Statement of Senator Tim Johnson
Senate Committee on Banking, Housing and Urban Affairs
"The Semiannual Monetary Policy Report to the Congress"
July 15, 2008

Chairman Dodd. Thank you very much for holding today's hearing. I do not think there could be a more appropriate time for the Federal Reserve Chairman to give his Semiannual Monetary Report to Congress. Since the last report to Congress in February, the Federal Reserve has taken unprecedented actions using many tools in its monetary policy tool box to affect the supply and availability of money, and the rate of interest on that money. These actions include the lowering of interest rates by 325 basis points over the past year, a step generally used to combat unemployment in a recession. Instead, this tool was used to create liquidity for hurting banks. As you are aware, Mr. Chairman, the Fed's monetary policy is being pulled in different directions by its duel goals: we are in a situation where continued low interest rates could fuel inflation, in fact today's news places inflation at a level higher than economists predicted. That said, increasing interest rates could be harmful to the banks and credit availability to consumers. This problem is further complicated by high oil and food prices, and a housing market in flux.

In addition, the Fed created the Primary Dealer Credit Facility and the Term Securities Lending Facility, brokered the deal for JP Morgan Chase to purchase a faltering Bear Stearns, and most recently opening the discount window to Fannie Mae and Freddie Mac. Each of these steps, while needed, are unique.

Given the recent market concerns regarding Fannie Mae and Freddie Mac, I hope to hear more about the Federal Reserve's decision to give them access to capital similar to that recently made available to investment banks. Freddie Mac and Fannie Mae provide essential stability to mortgage markets in our country even in these uncertain times. I am hopeful that GSE reform can be completed quickly to provide additional oversight and protect the secondary mortgage market. I also look forward to reviewing the Treasury's proposal in the coming days to address expanding the line of credit for Freddie and Fannie and giving the Federal Reserve some oversight in their capital requirements. These proposed changes make a strong regulator even more necessary to ensure the safety and soundness of the GSEs. While Fannie Mae and Freddie Mac were in a stronger regulatory situation than investment banks, there must be additional oversight and limitations established if any private business is forced to turn to the federal government for this type of assistance.

I think it is safe to say that the slowdown in the housing market turned into a mortgage crisis because of lax oversight by federal regulators and lenders and borrowers taking on too much risk. This then spread into the financial markets, and finally is affecting confidence in Freddie Mac and Fannie Mae.

Despite the Fed's actions to stabilize financial markets, we have also recently seen the failure of the $32 billion-asset thrift, IndyMac. This failure will cost the FDIC fund $4 billion to $8 billion and will likely take the federal deposit fund below the 1.15% reserve ratio threshold, a threshold that will only be restored with an increase in premiums to member institutions. IndyMac specialized in Alt –A mortgages to consumers without income documentation and assets necessary to qualify as prime borrowers. Why were steps not taken sooner to address the lending practices of this bank?

In addition, yesterday, the Federal Reserve finalized its new HOEPA regulations. These new regulations include needed changes regarding income documentation, ability to pay, escrow, and prepayment penalties for mortgages. I hope these changes will lead to more sound lending practices, but will not make it harder for qualified homebuyers to gain access to credit.

As the financial turmoil continues, I applaud the Federal Reserve for using its tools to lessen the volatility in the markets, but I have concerns going forward that many of these tools have been used up and that the tools left will not give the Federal Reserve the flexibility it has had over the past year. I am also concerned that some of these actions may perpetuate an idea that the government is in the business of propping up ventures when they go bad at no cost to the risk takers. I am committed to ensuring the safety and soundness of the financial sector without burdening the taxpayer, and I look forward to hearing how the Fed will continue to address to problems plaguing our economy.