

United States House of Representatives  
Committee on Financial Services  
2129 Rayburn House Office Building  
Washington, D.C. 20515

July 9, 2021

## Memorandum

**To:** Members, Committee on Financial Services  
**From:** FSC Majority Staff  
**Subject:** July 14, 2021, Full Committee Hearing entitled, “Monetary Policy and the State of the Economy”

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The full Committee on Financial Services will hold a hearing entitled, “Monetary Policy and the State of the Economy” on Wednesday, July 14, 2021, at 12:00 p.m. ET, on the virtual meeting platform Cisco WebEx. The Honorable Jerome H. Powell, Chair, Board of Governors of the Federal Reserve System, will be the sole witness.

### Purpose and Background

The Federal Reserve Act directs the Chairman of the Board of Governors (Board) of the Federal Reserve System (Federal Reserve or Fed) to testify before the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs twice a year on how the Board handles monetary policy and its observations on economic developments.<sup>1</sup> Each appearance requires the Board to supply the Committees with a written report known as the Monetary Policy Report.<sup>2</sup> The Federal Reserve System consists of a 7-member Board of Governors, as well as 12 Reserve Banks located in various regions around the country. The Fed’s functions include conducting monetary policy, promoting financial stability, supervising and regulating certain financial institutions, and fostering payments and settlements.<sup>3</sup> The Board has seven Governors, including a Chair, a Vice Chair, and a Vice Chair for Supervision. Chair Powell is serving a term as Chair that began in February 2018 and will expire in February 2022. There is currently one vacancy on the Board.<sup>4</sup> Monetary policy decisions are made by the Federal Open Market Committee (FOMC), which is comprised of the Board, the president of the Federal Reserve Bank of New York, and an annual rotation of four of the remaining Reserve Bank presidents.<sup>5</sup>

### Overall Economic Outlook and Monetary Policy

Following the declaration of the COVID-19 pandemic and widespread financial market turmoil, the FOMC announced on March 15, 2020 that it would cut the overnight interest rate 1 percent, to a range between 0 and 0.25 percent (also called the “zero lower bound”).<sup>6</sup> At the same time, the FOMC announced that it would make large scale asset purchases (LSAPs) of \$500 billion in Treasury securities and of at least \$200 billion in agency mortgage-backed securities (MBS) issued by Fannie Mae, Freddie Mac, and Ginnie Mae over the next few months.<sup>7</sup> In the months since, the FOMC has continued making LSAPs, which are often referred to as “quantitative easing,” purchasing \$80 billion of Treasuries and \$40 billion

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<sup>1</sup> Section 2B of the [Federal Reserve Act](#) (12 USC 225b).

<sup>2</sup> *Id.*

<sup>3</sup> See Fed, [About the Fed](#) (accessed Jul. 2, 2021).

<sup>4</sup> See Fed, [Board Members](#) (accessed Jul. 6, 2021).

<sup>5</sup> For more background on the Federal Reserve System’s structure and its conduct of monetary policy, see the Financial Services Committee [memo](#) prepared for the hearing entitled “Monetary Policy and the State of the Economy” (Feb. 11, 2020).

<sup>6</sup> FOMC, [Federal Reserve Issues FOMC Statement](#), (March 15, 2020).

<sup>7</sup> *Id.*

in MBS each month.<sup>8</sup> The Fed’s total holdings of Treasury securities on its balance sheet has grown by over \$2 trillion compared with February 2020, and its holdings of MBS has increased by nearly \$1 trillion over the same time period.<sup>9</sup>

Through the CARES Act and Consolidated Appropriations Act of 2021, Congress provided trillions of dollars in fiscal relief to the economy, including the authorization of \$454 billion for emergency lending facilities set up by the Federal Reserve. With the exception of the Paycheck Protection Liquidity Facility, which will expire on July 30, 2021,<sup>10</sup> the CARES Act facilities have now been shut down.<sup>11</sup> On March 11, 2021, President Biden signed a \$1.9 trillion COVID relief package called the American Rescue Plan (ARP) into law. Among other provisions, the ARP funded \$160 billion for a national vaccination program, \$360 billion in aid to state and local governments, expanded child care assistance, \$300 in supplemental weekly unemployment insurance benefits through September 6, and increased child tax credits designed to support the families of 66 million children.<sup>12</sup> At his June 16, 2021 press conference following the FOMC’s meeting, Chair Powell credited “[w]idespread vaccinations, along with unprecedented fiscal policy actions,” with “providing strong support to the recovery.”<sup>13</sup> The economy has added 3.25 million jobs since January 2021.<sup>14</sup> The strong growth observed in the first quarter of 2021 has sparked concerns about inflation, which has grown more rapidly than expected in the first half of the year. In May 2021, the 12-month change in the consumer price index reached 5%,<sup>15</sup> although this includes food and energy prices that are highly volatile and therefore excluded from the Fed’s preferred inflation measure, the core personal consumption expenditures (PCE) index. The annual change in core PCE remained elevated above 3% throughout the spring,<sup>16</sup> though Powell has maintained that this is likely “transitory” inflation. For instance, Powell has stated that supply bottlenecks related to the pandemic have forced up prices of commodities like lumber, although this is beginning to subside.<sup>17</sup> Other pandemic-driven factors, such as a surge in the demand for used cars outstripping supply, and a sharp uptick in airline prices now that people are beginning to fly again, are seen as causing a temporary increase in inflation.<sup>18</sup>

The Fed’s summary of economic projects (SEP) in June indicated that the FOMC now expects to raise interest rates some time in 2023, sooner than previously anticipated.<sup>19</sup> Whereas only four FOMC participants believed a rate hike in 2022 would be appropriate as of March, the June SEP showed that seven out of 18 FOMC participants now project increasing interest rates as soon as next year.<sup>20</sup> The debate over how temporary recent inflation has been and whether to move up projections for monetary tightening is the first major test of the FOMC’s new monetary policy framework, which was formally adopted at its January 2021 meeting. The new framework clarified that the Fed’s inflation target of two percent will not be treated as a ceiling, and that “following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for

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<sup>8</sup> Barrons, [Fed Reiterates Pledges on Net Zero Rates and \\$120 Billion in Monthly Bond Buys](#), (Jan. 27, 2021).

<sup>9</sup> See [Federal Reserve statistical release](#), (Jul. 1, 2021) and [Federal Reserve statistical release](#), (Feb. 27, 2020).

<sup>10</sup> Fed, [Report on Paycheck Protection Program Liquidity Facility](#), (Jun. 28, 2021).

<sup>11</sup> For more information on the actions taken by Congress and the Fed, see materials and testimony from the Financial Services Committee hearing entitled, [Monetary Policy and the State of the Economy](#), (Feb. 24, 2021), and the Committee hearing entitled, [Oversight of the Treasury Department’s and Federal Reserve’s Pandemic Response](#), (Mar. 23, 2021).

<sup>12</sup> The White House, [American Rescue Plan](#), (Mar. 11, 2021).

<sup>13</sup> FOMC, [Transcript of Chair Powell’s Press Conference](#), (June 16, 2021).

<sup>14</sup> Bureau of Labor Statistics, [Employment 1-month net change](#), (Jul. 7, 2021).

<sup>15</sup> Bureau of Labor Statistics, [Consumer Price Index Summary](#), (Jun. 10, 2021).

<sup>16</sup> Federal Reserve Bank of Cleveland, [Median PCE Inflation](#), (May 2021).

<sup>17</sup> *Id.*

<sup>18</sup> Washington Post, [Rising prices: What meat, clothing, and five other everyday items tell us about inflation](#), (Jun. 12, 2021).

<sup>19</sup> FOMC, [Summary of Economic Projections](#), (Jun. 16, 2021).

<sup>20</sup> *Id.*

some time.”<sup>21</sup> The Fed’s most recent estimates are aligned with that objective, with the median estimate of 3.4 percent inflation at the end of 2021, falling to just slightly above 2 percent in 2022 and 2023.<sup>22</sup>

### **Macroeconomic Trends and Labor Market Conditions**

Although the economy has made steady progress, with 850,000 jobs added in June,<sup>23</sup> the employment shortfall from January 2020 remains significant, with nearly 7 million fewer jobs than in February 2020, and continued stress in several hard-hit sectors, such as leisure and hospitality, construction, manufacturing, and government.<sup>24</sup> As Chair Powell acknowledged in his June press conference, “joblessness continues to fall disproportionately on lower-wage workers in the service sector and on African Americans and Hispanics.”<sup>25</sup> The latest jobs figures show that the Black unemployment rate stands at 9.7%, compared with 5.4% for White workers.<sup>26</sup>

Job openings reached a historic high of 9 million in April 2021,<sup>27</sup> but as Chair Powell has noted, the pace of filling the large amount of job openings has been slow.<sup>28</sup> A common explanation for the slow pace of hiring is that many individuals report being unable to return to work until school re-opens in the fall.<sup>29</sup> This trend was seemingly confirmed by the Fed’s 2020 Survey of Household Economic Decisionmaking, which found that 68% of parents reported disruptions in their employment due to child care and schooling needs, with 25% of women either working less or not working at all, and the percentage of Black mothers reporting that they were working less or had stopped working growing by 12%.<sup>30</sup> There are reports of employers offering higher wages and benefits as an incentive to draw employees back into the workforce.<sup>31</sup> By some accounts, this trend has translated to robust wage growth, although mostly in the hard-hit hospitality and leisure sector, which is adding jobs back at a fast rate and is influenced by temporary factors like tips from the return of in-person customers and hiring bonuses.<sup>32</sup> Several FOMC participants have begun to speak out in favor of gradually paring back – or “tapering” – the size of the Fed’s monthly LSAPs. Stressing a potential real estate bubble lurking in the sustained high housing prices observed in recent months, the presidents of the Reserve Banks of Boston, St. Louis, and Dallas have spoken favorably of a “two-speed taper” that would phase out MBS purchases first, arguing that low rates enable home buyers to make higher offers.<sup>33</sup> Governor Lael Brainard and other Fed officials have pushed back against this idea, calling the impact of the Fed’s LSAPs in Treasuries and MBS “roughly the same.”<sup>34</sup> Chair Powell has not said exactly when the Fed will begin scaling back its LSAPs, but has committed to a tapering process that is “orderly, methodical, and transparent,” and has suggested that the Fed will signal in advance when it is ready to begin tapering.<sup>35</sup>

In identifying spending priorities for the infrastructure package and other fiscal plans to be introduced in Congress, President Biden has highlighted several factors that appear to be hampering economic recovery. For example, Biden has proposed investing \$225 billion in reducing the cost of childcare for families,

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<sup>21</sup> Fed, [Guide to changes in the 2020 statement on Longer-Run Goals and Monetary Strategy](#), (Aug. 27, 2020).

<sup>22</sup> FOMC, [Summary of Economic Projections](#), (Jun. 16, 2021).

<sup>23</sup> Bureau of Labor Statistics, [Employment Situation Summary](#), (Jul. 2, 2021).

<sup>24</sup> Economic Policy Institute, [Jobs and Employment Economic Indicators](#), (Jul. 2, 2021).

<sup>25</sup> FOMC, [Transcript of Chair Powell’s Press Conference](#), (Jun. 16, 2021).

<sup>26</sup> Bureau of Labor Statistics, [Employment status of the civilian population by race, age, and gender](#), (Jul. 2, 2021).

<sup>27</sup> Indeed, [Indeed Job Seeker Survey](#), (Jun. 29, 2021).

<sup>28</sup> FOMC, [Transcript of Chair Powell’s Press Conference](#), (Jun. 16, 2021).

<sup>29</sup> Indeed, [Indeed Job Seeker Survey](#), (Jun. 29, 2021).

<sup>30</sup> Fed, [Report on the Economic Well-Being of U.S. Households](#), (May 2021).

<sup>31</sup> New York Times, [From Appetizers to Tuition, Incentives to Job Seekers Grow](#), (Jun. 8, 2021).

<sup>32</sup> Bloomberg, [Surprise Jump in U.S. Wages Gives Inflation Debate a New Twist](#), (Jun. 8, 2021).

<sup>33</sup> Wall Street Journal, [Fed Officials Debate Scaling Back Mortgage-Bond Purchases at Faster Clip](#), (Jun. 28, 2021).

<sup>34</sup> *Id.*

<sup>35</sup> FOMC, [Transcript of Chair Powell’s Press Conference](#), (Jun. 16, 2021).

funding child care providers, and raising wages for child care workers.<sup>36</sup> Other proposed investments are likely to mitigate inflationary pressures, such as Biden’s proposal to invest \$50 billion to address the semiconductor shortage,<sup>37</sup> which is seen as a factor in increasing car prices.<sup>38</sup> Asked about the hot housing market at his April 2021 press conference, Chair Powell called the current environment “the strongest housing market that we’ve seen since the Global Financial Crisis,” but also cautioned that demand is outstripping supply, which runs the risk of pricing out first-time homebuyers.<sup>39</sup> Past research has indicated that high housing costs can be a major driver of inflation.<sup>40</sup> President Biden has proposed substantial investments that would help low-and-moderate income homebuyers and homeowners, in addition to renters, obtain affordable housing.<sup>41</sup>

### **Financial Stability, including Climate Risks**

Although the Fed’s May 2021 financial stability report showed improvement on a number of fronts as the economy continues to recover, corporate debt and high levels of leverage held by nonbank financial institutions (NBFIs) continue to be concerns.<sup>42</sup> The report cited the large losses experienced by some banks in the March 2021 collapse of Archegos Capital Management as an example of risks from NBFIs, and noted that “[w]hile broader market spillovers appeared limited, the [Archegos] episode highlights the potential for material distress at NBFIs to affect the broader financial system.”<sup>43</sup> Cryptocurrencies were also cited as a source of a potential short-term financial stability shock.<sup>44</sup>

After joining the Network for Greening the Financial System, an international consortium of central banks dedicated to climate risk management, on December 15, 2020,<sup>45</sup> the Fed announced the formation a new team within the Fed’s Supervision and Regulation Department that will consider the ramifications of climate change for the financial institutions that the Fed regulates.<sup>46</sup> On March 31, 2021, the Financial Stability Oversight Council (FSOC) convened for the first time with Treasury Secretary Janet Yellen as Chair, and heard a presentation from staff at the Fed about the financial stability implications of climate change.<sup>47</sup> On May 20, 2021, President Biden issued an executive order directing Secretary Yellen to engage with FSOC members, which includes the Fed, to assess “in a detailed and comprehensive manner, the climate-related financial risk, including both physical and transition risks, to the financial stability of the Federal Government and the stability of the U.S. financial system.”<sup>48</sup>

### **Bank mergers**

Several large bank mergers and acquisitions have been approved in recent years, including the merger of BB&T and SunTrust in November 2019,<sup>49</sup> the acquisition of E\*Trade by Morgan Stanley in September 2020,<sup>50</sup> and the acquisition of TCF by Huntington in May 2021.<sup>51</sup> The Fed’s guidelines for bank merger review have not been updated since 1995, and regulators have not formally rejected a merger application

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<sup>36</sup> The White House, [Fact Sheet: American Families Plan](#), (Apr. 28, 2021).

<sup>37</sup> Wall Street Journal, [Biden Calls for \\$50 Billion to Boost U.S. Chip Industry](#), (Mar. 31, 2021).

<sup>38</sup> Reuters, [U.S. consumer prices post largest gain since 2009 as inflation ramps up](#), (May 12, 2021).

<sup>39</sup> FOMC, [Transcript of Chair Powell’s press conference](#), (Apr. 28, 2021).

<sup>40</sup> Emmons, [Excluding Housing Costs, U.S. Inflation is Well Below 2%](#), (Jan. 17, 2020).

<sup>41</sup> The White House, [Fact Sheet: The American Jobs Plan](#), (May 26, 2021).

<sup>42</sup> Fed, [Financial Stability Report](#), (May 2021).

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> Fed, [Federal Reserve Board announces it has formally joined the Network for Greening the Financial System](#), (Dec. 15, 2020).

<sup>46</sup> Reuters, [U.S. Fed taps official to lead new climate change team](#), (Jan. 25, 2021).

<sup>47</sup> U.S. Department of the Treasury, [Readout of Financial Stability Oversight Council Meeting](#), (Mar. 31, 2021).

<sup>48</sup> The White House, [Executive Order on Climate-Related Financial Risk](#), (May 20, 2021).

<sup>49</sup> Fed, [Federal Reserve Board announces approval of application by BB&T Corporation to merge with SunTrust Banks](#), (Nov. 19, 2019).

<sup>50</sup> Fed, [Federal Reserve announces order of approval of notice by Morgan Stanley](#), (Sept. 30, 2020).

<sup>51</sup> Fed, [Order approving Acquisition of Bank Holding Company](#), (May 25, 2021).

since 2003. Since 2014, the Fed has approved over 90% of all merger applications they receive every year.<sup>52</sup> On February 16, 2021, Governor Michelle Bowman gave a speech calling for an update to the Fed’s banking antitrust analysis to “better reflect the competition” that banks face “in an industry quickly being transformed by technology and non-bank financial companies.”<sup>53</sup> On May 17, 2021, the *Capitol Forum* published a story indicating that the Fed is “quietly pushing ahead with a plan to loosen bank merger rules.”<sup>54</sup> On July 9, 2021, President Biden issued an executive order encouraging the Department of Justice, along with federal banking agencies, including the Fed, to “update guidelines on banking mergers to provide more robust scrutiny of mergers.”<sup>55</sup>

### **Real Time Payments and Central Bank Digital Currencies**

In August 2019, the Fed began developing the FedNow Service, a real-time payments system.<sup>56</sup> In January 2021, the Fed announced the selection of more than 110 organizations that are participating in a FedNow Service’s pilot program.<sup>57</sup> On June 1, 2021, the Fed issued a proposed rule to govern funds transfers over the FedNow Service, and after originally estimating the service would be ready in either 2023 or 2024, the Fed indicated it is expected to be available in 2023.<sup>58</sup> Responding in part to moves by central banks in Europe and China to adopt a central bank digital currency (CBDC), Chair Powell announced on May 20, 2021 that the Fed was actively exploring a CBDC and would release a report on the subject by the end of this summer.<sup>59</sup> Staff at the Fed have indicated that a CBDC “may take many different forms,” and have laid out a set of preconditions for development of a CBDC that includes “clear legal authority” and adequate safeguards to address concerns regarding privacy, anti-money laundering, and more.<sup>60</sup>

### **Bank Capital, Leverage, and Stress Testing**

On March 19, 2021, the Fed effectively reinstated a capital requirement on the largest banks by announcing that it was ending a short-term adjustment to its calculation of the SLR that allowed large banks to include U.S. Treasury securities and central bank reserves in their reporting of Tier 1 capital.<sup>61</sup> Notwithstanding concerns raised by various experts that big bank capital and related requirements have been relaxed in recent years,<sup>62</sup> the Fed indicated it may propose future changes to the SLR. Chair Powell claimed that in doing so, the Fed “will take whatever actions are necessary to ensure that any changes we do make, or recommend, do not erode the overall strength of bank capital requirements.”<sup>63</sup> On June 24, 2021, the Fed announced the results that it had completed stress tests to measure 23 large banks’ response to stress in the commercial real estate and corporate debt sectors, and had concluded that they were well-capitalized enough to withstand a severe shock.<sup>64</sup> The Fed subsequently lifted remaining restrictions on stock buybacks and dividend payments, reportedly “paving the way for a sharp increase in buybacks and dividends.”<sup>65</sup>

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<sup>52</sup> See Fed, [Semiannual Reports on Banking Applications Activity](#) (accessed Jul. 6, 2021). Note that merger applications not approved were withdrawn, not denied. Also see Jeremy C. Kress, [Modernizing Bank Merger Review](#), (2020).

<sup>53</sup> Governor Michelle Bowman, [My Perspective on Banking Regulation and Supervision](#), (Feb. 16, 2021).

<sup>54</sup> The Capitol Forum, [Federal Reserve Wants to Ease Bank Merger Review Standards; seeks DOJ buy-in](#), (May 17, 2021).

<sup>55</sup> The White House, [Fact Sheet: Executive Order on Promoting Competition in the American Economy](#), (Jul. 9, 2021).

<sup>56</sup> House Financial Services Committee hearing, “[The Future of Real-Time Payments](#),” (Sep. 26, 2019).

<sup>57</sup> Fed, [Federal Reserve announces FedNow Pilot Program Participants](#) (Jan. 25, 2021).

<sup>58</sup> Fed, [Board invites comment on proposed rule to govern funds transfers over the Federal Reserve Banks’ FedNow Service](#) (June 1, 2021).

<sup>59</sup> Business Insider, [The Fed is advancing its efforts to develop a digital currency](#), (May 20, 2021).

<sup>60</sup> FedNotes, [Preconditions for a general-purpose central bank digital currency](#), (Feb. 24, 2021).

<sup>61</sup> Fed, [Federal Reserve announces temporary change to its supplementary leverage ratio for bank holding companies will expire as scheduled on March 31](#), (Mar. 31, 2021).

<sup>62</sup> For example, see Daniel K. Tarullo, former Fed Governor, [Taking the Stress Out of Stress Testing](#) (May 21, 2019); and Money and Banking, [An Open Letter to Randal K. Quarles, Federal Reserve Vice Chair for Supervision](#), (June 21, 2020).

<sup>63</sup> American Banker, [Key capital measure not working as Fed intended, Powell says](#) (June 16, 2021).

<sup>64</sup> Fed, [Federal Reserve releases results of annual bank stress tests](#), (Jun. 24, 2021).

<sup>65</sup> Barron’s, [Buybacks and dividends are on the way as banks pass stress tests](#), (Jun. 25, 2021).