruptive implications for the markets.

Representative Brady. A final point, a real quick question. You know, SEC aside, I do think there is merit in allowing banks to set aside greater capital reserves during good economic times to be able to make it through the tougher times.

Spain uses a model that provides that—it seems to have done, in the banking sector, fairly well in the financial recovery—unlike in pensions where the IRS takes a dim view of companies setting aside too much reserves during good times, seeing it as tax evasion.

Is there merit in Congress specifically addressing the issue of banks being able to put aside more reserves during good times, you know, regardless necessarily of the—maybe setting aside per category versus per specific loans in order to build up those reserves for times like this?

Chairman Bernanke. I don't know whether it is best handled by Congress or by the regulators, but the basic idea I certainly agree with, which is that a lot of the reserve policy was governed by a desire to avoid income smoothing and those kinds of things.

Representative Brady. Sure.

Chairman Bernanke. And as a result, the main purpose of reserves—which is to protect against losses—was lost. And there was not enough reserving done in advance of the crisis. So I am very much in favor, and I think the world is coming around to the view that banks should be allowed to reserve not only for known losses but for, you know, yet unknown but nevertheless predictable losses that they will face in the future.

So, yes, I very much encourage the regulators and Congress to look at ways to make sure that banks are able to reserve substantially during good periods so that they can run it down during a crisis.

Representative Brady. Makes sense. Thanks, Chairman.

Chair Maloney. Mr. Chairman, we understand that you have to leave, but I would like to give Representative Cummings an opportunity to ask his questions. Because of other committee commitments, he was not able to be here for the first round of questions. Do you have time?

Chairman Bernanke. Certainly.

Representative Cummings. Thank you, Madam Chair. I apologize. I had to be on the Floor to argue three bills, and so I apologize, because I really wanted to hear all of your testimony. And I know, my staff tells me that we've gone over small business quite a bit.

But you did say one thing before I left that I was just curious about, when you were talking about the consumer protection agency, and you implied that when borrowers were having difficulty getting access to credit it might not be a bad idea—or it might be helpful, and you correct me if I'm wrong, if the consumer protection agency was inside the Fed. Is that a fair statement? Is that what you said?

And then I want you to explain it to me.

Chairman Bernanke. No. What I said was that there would be some benefit of the consumer protection agency working in a way that is cooperative with the bank safety and soundness regulators

and examiners. Because the safety and soundness examiners would have an understanding of the implications of the consumer protection rules for the costs and the business models of the banks, which in turn would affect whether or not credit would be constrained.

Because you don't want to create rules that just mean that people can't get credit.

Representative Cummings. Yes, yes. The thing, you know, there's something going on here in our country, and the President, before he became President, said something that I found—I quote him all the time—he said: We have an empathy deficit. He's been saying this long before he became President.

And, you know, I look at what has happened in the health care area. I look at what is happening in the financial area. It seems almost that it is okay, it seems okay, with some folks that if people fail, or if they are too weak in a moment, just let them die, let them fall off the cliff.

And when we talk about these small businesses, I sat in a meeting yesterday in Baltimore in my District and literally people were in tears. These were people, good business people, who have had impeccable records. Now they can't get a line of credit. They've got business that they could do, but they can't get a line of credit. They had one. And so it seems to me, I just refuse to believe that we cannot help these Americans who go out there every day, do the right thing, not trying to get a big bonus, just trying to do the right thing, employ their employees, produce what they're supposed to produce, but yet and still it seems like when it comes to them, it's okay to say, you know, Johnny, sorry, you know, yeah, we're going through this economic storm, you're going to be collateral damage. Collateral damage means you die in the process—that is, your business dies. You may never come back to do this business again. And it's okay.

And like I said, I felt the same thing when we were dealing with the health bill. You know, it's like, okay, 45,000 Americans die? All right. Too weak. Let them go. That's not the spirit of this country. That's not the country that I grew up in. And that's not the country that I believe in.

So I am just wondering—and I know the Fed has certain powers and certain things, and maybe you can't force people, the banks to lend, whatever, but there's something awfully wrong. And you basically—and I know that there are some folk who the credit may not be what it is, but there are a lot of people who have decent credit, and who were doing fine, and could get the business. The business is like right there, and they cannot reach it because they cannot get the money.

As I told my constituents yesterday, sometimes $25,000 is worth $10 million because it acts as a bridge. So, you know, I had a lot of questions I wanted to ask, but I beg you to even go further. And I know you've been—and I support you 100 percent, Mr. Bernanke, but I just believe with all my heart that we can do better. I just do.

And I don't know what that better is. I read in the papers where the banks say they're doing okay, they're paying the money back and whatever, while my folks are drowning. There's something wrong with that picture. It doesn't make sense.

I know it's complicated, but we have brilliant people like you and your staff to figure it out. Comment?

Chairman Bernanke. Yes. It is very important from an empathy perspective and from an economic perspective to get small business growing again. Absolutely. I talked a lot today about what we're doing with banks in our supervisory and I just want to reiterate that we are looking for feedback and ideas from the banks and others who will give us more explicit suggestions, because we are really working hard on this.

But let me also say that there are things that Congress is doing and can do. There's money that's flowed through the CDFIs, which has helped community development. There are proposals to use TARP money to incentivize small banks to make loans to small businesses.

There's the SBA. So there are things that can be done, and if Congress wants to go in that direction there are instruments that can be used.

Representative Cummings. We have to do our part, and we know you're going to continue to do your part.

[The prepared statement of Representative Cummings appears in the Submissions for the Record on page 54.]

Chair Maloney. The gentleman's time has expired. And I know we're up against——

Representative Cummings. Thank you, Mr. Chairman.

Chair Maloney [continuing]. Time constraints, but in the spirit of Bipartisanship, Congressman Burgess has requested the consideration of a one-minute last question, if your time is——

Chairman Bernanke. Certainly.

Representative Burgess. Thank you. And thank you, Chairman, for your visit today. I hope you see the exchange has been cordial and collegial, and I hope we will be able to see you back sooner rather than later because there are a lot of important things.

Just on that issue of TARP, though, TARP was supposed to die last December 31st, and people know that, and they're angered that TARP is still there. TARP is not to be a slush fund for any activity, no matter how benign it might seem. That's the wrong way to go. Find another way to fund that, but not TARP. Let's let TARP die.

I just do have to ask you, because two years ago when we were cruising into this really rocky part of the economy, one of the early—perhaps not the early, but a mid-level harbinger was $5 a gallon diesel and $4 a gallon gasoline in the summer of 2008.

I've got to tell you, I filled up right before I left and $2.78 for regular gasoline in the DFW market in Texas. In a month we get the clean air stuff where we've got to be buying these special blends. It goes up a dollar. So by the end of May we will be paying nearly $4 a gallon for gasoline again.

Is the price of oil, the price of fuel, unimportant now in the consideration for the global economy? And if it is unimportant, at what price point does it become important again?

Chairman Bernanke. Well every dollar that the price of oil goes up is another dollar out of the pockets of consumers, and that

makes it harder for them to spend on other things. And it also adds to inflation. So it is definitely a negative.

We are at $85 a barrel right now. The forward curve is pretty flat. Markets don't expect large increases in the future, but we don't know. We'll have to watch it very carefully. It depends a lot on global economic activity, which has been stronger generally speaking than in the U.S. and Europe.

So of course we are still a long way from $145, which is where we were a couple of summers ago. So I do not think at this point that the price of oil is a serious threat to the recovery, but clearly if it moved a lot it would be a negative, and we have to watch that and be careful.

Representative Burgess. It looks like for what the consumer sees, at least in my market, it may be very close to what it was two summers ago.

Chairman Bernanke. Yes, I do not understand that dollar extra from oil?

Representative Burgess. Well because the summer driving season they always jack the price up——

Chairman Bernanke. Okay.

Dr. Burgess [continuing]. Supply and demand. And then of course the Clean Air Act does require we use special ethanol blends that always cost more. You've got to transport the ethanol. It's more expensive. And that is a whole separate discussion. But I've got to believe it is going to play a role in the recovery, and it is likely not going to be a positive role.

Chairman Bernanke. Natural gas prices are down.

Representative Burgess. Yeah. That is actually not a good thing for my District. We would like to see those back up.

Chair Maloney. Thank you once again, Chairman Bernanke, for testifying today. Since you testified last May, the economy has shown great progress. And the unprecedented actions taken by the Federal Reserve to inject liquidity into our financial system played a key role in the turnaround of the economy.

I look forward to working with you in the future, and the Committee looks forward to working with you as we continue to build on the economic progress so far, and certainly on our goal of employing more Americans.

Thank you so much for your testimony and for staying even past your time. So we really, really do appreciate it. Thank you.

Chairman Bernanke. Thank you, Madam Chair.

Chair Maloney. We are adjourned.

[Whereupon, at 12:21 p.m., Wednesday, April 14, 2010, the hearing was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF CAROLYN MALONEY, CHAIR, JOINT ECONOMIC COMMITTEE

America is on a path toward economic recovery. A large part of the credit for this turnaround is due not only to President Barack Obama but also to Ben Bernanke, the Chairman of the Federal Reserve, a respected scholar on the Great Depression.

Under his guidance, the Fed took creative and effective actions to inject liquidity into our financial system which saved our nation from economic catastrophe.

I am confident that you will continue to steer monetary policy at the Fed carefully through the next set of obstacles balancing the creation of robust economic growth with the prevention of inflation.

Our hearing today on the economic outlook is timely for many reasons.

Just this week, the committee of economists responsible for dating the end of recessions announced that the recovery is still too fragile to announce that the recession is over.

But there are indications that we are indeed well on our way to economic recovery:

- After 4 straight quarters of negative growth, the economy grew during the last two quarters of 2009. There is a consensus that when the latest GDP numbers are announced on April 30th, we will see that our economy continued to expand during the first quarter of 2010.
- The most recent employment report showed that 162,000 jobs were created in March, with three-fourths of those new jobs coming from the private sector.
- Manufacturing employment was up for 3 straight months.
- The stock market is at its highest in almost 15 months.
- Temporary help, a leading indicator of the health of the labor market, has added 313,000 jobs since October 2009.
- Sales of cars and light trucks were up in March.
- And many surveys of the economy are optimistic about growth in both the service and manufacturing sectors.

These improvements in our economy are proof that actions taken by Congress, the Fed, and the Administration have started to have an impact.

In the last year, Congress enacted policies that supported struggling families and encouraged job creation. The Recovery Act provided tax relief for 95 percent of American families and created jobs while investing in clean energy technologies, infrastructure, and education.

Last year, we extended the $8,000 first-time homebuyers credit that will spur construction jobs. We extended a host of safety net programs that will help struggling families weather the economic storm. We extended the net operating loss carry-back provision that will help small businesses hire new employees. And we are boosting funding for small business loans via the Small Business Administration.

We passed the HIRE Act to give tax breaks to businesses that hire unemployed workers.

Without these measures the depth of the contraction would have been much deeper and far longer.

Although the recent estimates of the cost of the bailout of the financial system are much lower than initially expected, the true cost of the financial system failure in terms of lost employment is immeasurable.

Much of the budget deficit over the next 10 years should be attributed to the financial crisis—economists have estimated that the budget deficit has increased by $3.1 trillion due to the decline in tax revenues from the long line of workers who have lost their jobs.

While we have come far in stabilizing the financial system, we would like to hear your thoughts on various reform proposals that have been introduced in this Congress to make sure that financial institutions don't take on excessive risk and have appropriate capital requirements.

We also look forward to hearing your take on upcoming challenges, including the housing market. One important factor in the housing market's current recovery is the low mortgage interest rates that were sustained by the Fed's purchases of mortgage-backed securities and Fannie and Freddie debt.

Now that the Fed has completed those purchases, we would like to hear your assessment of the housing market and the impact of the Fed's exit on mortgage rates.

On another note, I am grateful for your leadership in ushering in new rules to prevent unfair or deceptive practices with respect to credit card accounts and the rules the Fed put into place to curb excessive overdraft fees.

Chairman Bernanke, we thank you for your testimony and I look forward to working with you as the committee continues our focus on fixing the economy, putting people back to work, and helping struggling families.

PREPARED STATEMENT OF REPRESENTATIVE KEVIN BRADY

I am pleased to join in welcoming Chairman Bernanke before the Committee.

The Federal Reserve's injection of $1.3 trillion of liquidity in the fall of 2008 quelled the panic in financial markets. Although I disagree with the Fed's participation in the "bailouts" of AIG and Bear Stearns because these institutions were *insolvent*, the Fed's timely actions as lender of last resort to *solvent, but illiquid* financial institutions and markets prevented the financial panic from becoming a depression.

During the spring of 2009, the Supervisory Capital Assessment Program, commonly known as the "stress test," and the subsequent capital increases by large banks restored confidence in financial institutions and markets. Largely because of these decisive actions, the U.S. economy is now beginning to recover. However, the recovery will continue to be subpar as businesses delay critical hiring and investment decisions due to the uncertainty generated by the dangerous level of federal debt and proposals by President Obama and Congressional Democrats to increase taxes, raise energy prices, and enact job-killing regulations.

Despite recent guidance from Washington to bank examiners about commercial mortgage loans, I am concerned that bank examiners are exacerbating real estate problems through their inflexibility. Pressed by their regulators, community and regional banks may not be renewing some performing commercial mortgage loans even though their underlying cash flow can easily service the debt.

That said, I would like to share with you my concerns about monetary policy going forward. We are in danger of repeating the mistakes that produced stagflation in the 1970s. Because of the lag time between monetary policy decisions and their effects, the Federal Reserve must act to prevent inflation well before the public perceives that prices are rising.

Yet there are voices demanding that the Federal Reserve *delay* action. Recently, economist Laurence Ball advocated keeping the federal funds rate extraordinarily low even as prices rise to reduce the unemployment rate, notwithstanding the fact that the so-called Phillips Curve trade-off between inflation and unemployment had been thoroughly discredited three decades ago.

Price stability contributes to economic growth, and only the Federal Reserve can maintain price stability. My concern is that Administration officials may press the Federal Reserve to delay raising interest rates and unwinding the expansion of its balance sheet to cover for the Obama's anti-growth policies.

Taxes, especially on small businesses and investment, are about to soar as the 2001 and 2003 rate reductions expire and $569 billion of new taxes to fund Obama's health care scheme are implemented. Additional costs are lurking in the form of regulations to control "greenhouse gas" emissions and complex "cap and trade" legislation.

Despite these tax increases, the CBO projects that higher spending under the President's budget would create deficits of $9.8 trillion over the next ten fiscal years, spiking publicly held federal debt to 90 percent of GDP by 2020. Unless Congress controls federal spending, these deficits will crowd-out private investment and slow economic growth.

Chairman Bernanke, I urge you to resist any attempt to delay raising interest rates in order to offset these anti-growth policies.

Regarding financial services legislation, I am concerned about weakening the Fed's independence, institutionalizing "too big to fail," and perpetuating the status of Fannie and Freddie as zombie banks. Making the President of the Federal Reserve Bank of New York a political appointee and stripping the supervision of smaller banks and their holding companies from the Fed would weaken the regional Reserve Banks and undermine the Fed's independence. Moreover, diverting the Fed's profits from the Treasury to pay for the Consumer Financial Protection Bureau would set a dangerous precedent that could open the floodgates for other off-budget federal spending.

The perverse incentives arising from the presumption of government backing caused large financial institutions, especially Fannie and Freddie, to take excessive risks and inflate a huge bubble in the housing market. Instead of ending "too big to fail," the Senate bill would establish a permanent bailout fund for large financial institutions that may exacerbate this problem by identifying who the government regards as too big to fail.

Incredibly, the Senate bill does not provide for final resolution of Fannie Mae and Freddie Mac despite costing taxpayers $128 billion so far with no prospect for any recovery. Like walking zombies, Fannie and Freddie with their explicit government backing are frightening most private capital away from re-entering housing finance.

Chairman Bernanke, I look forward to your testimony.

Prepared Statement of Senator Sam Brownback, Ranking Minority Member

Thank you Chairwoman Maloney for arranging today's hearing and thank you Chairman Bernanke for testifying today about the economic outlook.

I am anxious to hear your update on the status of and outlook for the nation's economy. I am equally interested in probing your views on a number of other issues regarding the structure and role of the Federal Reserve in monetary policy and financial regulation. Lastly, I hope we can discuss the frightening fiscal picture facing the United States and the implications that the massive run up in federal spending and debt will have on future economic growth.

Although the U.S. has experienced positive economic growth since the second half of 2009, the labor market remains incredibly weak and unemployment is not expected to fall below 8.0% until 2012. The official unemployment rate of 9.7%, while unacceptably high, masks the weakness in the labor market. For the first time since 1962, we have witnessed year over year declines in the civilian labor force—a disturbing trend.

The Federal Reserve's aggressive actions continue to prop up the economy through exceptionally low interest rates, as well as close to $2.0 trillion in purchases of long-term securities. There has been some concern, both among economists and policymakers as well as within the FOMC, that maintaining interest rates at record-low levels could contribute to an increase in financial imbalances and heightened risks for long term macroeconomic and financial stability. I am interested in hearing what indicators you will be watching for an indication that the economy has reached a level of strength that the Federal Reserve can shift its accommodative posture by increasing interest rates, begin selling its long-term securities, or engage in a combination of both.

The Federal Reserve has played a monumental role in management of the financial crisis that began in 2008. Although there is little doubt that the Federal Reserve's actions have, on net, helped alleviate the financial crisis and economic downturn, many of the decisions made by the Federal Reserve have been quite controversial. The actions of the Federal Reserve and of the Federal Open Market Committee (FOMC) are highly dependent upon the members and makeup of the Federal Reserve. I have long been concerned that too much power is concentrated in the hands of Washington and New York to the detriment of the rest of the nation.

Presently, the Federal Reserve Bank of New York enjoys a special status and privilege. Unlike other regional Federal Reserve Banks, it has a permanent seat on the FOMC. Unfortunately, the financial reform legislation passed out of the Senate Banking Committee on a strictly partisan vote goes in the wrong direction. The legislation would expand upon the special status enjoyed by the NY Fed by making its president a presidential appointment. This will only serve to politicize the FOMC and ensure that the interests of Washington and New York are even more dominant.

When financial reform legislation reaches the Senate floor, it is my intention to offer an amendment that will eliminate the special status afforded to the Federal Reserve Bank of New York by restructuring the FOMC to ensure that the rest of the country has a voice equal to, if not greater than, Washington and New York.

Another concerning aspect of the financial reform legislation recently passed out of the Senate Banking Committee is the elimination of the Federal Reserve's supervision of nearly 6,000 small and midsized banks. The Kansas banking community is particularly troubled by the potential transfer of supervision from regional Federal Reserve Banks to the FDIC. The current relationship between the regional Federal Reserve banks and the institutions they monitor provides important insight into economic conditions facing small businesses around the country. A loss of this relationship and information could potentially strip the Fed of important information used in its policymaking decisions.

My final concern with the legislation passed by the Senate Banking Committee is that it seems not to have ended the notion of "too big to fail," but rather to have simply institutionalized it.

I am interested to hear Mr. Bernanke's opinion on the makeup of the FOMC, on the proposed change in supervision of small and midsized banks, as well as the proposed institutionalization of "too big to fail."

Finally, although fiscal policy is outside the domain of the Federal Reserve, it nonetheless is an issue that significantly affects both current and future economic and financial conditions, not to mention the prospective climate and lifestyle we will leave to our children and grandchildren.

After a record deficit in 2009, the budget deficit in 2010 will exceed 10% of GDP. That is, the U.S. will spend 71% more than it collects in tax revenues this year. And yet, despite the bleak fiscal outlook, the Administration and Congress continue to propose and pass massive new spending initiatives, such as the $2.6 trillion healthcare entitlement. These costly and most likely inefficient programs will stay with us forever and be paid for by hard working Americans.

The situation is even more disturbing when you consider that 18%, nearly one out of every five dollars of personal income in the country is the result of a transfer payment from some level of government. In contrast, at the end of 2000, less than 13% of personal income was derived from government transfer payments. This is an unsustainable trend.

With publicly held debt set to reach 90% of GDP by 2020 under the President's proposed budget, I am concerned that the U.S. is on the brink of a tipping point where our international creditors lose confidence in the United States. It seems that we are moving from a housing bubble to a government-debt bubble. But unlike Wall Street or smaller countries such as Greece, no one will be there to bail out the U.S. Rather, our failure to confront out-of-control spending and entitlement programs puts us at risk of suffering decades of substandard economic growth and of losing our prominent role in the global economy.

PREPARED STATEMENT OF BEN S. BERNANKE, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Chair Maloney, Vice Chairman Schumer, Ranking Members Brownback and Brady, and other members of the Committee, I am pleased to be here today to discuss economic and financial developments. I will also make a few remarks on the fiscal situation.

THE ECONOMIC OUTLOOK

Supported by stimulative monetary and fiscal policies and the concerted efforts of policymakers to stabilize the financial system, a recovery in economic activity appears to have begun in the second half of last year. An important impetus to the expansion was firms' success in working down the excess inventories that had built up during the contraction, which left companies more willing to expand production. Indeed, the boost from the slower drawdown in inventories accounted for the majority of the sharp rise in real gross domestic product (GDP) in the fourth quarter of last year, during which real GDP increased at an annual rate of 5.6 percent. With inventories now much better aligned with final sales, however, and with the support from fiscal policy set to diminish in the coming year, further economic expansion will depend on continued growth in private final demand.

On balance, the incoming data suggest that growth in private final demand will be sufficient to promote a moderate economic recovery in coming quarters. Consumer spending continued to increase in the first two months of this year and has now risen at an annual rate of about 2½ percent in real terms since the middle of 2009. In particular, after slowing in January and February, sales of new light motor vehicles bounced back in March as manufacturers offered a new round of incentives. Going forward, consumer spending should be aided by a gradual pickup in jobs and earnings, the recovery in household wealth from recent lows, and some improvement in credit availability.

In the business sector, capital spending on equipment and software appears to have increased at a solid pace again in the first quarter. U.S. manufacturing output, which is benefiting from stronger export demand as well as the inventory adjustment I noted earlier, rose at an annual rate of 8 percent during the eight months ending in February. Also, as I will discuss further in a moment, financial conditions continue to strengthen, thus reducing an important headwind for the economy.

To be sure, significant restraints on the pace of the recovery remain, including weakness in both residential and nonresidential construction and the poor fiscal condition of many state and local governments. Sales of new and existing homes dropped back in January and February, and the pace of new single-family housing starts has changed little since the middle of last year. Outlays for nonresidential construction continue to contract amid rising vacancy rates, falling property prices, and difficulties in obtaining financing. Pressures on state and local budgets, though

tempered by ongoing federal support, have led to continuing declines in employment and construction spending by state and local governments.

As you know, the labor market was particularly hard hit by the recession. Recently, we have seen some encouraging signs that layoffs are slowing and that employment has turned up. Manufacturing employment increased for a third month in March, and the number of temporary jobs—often a precursor of more permanent employment—has been rising since last October. New claims for unemployment insurance continue on a generally downward trend. However, if the pace of recovery is moderate, as I expect, a significant amount of time will be required to restore the 8½ million jobs that were lost during the past two years. I am particularly concerned about the fact that, in March, 44 percent of the unemployed had been without a job for six months or more. Long periods without work erode individuals' skills and hurt future employment prospects. Younger workers may be particularly adversely affected if a weak labor market prevents them from finding a first job or from gaining important work experience.

On the inflation front, recent data continue to show a subdued rate of increase in consumer prices. For the three months ended in February, prices for personal consumption expenditures rose at an annual rate of 1¼ percent despite a further steep run-up in energy prices; core inflation, which excludes prices of food and energy, slowed to an annual rate of ½ percent. The moderation in inflation has been broadly based, affecting most categories of goods and services with the principal exception of some globally traded commodities and materials, including crude oil. Long-run inflation expectations appear stable; for example, expected inflation over the next 5 to 10 years, as measured by the Thomson Reuters/University of Michigan Surveys of Consumers was 2¾ percent in March, which is at the lower end of the narrow range that has prevailed for the past few years.

FINANCIAL MARKET DEVELOPMENTS

Financial markets have improved considerably since I last testified before this Committee in May of last year. Conditions in short-term credit markets have continued to normalize; spreads in bank funding markets and the commercial paper market have returned to near pre-crisis levels. In light of these improvements, the Federal Reserve has largely wound down the extraordinary liquidity programs that it created to support financial markets during the crisis. The only remaining program, apart from the discount window, is the Term Asset-Backed Securities Loan Facility for loans backed by new-issue commercial mortgage-backed securities, and that facility is scheduled to close at the end of June. Overall, the Federal Reserve's liquidity programs appear to have made a significant contribution to the stabilization of the financial system, and they did so at no cost to taxpayers and with no credit losses.

The Federal Reserve also recently completed its purchases of $1.25 trillion of federal agency mortgage-backed securities and about $175 billion of agency debt. Purchases under these programs were phased down gradually, and to date, the transition in markets has been relatively smooth. The Federal Reserve's asset-purchase program appears to have improved market functioning and reduced interest-rate spreads not only in the mortgage market but in other longer-term debt markets as well.

On net, the financial condition of banking firms has strengthened markedly during recent quarters. Last spring, the Federal Reserve and other banking regulators evaluated the nation's largest bank holding companies under the Supervisory Capital Assessment Program, popularly known as the stress test, to ensure that they would have sufficient capital to remain viable and to lend to creditworthy borrowers even in a worse-than-expected economic scenario.[1] The release of the stress test results significantly increased market confidence in the banking system. Greater investor confidence in turn allowed the banks to raise substantial amounts of new equity capital and, in many cases, to repay government capital. The Federal Reserve and other bank regulators continue to encourage the banks to build up their capital,

[1] For more on the SCAP, see Ben S. Bernanke (2009), "The Supervisory Capital Assessment Program," speech delivered at the Federal Reserve Bank of Atlanta 2009 Financial Markets Conference, Jekyll Island, Ga., May 11, *www.federalreserve.gov/newsevents/speech/bernanke20090511a.htm*; Board of Governors of the Federal Reserve System (2009), "Federal Reserve, OCC, and FDIC release results of the Supervisory Capital Assessment Program," press release, May 7, *www.federalreserve.gov/newsevents/press/bcreg/20090507a.htm*; and Daniel K. Tarullo (2010), "Lessons from the Crisis Stress Tests," speech delivered at the Federal Reserve Board International Research Forum on Monetary Policy, Washington, March 26, *www.federalreserve.gov/newsevents/speech/tarullo20100326a.htm*.

ensure that they have adequate liquidity, improve their risk management, and restructure their employee compensation programs to better align risk and reward.

Despite their stronger financial positions, banks' lending to both households and businesses has continued to fall. The decline in large part reflects sluggish loan demand and the fact that many potential borrowers no longer qualify for credit, both results of a weak economy. The high rate of write-downs has also reduced the quantity of loans on banks' books. Banks have also been conservative in their lending policies, imposing tough lending standards and terms; this caution reflects bankers' concerns about the economic outlook and uncertainty about their own future losses and capital positions.

The Federal Reserve has been working to ensure that our bank supervision does not inadvertently impede sound lending and thus slow the recovery. Achieving the appropriate balance between necessary prudence and the need to continue making sound loans to creditworthy borrowers is in the interest of banks, borrowers, and the economy as a whole. Toward this end, in cooperation with the other banking regulators, we have issued policy statements to bankers and examiners emphasizing the importance of lending to creditworthy customers, working with troubled borrowers to restructure loans, managing commercial real estate exposures appropriately, and taking a careful but balanced approach to small business lending.[2] We have accompanied our guidance with training programs for both Federal Reserve and state examiners, and with outreach to bankers throughout the industry. For example, we just completed a training initiative that reached about 1,000 examiners. We are also conducting a series of meetings across the country with private- and public-sector partners to gather information about the credit needs of small businesses and how those needs can best be met.

We have also stepped up our information gathering, so that we can better understand factors that may be inhibiting bank lending. These efforts include a survey by examiners of banks' practices in working out loans, the results of which will serve as a baseline against which we will assess the effectiveness of our supervisory guidance. We are also obtaining additional information on small business credit conditions. For example, we assisted the National Federation of Independent Business in developing a survey to assess barriers to credit access by small businesses.[3] And we are using our own Senior Loan Officer Opinion Survey on Bank Lending Practices to monitor changes in bank lending to small businesses.[4]

FISCAL POLICY

In addition to the near-term challenge of fostering improved economic performance and stronger labor markets, we as a nation face the difficult but essential task of achieving longer-term sustainability of the nation's fiscal position. The federal budget deficit is on track this year to be nearly as wide as the $1.4 trillion gap recorded in fiscal year 2009. To an important extent, these extremely large deficits are the result of the effects of the weak economy on revenues and outlays, along with the necessary actions that were taken to counter the recession and restore financial stability. But an important part of the deficit appears to be structural; that is, it is expected to remain even after economic and financial conditions have returned to normal.

In particular, the Administration and the Congressional Budget Office (CBO) project that the deficit will recede somewhat over the next two years as the tem-

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[2] See Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision (2008), "Interagency Statement on Meeting the Needs of Creditworthy Borrowers," joint press release, November 12, *www.federalreserve.gov/newsevents/press/bcreg/20081112a.htm*; Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, Office of Thrift Supervision, and Conference of State Bank Supervisors (2010), "Regulators Issue Statement on Lending to Creditworthy Small Businesses," joint press release, February 5, *www.federalreserve.gov/newsevents/press/bcreg/20100205a.htm*; Board of Governors of the Federal Reserve System, Division of Banking Supervision and Regulation (2009), "Prudent Commercial Real Estate Loan Workouts," Supervision and Regulation Letter SR 09-7 (October 30), *www.federalreserve.gov/boarddocs/srletters/2009/SR0907.htm*; and Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Reserve Board, Federal Financial Institutions Examination Council and Office of Thrift Supervision (2009), "Policy Statement on Prudent Commercial Real Estate Loan Workouts," joint policy statement, October 30, *www.federalreserve.gov/boarddocs/srletters/2009/sr0907a1.pdf*.

[3] See William J. Dennis (2010), "Small Business Credit in a Deep Recession," National Federation of Small Business Research Foundation (Washington: NFIB, February), available at *www.nfib.com/ResearchFoundation*.

[4] See Board of Governors of the Federal Reserve System, "Senior Loan Officer Opinion Survey on Bank Lending Practices," webpage, *www.federalreserve.gov/boarddocs/SnLoanSurvey*.

porary stimulus measures wind down and as economic recovery leads to higher revenues. Thereafter, however, the annual deficit is expected to remain high through 2020, in the neighborhood of 4 to 5 percent of GDP. Deficits at that level would lead the ratio of federal debt held by the public to the GDP, already expected to be greater than 70 percent at the end of fiscal 2012, to rise considerably further. This baseline projection assumes that most discretionary spending grows more slowly than nominal GDP, that no expiring tax cuts are extended, and that current provisions that provide most taxpayers relief from the alternative minimum tax are not further extended. Under an alternative scenario that drops those assumptions, the deficit at the end of 2020 would be 9 percent of GDP and the federal debt would balloon to more than 100 percent of GDP.[5]

Although sizable deficits are unavoidable in the near term, maintaining the confidence of the public and financial markets requires that policymakers move decisively to set the federal budget on a trajectory toward sustainable fiscal balance. A credible plan for fiscal sustainability could yield substantial near-term benefits in terms of lower long-term interest rates and increased consumer and business confidence. Timely attention to these issues is important, not only for maintaining credibility, but because budgetary changes are less likely to create hardship or dislocations when the individuals affected are given adequate time to plan and adjust. In other words, addressing the country's fiscal problems will require difficult choices, but postponing them will only make them more difficult.

Thank you. I would be pleased to take your questions.

PREPARED STATEMENT OF REPRESENTATIVE ELIJAH E. CUMMINGS

Thank you, Madam Chair.

It is always a privilege to have Dr. Bernanke before us, and this latest installation is no different.

After nearly falling off a cliff, the U.S. economy remains teetering on the edge, and the policies adopted by Dr. Bernanke, President Obama, and Secretary Geithner will determine how sure our footing is for the recovery.

Through a series of extraordinary measures to create liquidity in the economy and support bank capitalization, the Federal Reserve has helped create stability in the financial sector.

The stock market topped 11,000 recently, and banks are both recording profits and paying bonuses.

However, I have a hard time trumpeting our success to my community in Baltimore.

The minority business leaders with whom I met yesterday are struggling to keep their doors open, for one simple reason: They cannot access lines of credit.

These are successful, capable firms, and they are shut out of the market because they cannot get a simple business loan.

I am incapable of exaggerating how upset I was when I heard them describe how they may have to shut down because they could not maintain financing.

During the recession, the Federal Reserve and Treasury placed the utmost importance on maintaining the market for short-term commercial paper and other forms of overnight financing.

Investment banks that recklessly leveraged themselves to the hilt, holding our economy hostage, would have failed if we shut off the overnight financing faucet.

So we left the faucet on, and made it extremely inexpensive to access. The Federal Reserve and the taxpayers successfully funded the "no trader left behind" policy.

Now, when our neighborhood contractors, grocery stores, accounting firms, and cleaning businesses need a loan to bid on a government contract, or a line of credit to continue to make payroll each month, the faucet turns up dry for them.

I am pleased with Dr. Bernanke's efforts, and I do not doubt his motivations in the least.

But I just cannot see our efforts as truly successful when not just one, but many, small and minority firms are forced to shut their doors for a simple lack of credit.

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[5] These figures have been calculated by the Federal Reserve using the CBO's estimates of the budgetary effects of selected policy alternatives to adjust the CBO's baseline budget projection released in a recent report (see Congressional Budget Office (2010), *The Budget and Economic Outlook: Fiscal Years 2010 to 2020* (Washington: CBO, January), also available at *www.cbo.gov/ftpdocs/108xx/doc10871/frontmatter.shtml*). The specific alternative policies used in these calculations included the CBO's estimates of the effects of reducing troop levels in overseas military operations to 60,000 by 2015, increasing regular discretionary appropriations at the rate of growth of nominal GDP, extending all expiring tax provisions, and indexing the alternative minimum tax for inflation.

The Federal Reserve, and this Congress, owes them more.

Hearings like this one today, that embrace honest and frank discussions of policy, will help move us toward meeting our obligations to these constituent firms, and the families who depend on them.

With that, Madam Chair, I look forward to our discussion with Dr. Bernanke, and I yield back the balance of my time.

ELIJAH E. CUMMINGS
7TH DISTRICT, MARYLAND

COMMITTEE ON
TRANSPORTATION AND INFRASTRUCTURE
CHAIRMAN, SUBCOMMITTEE ON COAST GUARD AND MARITIME TRANSPORTATION
SUBCOMMITTEE ON RAILROADS, PIPELINES AND HAZARDOUS MATERIALS

COMMITTEE ON
OVERSIGHT AND GOVERNMENT REFORM
SUBCOMMITTEE ON DOMESTIC POLICY
SUBCOMMITTEE ON FEDERAL WORKFORCE, POSTAL SERVICE AND THE DISTRICT OF COLUMBIA

JOINT ECONOMIC COMMITTEE

SENIOR WHIP

Congress of the United States
House of Representatives
Washington, DC 20515

☐ 2235 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-2007
(202) 225-4741
FAX: (202) 225-3178

DISTRICT OFFICES:

☐ 1010 PARK AVENUE
SUITE 105
BALTIMORE, MD 21201-5037
(410) 685-9199
FAX: (410) 685-9399

☐ 754 FREDERICK ROAD
CATONSVILLE, MD 21228-4504
(410) 719-8777
FAX: (410) 455-0110

☐ 8267 MAIN STREET
ROOM 102
ELLICOTT CITY, MD 21043-9903
(410) 465-8259
FAX: (410) 465-8740

www.house.gov/cummings

April 21, 2010

The Honorable Carolyn B. Maloney
Chair, Joint Economic Committee
G-01 Dirksen Senate Office Building
Washington, DC 20515

Dear Chair Maloney:

Thank you for holding the hearing last Wednesday with Dr. Bernanke, and for your continued leadership ensuring that all policy solutions are given their due attention and consideration in the economic recovery.

I write to respectfully request that the following questions be placed in the record for the hearing of Wednesday, April 14, 2010, "The Economic Outlook with the Honorable Ben Bernanke", and that Dr. Bernanke be instructed to respond in writing.

Thank you for your assistance in this matter. Please do not hesitate to contact me or Martin Levine on my staff, at 202.225.4741, with any questions.

Sincerely,

Elijah E. Cummings
Member of Congress

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The Honorable Carolyn B. Maloney
April 21, 2010
Page 2

For the Honorable Ben Bernanke, Chairman, Federal Reserve Board of Governors

1) Dr. Bernanke, you yourself have publically noted the dangers of a "too big to fail" policy. However, criticism has been leveled at the House financial services financial regulatory reform bill, as well as the current Senate proposal as failing to actually prevent another "too big to fail" scenario.

    a) Do you believe that either proposal goes far enough to prevent the moral hazard that many cite for the reckless behavior of financial institutions?

    b) One of the results of Graham-Leach-Bliley era deregulation and recent financial troubles has been the resulting concentration of commercial banking in four firms, controlling some 40 percent of deposits. Do you believe that small banks can or should still realistically survive, when they must essentially adopt a different business model that doesn't include the assumption that they will be bailed out?

The Honorable Carolyn B. Maloney
April 21, 2010
Page 3

2) A recent article in *BusinessWeek* contrasted the economic philosophies of the Clinton Administration (under Treasury Secretary Robert Rubin) and the current Obama Administration, specifically pointing to the Rubin mantra of lower government spending, lower budget deficits, and open trade – all of which supported a faith in the free market system. Your predecessor, Dr. Greenspan, also espoused this philosophy during his 17 year tenure as Fed Chair.

   In contrast, the authors showed that the current administration has been willing to utilize Keynesian public spending to stimulate the economy and help us emerge from the recession.

   While the article was titled *"Why the Obama Plan Is Working"*, and cited the financial community's confidence in the current tactics, it also noted that polls show that Americans think the economy has gotten worse, not better.

   a) To what do you attribute this public failure to recognize the progress that has been made?

   b) Do you think a significant drop in unemployment or a slowing in foreclosure activity is required to sway public opinion?

   c) Should we worry that the public's unwillingness to embrace the administration's tactics will result in artificially low consumer confidence and demand?

   d) What should we take from the market's tacit endorsement of the Obama administration's course of action?

   e) Finally, the article notes that while the two philosophies may appear dramatically different, the current philosophy is not a dogmatic adherence to Keynesian principles, but rather a nod to pragmatism – taking whatever action is required to create economic recovery and growth. Do you agree with this conclusion, especially in light of the fact that Dr. Romer argued for a stronger government stimulus plan?

The Honorable Carolyn B. Maloney
April 21, 2010
Page 4

3) Congressman Hinchey and I asked that the Federal Reserve's purchase of agency debt and mortgage-backed securities not end as scheduled in March of this year, and I continue to believe this policy was incredibly beneficial, and should not yet have been discontinued.

   a) What impact did these purchases have on the primary housing market – both in terms of price stability and mortgage rates?

   b) What do you expect the result of the Fed's recent decision to be on prices and interest rates?

   c) One of the main reasons I opposed ending this program was that price stability helps slow the trend into negative equity, which can help stem the tide of foreclosures. If we can keep home values from crashing, we stand a better chance of keeping communities together. What, if any, action do you plan to take to ensure home price stability and to prevent foreclosures?

4) In a recent paper entitled "The World Needs Further Monetary Ease, Not an Early Exit", economist Joseph Gagnon argues that monetary stimulus is preferable to fiscal stimulus because monetary stimulus will "reduce the ratio of public debt to GDP by reducing interest expenses, increasing GDP, expanding tax revenues, and enabling an earlier start to fiscal consolidation". Further, he contends that central banks' discussion of withdrawing stimulus measures is misguided, and a failure to keep interest rates low would reduce GDP growth, delay improvements to the unemployment rate, and create great costs to the world economy in terms of lost income and personal hardship.

   a) How do you respond to Dr. Gagnon's contentions, and what Fed policies are being implemented to prevent the negative effects that he predicts?

The Honorable Carolyn B. Maloney
April 21, 2010
Page 6

5) You observed in your speech last week to the Dallas Regional Chamber that bank lending remains "very weak." I know that the Fed has provided guidance to examiners on the importance of bank lending to creditworthy borrowers. Without access to credit, businesses cannot expand their operations.

    a) Why does bank lending remain weak?

    b) Are creditworthy borrowers being turned away?

    c) What can Congress to do ensure that businesses – large and small – get access to credit?

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

BEN S. BERNANKE
CHAIRMAN

May 27, 2010

The Honorable Elijah E. Cummings
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed are my responses to the written questions you submitted following the April 14, 2010, hearing before the Joint Economic Committee. A copy has also been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I can be of further assistance.

Sincerely,

Enclosure

Questions for The Honorable Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System, from Representative Cummings:

1. Dr. Bernanke, you yourself have publically noted the danger of a "too big to fail" policy. However, criticism as been leveled at the House financial services financial regulatory reform bill, as well as the current Senate proposal, as failing to actually prevent another "too big to fail" scenario.

a) Do you believe that either proposal goes far enough to prevent the moral hazard that many cite for the reckless behavior of financial institutions?

The current legislative proposals address the "too big to fail" and moral hazard issues in a number of important ways. These proposals would subject all systemically important financial institutions to the framework for consolidated prudential supervision that applies today to bank holding companies. The proposals also require adoption of enhanced supervision and regulation for these firms, including enhanced capital, liquidity, and risk management requirements that reflect the important role the firms play in the financial sector. Enhanced requirements should reduce the incentives for financial firms to become very large in order to be perceived as too big to fail.

To complement the enhanced supervision of individual financial institutions, the proposals would also establish an interagency framework to monitor and address systemic risk across the full range of financial institutions and markets. Importantly, this includes establishment of an improved resolution process that would permit the government to restructure or wind down a failing systemically important firm in a way that mitigates the risks to financial stability and the economy and thus protects the public interest. The new resolution authority is designed to be a credible process for imposing losses on shareholders and creditors of the firm. A comprehensive approach containing each of these key elements is necessary to better protect against systemic risk.

As we implement and gain experience with the new rules, we may identify additional statutory changes that would enhance and strengthen the supervisory and regulatory framework and reduce moral hazard. We look forward to working with the Congress as we move forward in this process.

b) One of the results of the Graham-Leach-Bliley era deregulation and recent financial troubles has been the resulting concentration of commercial banking in four firms, controlling some 40 percent of deposits. Do you believe that small banks can or should still realistically survive, when they must essentially adopt a different business model that doesn't include the assumption that they will be bailed out?

Although the degree of concentration in the banking industry has increased in recent years and strong competition from large bank and nonbank competitors has posed challenges to smaller financial institutions, a very substantial number of small banks have continued to operate profitably. These include both long-established banks that operate with traditional community bank business models and others that have evolved to business models that focus on profitable

niche markets. Based on this evidence, it seems very likely that a large number of small banks will continue to achieve success in the U.S. banking market without direct government support and despite concentration in the industry.

2. A recent article in *BusinessWeek* contrasted the economic philosophies of the Clinton Administration (under Treasury Secretary Robert Rubin) and the current Obama Administration, specifically pointing to the Rubin mantra of lower government spending, lower budget deficits, and open trade – all of which supported a faith in the free market system. Your predecessor, Dr. Greenspan, also espoused this philosophy during his 17 year tenure as Fed chair.

In contrast, the authors showed that the current administration has been willing to utilize Keynesian public spending to stimulate the economy and help us emerge from the recession.

While the article was titled "Why the Obama Plan Is Working", and cited the financial community's confidence in the current tactics, it also noted that polls show that Americans think the economy has gotten worse, not better.

a) To what do you attribute this public failure to recognize the progress that has been made?

The unemployment rate remains very high, the housing market remains very weak, and many Americans continue to suffer acutely painful financial circumstances, including the intense dislocation associated with foreclosure. For many Americans, the risk of systemic financial collapse may never have seemed very tangible; accordingly, the fact that that risk has now been substantially reduced may not bring an immediate sense of relief.

b) Do you think a significant drop in unemployment or a slowing in foreclosure activity is required to sway public opinion?

Further improvements in the jobs situation and in the housing market would undoubtedly be helpful in bolstering confidence that a sustained economic recovery is under way.

c) Should we worry that the public's unwillingness to embrace the administration's tactics will result in artificially low consumer confidence and demand?

The Federal Reserve is focused on pursuing the dual mandate given to it by the Congress, namely to foster price stability and maximum sustainable employment. As the Federal Open Market Committee noted in its most recent statement, "The Committee ... continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period."

d) What should we take from the market's tacit endorsement of the Obama administration's course of action?

Again, the Federal Reserve is focused on pursuing the mandate given to it by the Congress. It is clear that a great deal of work and considerable time will be required before the maximum-sustainable-employment portion of the mandate will be fulfilled. In the course of working toward that objective, of course, we will also have to ensure appropriate attention to the price stability portion. In addition, we are heavily engaged in enhancing our oversight of financial institutions, including systemically important ones, and in the provision of consumer protection and oversight of payments systems.

e) Finally, the article notes that while the two philosophies may appear dramatically different, the current philosophy is not a dogmatic adherence to Keynesian principles, but rather a nod to pragmatism – taking whatever action is required to create economic recovery and growth. Do you agree with this conclusion, especially in light of the fact that Dr. Romer argued for a stronger government stimulus plan?

The recent financial crisis posed substantial risk to the financial and economic systems of the United States. To stem the effects of the crisis, it was critical that every relevant policy tool be brought to bear in a coordinated fashion. Now that the most acute phase of the crisis has passed, it is essential that policy continue to work toward the establishment of a secure, self-sustaining recovery. Beyond that, the policy agenda is long. Two items of primary concern are the enactment of much-needed financial reform, which will greatly reduce the chances of a financial calamity of this magnitude ever recurring, and a strong move toward putting the federal government on a sustainable fiscal trajectory. Both issues will require that difficult choices be made for the sake of improving the nation's financial and economic prospects.

3) Congressman Hinchey and I asked that the Federal Reserve's purchases of agency debt and mortgage-backed securities not end as scheduled in March of this year, and I continue to believe this policy was incredibly beneficial, and should not yet have been discontinued.

a) What impact did these purchases have on the primary housing market - both in terms of price stability and mortgage rates?

b) What do you expect the result of the Fed's recent decision to be on prices and interest rates?

c) One of the main reasons I opposed ending this program was that price stability helps slow the trend into negative equity, which can help stem the tide of foreclosures. If we can keep home values from crashing, we stand a better chance of keeping communities together. What, if any, action do you plan to take to ensure home price stability and to prevent foreclosures?

The Federal Reserve's large-scale asset purchases--its purchases of Treasury securities, agency debt, and agency mortgage-backed securities conducted from late 2008 through March 2010--appear to have lowered longer-term interest rates appreciably, perhaps by as much as

3/4 percentage point. In addition, these purchases may have helped improve liquidity in longer-term securities markets, particularly the markets for mortgage-backed securities and mortgages, and contributed to an improvement in investor confidence. Through such beneficial effects, these measures, in combination with the broad range of additional programs put in place by the Congress, the Federal Reserve, and other federal agencies, have helped to stabilize financial markets and institutions, preventing an even worse financial crisis, and have contributed to a resumption of economic growth.

Although the Federal Reserve has concluded its purchases of longer-term assets, its past purchases mean that it currently holds a very large volume amount of these securities--including about $1.7 trillion of securities acquired since late 2008. Based on economic theory and empirical evidence, we believe that longer-term interest rates will continue to be noticeably lower than would otherwise be the case as long as the Federal Reserve continues to keep a large volume of securities off the market. Consistent with this interpretation, longer-term yields did not change significantly after we stopped purchasing assets this spring. In addition, the Federal Reserve has kept its target for the federal funds rate at virtually zero, and it has reiterated that it expects that economic conditions will warrant exceptionally low levels of the federal funds rate for an extended period of time--a policy that is helping to keep a wide range of short- and long-term interest rates, including mortgage rates, at low levels. Altogether, the Federal Reserve's various policy actions are highly accommodative and are providing considerable support to the economic recovery in general, and to the housing sector and house prices in particular.

4. In a recent paper entitled "The World Needs Further Monetary Ease, Not an Early Exit," economist Joseph Gagnon argues that monetary stimulus is preferable to fiscal stimulus because monetary stimulus will "reduce the ratio of public debt to GDP by reducing interest expenses, increasing GDP, expanding tax revenues, and enabling an earlier start to fiscal consolidation." Further, he contends that central banks' discussion of withdrawing stimulus measures is misguided, and a failure to keep interest rates low would reduce GDP growth, delay improvements to the unemployment rate, and create great costs to the world economy in terms of lost income and personal hardship.

a) How do you respond to Dr. Gagnon's contentions, and what Fed policies are being implemented to prevent the negative effects that he predicts?

As I noted in response to question (3), the Federal Reserve has judged that the economic outlook currently calls for a very accommodative monetary policy and has indicated that economic conditions are likely to warrant a very low federal funds rate for an extended period of time. In addition, the Federal Reserve continues to provide support to the economy through its holdings of longer-term securities. The Federal Open Market Committee will continue to review its policy stance in light of the economic outlook. At the same time, the Committee recognizes that at some point the outlook will improve to the point that some reduction in the current unusual degree of monetary policy accommodation will be necessary to prevent the development of excessive inflationary pressures. The Federal Reserve has been carefully preparing to implement such a reduction in policy accommodation when appropriate.

5. You observed in your speech last week to the Dallas Regional Chamber that bank lending remains "very weak." I know that the Fed has provided guidance to examiners on the importance of bank lending to creditworthy borrowers. Without access to credit, businesses cannot expand their operations.

a) Why does bank lending remain weak?

b) Are creditworthy borrowers being turned away?

c) What can Congress do to ensure that businesses – large and small – get access to credit?

Despite general improvements in financial market conditions and in bank stock prices and earnings during recent quarters, lending is likely inhibited by various problems afflicting many banks, both large and small. Banks with capital positions that have been eroded by losses or those with limited access to capital markets may be reducing risky assets to improve their capital positions, especially amid continued uncertainty about the economic outlook and possible future loan losses. And, even though deposits are now plentiful, some banks have funding concerns. A number of other factors are also likely in play. Higher deposit insurance assessments increase funding costs. Some securitization markets remain impaired, reducing an important source of funding for bank loans. Finally, changes to accounting rules, beginning in 2010, will require many banks to move a large volume of securitized assets back onto their balance sheets, perhaps putting further pressure on bank capital.

While numerous factors have contributed to reduced bank lending, a lack of demand is a key factor as well. According to recent surveys conducted by the National Federation of Independent Businesses, financing conditions continued to be ranked as the top business concern by only a modest fraction (less than 5 percent) of small businesses; in contrast, about one-third of respondents cited poor sales as their most important problem. In addition, commercial bank responses to the Senior Loan Officer Opinion Survey on Bank Lending Practices continue to indicate reduced demand for loans from businesses, particularly small businesses.

The most important step we can take to improve credit availability to businesses both large and small is to achieve a sustainable economic recovery. Over the course of the past two years, the Federal Reserve has taken aggressive action in response to the financial crisis to help improve financial market conditions and strengthen U.S. banking organizations. We have acted on multiple fronts, instituting accommodative monetary policy, providing market liquidity, and issuing additional supervisory guidance to our bank examiners.

ROBERT P. CASEY, JR.
PENNSYLVANIA

COMMITTEES:
AGRICULTURE, NUTRITION, AND FORESTRY
FOREIGN RELATIONS
HEALTH, EDUCATION, LABOR, AND PENSIONS
SPECIAL COMMITTEE ON AGING
JOINT ECONOMIC

United States Senate
WASHINGTON, DC 20510

April 21, 2010

Honorable Carolyn B. Maloney
Chairwoman
The Joint Economic Committee
G-01 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairwoman Maloney:

Please submit the following question for the record following the April 14, 2010 hearing titled: The Economic Outlook with the Honorable Ben Bernanke.

Question: Recently I sent a letter along with five of my colleagues, encouraging Secretary Geithner to use Treasury's biannual exchange rate report to Congress to label China as a currency manipulator. Since sending the letter, it seems that they are seriously considering allowing their currency to appreciate.

Can you comment generally on this issue and how you see China currency policy impacting economic growth in our country? In your estimation, what would China have to do in order to make a significant positive impact?

Sincerely,

Robert P. Casey, Jr.
United States Senate

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

BEN S. BERNANKE
CHAIRMAN

May 27, 2010

The Honorable Robert P. Casey, Jr.
United States Senate
Washington, D.C. 20510

Dear Senator:

Enclosed are my responses to the written questions you submitted following the April 14, 2010, hearing before the Joint Economic Committee. A copy has also been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I can be of further assistance.

Sincerely,

Enclosure

Questions for The Honorable Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System, from Senator Casey:

Recently I sent a letter along with five of my colleagues, encouraging Secretary Geithner to use Treasury's biannual exchange rate report to Congress to label China as a currency manipulator. Since sending the letter, it seems that they are seriously considering allowing their currency to appreciate.

Can you comment generally on this issue and how you see China currency policy impacting economic growth in our country? In your estimation, what would China have to do in order to make a significant positive impact?

The Treasury Secretary has ultimate responsibility for U.S. exchange rate policy, including assessing whether or not China has been manipulating its currency. In general it would be in China's own interest to promote exchange rate flexibility, as it would allow for greater independence in monetary policy and reduce China's reliance on exports. It would also be commensurate with China's increasing global role and its responsibility to help contribute to growth in global demand. Although appreciation of the Chinese currency would benefit certain sectors of the U.S. economy, its effects on overall economic growth in this country would likely be modest. Notably, over the longer run, the level of U.S. employment has been relatively unaffected by the size of our trade deficits. However, in combination with actions to increase national saving in the U.S. and to increase domestic demand in China, appreciation of the renminbi could contribute significantly to the reduction of the large current imbalances in global trade and capital flows, which would reduce risks to financial stability as well as the reliance of the U.S. on foreign borrowing.