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THE ECONOMIC OUTLOOK

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BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

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TUESDAY, MAY 5, 2009

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

The committee met at 10:02 a.m., in Room 216, Hart Senate Office Building, Hon. Carolyn B. Maloney (Chair), presiding.

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

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

Staff present: Gail Cohen, Stacy Ettinger, Nan Gibson, Colleen Healy, Marc Jarsulic, Linda Jeng, Andrew Wilson, Chris Frenze, Bob Keleher, Robert O'Quinn, Jim Gilroy, Lydia Mashburn, Jeff Schlagenhauf, and Jeff Wrase.

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

Chair Maloney. The meeting will come to order. I want to welcome Dr. Ben Bernanke, the Chairman of the Federal Reserve and thank him very much for his testimony today.

And in appreciation of his time, I would like to put my opening statement in the record so that we have more time for questions with the members.

[The prepared statement of Representative Maloney appears in the Submissions for the Record on page 44.]

Chair Maloney. I recognize the Ranking Minority Member, for two minutes.

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

Senator Brownback. Thank you very much, Madam Chairman. Welcome, Chairman Bernanke. We are delighted to have you here, and very pleased that you could join us in reporting to Congress.

You have got a lot to report on. As I mentioned to you in the anteroom, I appreciated very much, your presentation on 60 Minutes recently and the assuring sense that you put in front of the public. I think the public needs to hear you and needs to hear you in a reassuring sense.

I do have a quick statement that I wanted to make, and I will have my full statement put into the record. But there are two points that I have deep concern about.

One is your thoughts about the projected tax increases into the economy, and its impact, or the discussion of that and its impact now, of what that is and its impact overall.

And the second—and this one is one that we talk about amongst the members, and the public certainly is a great deal right now, is that the possibility of looking at the bottom of this recession towards the end of the year, as you and many other economists are talking about, that we are creating a government debt bubble that we are going to have to deal with in a massive way, the way we have had to deal with the housing debt bubble.

And I have got the numbers here that I have been looking at and am deeply concerned about. We had the head of the President's Council of Economic Advisors in last week, and we were talking about that very issue. And both—well, certainly in our fiscal policy, but also with the monetary policy, with the amount of funds that have been put forward, are we creating a government debt bubble?

And, finally, one other thought that I am going to be asking you about is: Chairman Hoenig out of Kansas City, has been putting forward the concept that "too big has failed," the policy of "too big to fail," has failed and that we need to get in a regularized system for our big banks; that if they are insufficiently capitalized, if they cannot continue, that they should be allowed to fail in an orderly fashion. And I really do and will be seeking your thoughts and comments on that.

Welcome to the Committee, delighted you're here. Thank you, Chairman.

[The prepared statement of Senator Brownback appears in the Submissions for the Record on page 44.]

Chair Maloney. And the Chair recognizes Vice Chairman Schumer, who is on his way, for two minutes, and Mr. Brady.

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

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

There are a lot of questions related to the financial rescue plan, and to America's perilous budget situation.

Recently released minutes of the Federal Open Market Committee indicates that Fed staff has reduced its projections for economic growth for the second half of 2009 to 2010. I think that underscores the concerns that this Committee has raised that the Administration's optimistic economic projections may truly hide the deficit and understate its true cost.

One question: When is the Congress going to acknowledge that the current fiscal trends are simply unsustainable?

Last week, the *Financial Times* reported that the IMF now estimates the U.S. losses on toxic assets will be $1.9 trillion over the next five years.

The recently adopted Congressional Budget Resolution ignores these costs entirely in setting budget policy for this year. How expensive will the bank cleanup be, and will its costs be hidden from taxpayers?

There is widespread agreement that sustained economic recovery can't occur without an effective bank cleanup in place. The Administration has put forward a financial rescue plan, but many of its components are troubling.

The Special Inspector General, Neil Brofsky, last week, testified before this Committee that many of the safeguards on accountability, on protecting the new Public-Private Investment Program against vulnerabilities and conflicts of interest, collusion, money laundering, so far have been ignored by Treasury.

Will the Treasury recognize these problems and move quickly to correct them?

There are a number of actions that the Fed has taken that frankly has bewildered many of my constituents and left them wondering how the policies will affect their economic well being.

Small businesses in Texas report that many are having a tough time finding affordable credit because regulators are pressing banks to avoid risk, in fact creating a downward spiral. Has the pendulum swung too far in this direction?

Now we are looking at a number of actions, including the downward debt deflation default spiral. The Federal Reserve has expanded its balance sheet by 127 percent, from $946 billion last September to over $2 trillion last week. While this explosive growth does not pose an immediate inflationary danger, the Fed will need to begin contracting its balance sheet when the economy begins to recover.

What is the Federal Reserve's exit strategy to wind down its emergency credit facilities and reduce excess bank reserves to prevent higher inflation?

There are a number of questions to be asked and answered today. I look forward to visiting with the Chairman. These are important times. Thank you.

Chair Maloney. Thank you very much.

[The prepared statement of Representative Brady appears in the Submissions for the Record on page 46.]

Chair Maloney. Dr. Ben Bernanke is the Chairman and member of the Board of Governors of the Federal Reserve. Dr. Bernanke also serves as Chairman of the Federal Open Market Committee, the System's principal monetary policymaking body.

Before his appointment as Chairman, Dr. Bernanke was Chairman of the President's Council of Economic Advisors from June in 2005 to January in 2006. From 1994 to 1996, Dr. Bernanke was the Class of 1926 Professor of Economics and Public Affairs at Princeton University.

He was the Howard Harrison and Gabriele Sneider Beck Professor of Economics and Public Affairs, and Chair of the Economics Department at the University from 1996 to 2002.

Dr. Bernanke had been a Professor of Economics and Public Affairs at Princeton since 1985. He has published many articles on a variety of economic issues, including monetary policy and macroeconomics, and he is the author of several books and two textbooks.

He received a B.A. in Economics in 1975 from Harvard University, and a Ph.D. in Economics in 1979 from MIT.

Thank you very much, and we recognize you for as much time as you may consume. Thank you.

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

Chairman Bernanke. Thank you, thank you very much.

Chair Maloney, Vice Chairman Schumer, Ranking Members Brownback and Brady, and other Members of the Committee, I am pleased to be here today to offer my views on recent economic developments, the outlook for the economy, and current conditions in financial markets.

The U.S. economy has contracted sharply since last autumn, with real gross domestic product having dropped at an annual rate of more than six percent in the fourth quarter of 2008, and in the first quarter of this year.

Among the enormous costs of this downturn is the loss of some five million payroll jobs over the past 15 months. The most recent information on the labor market, the number of new and continuing claims for unemployment insurance, through late April, suggest that we are likely to see further sizable job losses and increased unemployment in coming months.

However, the recent data also suggests that the pace of contraction may be slowing, and they include some tentative signs that final demand, especially demand by households, may be stabilizing.

Consumer spending, which dropped sharply in the second half of last year, grew in the first quarter.

In coming months, household spending power will be boosted by the fiscal stimulus program, and we have seen some improvement in consumer sentiment.

Nonetheless, a number of factors are likely to continue to weigh on consumer spending, among them the weak labor market and the declines in equity and housing wealth that households have experienced over the past two years.

In addition, credit conditions for consumers remain tight. The housing market, which has been in decline for three years, has also shown some signs of bottoming.

Sales of existing homes have been fairly stable since late last year, and sales of new homes have firmed a bit recently, though both remain at depressed levels.

Although some of the boost of sales in the market for existing homes is likely coming from foreclosure-related transactions, the increased affordability of homes appears to be contributing more broadly to the steadying in the demand for housing.

In particular, the average interest rate on conforming 30-year fixed rate mortgages has dropped almost one and three-quarters percentage points since August to about 4.8 percent.

With sales of new homes up a bit and starts of single-family homes little changed from January through March, builders are seeing the backlog of unsold new homes decline, a precondition for any recovery in home building.

In contrast to the somewhat better news in the household sector, the available indicators of business investment remain extremely weak.

Spending for equipment and software fell at an annual rate of about 30 percent in both the fourth and first quarters, and the level of new orders remains below the level of shipments, suggesting further near-term softness in business equipment spending.

Recent business surveys have been a bit more positive, but surveyed firms are still reporting net declines in new orders and restrained capital spending plans.

Our recent survey of bank loan officers reported further weakening of demand for commercial and industrial loans. The survey also showed that the net fraction of banks that tightened their business lending policies stayed elevated, although it has come down in the past two surveys.

Conditions in the commercial real estate sector are poor. Vacancy rates for existing office, industrial, and retail properties have been rising. Prices of these properties had been falling and, consequently, the number of new projects in the pipeline has been shrinking.

Credit conditions in the commercial real estate sector are still severely strained, with no commercial mortgage-based securities having been issued in almost a year.

To try to help restart the CMBS market, the Federal Reserve announced last Friday that recently issued CMBS, will in June be eligible collateral for our term asset-backed securities loan facility or TALF.

An important influence on the near-term economic outlook is the extent to which businesses have been able to shed the unwanted inventories that they accumulated as sales turned down sharply last year.

Some progress has been made. The Bureau of Economic Analysis estimates that an acceleration in inventory liquidation accounted for almost one-half of the reported decline in real GDP in the first quarter.

As stocks move into better alignment with sales, a reduction in the pace of inventory liquidation should provide some support to production later this year.

The outlook for economic activity abroad is also an important consideration. The steep drop in U.S. exports that began last fall has been a significant drag on domestic production, and any improvement on that front would be helpful.

A few indicators suggest, again quite tentatively, that the decline in foreign economic activity may also be moderating and, as has been the case in the United States, investor sentiment and the functioning of financial markets abroad have improved somewhat.

As economic activity weakened during the second half of 2008 and prices of energy and other commodities began to fall rapidly, inflationary pressures diminished appreciably. Weakness in demand and reduced cost pressures have continued to keep inflation low so far this year.

Although energy prices have recently risen some, the personal consumption expenditure price index for energy goods and services in March remained more than 20 percent below its level a year earlier.

Food price inflation has also continued to slow as the moderation in crop and livestock prices has been passing through to the retail level.

Core PCE inflation, which excludes food and energy prices, dropped below an annual rate of one percent in the final quarter of 2008 when retailers and auto dealers marked down their prices significantly.

In the first quarter of this year, core consumer price inflation moved back up but to a still low annual rate of 1.5 percent.

We continue to expect economic activity to bottom out, then to turn up later this year. Key elements of this forecast are assessments that the housing market is beginning to stabilize, and that the sharp inventory liquidation that has been in progress will slow over the next few quarters. Final demand should also be supported by fiscal and monetary stimulus.

An important caveat is that our forecast assumes continuing gradual repair of the financial system. A relapse in financial conditions would be a significant drag on economic activity and could cause the incipient recovery to stall. I will provide a brief update on financial markets in a moment.

Even after a recovery gets underway, the rate of growth of real economic activity is likely to remain below its longer-run potential for awhile, implying that the current slack in resource utilization will increase further.

We expect that the recovery will only gradually gain momentum and that economic slack will diminish slowly. In particular businesses are likely to be cautious about hiring, implying that the unemployment rate could remain high for a time even after economic growth resumes.

In this environment, we anticipate that inflation will remain low. Indeed, given the sizable margin of slack in resource utilization and diminished cost pressures from oil and other commodities, inflation is likely to move down some over the next year relative to its pace in 2008.

However inflation expectations, as measured by various household and business surveys, appeared to have remained relatively stable which should limit further declines in inflation.

As I noted, a sustained recovery in economic activity depends critically on restoring stability to the financial system. Conditions in a number of financial markets have improved in recent weeks, reflecting in part the somewhat more encouraging economic data.

However, financial markets and financial institutions remain under considerable stress and cumulative declines in asset prices, tight credit conditions, and high levels of risk aversion, continue to weigh on the economy.

Among the markets that have recently begun to function a bit better are the markets for short-term funding, including the interbank markets and the commercial paper market.

In particular, concerns about credit risk in those markets appear to have receded somewhat. There is more lending at longer maturities and interest rates have declined.

The modest improvement in funding conditions has contributed to diminished use of the Federal Reserve's liquidity facilities for financial institutions and of our commercial paper facility.

The volume of foreign central bank liquidity swaps has also declined as dollar funding conditions have eased. The issuance of asset-backed securities or ABS, backed by credit card, auto, and student loans, all picked up in March and April and ABS funding rates have declined, perhaps reflecting the availability of the Federal Reserve's TALF facility as a market backstop.

Some of the recent issuance made use of TALF lending, but lower rates and spreads have facilitated issuance outside the TALF, as well.

Mortgage markets have responded to the Federal Reserve's purchases of agency debt and agency mortgage-backed securities, with mortgage rates having fallen sharply since last fall as I noted earlier.

The decline in mortgage rates has spurred a pick up in refinancing as well as providing some support for housing demand. However, the supply of mortgage credit is still relatively tight and mortgage activity remains heavily dependent on the support of government programs for the government sponsored enterprises.

The combination of a broad rally in equity prices and a sizable reduction in risk spreads in corporate debt markets reflects a somewhat more optimistic view of the corporate sector on the part of investors and perhaps some decrease in risk aversion.

Bond issuance by nonfinancial firms has been relatively strong recently, but still, spreads over Treasury rates, paid by both investment-grade and speculative-grade corporate borrowers remain quite elevated.

Investors seemed to adopt a more positive outlook on the condition of financial institutions, after several large banks reported profits in the first quarter, but readings from the credit default swap market and other indicators show that substantial concerns about the banking industry remain.

As you know, the federal bank regulatory agencies began conducting the Supervisory Capital Assessment Program in late February. The program is a forward-looking exercise intended to help supervisors gauge the potential losses, revenues, and reserve needs for the 19 largest bank holding companies in a scenario in which the economy declines more steeply than is generally anticipated.

The simultaneous comprehensive assessment of the financial conditions of the 19 companies, over a relatively short period of time, required an extraordinary coordinated effort among the agencies.

The purpose of the exercise is to ensure that banks will have sufficient capital buffer to remain strongly capitalized and able to lend to creditworthy borrowers, even if economic conditions are worse than expected.

Following the announcement of the results, bank holding companies will be required to develop comprehensive capital plans for establishing the required buffers. They will then have six months to execute those plans, with the assurance that equity capital from the Treasury under the Capital Assistance Program will be available as needed.

I will conclude with just a few comments on Federal Reserve transparency. The Federal Reserve remains committed to transparency and openness, and in particular to keeping the Congress and the public informed about its lending programs and balance sheet.

As you may know, we have created a separate section of our website devoted to providing data, explanations, and analyses bearing on these topics and related issues.

Recent postings include the annual financial statements of the 12 Federal Reserve Banks, the Board of Governors, and the limited liability companies created in 2008, in response to risks to the financial system, as well as the most recent reports to the Congress on our emergency lending programs.

Earlier this year, I asked Vice Chairman Kohn to lead a review of our disclosure policies, with the goal of increasing the range of information that we make available to the public. The group has been making substantial progress, and I am pleased to say that we will soon be adding to the website, material that provides the information requested in the Dodge–Shelby Amendment to the recent Budget Resolution.

Specifically, we will be adding new tables that provide information on the number of borrowers under each program, and more information on the details of the credit extended, including measures of the concentration of credit among borrowers.

In addition, we will be providing monthly information on the collateral that is being taken under our various lending programs, including breakouts by type of collateral and by ratings categories, and we will be supplementing information provided on the valuation of collateral for the Maiden Lane facilities and the commercial paper credit facility.

Finally, we will be providing additional information on the extent of our contracting with private firms with respect to our lending programs, as well as on the terms and natures of such contracts.

Over time, we expect to continue to expand the range of information on our website, as our review of disclosure practices proceeds.

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

[The prepared statement of Hon. Ben S. Bernanke appears in the Submissions for the Record on page 47.]

Chair Maloney. Thank you very much for your testimony. My basic question is: Is there any good news? Can you elaborate more?

You mentioned in some interviews that you were seeing green shoots for recovery in the economy. And has the recent report on real GDP for the first quarter of 2009 changed your views on the economy?

Chairman Bernanke. Chair Maloney, as you know the numbers, the headline numbers for GDP growth in the fourth and first quarter, were very negative, both minus-six percent at an annual rate.

But I think a bit of good news was in the composition of growth in the first quarter. As I mentioned in my testimony, about half of the decline in GDP in the first quarter represented the liquidation of excess inventories.

And as inventories are worked down, firms will be able to increase their production to meet what looks to be some stabilization in final demand.

And so we are hopeful that the very sharp decline we saw beginning last fall through early this year will moderate considerably in the near term and that we will see positive growth by the end of the year.

Chair Maloney. Can you explain why the results of the stress tests were delayed?

Chairman Bernanke. Yes. This was a very comprehensive exercise, unprecedented in its scale and scope. The three federal oversight agencies collaborated very closely, working through the entire portfolios, the reserving practices, and the earnings of the 19 largest banks in the country, so it was a very expensive and detailed exercise.

After we completed our first set of data, we took the data back to the banks and we gave them an opportunity not to negotiate but to point out where there were misunderstandings, communications problems, data issues, and so on, which we, as an appropriate measure, agreed to look at.

We have reviewed those data. We have looked at the numbers. We have looked at the assumptions. And we have now satisfied ourselves that the data we have are accurate reflections of the financial conditions of those banks.

Chair Maloney. The IMF estimates that U.S. banks will require between $275 billion and $500 billion in additional capital, depending on the leverage requirements from the regulators. Do you agree with these IMF estimates?

There are several independent rating organizations, financial organizations that have come up with large amounts, $500, $700 billion. Do you agree with these numbers?

Chairman Bernanke. Well, I am not ready to pre-disclose the results of the tests that will come out on Thursday afternoon, but I would point out that while banks have certainly sustained substantial losses both in the last few years and going forward, they have also taken significant writedowns, they have reserved, and there is substantial earning capacity, so there are a number of offsets that will help to make up those losses.

And, finally, of course to the extent that there are banks that need capital our hope is that many of them will be able to raise that capital through either private equity offers or through conversions and exchanges of existing liabilities to strengthen their capital bases.

So I would say that number overestimates the call on the government going forward.

Chair Maloney. And do you think the amount of capital will be available from the private sector to shore up these banks and to——

Chairman Bernanke. I have looked at many of the banks and I believe that many of them will be able to meet their capital needs without further government capital through either issuance of new capital or through conversions and exchanges, or through sale of assets and other measures that would raise capital.

Chair Maloney. Well, as a last resort, the Federal Government could provide access to capital. We have roughly I believe $110 billion left from the $700 billion TARP Program. Do you estimate that we might need more than what is remaining in the TARP Program, the $110 billion?

Chairman Bernanke. Well, I would leave that to the

Administration. I think they just recently indicated that they don't think there is a near-term need.

Chair Maloney. That would be terrific. My time has expired.

Senator Brownback. Thank you, Chair. Welcome.

I want to talk about a couple of areas and ask you, in the fields that we had mentioned, the Administration is likely to need to borrow around $2 trillion this year just for this year's operating.

I mentioned to you about a government debt bubble that we are looking at. I am sure you have concerns about that. Are there signals that you are looking at and considering as to whether or not this is occurring or is not occurring on a government debt bubble?

Chairman Bernanke. Senator, the U.S. Government debt is bearing yields, which are, I think, indicative of confidence. The relatively low yields that we see on ten-year and even 30-year debt suggests that investors in those securities, first of all, appreciate the liquidity and safety of those securities, and, secondly, that they are confident that the U.S. will have low inflation and fiscal stability in the long term.

Having said that, it is imperative on all of us as the policymakers, particularly the Congress which is responsible for fiscal policy, to make sure that we do achieve the necessary stabilization that will allow deficits to come down, that will allow us to deal with those issues.

So, there is confidence in the market that we will deal with these problems, and we must fulfill that confidence and address those issues.

Senator Brownback. Well, maybe—what sort of signals will you be looking for from the marketplace to start unwinding the Fed position that you are in, perhaps to guide us a little bit of what signals we should be looking for from the marketplace, for us to start unwinding this debt position?

Chairman Bernanke. Certainly. Well, first, many of the programs, particularly the short-term lending programs that we have, have been priced in such a way that they are not particularly attractive when markets are closer to normal.

In fact, we have already seen that a number of our liquidity programs like the Term Securities Lending Facility, the Commercial Paper Facility, and others, are just seeing reductions in demand from the private sector, and so those short-term facilities are shrinking on their own. And that is a good sign that demand for that short-term liquidity is either diminishing or is being replaced by private-sector liquidity.

Otherwise, the task for us is very similar to any recovery, which is to try to address as best we can where we think the economy is going over the next few quarters, and to try to achieve a balance in financial conditions that will be consistent with our mandate to achieve both price stability and maximum employment.

So we will have to continue to make our forecasts the best we can and we will certainly be withdrawing liquidity and financial accommodation in an appropriate way to make sure that we both achieve recovery, that we don't snuff our recovery too early, but on the other hand that we don't deal with inflation in the longer term.

Senator Brownback. You mentioned on us being responsible to maintain the market confidence. Do you have a thought on considering tax increases at the present time by the Congress?

Chairman Bernanke. Well, in the near term we have to worry about spending power certainly. In the longer term I think it is very important that Congress make sure that the deficits are not excessively large.

Different Members of Congress will have different views. I think the main thing is that you be consistent. If you want to increase spending, then you have to be willing to accept the tax increases and the consequences that that may have for growth and efficiency.

If you want to have low taxes, then you have to be willing to accept and find program cuts that will match the two. So, the main thing is that people will understand that they need to be consistent between their preferences on revenues and spending.

Senator Brownback. “Too big to fail,” has been challenged by some Fed Chairmen, one in Kansas City and other places. Do you think we need to amend that, or allow some of the big financial institutions to go through an orderly restructuring process?

Chairman Bernanke. Well, Senator, “too big to fail,” has been sometimes called a policy or a doctrine. It is not a policy; it is a problem. It is a huge problem. It has arisen because we do not have adequate legal powers to safely wind down a large financial holding company or a bank holding company with many divisions, many companies, subsidiaries, many complex interactions with the financial markets.

There is a very strong contrast between the powers we have for, say, a small bank—where the FDIC can come in and wind it down in an orderly way—versus the lack of powers we have for dealing with non-banks, including holding companies, insurance companies like AIG, or investment banks like Lehman Brothers.

So, for about a year I have been asking Congress to come up with a resolution regime that would allow us to address the safe and sound unwinding of a troubled large financial institution.

Under current law, to allow one of these companies to go into a disorderly bankruptcy is enormously disruptive and would damage not only the company itself of course but also the whole financial system and the economy.

So I am very much in favor of taking strong steps to end “too big to fail,” and I have given a number of speeches on that subject. But certainly one prerequisite for doing that is having a resolution regime that will allow us, in a way analogous to what the FDIC does, to come in and safely wind down a large company.

Senator Brownback. Thank you very much. Thank you, Chair.

Chair Maloney. Thank you very much. I just want to add that the Financial Services Committee is working on legislation such as the Chairman described, for legal powers to wind down large holding companies.

Representative Cummings is recognized for five minutes.

Representative Cummings. Thank you very much, Madam Chair, and thank you, Mr. Bernanke, for your testimony and for your service.

If the Federal Reserve or the Department of the Treasury, or both, are directing firms to acquire other firms or to take other specific actions, how can we avoid concluding that the firms are at least to some degree, nationalized?

What was the involvement of the Federal Reserve with Bank of America’s acquisition of Merrill Lynch? And did you or, to your knowledge, did Henry Paulson push the Bank of America CEO, Ken Lewis, not to discuss the details of the merger?

Chairman Bernanke. Let me address your question about Bank of America and Merrill Lynch because it is very important.

I received a letter from Chairman Kucinich and Chairman Towns of the House Oversight and Government Reform Committee asking exactly the question you asked, and I replied to them in a letter last week where I stated that absolutely not, that I absolutely did not in any way ask Mr. Lewis to obscure any disclosures or to fail to report information that he should be reporting.

In that letter, I offered to that Committee, and I have subsequently offered both to the House Financial Services Committee and the Senate Banking Committee, full access to all papers, documents, notes, related to those meetings and to the Bank of America–Merrill Lynch transaction that will support my unconditional assertion that in no way did I ever ask Mr. Lewis to fail to disclose necessary information.

I would add, finally, on that subject, that the meeting where we met with Mr. Lewis was attended by quite a few supervisory and legal staff, including the General Counsel of the Federal Reserve, and he was, of course, very alert to make sure that everything that happened in the meeting met all of the necessary legal requirements.

Representative Cummings. Well as a member of the Oversight and Government Reform Committee, we will follow up on that, and I appreciate your answer.

Now can you get to the first part of my question?

Chairman Bernanke. The first part of the question had to do with nationalization.

Representative Cummings. Yes.

Chairman Bernanke. Yes. So, it is the case that the government obviously has some ownership of a number of financial institutions. I don't know, but "nationalization" means different things to different people.

I think our view is that we don't want substantial government ownership to be a long-term situation, and what we want is the firms to take actions that are necessary so that they no longer rely on government support.

Now we have a number of tools to do that. One is a supervisory tool. The supervisors have considerable latitude to take steps to require changes in management, to require sales of assets, restructuring of businesses, or other steps as needed to raise capital and to strengthen their business plans.

Likewise the Treasury, through its ownership rights, can also establish policies and make requirements.

So we have plenty of tools. We would not have really substantially greater tools under a different legal regime, I think. The issue here though is to find ways to get firms out of a situation where they are dependent on government capital. And we are hopeful that that can be done over the next few years.

Representative Cummings. *The New York Times* Editorial Page ran two very interesting columns yesterday. First, Paul Krugman, one of my favorites, argued that defensive actions by families and businesses, like increased household savings and wage cuts to prevent job losses, put downward pressure on consumer spending and keep the economy depressed. Only continued drastic stimulus actions, he argued, can break this cycle.

Second, Alan Meltzer wrote that the Federal Reserve had sacrificed its independence by subordinating concerns over inflation and engaging in fiscal policy normally left to the Legislative

Branch and becoming, quote, "the monetary arm of the Treasury," unquote.

Do you agree with Mr. Krugman? And if so, what measures are most important moving forward?

And as far as Dr. Meltzer is concerned, Dr. Meltzer clearly evaluates the Federal Reserve from an historical perspective. How do you respond to his claim about the Fed's independence? Is there historical precedent for the current level of outstanding Federal Reserve credit?

Chairman Bernanke. Well, Congressman Cummings, I hope you appreciate the irony of on the same page two distinguished economists, one worried about inflation, the other one worried about deflation.

Representative Cummings. I found that very interesting.

Chairman Bernanke. I think that suggests the difficulty of the situation we are in, to try to navigate between the Scylla and Charybdis of these two risks.

We are very committed to price stability. We have recently provided projections which suggest how we plan to approach medium-term price stability and give information about what we think inflation ought to be in the medium term.

We firmly believe that we will be able, after stimulating the economy, to help it recover from this very difficult financial and economic situation we are in, to come to a situation where we emerge with sustainable growth and price stability. We are spending enormous amounts of time planning that, thinking about our exit strategy, and so on.

I would also take great exception to the notion that the Fed has sacrificed its independence. I would make two comments on that.

The first is that the critical element of Fed independence is monetary policy. Monetary policy has remained completely independent of all other government institutions. We have not sought advice or input on any aspect of monetary policy. It remains completely independent and it will remain independent.

On other aspects, I think it is important during a period of crisis for the major parts of the government to work together. I think the American people would like to see the Federal Reserve and the Treasury working together.

In past financial crises there has been a good bit of cooperation. At the same time, the Fed and the Treasury recently issued a joint statement clarifying that there are distinct and different roles for the Fed and the Treasury, and in particular the taking of credit risk.

The making of credit decisions are the Treasury's province, and importantly we talked also about the need for a resolution regime once again so that the Fed would not get stuck into these situations like we are with AIG, which was a really undesirable outcome, I am the first to admit, but was necessary because we had no well-structured resolution regime.

So we have tried to put out a clear statement of where we think the line is, and we continue to maintain our independence, particularly in the area of monetary policy where it's particularly important.

Representative Cummings. Thank you, very much.

Chair Maloney. Mr. Brady is recognized for five minutes.

Representative Brady. Thank you, Mr. Chairman. A lot of private capital is sitting on the sidelines. Neither Administration has yet successfully removed the toxic assets from bank balance sheets.

Given that, how do you expect these stress-tested banks to recapitalize? How much do you think is a fair ratio between private capital and government sources?

Chairman Bernanke. Well, our approach will be to ask the banks to go first to private sources. And as I said before, I think that many of them will be able either to raise new equity capital to convert existing forms of capital into common equity, or to sell assets or take other measures that will allow them to recapitalize themselves without any, or without substantial, Treasury capital. So that will be our first priority.

It remains to be seen how receptive the markets will be, and what they will be able to accomplish. But I do think that there will be significant opportunities for capital-raising outside the government's programs.

Representative Brady. Do you think it will be a majority from private sources?

Chairman Bernanke. I think it will be significant. It is hard for me really to say at this point, because it depends on the market's reception of what the banks propose to do.

Representative Brady. Removing those toxic assets is real key to the economy; as in new proposal for a Public-Private Investment Program. Last week the Special Inspector General for TARP and those programs identified a number of vulnerabilities and recommended both transparency, as you do, in the current bailout dollars but also putting in place ahead of time some basic safeguards to deal with collusion, conflict-of-interest, money laundering, just basically again to build consumer confidence and also investor confidence in those measures.

Are you aware of the Inspector General's recommendations? And do you support them?

Chairman Bernanke. Yes, I am quite aware and I think they are very constructive. The place that they are most relevant to the Federal Reserve is in the TALF program that I mentioned, because it uses TARP capital. And the Special Inspector General for TARP had a number of suggestions.

We have worked with his office. Nothing is perfect; there is always a possibility of some problem. But we believe that we have taken substantial steps both to protect the taxpayer from credit loss, and to protect the system from any kind of abuse or illegal activity.

We will continue to work with the Special Inspector General and make sure that we are, in all of our programs, protecting the taxpayer.

Representative Brady. Treasury has not yet adopted many of those recommendations. Would you urge them to move quickly on that?

Chairman Bernanke. I would leave it to them to discuss what their concerns are. I don't really know what the issues are that they are raising. But obviously we are all interested in making sure that the appropriate safeguards are in place.

Representative Brady. With the cost of the deficits running unprecedently high in this country, there is some concern about what additional costs would come about because of the whole financial rescue efforts.

Last week the International Monetary Fund estimated that those costs to U.S. Taxpayers over the next five years will be $1.9 trillion. Do you see that estimate as too high, or too low?

Chairman Bernanke. I don't know what that includes. If it means to include financial——

Representative Brady. It included all the Fed actions from the loan guarantees, to the nonstandard capitalization——

Chairman Bernanke. From the Fed, we don't expect to lose any money. From the Treasury there's some risk in their investments, but those numbers are—I have no idea what they refer to.

Representative Brady. Okay. As we move forward, what do you see as the Federal Reserve's exit strategy to wind down its emergency credit facilities and reduce the excess bank reserves to prevent higher inflation?

Chairman Bernanke. Congressman, we have spent a lot of time on this. I just want to assure you that we made all our meetings into two-day meetings, and we spend the whole first day reviewing our balance sheet, our programs, and thinking very heavily and extensively about exit strategy.

We have a plan in place. We are trying to strengthen and improve it. Some of the components are, first, that many of the short-term programs will either wind down naturally or can be wound down. That is about up to a trillion dollars of balance sheet that can be wound down through that process.

Secondly, very importantly, Congress gave us last year the ability to pay interest on reserves. By paying interest on excess reserves, banks will hold their reserves with the Fed. That will allow us to raise interest rates, even if excess reserves remain very substantial in the system. So that tool in itself will be a very powerful tool.

Third, we are looking at what is called reverse-repurchase agreements, which essentially would allow us to finance on a short-term basis some of our asset holdings with nonbank investors, such as securities dealers or others. That would drain excess reserves from the system, and also have the same effect.

Fourth, Treasury deposits at the Fed drain reserves from the excess reserves from the system, as they have done last year for example.

And finally, if necessary, we can always sell some of our assets into the market.

So we have a number of options. The exact timing and sequencing remains to be seen. We are looking at that. We hope to release more information about that, but we do believe that we have all the tools that we need to exit, to help this economy get back to a sustainable growth path, but also to ensure that we come out of this with price stability.

Representative Brady. All right. Thank you, Chairman.

Chair Maloney. Thank you. And the Chair recognizes the Vice Chair for five minutes.

OPENING STATEMENT OF HON. CHARLES E. SCHUMER, A U.S. SENATOR FROM NEW YORK

Vice Chair Schumer. Thank you, Madam Chairperson. I want to thank you for the outstanding way that you have conducted not only this hearing, but your tenure thus far as Chairman of the JEC, and I look forward to working together on many more issues.

Today I want to focus on one of the issues that affect the economic well being of American families, and an issue I worry has been overlooked in our focus, understandably, on persevering the health of global credit markets and large financial institutions.

I am talking about consumer credit. I am very concerned we have not done enough to stop some of the same predatory behaviors that got us into this mess in the first place.

American families should not suddenly find their economic well being threatened by capricious and indefensible decisions of their credit card companies.

Originally, as you know Mr. Chairman, even before you were Chairman, I used to think disclosure was enough. Now even the Fed agrees that disclosure is no longer enough because the credit card companies always find ways around it and engage in awful practices.

I have heard from an increasing number of my constituents that interest rates on their accounts have doubled or tripled overnight, without any misconduct on their part. Now is not the time for credit card companies to arbitrarily turn American families into a cash spigot.

So two weeks ago Senator Dodd and I wrote to you to urge you to use your emergency authority to put the Federal Reserve's new credit card rules into place immediately.

In a letter that you sent me yesterday—right here [indicating]—you declined to do so. I believe that the Federal Reserve's failure to protect consumers from these outrageous rate increases is unconscionable.

And, Mr. Chairman, while I have applauded you for some of the actions you have taken in this area, I have to tell you that the decision does a disservice to you and the Federal Reserve. Consumer protection, in my judgment, long before you were there, has been a weak point in the Federal Reserve.

You have acted swiftly to use your emergency powers to steady teetering financial institutions. It is fair to ask why you won't use the same powers to aid American families who are at just as great a risk.

So I have three—well, two questions, but just one other comment. What about the family that has a $10,000 balance—that is the average balance—and has had its rate go from 7 to 23 percent? We have heard of that. Every one of us has heard of that kind of jump.

That would mean that a family's monthly payment would go from $58 a month to $192 a month, not even accounting for compounding the interest over the course of a year. That is just outrageous. From a family that would have a rough time affording it.

So I would ask you how you answer that family.

Two other questions, and then I will finish and let you conclude. By all accounts, arbitrary credit rate increases are on the rise. In other words, the companies are doing more of this now. And the feeling is they are doing more of it because they know your rules will go into effect in a year-and-a-half.

So that does not seem right. And isn't this the same problem at the heart of our economic crisis—the regulatory system putting financial institutions ahead of consumers that is allowing this to happen for the next year-and-a-half?

And finally, and maybe most importantly, the original purpose of the Fed's 18-month delay in the effective date of the new credit card rules was to give the banks time to, quote, "redesign their systems, make changes to their operations." This strikes me as nonsense.

If the banks needed to redesign their systems to make more profit, it would not take them a year-and-a-half. You know that, and I know that. They are very capable of moving up their timetables when they need to.

I have asked a few people, why would it take a year-and-a-half? And nobody can figure that out. So how do the benefits of prolonging the suffering of consumers outweigh the costs of forcing these banks to immediately improve predatory credit card practices?

Those are my three questions. And I say that as somebody who respects you and admires you, but is very frustrated about this issue and was disappointed in your answer to Senator Dodd and me.

Chairman Bernanke. Well, Senator, I am frustrated as well. And I do not think our positions are as far apart as you seem to think.

First of all, we did pass of course very extensive changes in disclosures and regulation which included among them a virtual ban on the issue we are talking about, which is retroactive interest rate increases on existing balances. We can question the exact amount of time we left for them to restructure their business plans and so on, but that was the intention. And I note that Congress is also putting delays into their proposed credit programs.

I am very concerned——

Vice Chair Schumer. Excuse me, but the Congressional delays are not close to as long as yours.

Chairman Bernanke. Let me come back to that.

I am very concerned, as you are, about the reports that you are hearing about increases in rates, on retroactive ones, particularly when they are not associated with some credit event, some action taken by the consumer. And we are, I assure you, looking carefully into that to try to understand how extensive it is and how important it is.

Now we have here a quandary, though, which is the following: We could move up the date on which this prohibition is effective. One question that I think we need to think through is would that be good for consumers?

If we moved up the date, the obvious response of the companies would be first to raise the rate preemptively, so that would happen faster. And secondly—because I do believe they do need some time to think through how to restructure their business model so they can put out credit to riskier consumers in a way that they find profitable—I think that their short-term response would be just to cut a lot of people off.

So from the perspective of consumers, my real quandary is how can we best help consumers in a way that doesn't just create worse problems in the market? And that is the issue that I am still grappling with.

Vice Chair Schumer. My time is up, but I think you could figure out a better way than the one you have chosen.

[Press release titled "Schumer Demands Answers From Bernanke at Hearing After Fed Rejects Push to Freeze Rates on Existing Credit Card Balances" appears in the Submissions for the Record on page 50.]

Chair Maloney. Okay, Representative Campbell.

Representative Campbell. Thank you, Madam Chairwoman, and Mr. Chairman.

If you determine in the stress test that will be released later this week that a bank needs additional capital, and if its plan that you describe in your opening statement is either determined not to be workable or in that six-month period a bank is unable to execute their plan, unable to raise the capital they thought from the sources they thought, what then?

Chairman Bernanke. Then they would have to avail themselves of the Treasury's backstop, terms and conditions have been put on the Treasury's web site, a so-called Mandatory Convertible Preferred type of equity, which is initially preferred equity but can be converted to common as needed to meet common ratios.

Representative Campbell. So they would be required to get that additional capital through that venue if they were unable to raise it from——

Chairman Bernanke. Yes. This is a supervisory exercise, and supervisors have the right to require that banks meet certain capital standards. If the banks cannot meet those standards in the private market, which is our strong preference, then they have to take government capital to meet those standards.

Representative Campbell. Okay. You are doing a stress test on the 19 largest banks. What about banks 20 through 50, or 20 through 60, or whatever?

Chairman Bernanke. It is not our intention to do stress tests on additional banks. Those banks, however, will have access, as I understand it—and of course I have to defer to the Treasury on all details—but my understanding is that those banks will have access to all the same capital programs that are available to the top 19.

Representative Campbell. So it will not necessarily be a case where bank 22 would fail under a scenario where bank 18 would not, because it would have access to——

Chairman Bernanke. I do not know all the details of the Treasury's plan. And of course there are issues related to the smallest banks which are not publicly traded, and so on, which we already saw with the Capital Purchase Program, the first round of capital. But the intention of the Treasury, as I understand it, is to make capital available to all banks.

Representative Campbell. Okay. I want to switch to talking about the program under which the Federal Reserve is buying Treasury Bills now, which I believe is $300 billion. I don't know how much you have bought so far, or what is going on, but I wanted to ask you about that program which I think is akin to a company buying back its own stock.

You talked about the interest rates on longer term. Is that your plan? Is that your objective, to try and keep the longer term Treasury Bill interest rates down? How would you get out of this program?

I do not think it has been done since the 1960s, I believe, so can you talk a little bit about that?

Chairman Bernanke. No, the Federal Reserve and other Central Banks regularly buy and sell government debt in open market operations, and we have been doing that for many years.

We announced a plan to purchase $300 billion in order to try to provide broader liquidity and to help private credit markets. That is our objective. And we think it has been beneficial because we have seen improvements in mortgage markets and corporate bond markets and so on.

We are not trying to target a particular interest rate. Again, our objective is to provide more liquidity to the system and to help private credit markets. And I think that it has had some benefit.

Representative Campbell. It is not something, though, you have done to this kind of degree for a long time, correct?

Chairman Bernanke. That's true. But again, we routinely transact in Treasuries. That is our primary asset that we buy and sell. And we have added to that of course GSE securities, as well.

Representative Campbell. Is this something you would expect to continue at a larger volume as was mentioned by some of my colleagues here, as the government sells more and more debt, as the deficits increase?

Chairman Bernanke. Well again, our objectives have nothing to do with the government's debt, per se. Our objectives have to do with strengthening private credit markets, and those decisions will have to be made by the FOMC as we look at the state of the economy and try to judge the efficacy of the various steps that we have taken.

Representative Campbell. Okay. A quick question about AIG in my remaining moments. I believe a few months ago there was about $1.6 trillion of assets left in the Financial Products Division, which were trying to be wound down. Are you aware of, or can you report on the process of winding that down?

Chairman Bernanke. I don't have precise numbers for you, but we understand that it is imperative to wind that Financial Products Division down as quickly as possible, and we have looked into a number of alternatives including using outside consultants and so on to wind that down as quickly as we can.

Representative Campbell. Is AIG going to need more capital from the government because of losses on that portfolio?

Chairman Bernanke. I do not know. They have not yet, as far as I understand they have not yet taken up the $30 billion backstop line that the U.S. Treasury provided in March.

Representative Campbell. Okay, and the final question: In September–October we, many of us—I believe you and I—believe that we were near, I will use the term, collapse of the financial system. Have we dodged that bullet? Are we past that? Or is there a scenario under which that fear and panic could return?

Chairman Bernanke. Well one can never predict anything with certainty, but I think we are in far better shape today than we were in September and October. And while I know there are many critics of the TARP, and I understand the criticisms, and there are many issues, I do believe the availability of that capital helped us dodge what would have been a truly cataclysmic collapse of the global banking system, which would have had terrifically bad effects on the U.S. economy.

So it was very important at that time. I think we have made a lot of progress. The financial markets are still fragile. We do not want to take anything for granted, but we have I think come a long way since last fall.

Representative Campbell. Thank you, Mr. Chairman.

Chair Maloney. Representative Sanchez.

Representative Sanchez. Thank you, Madam Chair, and thank you Chairman Bernanke for being before us again today.

My questions are intertwined. I was one of those that did not vote for the TARP for all, the reasons that we have seen come to bear, but I did vote for the stimulus package. A lot of us took a deep breath as we voted for $800 billion to be put into the market so that people would keep their jobs and maybe we would create some new jobs.

Then we passed the fiscal year 2009 Omnibus bill which was an increase over the previous year's spending. President Obama's new budget that has come to the Congress has been criticized for being such a large number. Part of it of course was that we put the true war spending into it which increased it, but the Congress has been looked at like we are spending a lot of money.

But when I turn around and I look at what the Treasury and what the Fed has been doing with policy, with I think the 28 programs between the two of you, many of them under your jurisdiction, I count almost about $3 trillion worth of money hanging out there being moved around, et cetera.

Some of that I think is sitting in banks as reserves maybe against a commercial real estate problem that I want to ask you about, too, but a lot of these banks have been sitting on money and the criticism has been that money is not getting out, and the small and medium-sized businesses are having that credit crunch.

But if that money comes flooding out, we have the problem of possible inflation shooting up. So there is a lot of money out there, much of it put out—and I understand why—by you in trying to manage the situation.

I guess my question comes back to what was alluded to by two or three of the Members who have already asked questions. How do we manage that investment? How do we rein that in? How do we make sure that the banks do not all of a sudden open up the lending spout, which we have all wanted to happen, and yet at the same time avoid it having an inflationary impact?

I think it is important for Americans to try to understand this large chunk of money, or monetary policy out there that is creating possibly even more money than the Congress appropriated.

Chairman Bernanke. Thank you for the question. I would first like to draw a very strong distinction between the fiscal spending and the Fed's lending programs.

Our lending programs are just that. They are lending programs. And they are, with the exception of some of the things involved with AIG and that kind of thing—which is less than 5 percent of our balance sheet—the whole bulk of all those programs are very safe. They will be repaid, with interest. We are making money for the Treasury.

Representative Sanchez. I am not worried about that repayment, per se.

Chairman Bernanke. Okay, so——

Representative Sanchez. I am more worried about——

Chairman Bernanke. There is a difference between spending money and then lending it out and getting it back with interest.

Representative Sanchez. Right. But if it all floods at the same time——

Chairman Bernanke. That is the question Mr. Campbell asked me about, I believe, which is how do we make sure that the monetary base contracts at an appropriate time to make sure that there is no inflation after the recovery begins.

And as I indicated, we have a whole set of tools that we will use. Those include winding down short-term lending programs, which happen automatically to some extent and which we can do any time we choose; none of them is longer than three months in duration.

Secondly, we do have this very important power of being able to pay interest on reserves. If we want to raise the Federal Funds Rate to say 2 percent, just to make up an example, and we pay 2 percent on Reserves to banks, why would they lend it out at less than 2 percent? So that would allow us basically to raise interest rates to 2 percent.

Beyond that, we have a whole set of other tools that we can use. And I just want to assure the American people that we are very focused—like a laser beam, if I may—on this issue of the exit and making sure that we have price stability in the medium term. We are working very hard to make sure that, while on the one hand it is very important for us to provide a lot of support for this economy right now because it needs support, at the same time we understand the necessity of winding this down in an orderly way at the appropriate moment so that we will not have inflation problems on the other side.

It was also mentioned that *The New York Times* had one article about inflation and one about deflation. There are risks on both sides and we are trying to manage this as well as we can.

Representative Sanchez. The commercial real estate market, have you been watching that? And do you see the same impact as we did in residential real estate? And I will end with that. Thank you, Madam Chairwoman.

Chairman Bernanke. I don't think the commercial real estate market got as out of line in terms of prices and so on as the housing market did, but it is currently weakening. As I mentioned in my testimony, rents are down. Vacancies are up. And a lot of commercial real estate owners are having difficulty refinancing their debt, or obtaining new financing for new projects.

In particular, one of the main sources of commercial real estate financing is the CMBS, Commercial Mortgage Backed Securities Market, where lenders can securitize those loans into the secondary market.

So among those programs which you mentioned, the Fed is trying to get the financial system working again. And we have included just now Commercial Mortgage Backed Securities in our so-called TALF Program, which we hope will get investors interested back into this market and get it going again.

I think that is very important to address the fact that there is a large amount of CRE refinancing coming due in the next year or two, and we need to have that market functioning so that that can happen smoothly.

So there is a problem there, both from the bank's perspective and from the economy's perspective, and we are doing what we can to try to address it.

Representative Sanchez. Thank you, Madam Chairwoman.

Chair Maloney. Representative Paul.

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

I have a couple of questions, but first I want to mention that I find it awfully frustrating at times when we always talk about inflation and we only talk about prices. We have prices under control, and there is no inflation.

We have to realize that the monetary base, the liquidity, was doubled in a few short months. To me there is a lot of inflation out there. It is already inflated. We are in the midst of inflation. Because the prices have not gone up does not mean we do not have the distortion.

It was that system that gave us the financial bubble: the artificially low interest rates, the malinvestment, and all the mistakes made. And now we are trying to correct all that by doing the very same thing.

So I think some day we are going to have to address this somewhat differently, because I am not very optimistic that we can solve our problems with more spending and more borrowing and more inflation in order to solve those problems.

But you answered this question several times and I want to bring it up again, and that has to do with when will some of this liquidity be drained?

I do not think the answer you have given is very specific, and I do not expect that I will get a more specific answer, but I am going to try. What if we have a situation where prices are—which is not the best measure of inflation—but let us say the Consumer Price Index and the PPI is going up 8 to 10 percent, and there is no economic growth. Where are you then? Because that is not impossible. It has happened. It has happened in our history; it happens throughout the world; it is a common thing. It has put you between a rock and a hard place. If you drain, interest rates go up and the economy further crashes; if you don't, you have the explosion.

Can you give me an idea what you precisely would do if you faced the situation where prices were going up 10 percent with no economic growth?

Chairman Bernanke. Well, I think that is an unlikely scenario, but we certainly would have to take steps to ensure price stability. If inflation gets out of control, we know that has very adverse effects on the economy both in the medium and long term, and so we would obviously have to address that.

Representative Paul. Which means you would have to raise interest rates.

Chairman Bernanke. That's exactly the same problem that is always faced by monetary policy—which is, in a recovery when the economy is starting to grow but has not yet gotten very far, perhaps, and unemployment is still above where you would like it to be—you have to take away the punch bowl, as someone once said, in order to avoid the inflation risk.

Representative Paul. See, I see this as the real problem. Because we practice economic planning through manipulation of money and credit. Socialism always fails because they don't have a pricing structure.

Interventionism and inflationism fail because we don't have a free market pricing system of money, the—interest rates. Therefore it fails. It comes to a conclusion. And inevitably it leads to a more socialized economy.

Just witness what we are talking about: taking over companies; taking over insurance companies; taking over banks. This has been the prediction of the free market economists, and yet we continue down this path of socializing our entire economy.

But I do want to address one other subject that has to do with transparency. You said you have made a commitment to transparency and openness, which is very good; there's a lot of us that want that, and I have dealt with that and have legislation, HR 1207, dealing with that. But in a real sense, I know what you are doing here, but, you know, the Code really protects you from telling us some of the things we would like to know.

For instance, in 1978 when the GAO was given the authority to audit the Fed, it put exclusions in there, but you can't ask these questions. Precisely, if I wanted to know about all your agreements and discussions with foreign central banks, with foreign governments, with international financial organizations, you have no obligation, and you haven't volunteered to do this, so is there a way that you would—since you are moving in this direction—move and consider supporting a position where Congress has the right to know these very, very crucial, vital issues dealing with their money?

I mean, everything you do deals with their value of their money. Would you ever be open to repeal of some of those provisions?

Chairman Bernanke. Yes, I would.

Now let me be specific. We have many programs where we lend money. We take collateral, and we are repaid. I just want to assure you, first of all, that we have very substantial oversight and controls.

We have, besides internal divisions which monitor these programs, we have an independent IG, and we have an external auditing company, a private company, which provides audits every year and has given us a clean bill of health on all our financial controls, all the level of Sarbanes–Oxley requirements.

That being said, if Congress needs more information about the operations that we are doing, exactly how we manage our collateral, how we manage our lending, those sorts of things, I think we can talk to you about providing more information about that. And, if necessary, working with the GAO.

Where I would be very careful and would like to be very clear, there has been some discussion of the GAO, quote, "auditing monetary policy." I don't know what that means, but I certainly would resist any attempt to dictate to the Federal Reserve how to make monetary policy.

It is the independence of monetary policy which is crucial to the maintenance of price stability and economic growth in this country. And interference would not be acceptable. But if it is an issue of making sure that we are appropriately managing our systems and doing what we say we are doing in terms of our lending, we want to be open. We want you to understand that we are taking every precaution to protect the Taxpayer.

Representative Paul. Of course it's the policy that's the only thing that really counts.

Chair Maloney. The gentleman's time has expired.

Congressman Snyder.

Representative Snyder. Thank you, Madam Chair. Welcome, Mr. Chairman.

When Senator Schumer brought up his issues about credit cards, there are probably not too many advantages of the mail stacking up at home when we are up here this week for a week at a time, but a couple of weeks ago I went home and I had one of these announcements from my bank that my credit card percentage was going up, but delightfully what also arrived a day or two later was from the same bank, because of my high credit score, an opportunity to get a credit card, which I thought was kind of an indication of where these banks were at. But it does not mean anything except that it enabled me to go down with righteous indignation to my bank.

Mr. Chairman, in your written statement you say the following, quote: "The steep drop in U.S. exports that began last fall has been a significant drag on domestic production and any improvement on that front would be helpful."

I know it is not in your lane of activity, but some of us, particularly from agricultural states, just do not understand why the new Administration has not changed the restrictions on agricultural sales financing to Cuba.

I mean, it is now legal to sell agricultural products to Cuba. If there was a modernization of the financing transaction rules which the Bush Administration put in, it would be several hundred billions—millions a year to American exporters, which I think is your goal to be helpful right now and a good signal on trade.

I wanted to ask you, you had mentioned several times in the discussion about institutions that are too big to fail, they are only too big to fail if they cannot be in their failure an orderly—in an orderly fashion taken care of. And you referred to your suggestions for a Resolution regime.

Have you put out something written? I was with a group of folks that met with you some weeks ago when we thought you were going to forward to us some written proposal. Is there a written proposal that you have put out?

Chairman Bernanke. There is proposed legislation, yes.

Representative Snyder. Proposed legislation that you have put out, from you? Is there something you have put out?

Chairman Bernanke. Yes.

Representative Snyder. The Chairwoman has made mention of it.

Chairman Bernanke. Yes. And the Treasury also has put out proposals that are very similar.

Representative Snyder. I suspect you saw this. As I was looking through last night your impressive bio, I saw the April 27th Business Week. It says: What good are economists anyway? And then the answer came out, was brought home in morning's *Washington Post* in which it talks about the Fed's $1.17 trillion and what they referred to as unprecedented intervention.

Continue the discussion you had with Representative Paul. If you were sitting on this side, looking at you—because none of us up here understand your business. I mean, that's the answer to "what good are economists, anyway?" I can't talk about economists in general, but we have put tremendous value on you and on your skills.

Should we be concerned about this dramatic increase that has occurred as part of what you refer to as helping us avoid a, quote, truly cataclysmic collapse? Should we be concerned that one person has that kind of power?

Chairman Bernanke. Well you certainly should take a strong interest in it, and I certainly don't blame you for that. After this testimony I am going to lunch to meet with a group of Senators to go through our balance sheet and our programs and try to answer all their questions. So we owe it to you to make sure you understand what we are doing and why we are doing it and what the results are.

But our sense is that this is an unusual, extraordinary time. We have used powers we have not invoked since the 1930s. We have done that because we thought it was necessary to help protect the U.S. economy in a time of extraordinary financial crisis. We have done so in a responsible way using powers that the Congress gave us in the pursuit of the Congressional mandate for full employment and price stability.

I am happy to meet with you individually and go through with you every program, and talk to you about what the purposes are. I fully understand your interest, and you should be interested, and I am more than happy to make myself available to help you understand what we are doing and if you have concerns to try to address them.

Representative Snyder. I went on your web site this morning and just looked over one of the descriptions of one of the agreements you have with a financial institution.

It seems like you apparently have an executive pay provision with all, or most of these deals? Is that correct? At least the ones that I looked at did, said it had to be approved by, apparently by you.

My question is: As you have heard these debates over the last several months about executive pay—and I have voted against several of these in the House—do you have any concerns that, as our populous spirit takes over in terms of sending a signal we don't like some of these bonuses, that in fact we may be driving some of these institutions from participating in a process which in your words we are trying to avoid the truly cataclysmic collapse?

Chairman Bernanke. I don't think the American People object to high pay, per se. I think they object to high pay which is not tied to performance.

Representative Snyder. Right.

Chairman Bernanke. So that is the question. And I think that is the concern people have about some of the pay that has been given out on Wall Street recently, obviously given the many failures that we have seen there.

My perspective, and I think the perspective of the financial regulatory community towards executive compensation is that it should be structured in such a way first that it ties closely remuneration to actual, measurable performance, number one; and secondly, that it is not structured in a way that induces unnecessary or excessive risk-taking.

So we are working in the Federal Reserve on supervisory guidance, or other types of rules, that will tell banks to structure their compensation not just at the very top level but down much further in a way that is consistent with safety and soundness. Which means that payments, bonuses and so on, should be tied to performance and should not induce excessive risk. I think that is the important thing.

Now, of course, we are required by Congress to follow through on certain executive compensation restrictions for 13.3 recipients and for TARP recipients, and we obey those rules. But my philosophy on this is that we should think about the structure of compensation and make sure that it is achieving its appropriate objective.

Representative Snyder. All right, thank you, Mr. Chairman. Thank you, Madam Chair.

Chair Maloney. Thank you, Mr. Snyder. Congressman Burgess.

Representative Burgess. Thank you, Madam Chair.

Thank you, Chairman, for being here with us this morning. In your testimony—and I apologize for being late—"As economic activity weakened during the second half of 2008, prices of energy and other commodities began to fall rapidly, inflationary pressures diminished appreciably."

If indeed the green-shoot theory is correct and we are beginning to emerge into a period of recovery, what do you see as the effect of rising prices during that recovery?

Chairman Bernanke. Well, if——

Representative Burgess. What do we do when prices begin to rise?

Chairman Bernanke. If our forecast is correct, then we will start to see some economic growth, but it will be slow at first and there will still be a lot of unemployment and slack in the economy. We don't expect, therefore, commodity prices to rise very much and we don't expect to see much inflation.

So our forecast, despite the green shoots theory, is still for inflation to be quite contained for the next couple of years.

Representative Burgess. Well you referenced yesterday's *New York Times*, and I wasn't going to bring it up, but since you did——

Chairman Bernanke. Someone on the panel did.

Representative Burgess [continuing]. Let's look at a couple of the things that were talked about. I mean, you made the point I think to Representative Snyder, or maybe it was Representative Paul, that independence—that it is critical to have the independence of the monetary policy, but the question was raised in *The New York Times* yesterday, not doubting the knowledge or technical ability of the Federal Reserve, the writer doubted the commitment of the Administration and the autonomy of the Federal Reserve, thinking that the Fed has sacrificed its independence to become the monetary arm of the Treasury.

And then further quoting from the article by Alan Meltzer: Independent Central Banks do not do what this Fed has done. They leave such fiscal actions to the Legislative Branch—that would be us—they leave such fiscal actions to the Legislative Branch. By that same token—well, let me move on. The Central Bank was made independent, expressly so. It could refuse to finance deficits. Is there a political consensus that the much larger Obama deficits will not pressure the Fed to expand reserves to buy Treasury Bonds?

How would you respond to Alan's writing?

Chairman Bernanke. Well, I will recap a few points I made earlier, which is that I think close cooperation of the authorities, the Fed and the Treasury in particular, in a situation of extreme financial crisis and risk to the system is necessary, and that the American People would want to see their government working collaboratively to try to solve those problems.

And so we have done that both with the previous Administration and with this Administration. So there is no political aspect to it.

That being said, we understand there are important lines of distinction between what the Fed does and what the Treasury does, and the Treasury understands that as well. We issued recently a joint statement which tried to delineate those lines.

And in particular one of the key principles is that nothing that we do to support the financial markets or work with the Treasury must in any way compromise the independence of monetary policy, which is the critical element and which is what is going to allow us to make sure we have price stability and will allow us not to monetize deficits but only to take policy actions needed to achieve sustainable employment and price stability, which is our objective.

Representative Burgess. Well the—and I think Representative Snyder brought up the point from the article this morning. And then that separation of fiscal policy and monetary policy, when he says "Who Needs Economists?" Well, we do because we don't understand that distinction. But it does seem as if we are getting to a point where the Fed is monetizing the debt.

Let me just move on to another aspect. It came out earlier, and I think you just reaffirmed that there was activity last fall, that in your opinion was necessary. In the interest of full disclosure, I voted against that both times.

I also voted against the stimulus package in February. Now I had a lot of people back home ask me—they didn't think it was right what we did in October, but if you want to stipulate that that was necessary because of an unprecedented occurrence in our credit markets, why was it not necessary to give that time to work before then adding a like amount of money to that in the stimulus package?

Was there a disconnect on the part of Congress with reality? Were we just spending money to spend money at that point?

Chairman Bernanke. Well those two packages have very different purposes. I think to achieve the successful recovery we have to do two things. One is to get the economy going again. I am not going to get into the details of the fiscal policy, and I am sure people can differ on various aspects of it, but the objective of the fiscal policy was to get economic activity and jobs going again.

The purpose of the Stabilization Act last fall that you mentioned was specifically to stabilize the financial system, which is the other critical element of recovery. So they had very different purposes and different structures.

Again, the program from last fall is made up of asset purchases and loans, and I think a very substantial part of that will be recovered, perhaps even all of it. So they are very different programs with different objectives.

Chair Maloney. The gentleman's time has expired.

Congressman Hinchey is recognized for five minutes.

Representative Hinchey. Thank you, Madam Chairman, and thank you, Chairman Bernanke for your statement today and the very firm answers to the questions that you've received.

I would like to just emphasize something that Senator Schumer said about the interest rates on credit cards and what a big problem that is causing and increasing for low- and middle-income working Americans.

The credit card interest rates are going up for a lot of people in the range of 30 percent and higher, and in come cases even 41 percent. But I would like to emphasize in that context that we have introduced legislation here, myself and others, in the House and in the Senate which would put a cap on interest rates on credit cards. I think that is something that is very important.

If you would like to comment on that, I would appreciate it. The main problem that we are facing I think in this economy is the downturn in the gross domestic product. Just from the recent information we have, the GDP has gone down 6.1 percent in the first quarter of this year and 6.3 percent in the last three months of last year. And one of the reasons for that is because the GDP is driven by low- and middle-income working Americans, more than 70 percent of it driven by working Americans and whether they spend and how they spend, but what we have seen is employee wages in the private sector increase only two-tenths of one percent in the first quarter of this year. That is a record low. We have never seen anything like that before.

At the same time, household debt as a percentage of income is the highest it has been since the 1930s.

This is just another way in which the economic conditions we are facing now are so similar to the conditions of that Depression back then in the 1930s.

One of the things that we did with the stimulus bill, in addition to putting money back into this economy to generate jobs and to address the needs that have been so neglected for decades, one of the other things that we did in that so-called stimulus bill, that investment program, was to provide tax relief for 95 percent of Americans by a $400 rebate in the context of that stimulus bill. And also an adjustment in the Alternative Minimum Tax.

I wonder if you have any thoughts about what the Federal Reserve could be doing and what we should be doing here, in addition to this so-called stimulus bill that we have passed and which is now having significantly positive effects, which will increase over time. What else is it that we should be doing here in this Congress to invigorate this economy, rather?

Chairman Bernanke. Well there are a lot of things you might consider, but personally I think it would be very important for the Congress to focus on getting the financial system fixed. And there are two elements to that.

One is, as I have already mentioned, this resolution regime that we can find a way to address too-big-to-fail, to deal with companies that are, on the one hand, in danger of failing but are so large and interconnected that their failure would endanger the entire financial system in the economy.

And the second is closely related to that, which is part of the deal I think, is to look again at financial regulation to make sure that our financial system is better regulated and we can avoid problems like this in the future.

On fiscal policy, you have taken some strong actions, and they are just beginning to kick in. I am eager to see what effects they will have.

Representative Hinchey. Okay, well let me then ask you just one other question. One of the things that we are facing is the significance of the TARP bill, which was very questionable when it was presented by Secretary Paulson back when it came through.

Now we have SIGTARP, which is overseeing the way in which that TARP bill is being handled, which, I think is absolutely necessary because of the huge amount of money that is being pushed out there, instead of some of that money being put into the hands of working Americans, stimulating their economy, which would drive the gross domestic product up more effectively.

Nevertheless, this TARP Program is continuing. So I would wonder if you could answer one or more of these questions:

The requirements:

That we would require the Treasury to account for all taxpayer funds that are used in the TARP program;

To require recipients of funds under the Capital Assistance Program to report how they use those funds;

And require strong oversight, accountability, and conflict-of-interest provisions for the Public-Private Investment Program.

Chairman Bernanke. First, on the Treasury having to account for its use of funds, of course they should do that. They do provide detailed information on all the loans and investments that they make on their web site, as far as I understand it. If there are other things they should do, again they should be providing as much information as possible about how they are using the money to the American people.

I think in principle it is good to ask banks to account for how they use the money, but there are some problems in practice, which of course is that money is fungible. If I may use an analogy, if a taxpayer called you up and said I don't want my money being used for, say, defense, how would you say that all the money goes into one big pot. It is kind of hard to exactly explain to that person where their money is really going in some sense.

The purpose of the TARP money is to create capital which is then supporting other activities, lending and other activities.

On oversight and conflict-of-interest, I could hardly disagree with you on that. Clearly, we want to make sure there is no fraud or other problems related to any of these programs.

I would mention that the Federal Reserve has had a lot of contact with SIGTARP over the TALF, which uses TARP capital, and we are working hard to make sure that they are comfortable with all the safeguards that we are taking to avoid any such conflicts of interest or fraud.

Representative Hinchey. Thank you.

Chair Maloney. Thank you. The gentleman's time has expired. Senator Casey.

Senator Casey. Madam Chair, thank you very much for this hearing. And Chairman Bernanke, thank you for your testimony, your presence here, and your public service.

I wanted to focus on two areas. One is on jobs and the job picture, meaning the unemployment rate, and the data that we see and try to, as best we can, make sense of.

And then secondly, a question about the perception that the American People have as to where our economy is now and where it will go.

First with regard to the unemployment numbers, we have heard that more than 5 million jobs have been lost. The rate, as you know, nationally in February was 8.1, March 8.5, one projection in April of 8.9.

In Pennsylvania we have been behind, fortunately unlike in our past where we would run ahead of the national rate, thank goodness, but it is far too high. We have gone from a rate of 7.5 in February to 7.8 in March, and we do not yet know what April will bring. The March number in Pennsylvania translates into just a couple of hundred jobs under 500,000 unemployed. So even in a state where the rate seems relatively low, it is a huge number of people unemployed.

There have been a number of projections about the rate for 2009 and 2010. In fact, even for 2010 the blue chip number I guess is 9.4, and; the CBO projects at 9. I guess all of that is a predicate for—the question—where do you think the rate is going? Do you have a sense of where it could go in 2009 and 2010?

Maybe the simplest way to ask is: Will it go to 10 in 2010? What is your sense of that?

Chairman Bernanke. As I mentioned in my testimony, the loss of jobs and the deterioration of the labor market is one of the most distressing aspects of this whole episode. We have already seen about 5 million jobs lost.

The forecast we have is for the economy in terms of growth to begin to turn up later this year, but initially not to grow at the rate of potential. Which means that unemployment and resource slack will continue to rise into 2010.

We think that the unemployment rate will probably peak early in 2010 and then come down relatively slowly after that. Currently we do not think it is going to get to 10 percent. We are somewhere in the 9s, but clearly that is way too high.

The issue of re-employment is complicated by the fact that part of what is happening, besides having the recession, of course, is that our economy is adjusting to the changes in sectoral composition. We are going to have fewer investment bankers and fewer construction workers probably in the future because those sectors got very large, and those people will find work in new areas.

So there is going to be some reallocation of labor among different sectors, which is going to affect the rate of re-employment, as well.

I would just make the comment that several people have expressed concern about inflation. It is very hard for serious inflation to take off when you have this kind of slack in the economy. Rep. Hinchey mentioned wages. Wages are growing even more slowly, which is also not suggestive of inflation certainly.

So it is these slack conditions projected for a period which has allowed us, or I think required us, to take the aggressive approach that we have to try to get this economy moving again. But I agree with you—it is a serious problem. And even when the economy begins to grow, it will take awhile for unemployment to come back to an acceptable level.

Senator Casey. And I guess that assessment—a lot of your testimony this morning—is consistent with what I have heard in Pennsylvania, sometimes directly from employers, but also people who interact with employers.

For example, on page 4 you say, in the middle of the second full paragraph, "We expect that the recovery will only gradually gain momentum and that economic slack will diminish slowly."

In other words, it will not be a spike, nor a turning point that will lead to a dramatic change. That seems very consistent. And also the caveat that you note on page 4, where recovery assumes the continuing gradual repair of the financial system.

I guess all of it—and I know I am just about out of time—provides a backdrop for a question—the American People, whether they are stressed immediately with the loss of a job or a house, or whether they are simply observing and nervous and concerned about the future—they have been hit with a torrent, or an avalanche, of data. I guess in light of all that data, yes, we see signs of recovery, maybe just flickers here and there. However, the job numbers and the unemployment rate lag, so what do you tell people?

In other words, do you say don't get too focused on the unemployment rate, that that will not tell the whole picture? Or what else do you say to people who are looking for signs of hope but do not want to be overly optimistic when the signs of hope are juxtaposed with high unemployment numbers? I mean, I know it is a tough question to answer in terms of advice or guidance for people.

Chairman Bernanke. I have two very different comments. One has to do with the nature of our labor market, which is extraordinarily dynamic. So when you see 1000 jobs lost in an area, it could well be the result of 4000 being created and 5000 being terminated.

So even in a period like this, there are many, many new jobs being created in new industries, new businesses, and so on. So there are opportunities for people, and particularly during periods like this you sometimes see remarkable innovations in business models and technology and so on.

So it is not the case that there are no opportunities. There are opportunities.

The second thing I would say is that Americans are very good at being adaptable. We have in particular, for example, a very diverse educational system that includes not just K–12 and college, but also junior colleges, community colleges, technical schools, adult education, apprenticeship programs, all kinds of things. So there are lots of opportunities for people to retool as necessary if they think their job is not coming back in that particular area.

So building that human capital is something that people should do and can do, knowing that if they have the skills they will find opportunities.

Senator Casey. I am out of time. Thank you, very much.

Chair Maloney. The Chairman has indicated he has to leave at 12:00, so we have time for a few additional questions for another round.

First of all I want to publicly acknowledge and thank you for your leadership in coming forward with rules to crack down on abusive, unfair, deceptive, anti-competitive practices by the credit card industry.

This was an area I had been working on for years. I had a bill that cracked down on the most abusive practices, like retroactive interest rate increases. Going forward, this bill will give notice so consumers can get out of abusive credit cards and go to another card, putting competition in the system. It was not until you came out with similar rules, that greatly reflected the bill that I had authored, that the momentum gathered in Congress to pass it last year. The rule change you put in place in December gave us the additional momentum to pass a very strong bill last week.

Originally I had an enforcement 30 days after passage. It went to the committee and the committee voted to keep with the July 2010 date of the Federal Reserve. That can be changed in the Senate. We did accept an amendment of mine to put into effect immediately, or within 30 days after the rules are put into effect. The 45-day notice allows consumers to move to another card and get out of an abusive system that is unfairly jacking the interest rate.

But I truly believe that you played a very brave and important role in helping this adjustment in our economy. It was a very, very difficult bill to pass, and your leadership is greatly appreciated by me, and I am sure the consumers in our country.

I want to talk to you about one of the options for banks to convert the TARP shares into common equity, boosting government ownership in those companies. How much influence will the government seek in the day-to-day operations of such decisions as credit allocation management, the governance, board seats, mergers, acquisitions, asset sales? Do you see government being dominant, or passive, in this transformation?

Chairman Bernanke. First, it is obviously not our intention or desire to have long-term government ownership of banks. That is not desirable. It is not efficient. It is not good for the economy.

So the top priority will be to get banks on a path where they can pay back and get out of the situation where they are partially owned by the government. So whatever actions are needed to achieve that, the supervisors, with the support of the Treasury, will work with the banks to raise capital, to sell assets, to do whatever they need to do. So that is the top priority.

In that respect, it is not a hands-off policy because we want to make sure they are taking the steps necessary to emerge from this situation.

In terms of day-to-day management, I think the Treasury may well want to set broad policies, for example, on lobbying, dividend payments, or things of that sort, which is appropriate. But it is not really a good idea for the government to try to manage day-to-day business decisions, and for that purpose we have to have management there that we think is effective and let them make those decisions.

So again the bottom line is, yes, we have to be active in the sense of making sure that banks are working towards strengthening themselves and have appropriate broad policies, but we certainly do not want to be involved in day-to-day operations.

Chair Maloney. How concerned should common stockholders be that the stress test results will require fresh capital infusions for some of the banks? It has been preliminarily reported that 10 banks will need cash infusions.

What impact is that going to have on stockholders? How concerned should they be?

Chairman Bernanke. Well I can't preview the results, which will come out on Thursday afternoon. Our hope is that this program will, on the one hand, provide a lot of information to the markets and will restore confidence in the banks. That is a very important part of this whole process, just letting people see what is on the banks' balance sheets. And that will be part of the healing process that will make these banks able to be more profitable and more effective in the future.

So I am hopeful that in the medium-term at least that both investors and borrowers will benefit from this.

Chair Maloney. Well the transparency definitely builds more confidence, and with confidence comes more capital. What additional steps do you see the Federal Government taking?

For example, if the IMF numbers are higher than the TARP money that we have and the access to capital, do you see any other initiative to raise government money, if it is so needed? What other steps do you see, if any? Let me say, you have definitely not been boring during this crisis. You have been incredibly innovative coming up with many other ideas of how to approach challenges.

So what's next, if we needed the help?

Chairman Bernanke. I look forward to a long period of boredom. [Laughter.]

Chair Maloney. I think the country would like a little boredom, too.

Chairman Bernanke. Yes, we all would.

On the bank situation, it should be very clear that the assessment is to make sure that banks have not just minimal capital but more than minimal capital; that they are strongly capitalized, and that they are strongly capitalized even if the economy gets worse than we currently think it will.

So our hope and expectation is that this will provide enough capital for the banks to be healthy and to provide the important support to the economy they need to provide. So I do not have at this moment any future plans I can share with you, or that I know.

Chair Maloney. My time has expired. Ranking Minority Member Senator Brownback.

Senator Brownback. Thanks, Chairman.

I get from my banks all the time that the regulators are on them way too much with the capital that they have—and I am talking here about these are local banks, regional banks really throughout the state. They really feel like that they are under the gun, and that it is harming the overall economy, what is taking place, particularly if they are involved in any sort of real estate investment, whether it is home loans or commercial properties, that they are being hammered.

They believe it is unfairly so, and they believe it is also very harmful on the economy of what's taking place. I know you have heard this from some other members, but I want to really drive this point, because what I have seen taking place in these downturns before is that the regulators, maybe they get overly blamed for it, but it certainly seems like they have a big impact on when the recovery happens by what they will allow on credit standards and by what the banks believe they will allow on credit standards.

And I think they are harming the length or the viability of the recovery right now from what I am hearing across the state from both bankers and from what I'm hearing from anybody associated with any real estate business.

I don't know if you have a response to that, but I would really hope you watch that very carefully, because I think it is going to hurt us from recovering strong.

Chairman Bernanke. Senator, I do have a response, which is that there is always this tension between making sure the banks are making safe and sound loans—because we do not want to have them lose money—versus making sure that credit is sufficient.

We just want to call your attention, the regulators put out a joint statement in November called "Lending To Credit Worthy Borrowers," which had a number of components, but the thrust was that it is very important for examiners when they are in the bank to, on the one hand, make sure that the loans are safe and sound and appropriately underwritten and so on, and on the other hand, that banks make loans to credit-worthy borrowers to maintain their customer relationships and so on. And excessive conservatism by the examiners can be destructive, as you comment.

So we issued that statement, and at least in the Federal Reserve we have made efforts through training programs and examination manuals and so on to try to communicate to our examiners in the field that we really need them to take that more balanced approach.

Now I hear from bankers exactly what you are saying, so I am sure we are not always successful, although in some cases maybe they are underestimating the risk of some of the things they want to do. But it clearly is an issue and we are very much attentive to it.

Senator Brownback. They are saying it is particularly harmful on commercial real estate, and that is the very weak part that you were noting in the economy now anyway. I don't know if everybody just didn't quite get the memo across the country or what the case is.

Another question that I get from a number of people is how do we get the private capital back out into the market and working?

It just seems like it has really been scared and it is on the sidelines, so that you are putting a lot of money into the system but there is not as much velocity that needs to take place with the money.

Do you see things that need to be done there? Or do you have questions about what it is going to take to get the private capital back working into the marketplace?

Chairman Bernanke. Well we, and the Treasury, and others have taken steps to try to get these markets going again, and I think we are seeing some fruits now, as I talked about in my testimony. We have seen some issuance of asset-backed securities, which was not there for a long time.

We are seeing a pretty healthy corporate bond market. We are expecting that with our Banking Assessment Program that we will see some equity coming into the banking sector. So clearly we are not normal yet, but we are seeing some improvement in terms of money coming off the sideline.

Senator Brownback. One of the things I get asked by a number of people is concern about foreign purchases of our debt, and that we are very dependent upon that particularly from the Chinese.

If that something that you are concerned about, about the level of U.S. Government debt being purchased by foreign borrowers, particularly by the Chinese, and whether or not they will back off from purchasing of our foreign debt at some time here in the near future?

Chairman Bernanke. Well I don't think there is any prospect of any big shift in the portfolio preferences of foreign investors. Right now the U.S. debt is very liquid, very safe, and there is a big demand for it, frankly.

In fact, during the crisis there were a lot of purchases of debt by foreigners because they thought that was the safest asset around. I do think there are two issues.

One is that the acquisition of U.S. debt by foreigners does affect our Current Account Deficit, which I have argued is part of the reason for this whole crisis, because all the money flowing in at relatively low interest rates stimulated a lot of lending, some of which did not turn out to work out so well. So that is part of the problem.

Then of course we have issues related to the fiscal outlook where we need to make sure that we keep the confidence of not just foreign investors but domestic investors as well by providing a fiscal plan for stabilizing our debt level going forward.

So I think we will be fine, but we do need to address both the Current Account and the Fiscal Deficits as part of our overall macro policies.

Senator Brownback. Thank you.

Chair Maloney. The gentleman's time has expired. The

Chair recognizes herself for 30 seconds.

Following up on the Ranking Member's question, what would happen if some of our foreign partners failed to buy our debt, as some have threatened? What would happen to our economy if we were not able to sell that debt?

Chairman Bernanke. Well it would cause interest rates to go up, for example. So it would have effects on our economy. But again, I do not foresee this as being a likely near-term situation because the demand for our debt remains strong, so long as people have confidence in the policies of the U.S. Government, and that is the key issue.

Chair Maloney. The Chair recognizes Mr. Cummings for five minutes.

Representative Cummings. Mr. Bernanke, Chairman, I have listened to you, every syllable, and I have sat here and listened very carefully, and I think about all of my constituents, many of whom have lost their savings, which they are never going to get back by the way, their homes, their health care, their jobs, and I am wondering what can you say to them?

Because, what is happening—I want to follow up on some of the things that Senator Casey said—people are feeling like everybody is running to the rescue of Wall Street with a fire engine and hoses and making sure that the fire is put out, but they see themselves being consumed by the fire and people saying, well, wait a minute, we'll take care of Wall Street and we'll get to you later on.

And we I think fully understand that there are certain things that have to be done so that we see the connection between making sure Wall Street is safe and sound, but at the same time those folks are looking at you right now saying—I mean, probably almost on the edge of their seats, saying: Tell me something so that I can continue to have some hope.

I mean, what do you have to say to them?

Chairman Bernanke. Well an analogy I have used before which your fire metaphor suggested is:

Suppose you have a neighbor who smokes in bed in the house next door and sets fire to his house. You could punish him by not calling the fire department, I suppose, but if your house is next door you are going to catch fire, too. So you are better off calling the fire department, putting out the fire, and then later on fixing the fire code to make sure it doesn't happen again.

That is what is happening with Wall Street. If Wall Street burns, it is going to—we have already seen the effect it has on the economy.

Representative Cummings. Yes. Well you are going right where I want you to go. [Laughter.]

Chairman Bernanke. Uh-oh. [Laughter.]

Representative Cummings. No. In other words, the American people want the—I mean many of them want the fire put out. But they are saying: Hey, we are on fire, too. What about us?

Are you following what I'm saying?

Chairman Bernanke. I do.

Representative Cummings. It is not that they—that is why I said we all understand that we have got to deal with Wall Street. But when it came to the issue like with what Mr. Schumer mentioned, the whole credit card issue and the Chairwoman mentioned, they are looking at these things and saying: Well, Mr. Chairman Bernanke, we see you racing over there, but, hey, hey, what about us?

Chairman Bernanke. Well on credit cards I think we could have a legitimate discussion about the right tactics. I raised some issues about the problems it might cause if we moved that interest rate rule up to the near term.

Representative Cummings. But I am talking about in general can we do more for them?

Chairman Bernanke. But in general, as you know—and Chair Maloney was just kind enough to mention it—we have taken very strong actions on credit cards. We have eliminated a lot of the worst practices and we hope to make a much better credit market going forward.

We have taken similar actions on mortgages, as well. So consumer protection is critically important. We are committed to it. It makes for better markets.

Problems in consumer protection are part of the reason we are in this mess in the first place—like in the subprime market, for example—and going forward we need to pay a lot of attention to that. So I am a hundred percent with you on that.

Representative Cummings. One of the things that you said, which I thoroughly agree with, is that there are some instances where jobs are being eliminated but jobs are being created.

There is a company in my District called Well Doc that I visited just about two weeks ago basically which has become very innovative by using cell phones to help people control their blood pressure medication regimen.

I mean, they are booming with contractual opportunities. And I am wondering, is there anything that you see that the Obama Administration might be able to do, or we may be able to do, to encourage innovation?

Because the President has often talked about innovation and how that would lead to more jobs, but it sounds like that is one of the things that we almost have to do. Because, like you said, we are losing jobs in some areas that will probably never come back, some of them.

So are you satisfied with all the things that the President is doing? And I think he is doing his very, very best, but I mean are you satisfied that he is using all the tools that he might have available, and do you suggest anything else?

Chairman Bernanke. Well I mean there are a number of ways to approach this, some of which are addressed. Education is obviously critical. We want to train more students with science and math capability. That's obviously very important. There are reviews and thinking about the patent laws and those sorts of things that make those more effective.

One issue that comes up—and I know is not a very popular one, but I'll raise it anyway—which is that I think our immigration laws discriminate pretty heavily against highly talented scientists and engineers who want to come to this country and be part of our technological establishment.

I think that if you allowed more people with high skills, high technical skills, to come here, you would keep companies here, you would have more innovation here, and you would have more growth here. Although I know that is controversial, I think that is something to think about.

An area which has been hurt somewhat by the financial crisis is venture capital. That is important. That is still operating, but I hope as the financial sector recovers we will see more venture capital money available for new startups and support technology.

So there are a lot of different things that Congress and the Administration can do. I know the President has addressed, certainly, some of these issues.

Representative Cummings. Thank you very much.

Chair Maloney. Mr. Brady, Congressman Brady.

Representative Brady. Thank you, Madam Chairman, thank you for holding this hearing.

You note in your testimony, there has been an impact from a decrease in export sales on the U.S. economy. There is I think a growing knowledge that it is no longer enough just to buy American; we have to sell American products and services throughout the world, and that is playing an increasingly important part of our economy.

Some of our U.S. companies can access those markets from here. Many find, to be competitive and to meet the consumer demand, they have to engage in other countries.

When they do, they discover that the U.S. is one of a very few nations that has a worldwide taxing system versus a territorial local taxing system, and so we have put in place over the years a number of elements to try to keep businesses competitive. For example, allowing them to deduct the foreign taxes that they pay in that country, or not taxing them until they repatriate, bring back those dollars or dividends here to the United States.

Yesterday, the President unveiled an international tax reform package that severely limits those deductions on double taxation, and would tax immediately much of that income. It is under the claim of closing corporate loopholes and tax evasion, all of which we support, but I believe there are significant unintended consequences to that type of effort.

There is a distinction between tax evasion and tax competitiveness. I don't want you to weigh in on tax policy. I have learned you are not going to anyway, but there are some I think who want to rush this legislation through. And given the embarrassment of the AIG bonus legislation and other examples where Congress has rushed to a judgment, given the complexity of the international tax code, given the competitiveness issues, is it important for Congress to thoroughly examine all of these international tax proposals, to make sure that we thoroughly understand what the impact could be, both on jobs here at home, and our ability to compete overseas?

Chairman Bernanke. Well, Congressman, it is hard to disagree that any complex bill should receive thorough consideration. The tax law is very complex, certainly, and I hope that the appropriate Committees will look at this very carefully.

Representative Brady. Do you see the way we tax internationally on a global system as a challenge, as we compete internationally?

Chairman Bernanke. As a general rule, I think we need to think about international competitiveness as we look at our corporate tax policies, but I don't have any comment on the specific proposals from yesterday.

As you say, I don't want to comment on tax policy, anyway, and I really haven't had a chance to review it, in any case.

Representative Brady. Well, I'm not asking you to but I'm just trying to get your advice on how Congress ought to look at a very complicated system, one that probably rivals our financial system in its complexity, but has huge impacts on our jobs here at home.

Thank you, Mr. Chairman, thank you, Madam Chairman.

Chairman Bernanke. Certainly.

Chair Maloney. Thank you. Congressman Snyder, for five minutes.

Representative Snyder. Thank you, Madam Chair. Mr. Chairman, thank you for staying close to the noon hour here.

I appreciate your comments, by the way, that you said earlier in response to a question about the fungibility of money. I think that just because a Special Inspector General makes a recommendation doesn't necessarily mean that it is the best way to go about ensuring the success of some of these institutions.

I would think that we would want all of their products to be doing well, not just the ones that they would say specifically to put TARP funds into it. And that is, I think, the bigger issue, because money is fungible.

I wanted to ask, so much of your activity has been with an eye to of course the international markets, there was some apprehension, perhaps not as great now, that protectionism may rear its head as we are going through this.

What is your view on what you are seeing or hearing from around the world?

Chairman Bernanke. Well, I am heartened by the international commitment to avoid protectionism. It was a big element of the G–20 meetings in London for example, and in the G–7 meetings and G–20 meetings we just had in Washington.

So it is very, very important to avoid protectionism. It is important, if possible, to make continued progress on the World Trade Organization talks, but it is going to be a concern because people are going to be looking for scapegoats, and sometimes imports are part of that.

So I think it is very important for all of us. We learn from history that if we start to block imports, others will do the same, and we will just all be poorer as a result. And so maintaining a free and flexible trade system is very important.

Representative Snyder. You have talked about the need for us to repair our financial system regulation, regulatory system. You are always very precise in your words, as anyone in your job would be, but you referred to—you called for the "gradual repair." Why do you use the words, "gradual repair" of the financial system?

Chairman Bernanke. That is referring to the healing taking place in markets and to our expectation that there won't be an overnight recovery; it is going to take time for markets to return to normal. We want to see, perhaps, that there will be restructuring of securitization instruments and so on; banks to rebuild their capital; investors to regain confidence, and so on.

So we expect it to take some time. We hope to see continued progress. If it is faster, that is great, but we expect it to be gradual.

Representative Snyder. So your expectation is that there would not be some grand golden tablets coming from on high that says this is the regulatory system for the future, let's all adopt it? It will be more improvements, legislation here, regulation there, more legislation as months and years go by?

Chairman Bernanke. My use of the word, "repair," was referring to the conditions in the markets, not so much the regulation, per se.

Representative Snyder. All right.

Chairman Bernanke. But I do think that good new regulation will be helpful, but it is so complex and there are so many issues to be decided, I don't expect that will happen in the next few months. I am sure it is going to take awhile for the Congress to come to a satisfactory agreement on this.

Representative Snyder. You, in response to another question earlier, you talked about your independence and who you get advice from or don't seek advice from.

There is no legal obstruction, is there, from you seeking advice from anyone that you want to? I mean, I would assume that you can pick up the paper and read Federal Reports, and hear what Secretary Geithner is thinking, and hear what financial ministers around the world are thinking. There are no restrictions on who you can pick up the phone and call and say what do you think about such and such?

Chairman Bernanke. I continually talk to people in Washington and around the world about how they see the economy and what their concerns are. Obviously, we want to learn as much as possible.

But I want to be very clear that we make the decision based on our own assessment, our own information, and without recourse or concern about political considerations.

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

Chair Maloney. Congressman Burgess.

Representative Burgess. Thank you, Mr. Chairman, for staying with us.

Just one follow up from a hearing we had a couple of weeks ago with Thomas Hoenig, the president of the Federal Reserve, who came in and testified and raised some important questions regarding banks that are Too Big to Fail. He highlighted the fact that some of the institutions that are Too Big to Fail are in fact now blocking our path to recovery, and yet we continue to try to pump funds in to try to turn them around.

In fact, at that hearing we discussed the need to allow the failure to occur to remove the blockage that is caused by these institutions.

We are going to have the results of the stress test revealed at some point, I presume, this week. Just the stress tests themselves have the potential to adversely affect the banks involved, and we all recognize that and recognize why you have been so careful with the release of that information. But providing an additional six months' time to recapitalize stressed institutions seems to ignore the points raised by the president of the Kansas Federal Reserve, President Hoenig, and potentially we are just moving this problem further down the road. What if six months is not enough time for them to recapitalize? Do we then just postpone having to deal with the problem of having these banks that need to fail still being propped up?

Chairman Bernanke. Again, the first recourse that they will have over the six months is private sector capital, and that is going to be an interesting test to see what they can do with the government capital as a backstop.

I do not disagree at all with President Hoenig's basic premise, which is that too-big-to-fail is a big problem, and that companies that fail should be allowed to go bankrupt. I agree with that in principle.

The problem is that, as I tried to explain, our current laws do not allow a safe and sound unwinding of one of these companies, which is something we have learned to our great regret and chagrin in this episode. I do not think we have the tools to do it today, or tomorrow, but I do think that going forward there are a number of steps we can take. Not just a resolution regime, but other things we can do to strengthen our system so that if a firm does fail, the system as a whole will still remain resilient.

So I agree one hundred percent, we have to solve this problem. I do not think that means that we can start letting firms fail tomorrow, but we have to take a number of important steps so that in the future, whenever you come to this kind of situation, there will be a safe and sound way to unwind a failing firm that does not bring down big parts of the financial system with it.

Representative Burgess. Let me ask you a question. The only experience that I can draw on is that that I endured back in the late 1980s in the State of Texas. We lost all the savings and loans overnight. Our oil prices collapsed overnight. Real estate prices followed them down. Loans were suddenly undercapitalized. Loans that our businesses had were undercapitalized and we either had to come up with a lot of capital or we failed. Families had to tighten belts and do without.

I just do not see that occurring to that degree currently. And I guess my question is: Contractions occur as a part of the normal course of an economy. And if we have a contraction in the economy that we do not allow to occur, like these banks that are Too Big to Fail that we are propping up, and we do not allow the contraction in the economy to occur, are we in fact setting ourselves up for buying more pain later down the road by not allowing the economy the opportunity to right itself?

It was very painful what we went through in Texas, and I would not minimize that. I would not wish that on anyone. But we got through it and we had 25 or 30 years of sustained economic growth in the area, and really we were about a year behind the rest of the country on the advent of this recession because of some of what the effect of the energy prices last summer were.

So just that as a general question to close us out.

Chairman Bernanke. Certainly. I understand your point very well, but there is a critical difference between the bank or savings and loans in Texas and a multi-national holding company, or insurance holding company today. Congress put together in 1991 the FIDICA Act, with prompt corrective action and other rules which allow the FDIC, or in the old days, the Savings & Loan Corporation, to come in and, in a well-designed way, seize the bank, pay off the depositors, sell the assets, and do that all in a way which is understood, orderly and does not create a broader crisis.

And of course I should say that the FDIC is only applied to relatively smaller firms in most case. The trouble is we do not have a comparable system for dealing with these very complex, large, multi-dimensional financial holding companies, and it is exactly that kind of system that I am asking for.

If we could get a system like that, then we can address the problem exactly the way you would like us to address it.

Representative Burgess. And again, as you point out, that is an enormously complex undertaking. I was a little taken aback in President Obama's speech a week ago when he said we would have that, he would sign that bill before the end of the year. To the best of my knowledge, no one is actually working on that yet. So that is one of those things like you told Congressman Brady, that requires an enormous amount of thought and careful evaluation throughout the process.

So I hope with some of the things we will do in this committee that we can shed some light on that process, as well. Thank you, Mr. Chairman.

Chair Maloney. Thank you. The gentleman's time has expired.

I would like to thank Chairman Bernanke for testifying today and giving us a stronger understanding of the economic outlook. The meeting is adjourned.

Chairman Bernanke. Thank you.

Chair Maloney. Thank you.

[Whereupon, at 12:08 p.m., Tuesday, May 5, 2009, the hearing was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF REPRESENTATIVE CAROLYN B. MALONEY, CHAIR

I want to welcome Dr. Ben Bernanke, the Chairman of the Federal Reserve, and thank you for your testimony here today.

I cannot think of a person better able to help us understand what is happening in the real economy and in the financial sector.

Our hearing today on the economic outlook is timely for many reasons. It is no secret that the real economy still faces substantial headwinds.

The recession that began in December 2007 has still not run its course. Real GDP contracted at a 6.1 percent annual rate in the first quarter of this year and it is widely expected that the BLS will report large monthly job losses again this Friday.

In testimony before this committee last week, Dr. Christina Romer, the Chair of the President's Council of Economic Advisers, said that she expects GDP to contract during the second quarter.

But there are some indications of potential improvement in the economy. Consumer confidence is up, and the decline in house prices has moderated slightly.

Nonetheless, the dismal GDP and job loss numbers underscore the wisdom of the American Recovery and Reinvestment Act (ARRA) that Congress passed and President Obama signed into law in his first 30 days in office.

The recovery measures are just starting to work their way into the economy, and will provide a much needed boost to demand. Without these measures the depth of the contraction would be much deeper, and the recovery would take far longer.

We will be very interested to hear the Federal Reserve's view about the near term prospects for economic growth and job creation.

Developments in the real economy are of course strongly affected by conditions in the financial sector.

The failure of major financial institutions and the disruption of credit markets has taken a toll on business and consumer confidence, and made it difficult for businesses and households to fund everyday economic activity.

The Federal Reserve—in collaboration with the Treasury and the FDIC—has taken an extraordinary series of measures to preserve financial stability and to restore the proper functioning of key credit markets.

These measures have prevented a financial crisis from becoming something far worse, and we are grateful for your leadership.

How far we have come in restoring normal functioning to the financial system, and what remains to be done are key questions.

We all understand that a successful recovery in the real economy requires healthy banks and credit markets.

Not surprisingly, we are all eagerly awaiting the final results of the "stress tests" on the nation's 19 biggest banks, which have been postponed until Thursday.

The diagnosis delivered by regulators will provide a road map for restoring confidence in these institutions. Determining the capital needs of our largest banks is a critical step toward restoring financial stability that I hope will bring us closer to turning the corner on this crisis.

Additionally, Chairman Bernanke, I am grateful for your leadership in ushering in new rules to prevent unfair or deceptive practices with respect to credit card accounts. The relevant agencies received a tremendous response of more than 66,000 comments on the rules, including written comments from tens of thousands of individual consumers.

These rules are very similar to the bill we passed in the House last year and last week. Your support for doing away with these deceptive practices has provided momentum that I hope will push the legislation through the Senate and on to the President's desk.

Lastly, I want to commend you for establishing greater transparency at the Fed. To be sure, there are fewer "secrets of the temple" today, but I know you will appreciate that we must continue to work to strike a better balance between institutional interests and the public's right to know how their money is being spent.

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 SENATOR SAM BROWNBACK, RANKING MINORITY

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

Our economy is in the midst of a serious recession and many Americans are suffering from job losses, home losses, and uncertainty about their retirement savings, their jobs, and their children's future. Unfortunately, in addition, our financial system remains a problem.

Just last week, we learned that the economy contracted at a 6.1% annualized rate in the first quarter, on the heels of a 6.3% rate of decline in the fourth quarter of last year. Since the beginning of the recession in December 2007, job losses have totaled 5.1 million, with 3.3 million of those losses having occurred in just the past five months. We are poised for the longest recession in the post-World War II period, and we are by no means out of the woods yet.

Given the severity of the economic downturn that we face, and efforts already under way to try to offset the downturn, I believe that the last things we want to do is raise taxes and add uncertainty to the economic and financial environments. Unfortunately, that is happening.

Taxes on small business will go up. Taxes on capital income will go up. Many Americans, including retirees living partly on dividend income, will see their taxes go up and values of their portfolios hurt. Under a cap-and-trade scheme to generate higher prices on anything produced using carbon, taxes will go up for everyone. And we are learning this week of the administration's plans to limit the ability of companies to defer tax payments on overseas earnings, which will limit the ability of U.S. companies to compete and will likely lead to job losses here in the U.S.

In addition to the prospect of higher taxes, many businesses are in a precautionary mode, fearful of expanding their operations once the economy recovers and fearful of adding jobs to their payrolls. Some of that fear comes because they are uncertain about what will be the cost of carbon under a cap-and-trade scheme and what will be the cost of providing health care benefits given the administration's intentions to move toward greater government control of the health-care system.

With the administration's budget outline, we are adding trillions of deficit-financed Federal government spending, which adds trillions to our Nation's debt. The Congressional Budget Office (CBO) estimates that in the first six months of this fiscal year, the Federal deficit is running at over $950 billion. For all of 2009, the Administration will likely need to borrow around $2 trillion. And debt held by the public is projected by the CBO to rise from 41 percent of the gross domestic product in 2008 to around 54 percent in 2011. These are staggering sums and staggering amounts as a share of our total economy; we have not seen such a run-up in deficits and debt since World War II. Eventually, of course, the debt has to be paid off, meaning higher taxes for our children and grandchildren.

I am concerned about overreach by the administration on expanding the size of government and setting up costly and most likely inefficient programs that will stay with us forever and be paid for by hard working Americans. I am concerned about years and years of trillion dollar deficits and a piling up of our debt, pushing us to a tipping point where our international creditors lose confidence in investing in the United States. I am concerned that we are moving from a housing bubble to a government-debt bubble. And, I am concerned that we do not have a concrete plan for addressing losses in the financial system and confronting and resolving the problem of "too big to fail."

Kansas City Fed President Hoenig testified before this committee that, in his words, too big to fail has failed. He has advocated that we stare losses in the financial system in the face and take decisive action on big financial institutions that are in trouble. In his view, we have the tools to resolve and break up large, overleveraged, insolvent banks and we should get to work using them. I am interested in your thoughts on Mr. Hoenig's perspective.

I am also concerned about increasing inter-linkages between the Federal Reserve and Treasury. I compliment you, Chairman Bernanke, for your creativity in helping to thaw frozen credit channels by creating a number of innovative lending and asset-purchase programs to help steer credit to where it is needed the most. However, I have a concern about the increasing alliance of the Fed and Treasury.

As examples, I note that: Treasury deposited around $500 billion into a "supplementary financing account" at the Fed; Treasury and the Fed have combined forces to set up the Term Asset-Backed Securities Loan Facility, or TALF, to "leverage" TARP funds through the Fed; and the Fed is now purchasing longer-term Treasury securities in attempts to bring long-term interest rates down.

My concern is that the increasing alliance between the fairly independent Federal Reserve and the Treasury risks the injection of politics into decisions about how credit is allocated by the Federal Reserve and risks political influence in money growth and inflation. Ultimately, such an alliance risks the independence of the Federal Reserve. And, historically, we have seen instances in which Fed and Treasury alliances did not work out well, such as the period beginning in World War II and until March 1951 when the Treasury compelled the Fed to essentially peg

Treasury security yields. That alliance required that the Fed and Treasury strike an "Accord" to strengthen the Fed's independence. It is essential that the Fed's lending and asset acquisitions respect the integrity and isolation of fiscal policy and minimize risks of political entanglements involving Fed credit allocations.

PREPARED STATEMENT OF REPRESENTATIVE KEVIN BRADY, SENIOR HOUSE REPUBLICAN

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

The bursting of the credit and housing bubbles has thrown the economy into a severe recession, destroyed millions of jobs, and wiped out the savings of many Americans. Government policy mistakes, excessive leverage, and weak underwriting standards by financial institutions contributed to the current downturn.

The recently released minutes of the March 17–18 Federal Open Market Committee (FOMC) indicate that the Fed staff has reduced its projections for economic growth for the second half of 2009 and for 2010. This underscores the fact that economic reality is inconsistent with the relatively optimistic economic projections the Administration used in its budget and that understate its true cost. Deficit spending and federal debt are out of control. When is the Congress going to acknowledge that current fiscal trends are unsustainable?

Last week, the *Financial Times* reported that the IMF now estimates that U.S. losses on toxic assets will be $1.9 trillion over the next five years. The recently adopted Congressional budget resolution ignored these costs entirely in setting budget policy for 2010. How expensive will the bank cleanup be, and will its costs be hidden from the taxpayers?

There is widespread agreement that a sustained economic recovery cannot occur without an effective bank cleanup in place. The Administration has put forth a financial rescue plan, but many of its components are very troubling. Serious problems with the Public-Private Investment Program (PPIP) were identified by Special Inspector General Neil Barofsky in testimony before this committee on April 23.

According to his quarterly report, "Many aspects of PPIP could make it inherently vulnerable to fraud, waste, and abuse." The vulnerabilities identified in his report include conflicts of interest, collusion, and money laundering. He also noted as problematic the enormous size of the program and the degree of leverage so "that the taxpayer risk is many times that of the private parties, thereby potentially skewing the economic incentives." Will the Treasury recognize these problems and move quickly to correct them?

The extraordinary actions taken by the Federal Reserve during the financial crisis have bewildered many of my constituents and left them wondering how the Federal Reserve's policies will affect their economic well-being. Small businesses in Texas report that they are having a tough time finding affordable credit because regulators are pressing banks to avoid risk. Has the pendulum swung too far in this direction?

To prevent a downward debt-deflation-default spiral, the Federal Reserve has expanded its balance sheet from $946 billion in September 2008 to $2.1 trillion last week. While this explosive growth does not pose an immediate inflationary danger, the Federal Reserve will need to begin contracting its balance sheet when the economy begins to recover. What is the Federal Reserve's exit strategy to wind down its emergency credit facilities and reduce excess bank reserves to prevent higher inflation? And have these extraordinary credit facilities diminished the Federal Reserve's autonomy in setting monetary policy?

Many experts have suggested that the Federal Reserve should become the systemic risk regulator for all U.S. financial institutions, not just banks and their holding companies. Is the Federal Reserve capable and ready to perform this function?

The decisions made during the current turmoil will affect financial institutions and markets for decades. Yet, there has been little discussion among policymakers about how the financial system should function after the crisis abates. What changes in laws or regulations should be made to optimize the future performance of our financial system? Should securitization and the shadow banking system play as large of a role in financial intermediation as they did prior to the crisis? What should be the role, if any, for Fannie Mae and Freddie Mac?

Mr. Chairman, I look forward to your testimony and answers to some of these important questions.

PREPARED STATEMENT OF BEN S. BERNANKE, CHAIRMAN, BOARD OF GOVERNORS, 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 offer my views on recent economic developments, the outlook for the economy, and current conditions in financial markets.

RECENT ECONOMIC DEVELOPMENTS

The U.S. economy has contracted sharply since last autumn, with real gross domestic product (GDP) having dropped at an annual rate of more than 6 percent in the fourth quarter of 2008 and the first quarter of this year. Among the enormous costs of the downturn is the loss of some 5 million payroll jobs over the past 15 months. The most recent information on the labor market—the number of new and continuing claims for unemployment insurance through late April—suggests that we are likely to see further sizable job losses and increased unemployment in coming months.

However, the recent data also suggest that the pace of contraction may be slowing, and they include some tentative signs that final demand, especially demand by households, may be stabilizing. Consumer spending, which dropped sharply in the second half of last year, grew in the first quarter. In coming months, households' spending power will be boosted by the fiscal stimulus program, and we have seen some improvement in consumer sentiment. Nonetheless, a number of factors are likely to continue to weigh on consumer spending, among them the weak labor market and the declines in equity and housing wealth that households have experienced over the past two years. In addition, credit conditions for consumers remain tight.

The housing market, which has been in decline for three years, has also shown some signs of bottoming. Sales of existing homes have been fairly stable since late last year, and sales of new homes have firmed a bit recently, though both remain at depressed levels. Although some of the boost to sales in the market for existing homes is likely coming from foreclosure-related transactions, the increased affordability of homes appears to be contributing more broadly to the steadying in the demand for housing. In particular, the average interest rate on conforming 30-year fixed-rate mortgages has dropped almost 1¾ percentage points since August, to about 4.8 percent. With sales of new homes up a bit and starts of single-family homes little changed from January through March, builders are seeing the backlog of unsold new homes decline—a precondition for any recovery in homebuilding.

In contrast to the somewhat better news in the household sector, the available indicators of business investment remain extremely weak. Spending for equipment and software fell at an annual rate of about 30 percent in both the fourth and first quarters, and the level of new orders remains below the level of shipments, suggesting further near-term softness in business equipment spending. Recent business surveys have been a bit more positive, but surveyed firms are still reporting net declines in new orders and restrained capital spending plans. Our recent survey of bank loan officers reported further weakening of demand for commercial and industrial loans.[1] The survey also showed that the net fraction of banks that tightened their business lending policies stayed elevated, although it has come down in the past two surveys.

Conditions in the commercial real estate sector are poor. Vacancy rates for existing office, industrial, and retail properties have been rising, prices of these properties have been falling, and, consequently, the number of new projects in the pipeline has been shrinking. Credit conditions in the commercial real estate sector are still severely strained, with no commercial mortgage-backed securities (CMBS) having been issued in almost a year. To try to help restart the CMBS market, the Federal Reserve announced last Friday that recently issued CMBS will in June be eligible collateral for our Term Asset-Backed Securities Loan Facility (TALF).[2]

An important influence on the near-term economic outlook is the extent to which businesses have been able to shed the unwanted inventories that they accumulated as sales turned down sharply last year. Some progress has been made; the Bureau of Economic Analysis estimates that an acceleration in inventory liquidation accounted for almost one-half of the reported decline in real GDP in the first quarter.

[1] Board of Governors of the Federal Reserve System (2009), The April 2009 Senior Loan Officer Opinion Survey on Bank Lending Practices (Washington: Board of Governors, May 4), www.federalreserve.gov/boarddocs/SnLoanSurvey/200905.

[2] Board of Governors of the Federal Reserve System (2009), "Federal Reserve Announces Expansion of Eligible Collateral under Term Asset-Backed Securities Loan Facility (TALF)," press release, May 1, www.federalreserve.gov/newsevents/press/monetary/20090501a.htm.

As stocks move into better alignment with sales, a reduction in the pace of inventory liquidation should provide some support to production later this year.

The outlook for economic activity abroad is also an important consideration. The steep drop in U.S. exports that began last fall has been a significant drag on domestic production, and any improvement on that front would be helpful. A few indicators suggest, again quite tentatively, that the decline in foreign economic activity may also be moderating. And, as has been the case in the United States, investor sentiment and the functioning of financial markets abroad have improved somewhat.

As economic activity weakened during the second half of 2008 and prices of energy and other commodities began to fall rapidly, inflationary pressures diminished appreciably. Weakness in demand and reduced cost pressures have continued to keep inflation low so far this year. Although energy prices have recently risen some, the personal consumption expenditure (PCE) price index for energy goods and services in March remained more than 20 percent below its level a year earlier. Food price inflation has also continued to slow, as the moderation in crop and livestock prices has been passing through to the retail level. Core PCE inflation (prices excluding food and energy) dropped below an annual rate of 1 percent in the final quarter of 2008, when retailers and auto dealers marked down their prices significantly. In the first quarter of this year, core consumer price inflation moved back up, but to a still-low annual rate of 1.5 percent.

THE ECONOMIC OUTLOOK

We continue to expect economic activity to bottom out, then to turn up later this year. Key elements of this forecast are our assessments that the housing market is beginning to stabilize and that the sharp inventory liquidation that has been in progress will slow over the next few quarters. Final demand should also be supported by fiscal and monetary stimulus. An important caveat is that our forecast assumes continuing gradual repair of the financial system; a relapse in financial conditions would be a significant drag on economic activity and could cause the incipient recovery to stall. I will provide a brief update on financial markets in a moment.

Even after a recovery gets under way, the rate of growth of real economic activity is likely to remain below its longer-run potential for a while, implying that the current slack in resource utilization will increase further. We expect that the recovery will only gradually gain momentum and that economic slack will diminish slowly. In particular, businesses are likely to be cautious about hiring, implying that the unemployment rate could remain high for a time, even after economic growth resumes.

In this environment, we anticipate that inflation will remain low. Indeed, given the sizable margin of slack in resource utilization and diminished cost pressures from oil and other commodities, inflation is likely to move down some over the next year relative to its pace in 2008. However, inflation expectations, as measured by various household and business surveys, appear to have remained relatively stable, which should limit further declines in inflation.

CONDITIONS IN FINANCIAL MARKETS

As I noted, a sustained recovery in economic activity depends critically on restoring stability to the financial system. Conditions in a number of financial markets have improved in recent weeks, reflecting in part the somewhat more encouraging economic data. However, financial markets and financial institutions remain under considerable stress, and cumulative declines in asset prices, tight credit conditions, and high levels of risk aversion continue to weigh on the economy.

Among the markets that have recently begun to function a bit better are the markets for short-term funding, including the interbank markets and the commercial paper market. In particular, concerns about credit risk in those markets appear to have receded somewhat, there is more lending at longer maturities, and interest rates have declined. The modest improvement in funding conditions has contributed to diminished use of the Federal Reserve's liquidity facilities for financial institutions and of our commercial paper facility. The volume of foreign central bank liquidity swaps has also declined as dollar funding conditions have eased.

The issuance of asset-backed securities (ABS) backed by credit card, auto, and student loans all picked up in March and April, and ABS funding rates have declined, perhaps reflecting the availability of the Federal Reserve's TALF facility as a market backstop. Some of the recent issuance made use of TALF lending, but lower rates and spreads have facilitated issuance outside the TALF as well.

Mortgage markets have responded to the Federal Reserve's purchases of agency debt and agency mortgage-backed securities, with mortgage rates having fallen sharply since last fall, as I noted earlier. The decline in mortgage rates has spurred a pickup in refinancing as well as providing some support for housing demand. However, the supply of mortgage credit is still relatively tight, and mortgage activity remains heavily dependent on the support of government programs or the government-sponsored enterprises.

The combination of a broad rally in equity prices and a sizable reduction in risk spreads in corporate debt markets reflects a somewhat more optimistic view of the corporate sector on the part of investors, and perhaps some decrease in risk aversion. Bond issuance by nonfinancial firms has been relatively strong recently. Still, spreads over Treasury rates paid by both investment-grade and speculative-grade corporate borrowers remain quite elevated. Investors seemed to adopt a more positive outlook on the condition of financial institutions after several large banks reported profits in the first quarter, but readings from the credit default swap market and other indicators show that substantial concerns about the banking industry remain.

As you know, the federal bank regulatory agencies began conducting the Supervisory Capital Assessment Program in late February. The program is a forward-looking exercise intended to help supervisors gauge the potential losses, revenues, and reserve needs for the 19 largest bank holding companies in a scenario in which the economy declines more steeply than is generally anticipated. The simultaneous comprehensive assessment of the financial conditions of the 19 companies over a relatively short period of time required an extraordinary coordinated effort among the agencies.

The purpose of the exercise is to ensure that banks will have a sufficient capital buffer to remain strongly capitalized and able to lend to creditworthy borrowers even if economic conditions are worse than expected. Following the announcement of the results, bank holding companies will be required to develop comprehensive capital plans for establishing the required buffers. They will then have six months to execute those plans, with the assurance that equity capital from the Treasury under the Capital Assistance Program will be available as needed.

FEDERAL RESERVE TRANSPARENCY

I will conclude with a few comments on Federal Reserve transparency. The Federal Reserve remains committed to transparency and openness and, in particular, to keeping the Congress and the public informed about its lending programs and balance sheet. As you may know, we have created a separate section of our website devoted to providing data, explanations, and analyses bearing on these topics and related issues.[3] Recent postings include the annual financial statements of the 12 Federal Reserve Banks, the Board of Governors, and the limited liability companies created in 2008 in response to risks to the financial system, as well as the most recent reports to the Congress on our emergency lending programs.

Earlier this year I asked Vice Chairman Kohn to lead a review of our disclosure policies, with the goal of increasing the range of information that we make available to the public. The group has been making substantial progress, and I am pleased to say that we will soon be adding to the website material that provides the information requested in the Dodd-Shelby amendment to the recent budget resolution. Specifically, we will be adding new tables that provide information on the number of borrowers under each program and more information on the details of the credit extended, including measures of the concentrations of credit among borrowers. In addition, we will be providing monthly information on the collateral that is being taken under our various lending programs, including breakouts by types of collateral and by ratings categories. And we will be supplementing information provided on the valuation of collateral for the Maiden Lane facilities and the Commercial Paper Credit Facility. Finally, we will be providing additional information on the extent of our contracting with private firms with respect to our lending programs as well as on the terms and nature of such contracts. Over time, we expect to continue to expand the range of information on our website as our review of disclosure practices proceeds.

Thank you. I will be pleased to respond to your questions.

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[3] "Credit and Liquidity Programs and the Balance Sheet," a section of the Board's website, is available at www.federalreserve.gov/monetarypolicy/bst.htm.

FOR IMMEDIATE RELEASE
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Contact: Brian Fallon (Schumer)
202-224-7433

SCHUMER DEMANDS ANSWERS FROM BERNANKE AT HEARING AFTER FED REJECTS PUSH TO FREEZE RATES ON EXISTING CREDIT CARD BALANCES

SCHUMER, DODD HAD WRITTEN TO BERNANKE LAST MONTH URGING RULE BANNING RETROACTIVE RATE HIKES TO BE ENACTED IMMEDIATELY

SENATOR CALLS DECISION "UNCONSCIONABLE"; CALLS EXCUSE FOR NOT ACTING "NONSENSE"

WASHINGTON, DC—U.S. Senator Charles E. Schumer (D–NY) planned to fiercely quiz Federal Reserve Chairman Ben Bernanke at a Joint Economic Committee hearing Tuesday morning after the Fed rejected a proposal by Schumer and Senate Banking Chairman Christopher Dodd to immediately stop credit card issuers from slapping customers with rate increases on existing balances.

"The Federal Reserve's failure to protect consumers from these outrageous rate increases is unconscionable," Schumer said. "The Fed has acted swiftly to use its emergency powers to steady teetering financial institutions. It is fair to ask why they won't use the same powers to aid American families who are at just as great a risk."

In a letter to Bernanke and other regulators last month, Schumer and Dodd proposed that the Fed speed up implementation of a rule that would ban retroactive rate hikes on existing balances. That rule, already approved by the Fed, is not slated to take effect until July 2010, giving companies more than a year to raise rates on consumers preemptively to get under the deadline. Schumer and Dodd said the Fed should invoke its emergency powers to make the rule effective immediately. Both Senators said they had heard complaints from constituents who have seen their rates double or even triple almost overnight and without explanation.

But in a letter Schumer received late yesterday, the Fed announced it would not speed up the rule's enactment. The Fed stated it was unclear if the rate hikes were in anticipation of the upcoming implementation of these rules or if they were due to bank losses in the current economy. Schumer blasted that logic on Tuesday, noting "under either scenario, the Fed has given the green light to banks to take advantage of American families."

The Senate will be considering a major credit card reform bill later this month. Schumer is a co-sponsor of the legislation.