Central Banks

Chair Yellen Testimony before the U.S. Congress

Committee on Banking, Housing, and Urban Affairs

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- **Discretionary and data dependent policy will stay put through the normalization period**
- **Yellen refers to October as the anticipated end of QE3**
- **Some senators pressure for earlier federal funds rate increase to avoid financial bubbles**

Today's testimony reinforced the evidence that the FOMC hawkish members were likely defeated in the rules vs. discretionary policy argument and the discretionary policy will stay in place to see the completion of QE3 purchases and through the policy normalization process. In the stage of "prudent planning," Yellen perceives forward guidance as a comprehensive and sufficient tool to convey Fed policy. In defense of forward guidance replacing rule-based policy, Yellen stated that a "number of factors would make me disinclined to follow a mathematical rule. But it is important for the Fed to act in a predictable way," and there would be "no formula or mechanical answer on when the first rate increase will occur."

The decision on when the first federal funds lift-off from zero bound will occur continues to remain data dependent. And while Yellen reaffirmed that "the Committee's decisions about the path of the federal funds rate remain dependent on our assessment of incoming information and the implications for the economic outlook," she referred to the FOMC's Summary of Economic Projections as a useful source of FOMC participants' expectations. Yellen concluded that "what will actually happen clearly is going to depend on the progress the economy makes." Nevertheless, aside from the recent decline in the unemployment rate to 6.1%, Yellen also acknowledged that broader measures of the labor market are improving.

The QE3 "measured step" tapering would stay on the pre-planned course, ending the asset purchases program in October. "Very significant change" to the economic outlook would be required before altering the pre-set course of tapering. That change might take the form of the FOMC losing confidence that "the labor market would improve" and/or inflation progressing towards the 2% goal.

The reach for yield in the zero-lower-bound monetary policy environment has raised concern among both law makers and the Fed. Yellen's statement highlighted the ongoing issue of "brisk" issuance and stretched valuations of lower-rated corporate debt. She reassured that "we [the Fed] are closely monitoring developments in the leveraged loan market and are working to enhance the effectiveness of our supervisory guidance." Even though the macroprudential regulations are in place to contain financial risks, Yellen recognized that she "would never take off the table totally the idea that monetary policy might be needed to address financial-stability concerns."