

Janet L Yellen: Semiannual Monetary Policy Report to the Congress

Testimony by Ms Janet L Yellen, Chair of the Board of Governors of the Federal Reserve System, before the Committee on Financial Services, US House of Representatives, Washington DC, 11 February 2014.

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Chairman Hensarling, Ranking Member Waters and other members of the Committee, I am pleased to present the Federal Reserve's semiannual [Monetary Policy Report](#) to the Congress. In my remarks today, I will discuss the current economic situation and outlook before turning to monetary policy. I will conclude with an update on our continuing work on regulatory reform.

First, let me acknowledge the important contributions of Chairman Bernanke. His leadership helped make our economy and financial system stronger and ensured that the Federal Reserve is transparent and accountable. I pledge to continue that work.

Current economic situation and outlook

The economic recovery gained greater traction in the second half of last year. Real gross domestic product (GDP) is currently estimated to have risen at an average annual rate of more than 3-1/2 percent in the third and fourth quarters, up from a 1-3/4 percent pace in the first half. The pickup in economic activity has fueled further progress in the labor market. About 1-1/4 million jobs have been added to payrolls since the previous *Monetary Policy Report* last July, and 3-1/4 million have been added since August 2012, the month before the Federal Reserve began a new round of asset purchases to add momentum to the recovery. The unemployment rate has fallen nearly a percentage point since the middle of last year and 1-1/2 percentage points since the beginning of the current asset purchase program. Nevertheless, the recovery in the labor market is far from complete. The unemployment rate is still well above levels that Federal Open Market Committee (FOMC) participants estimate is consistent with maximum sustainable employment. Those out of a job for more than six months continue to make up an unusually large fraction of the unemployed, and the number of people who are working part time but would prefer a full-time job remains very high. These observations underscore the importance of considering more than the unemployment rate when evaluating the condition of the U.S. labor market.

Among the major components of GDP, household and business spending growth stepped up during the second half of last year. Early in 2013, growth in consumer spending was restrained by changes in fiscal policy. As this restraint abated during the second half of the year, household spending accelerated, supported by job gains and by rising home values and equity prices. Similarly, growth in business investment started off slowly last year but then picked up during the second half, reflecting improving sales prospects, greater confidence, and still-favorable financing conditions. In contrast, the recovery in the housing sector slowed in the wake of last year's increase in mortgage rates.

Inflation remained low as the economy picked up strength, with both the headline and core personal consumption expenditures, or PCE, price indexes rising only about 1 percent last year, well below the FOMC's 2 percent objective for inflation over the longer run. Some of the recent softness reflects factors that seem likely to prove transitory, including falling prices for crude oil and declines in non-oil import prices.

My colleagues on the FOMC and I anticipate that economic activity and employment will expand at a moderate pace this year and next, the unemployment rate will continue to decline toward its longer-run sustainable level, and inflation will move back toward 2 percent over coming years. We have been watching closely the recent volatility in global financial

markets. Our sense is that at this stage these developments do not pose a substantial risk to the U.S. economic outlook. We will, of course, continue to monitor the situation.

Monetary policy

Turning to monetary policy, let me emphasize that I expect a great deal of continuity in the FOMC's approach to monetary policy. I served on the Committee as we formulated our current policy strategy and I strongly support that strategy, which is designed to fulfill the Federal Reserve's statutory mandate of maximum employment and price stability.

Prior to the financial crisis, the FOMC carried out monetary policy by adjusting its target for the federal funds rate. With that rate near zero since late 2008, we have relied on two less-traditional tools – asset purchases and forward guidance – to help the economy move toward maximum employment and price stability. Both tools put downward pressure on longer-term interest rates and support asset prices. In turn, these more accommodative financial conditions support consumer spending, business investment, and housing construction, adding impetus to the recovery.

Our current program of asset purchases began in September 2012 amid signs that the recovery was weakening and progress in the labor market had slowed. The Committee said that it would continue the program until there was a substantial improvement in the outlook for the labor market in a context of price stability. In mid-2013, the Committee indicated that if progress toward its objectives continued as expected, a moderation in the monthly pace of purchases would likely become appropriate later in the year. In December, the Committee judged that the cumulative progress toward maximum employment and the improvement in the outlook for labor market conditions warranted a modest reduction in the pace of purchases, from \$45 billion to \$40 billion per month of longer-term Treasury securities and from \$40 billion to \$35 billion per month of agency mortgage-backed securities. At its January meeting, the Committee decided to make additional reductions of the same magnitude. If incoming information broadly supports the Committee's expectation of ongoing improvement in labor market conditions and inflation moving back toward its longer-run objective, the Committee will likely reduce the pace of asset purchases in further measured steps at future meetings. That said, purchases are not on a preset course, and the Committee's decisions about their pace will remain contingent on its outlook for the labor market and inflation as well as its assessment of the likely efficacy and costs of such purchases.

The Committee has emphasized that a highly accommodative policy will remain appropriate for a considerable time after asset purchases end. In addition, the Committee has said since December 2012 that it expects the current low target range for the federal funds rate to be appropriate at least as long as the unemployment rate remains above 6-1/2 percent, inflation is projected to be no more than a half percentage point above our 2 percent longer-run goal, and longer-term inflation expectations remain well anchored. Crossing one of these thresholds will not automatically prompt an increase in the federal funds rate, but will instead indicate only that it had become appropriate for the Committee to consider whether the broader economic outlook would justify such an increase. In December of last year and again this January, the Committee said that its current expectation – based on its assessment of a broad range of measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments – is that it likely will be appropriate to maintain the current target range for the federal funds rate well past the time that the unemployment rate declines below 6-1/2 percent, especially if projected inflation continues to run below the 2 percent goal. I am committed to achieving both parts of our dual mandate: helping the economy return to full employment and returning inflation to 2 percent while ensuring that it does not run persistently above or below that level.

Strengthening the financial system

I will finish with an update on progress on regulatory reforms and supervisory actions to strengthen the financial system. In October, the Federal Reserve Board proposed a rule to strengthen the liquidity positions of large and internationally active financial institutions.¹ Together with other federal agencies, the Board also issued a final rule implementing the Volcker rule, which prohibits banking firms from engaging in short-term proprietary trading of certain financial instruments.² On the supervisory front, the next round of annual capital stress tests of the largest 30 bank holding companies is under way, and we expect to report results in March.

Regulatory and supervisory actions, including those that are leading to substantial increases in capital and liquidity in the banking sector, are making our financial system more resilient. Still, important tasks lie ahead. In the near term, we expect to finalize the rules implementing enhanced prudential standards mandated by section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. We also are working to finalize the proposed rule strengthening the leverage ratio standards for U.S.-based, systemically important global banks. We expect to issue proposals for a risk-based capital surcharge for those banks as well as for a long-term debt requirement to help ensure that these organizations can be resolved. In addition, we are working to advance proposals on margins for noncleared derivatives, consistent with a new global framework, and are evaluating possible measures to address financial stability risks associated with short-term wholesale funding. We will continue to monitor for emerging risks, including watching carefully to see if the regulatory reforms work as intended.

Since the financial crisis and the depths of the recession, substantial progress has been made in restoring the economy to health and in strengthening the financial system. Still, there is more to do. Too many Americans remain unemployed, inflation remains below our longer-run objective, and the work of making the financial system more robust has not yet been completed. I look forward to working with my colleagues and many others to carry out the important mission you have given the Federal Reserve.

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

¹ See Board of Governors of the Federal Reserve System (2013), "[Federal Reserve Board Proposes Rule to Strengthen Liquidity Positions of Large Financial Institutions](#)," press release, October 24.

² See Board of Governors of the Federal Reserve System, Commodity Futures Trading Commission, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Securities and Exchange Commission (2013), "[Agencies Issue Final Rules Implementing the Volcker Rule](#)," joint press release, December 10.