

DATE: July 15, 2021
TO: Interested Parties
FROM: Brownstein Hyatt Farber Schreck
RE: Senate Banking, Housing, and Urban Affairs Committee Hearing

On Thursday, July 15, the Senate Banking, Housing, and Urban Affairs Committee convened a hearing entitled “The Semiannual Monetary Policy Report to the Congress”. Members considered testimony from Federal Reserve Board Chair Jerome Powell. The discussion focused on inflation fears, labor shortages and asset purchases, among other issues.

Present Members

- Sen. Sherrod Brown (D-OH) *Chair*
- Sen. Jack Reed (D-RI)
- Sen. Robert Menendez (D-NJ)
- Sen. Jon Tester (D-MT)
- Sen. Mark Warner (D-VA)
- Sen. Elizabeth Warren (D-MA)
- Sen. Chris Van Hollen (D-MD)
- Sen. Catherine Cortez Masto (D-NV)
- Sen. Tina Smith (D-MN)
- Sen. Jon Ossoff (D-GA)
- Sen. Raphael Warnock (D-GA)
- Sen. Patrick Toomey (R-PA) *Ranking Member*
- Sen. Richard Shelby (R-AL)
- Sen. Mike Rounds (R-SD)
- Sen. Thom Tillis (R-NC)
- Sen. John Kennedy (R-LA)
- Sen. Bill Hagerty (R-TN)
- Sen. Cynthia Lummis (R-WY)
- Sen. Steve Daines (R-MT)

Witness

[The Honorable Jerome H. Powell](#)

Chairman
Board of Governors of the Federal Reserve System

Member Opening Statements

Chair Sherrod Brown (D-OH) said the economy is growing because of the America Rescue Plan and because of President Biden’s leadership. He said small businesses are reopening, employees are going back to work and, for the first time in decades, employees are gaining power in the economy. Brown said the current administration is investing directly in workers, small businesses and communities. To continue this growth, he said the country needs investment in infrastructure which would create millions of jobs, increase economic competitiveness and spur growth in local communities. He added that communities need investment in infrastructure in order to build stronger local economies. Brown said small businesses are competing against large chains and big banks and there is a desperate need to give communities the investments needed to help them reach their potential. He accused big banks of raking in cash with the aid of the Federal Reserve. He said the Fed should be fighting this trend as well as protecting the progress that

has been made from Wall Street greed. He noted that the Fed has rolled back important safeguards allowing for corporations to increase their own power in the economy. Brown emphasized the need to have a system that works for everyone, and which stops the biggest banks from funneling their extra cash into buybacks rather than investing in the real economy. Brown called for the Fed to strengthen its commitment to the Community Reinvestment Act. In regards to the workforce, Brown said low unemployment rates are not desirable if the jobs being offered pay rock-bottom wages and workers have no power. Additionally, he said a growing GDP must benefit the workers who made its growth possible. He said the economy must be stable in the long-run while also allowing workers to reap the benefits.

Ranking Member Patrick Toomey (R-PA) said the economy has come roaring back since the COVID-19 pandemic, with the GDP being above pre-pandemic levels. He cautioned that the current unemployment rate is below the average of the past 20 years while inflation growing fast and could be worse than many people expected. He said he was confused by the Fed's continued purchasing of \$40 billion in mortgage-backed securities (MBS) each month. He criticized the Fed's inflation predictions over the last year, stating that the forecasts have not given him confidence. He said the Fed has consistently understated inflation over the last year while insisting it is transitory despite the recent unprecedented monetary accommodation which is driving the inflation. Toomey said the Fed's current monetary approach seems to be based on the belief it needs to prioritize maximum employment over price stability. He emphasized it is not the Fed's job to offset flawed congressional policies at the expense of its price stability mandate. He said there is a great risk in rising and persistent inflation. He concluded his remarks by raising concerns that the Fed has misused its independence to wade into politically charged areas like climate change and racial justice, rather than focusing on issues that are within its mandate.

Witness Opening Statement

The Honorable Jerome H. Powell (Chairman, Board of Governors of the Federal Reserve System) said the Federal Reserve is strongly committed to achieving the monetary policy goals that Congress has given it: maximum employment and price stability. He said in the first half of 2021, ongoing vaccinations have led to a reopening of the economy and strong economic growth, supported by accommodative monetary and fiscal policy. He said household spending is rising at an especially rapid pace and housing demand remains very strong. Powell believes conditions in the labor market have continued to improve, but there is still a long way to go. However, he cautioned the unemployment rate remained elevated in June at 5.9%, adding further that this figure understates the shortfall in employment. He said he anticipates job gains to be strong in coming months as public health conditions continue to improve and as some of the other pandemic-related factors currently weighing down economic recovery diminish. Despite substantial improvements for all racial and ethnic groups, he said the hardest-hit groups still have the most ground left to regain. He said inflation has increased notably and will likely remain elevated in coming months before moderating. He noted that to avoid sustained periods of unusually low or high inflation, the Federal Open Market Committee's (FOMC) monetary policy framework seeks longer-term inflation expectations that are well anchored at 2%, the Committee's longer-run inflation objective. While discussing monetary policy, he said the FOMC has kept the federal funds rate near zero and maintained the pace of asset purchases. Powell said, in assessing the appropriate stance of monetary policy, the Fed will continue to monitor the implications of incoming information for the economic outlook and would be prepared to adjust the stance of monetary policy as appropriate if there are signs that the path of inflation or longer-term inflation expectations were moving materially and persistently beyond levels consistent with Fed goals. He said the Fed is continuing to increase its holdings of Treasury securities and agency mortgage-backed securities at least at their current pace until substantial further progress has been made toward maximum-employment and price-stability goals. He added the Fed would provide advance notice before announcing any decision to make changes to Fed purchases. Powell said the Federal Reserve will do everything it can to support the recovery and foster progress toward statutory goals of maximum employment and stable prices.

Discussion

Big Banks

Chair Brown asked why Powell has been against stronger capital restraints and the use of a counter-cyclical buffer to curb runaway executives and stock buybacks. **Powell** said the severity of the stress test has very much been maintained. He noted that many financial institutions are well capitalized, leading the Fed to conclude that financial systems and banks are strong. He said the level of loss-absorbing capital in the system is about right. He emphasized the Fed is prepared to deepen the counter-cyclical buffer if economic conditions required it to do so.

Cybersecurity and Other System Risks

Sen. Jon Ossoff (D-GA) asked what the most significant threats were to the financial system over the medium term. **Powell** said cyber risk is a constant concern. He said it is an ongoing race to keep up. He stated he also worries about the development of new strains of the COVID-19 virus.

Community Reinvestment Act (CRA) and Community Development Financial Institutions (CDFIS)

Chair Brown and **Sen. Raphael Warnock (D-GA)** asked about the Fed's commitment to full CRA modernization with an integrative approach. **Powell** said he is fully committed to modernization and he is optimistic the Fed can produce something with broad support from communities and financial institutions. He said the Fed is actively working on modernization and is currently engaged in the publiccomment process.

Sen. Mark Warner (D-VA) asked how the Fed could support CDFIS and similar programs. **Powell** said the COVID-19 pandemic proved how invaluable CDFIS are for their communities. He said the Fed is trying to provide resources to help programs like CDFIS reach communities where traditional banking methods may be unavailable.

Sen. Tina Smith (D-MN) asked what the Fed has learned from the comments on the CRA proposal released last year. **Powell** said the Fed is learning a lot and will try to incorporate the comments received. He said the proposal has the support of the communities it is intended to benefit and the general support of banks.

Climate Change

Sen. Smith asked what role the Fed plays in climate risk discussions with financial institutions. **Powell** said there is a need for better data on the implications of climate change. He said once this data is available, the Fed can approach financial institutions to discuss disclosure issues, but cautioned that most discussions related to the issue are the province of the Securities and Exchange Commission (SEC).

Sen. Ossoff asked what threat climate change poses to the financial system and financial institutions. **Powell** said most of the threats of climate change are long-term risks. He said the Fed works with financial institutions to address their risks in the short-term.

Mortgage-Backed Securities (MBS)

Ranking Member Toomey asked Powell if he was concerned about the unintended consequences associated with the purchasing of \$40 billion worth of MBS per month. **Powell** said a number of factors are contributing to the housing crisis. He agreed monetary policy is one of these factors. However, he added other factors to consider are consumers with strong balance sheets, as well as global and widespread supply shortages. He said the difference between MBS purchases and treasury purchases is not very large. Powell highlighted that monetary policy is supporting the rising prices and that this issue needs to be addressed.

Digital Currency

Ranking Member Toomey asked if Powell agreed that in order for the Federal Reserve to create a digital currency it would need congressional authorization, and asked further what problem a Central Bank Digital Currency (CBDC) would solve. **Powell** said he is undecided if the benefits of a CBDC outweigh the costs. He said the more direct route would be to directly regulate stable coins. He agreed the Fed would need the support of Congress to develop a CBDC, and added that he would like to see broad societal support before pursuing a CBDC.

Sen. Cynthia Lummis (R-WY) asked if stable coins would be unnecessary if there was a CBDC. **Powell** said cryptocurrencies have failed to be a payment mechanism. He said stable coins are like money funds or bank deposits without appropriate regulation, suggesting that there should be increased oversight over such coins.

Labor Shortage

Sen. Steve Daines (R-MT) asked if the labor force participation rate would recover to pre-pandemic levels. **Powell** said before the pandemic people were staying in the labor force longer. He said during the COVID-19 pandemic, some long-term labor force participants retired while others opted to retire early. He said that data on the labor force participation rate remains murky, but suggested that the participation rate as a whole could be better.

Sen. Chris Van Hollen (D-MD) asked if there is any way to bring unemployment back down to 3.5% if the labor participation rate does not improve. **Powell** said the U.S. lags its peers in labor force participation. He said the country must have a strong job market to incentive workers to return to the labor force.

Sen. Jack Reed (D-RI) asked how the Fed would take into consideration the technological disparity in terms of the workforce and employment. **Powell** said companies are looking at ways to use technology more aggressively in business operations. He said there is a need to ensure people find their way back into the labor force even if not returning to the same job.

Childcare

Sen. Robert Menendez (D-NJ) and **Sen. Jon Tester (D-MT)** asked if disruptions in childcare due to the pandemic had a negative effect on national employment levels. **Powell** said yes, while also adding that school closures have impacted the figures.

Inflation

Sen. Mike Rounds (R-SD) asked about the 2% inflation goal and if the Fed is concerned with growing inflation. **Powell** said the current inflation rate is well above 2%, but noted that it is not tied to factors inflation is typically associated with. He said the current inflation rate is the result of the shock of reopening the economy and added that the Fed will continue to monitor the rate and risks over time.

Sen. Rounds and **Sen. Warner** asked what tools the Fed had to try to maintain the 2% inflation goal. **Powell** said the the Fed would rely on raising interest rates to curb inflation if there appears to be a systemic rise in inflation over time.

Sen. Thom Tillis (R-NC) asked if the Fed's belief that the rise in inflation is only transitory was still well founded. **Powell** said the current situation is unique and decisions will need to be guided by data. He said the Fed looks at all components that make up the Consumer Price Index (CPI) and the Fed currently does not see broad inflation power in many of these components.

Sen. Catherine Cortez Masto (D-NV) asked if the COVID-19 pandemic relief packages are the sole cause for the increase of inflation. **Powell** said many factors go into creating the inflation. He said, to put the cause of inflation simply, the current supply cannot keep up with demand. Complicating factors further, he said there is currently demand-rebounding due to the sudden reopening of the economy.

Sen. Richard Shelby (R-AL) asked if the inflation is significant cause for concern. **Powell** said the nation is currently expecting a large up-tick in inflation which the Fed is actively working to better understand. He reassured the panel that the Fed has the necessary tools to fight inflation should the current rise appear to be more than transitory.

Volcker Rule

Sen. Elizabeth Warren (D-MA) asked if in the past four years the Fed has done anything to make the Volcker Rule stronger to limit risky trading by the largest banks. **Powell** said the Fed has clarified the rule and noted that the stress capital buffer raises capital standards for the largest banks.

Sen. Tillis asked if the Fed was fully enforcing the Volker rule based on congressional intent. **Powell** said the Fed is committed to fully enforcing the rule. He emphasized that the Fed's role is to maintain the strength of financial institutions with the hope they do not have to be bailed out again.

Spending

Sen. John Kennedy (R-LA) asked at what point does the benefit of deficit spending become less than the marginal cost. **Powell** said national spending is currently not on a sustainable path. He said there will need to be an adjustment, but warned that adjustments must be timed for when the economy is strong.

Sen. Bill Hagerty (R-TN) asked why the Fed has continued its emergency relief spending posture and if the posture will continue into 2023. **Powell** said the Fed is watching the evolution of the economy. He noted there is still an elevated number of unemployed persons coupled with high inflation. He said the Fed will reduce its asset purchases when it decides the economy has achieved further substantial progress.