CHAIRMAN KEVIN BRADY

JOINT ECONOMIC COMMITTEE

MAY 7, 2014

Economic Outlook

To start, I congratulate Chair Yellen on her appointment to head the Board of Governors of the Federal Reserve System. I welcome you to your first appearance before the Joint Economic Committee and look forward to many more.

June will mark the fifth anniversary of the end of the "Great Recession." By virtually every economic indicator, this recovery ranks as the weakest or near the bottom. This recovery's persistent weakness has created a Growth Gap relative to other recoveries over the last half century. For example, if this recovery had merely been average, then:

- The U.S. economy would be $1.4 trillion larger (Figure 1);
- American workers would have 5.7 million more private-sector jobs available (Figure 2); and
- A family of four would have over $1,000 per month in additional real after-tax income (Figure 3).

Ironically, for an Administration that has repeatedly bemoaned income inequality, the one exception to this weakness is Wall Street—where the S&P 500 Total Return Index, adjusted for inflation, has more than doubled.

Last week, the Bureau of Economic Analysis (BEA) and the Bureau of Labor Statistics (BLS) released conflicting data about the strength of this recovery. On the one hand, according to the BEA, real GDP growth was basically flat in the first quarter, and according to the BLS, the labor force participation rate fell in April to 62.8 percent, tying a multi-decade low only reached in the Carter and Obama Administrations. Moreover, the employment-to-population ratio is actually lower than when the recession ended, which means there are proportionally less adults working today than when the recovery began. That's headed the wrong direction.

On the other hand, the BLS reported that, for only the fifth time since the recession ended, the monthly growth of non-farm payroll jobs in April exceeded the equivalent average monthly job growth during past recoveries with the unemployment rate declining to 6.3 percent from its October 2009 peak of 10 percent.

Correctly judging the strength of the labor market is very important because the Federal Open Market Committee has tied the tapering of large-scale asset purchases and the normalization of interest rates to its assessment of the labor market.

Members of the FOMC attribute much of the slack in the labor market to cyclical factors and believe that a highly accommodate monetary policy can strengthen economic output and employment. However, if a substantial portion of the weakness in the labor market is due to structural factors such as an aging population and a skills mismatch, then maintaining a highly accommodative monetary policy could instead create economic bottlenecks that would trigger price inflation.

Addressing structural unemployment requires much different policies such as reforming education, strengthening job-training programs, and modernizing means-tested entitlement programs to encourage work.

I am encouraged that the FOMC began to taper large-scale asset purchases in December and appears on track to terminate these purchases before the end of this year. However, I am concerned that the FOMC stated that it will likely maintain its zero-interest rate policy long after QE ends, and at levels below those that "the Committee views as normal in the longer run."

I am equally concerned that the discretionary nature of changes to the FOMC's forward-guidance is undermining the Fed's credibility—weakening the confidence of market participants and increasing uncertainty.

I believe the Federal Reserve helped to stabilize financial markets after the panic in the fall of 2008, but extraordinarily low interest rates and repeated rounds of quantitative easing have done more to stimulate Wall Street than help hard-working American families on Main Streets across America. As I noted earlier, since the recession ended the S&P 500 Total Return Index, adjusted for inflation, is up 108.2 percent, while real after-tax income per capita is only up 4.2 percent.

The Fed has Wall Street roaring, but has left middle-class families and Main Street business behind.

Chair Yellen, your predecessor was supremely confident that the Fed had the knowledge, tools, and political fortitude to exit smoothly from the Fed's extraordinary monetary actions and normalize interest rates and the size of its balance sheet before an inflationary outbreak could occur.

Yet the Fed—like many central banks—has an unsatisfactory track record over the last century in identifying economic turning points and acting in a timely manner to maintain stable prices.

So today, I am hopeful that you can enlighten this Committee on several points:

1. What is the FOMC's assessment of the strength of the labor market? How much of the weakness in the labor market do you believe is due to cyclical factors and how much is due to structural factors? What statistics are FOMC members using to judge the health of the labor market and how much weight are they being given?

2. Can an overly accommodative monetary policy create asset price inflation that may not be fully captured by the CPI or the PCE index? Do high stock prices reflect the fundamental strength of our economy, or are they partially due to a highly accommodative monetary policy?

3. Has the FOMC's failure to abide by its own "communications channel" prescriptions created more uncertainty and undermined the FOMC's credibility? And, when will the FOMC return to a rules-based approach to monetary policy that helped to achieve the good performance of the U.S. economy during the "Great Moderation"?

4. Is the Federal Reserve Bank of San Francisco correct that higher federal taxes—including higher marginal rates on individual income, capital gains, and dividends—are presently the main cause of "fiscal drag" on our economy?

5. Is there a better way for Congress to address the spending side of our fiscal imbalances than the present sequester enacted as part of the *Budget Control Act of 2011*?

6. Is the Fed willing to make its balance sheet more transparent? Specifically, will the Fed provide a consolidated list of holdings that includes not only maturity values, but also average purchase prices for each issue and the current market value of each holding?

With that, Chair Yellen, I look forward to your testimony. And, I note that the record will be kept open for one week so that Members can submit additional written questions for the record.

Figure 1

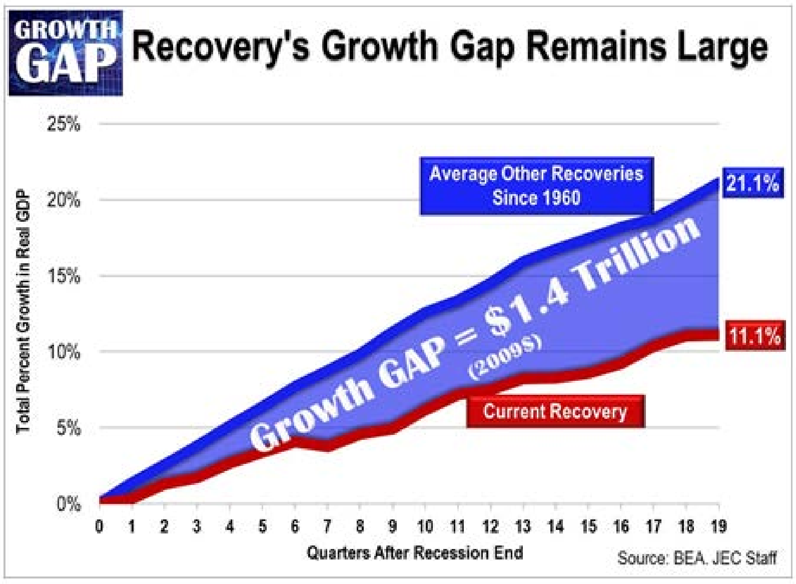

Figure 2

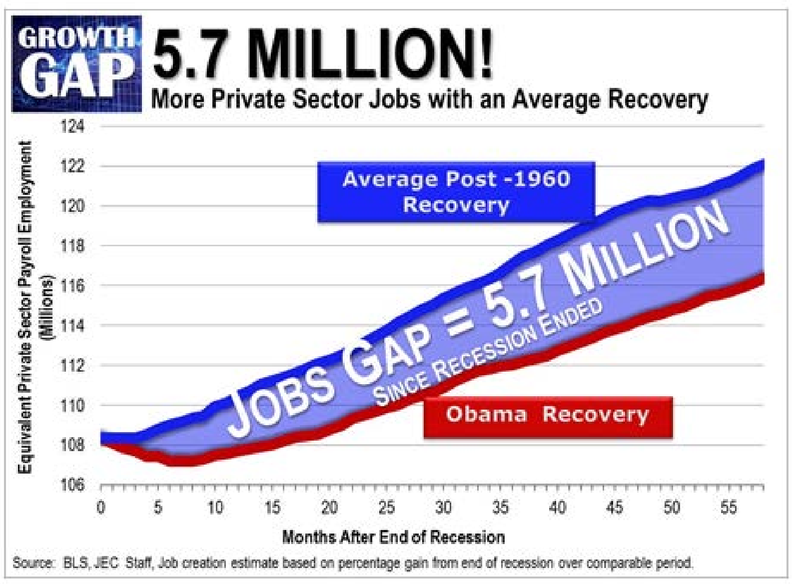

Figure 3