OPENING STATEMENT OF REP. MELVIN WATT

Hearing Entitled, "Unwinding Emergency Federal Reserve Liquidity Programs and Implications for Economic Recovery"

Thursday, March 25, 2010

Today's hearing is another in a series of steps in Congress' ongoing effort to examine the consequences of the global economic crisis. Today, we focus on how the Federal Reserve must now unwind its responses to the domestic part of the crisis in ways that minimize the future impacts of the responses so they don't have a deleterious impact on our economy.

In response to the global economic crisis, the Federal Reserve injected over $2 trillion into the economy through various liquidity initiatives, including the Term-Asset Backed Securities Loan Facility (TALF), the Commercial Paper Funding Facility and the Fed's commitment to purchase about $1.25 trillion of mortgage-backed securities. The immediate result of the Fed's actions was to expand its balance sheet dramatically and to put an unprecedented volume of reserves into the banking system. These steps were designed to unfreeze the domestic credit markets. Many economists and commentators credit the decisive steps taken by the Fed with saving the

U.S. economy from collapse and staving off an economic downturn that might have equaled or exceeded the Great Depression.

The central issue of today's hearing is how the Fed will decide the proper timing and sequencing of unwinding these emergency liquidity programs. The Fed must withdraw this liquidity while keeping inflation in check and encouraging job growth, all without hurting the fragile economic recovery that is underway. Every analysis I have seen has suggested that this will be a delicate balancing act that will have to be done just right to avoid significant damage to the economy. If recent history is any guide, the decisions the Fed makes to carry out this delicate balancing act, regardless of what these decisions are, will be second-guessed by the Congress and the public and this could call into question the independence of the Fed.

I am hopeful that we can use this hearing to understand better the policy options available to the Fed to unwind these programs and the potential policy implications of the various options. At the same time, I think we should be careful not to infringe on the Fed's ability and willingness to exercise its independent judgment about which options will be the most desirable and effective. So I view this hearing as an effort to educate members of our Committee, not as a forum for us to try to intimidate or browbeat the Fed into pursuing specific options.

We have asked the witnesses to provide information about specific monetary policy tools and options that are available to the Fed, including paying interest on reserves, entering reverse repurchase agreements, utilizing the recently introduced Term Deposit facility, conducting direct asset sales of the mortgage-backed securities it has purchased and any other options that might be appropriate. We need to understand the projected advantages and disadvantages of each option so we'll understand better what the Fed is doing when it uses particular options and, perhaps, even be in a position to explain to our constituents why particular steps are being taken.

Some economists have called into question whether traditional monetary policy tools, like lower interest rates, can work. They say that the U.S. could be in a "Balance-Sheet Recession" that occurs when private businesses are so focused on repairing their balance sheets after an asset-price bubble burst that the economy does not respond to normal monetary policy tools. They caution against cutting off emergency economic measures too soon, the mistake made by policymakers in Japan that resulted in a decade-long economic stagnation.

I especially look forward to Chairman Bernanke telling us how the Fed can effectively unwind its emergency liquidity programs while reducing inflationary fears, encouraging job growth and maintaining the fragile economic recovery, knowing full well that we all expect him to be a Master Conductor who will "wave the magic wand" that will lead our economy to play sweet music again.