Joint Economic Committee

Representative Kevin Brady • Chairman

OPENING STATEMENT

CHAIRMAN KEVIN BRADY

The Economic Outlook

Before the Joint Economic Committee

May 22, 2013

Chairman Bernanke, welcome again to the Joint Economic Committee.

Thank you for your service as Chairman of the Federal Reserve. You deserve great credit for the leadership that calmed America's financial crisis in 2008.

Four and half years after that crisis and nearly four years after the recession ended, the Fed is still engaging in extraordinary monetary actions and may continue doing so well into the future. Today, this Committee will examine how these actions have affected jobs and middle class Americans, and how and when the Fed will exit its current accommodative policies.

America's economy is improving, but faces significant challenges. We are experiencing the worst economic recovery since World War II. The ‘growth gap’ between this recovery and an average post-war recovery is large and growing. We are missing 4.1 million private sector jobs and $1.2 trillion from real GDP.

More troubling is that many economists are predicting a ‘new normal’ for America where long-term growth is diminished. The Congressional Budget Office recently reduced its estimate for future growth in real potential GDP from 3.2 percent to 2.2 percent. A one-percentage point difference may not sound like much, but it is huge. A one-percent growth gap means a $30 trillion smaller economy in 2062 – in constant dollars.

The unemployment rate has declined, which is very encouraging, but there are red flags that we shouldn't ignore.

Twenty million Americans cannot find a full-time job. Millions more—from recent college graduates to workers in their prime earning years—have simply given up looking for work. Long-term unemployment remains historically high, and the labor force participation rate is at a 35-year low.

While it's encouraging that since the recession hit bottom over 6 million Americans have found work, more than that—over 8 million Americans—have been forced onto food stamps. Regrettably, one-in-six Americans must now rely on food stamps.

With strong earnings reports and Fed's accommodative monetary policy, there's no question that Wall Street is roaring, but Main Street continues to struggle. Since the recession ended, in real terms, the S&P 500 Total Return Index has risen by 74.2 percent, while disposable income per person has only advanced a mere 2.3 percent.

That means that over the last four years the real disposable income for Joe Sixpack increased a mere $745. In an average recovery since 1960, he would have $3,604 more in his pocket by now.

Extraordinarily low interest rates have clearly boosted housing prices and housing construction with positive economic effects. However, those same low rates are punishing seniors, savers, pension funds and insurance products. Families may now feel more secure about their house, but less secure about their income and job prospects.

As for the Fed's unemployment rate targeting, quantitative easing has run out of steam. Long-term interest rates are already at a near 70-year low. Banks have $1.9 trillion in excess reserves at the Fed, and non-financial corporations have $1.5 trillion sitting on the sidelines. More liquidity and lower long-term rates cannot solve the problems that are holding back job creation in America.

Business investment in new buildings, equipment and software—which drive job creation—remains the missing ingredient in this recovery.

Monetary policy, no matter how thoughtfully applied, has its limits. It cannot fix poor Washington budget, regulatory and tax policies that are deterring business investment and the jobs that come with it.

I don't question the intention of current Fed policy to fulfill its dual mandate, but I question the policy’s effects on employment and worry about its future risks.

In the near term, these extraordinary monetary actions have become an enabler of bad fiscal policy: allowing President Obama and Congress to avoid the tough and necessary decisions that would clear the roadblocks to a stronger economy: such as addressing America's long-term financial sustainability, creating a pro-growth tax code, re-balancing regulation, and addressing the harmful economic effects of the President’s *Affordable Care Act.*

In the long term, the Fed's extraordinary monetary actions pose three risks to our economy:

- First, the Fed may be inflating new asset price bubbles.

- Second, large excess reserves at the Fed could become the fuel for future inflation when economic growth accelerates unless the Fed acts swiftly to contract its balance sheet.

- Third, the Fed's expansive balance sheet creates a perverse incentive for future financial repression, an economic term, which means channeling domestic savings to the federal government to lower its interest costs.

  Since 2009, the Fed has purchased the equivalent of 24 percent of all newly issued Treasuries. When growth picks up, the Fed cannot raise its target rate for federal funds and sell long-term Treasuries without recognizing substantial losses on its balance sheet, creating uncertainty.

> To avoid that, the Fed will likely boost the interest rate paid to banks on their reserves and increase reserve requirements, which restrict economic growth by limiting bank loans to small businesses and families. The net effect is "financial repression"—redirecting credit from the private sector through the Fed to the Treasury—to help contain federal interest costs.

Given these risks and the limits to monetary policy in the current economic recovery, the Federal Reserve should begin now to carefully exit from its extraordinary monetary actions and return to a more predictable, rules-based monetary policy that focuses on maintaining the purchasing power of the U.S. dollar over time.

Begin now with clear communication to the market, that will lessen uncertainty and form the best long-term foundation for maximum economic growth for America.

We intend to explore the Fed's exit strategy in detail today.

Chairman Bernanke, I look forward to your testimony.