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Opening Statement
Full Committee Hearing: The Semiannual Testimony on the Federal Reserve's Supervision and Regulation of the Financial System
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Thank you, Mr. Chairman.

Congress has provided the Fed with a great deal of independence to isolate it from political influence. However, Congress also gave the Fed narrowly-defined monetary and regulatory missions.

In the regulatory domain, the Fed has the authority to ensure the safety and soundness of the financial institutions that it regulates. But it doesn't have the authority to seek out and address political or theoretical risks in the distant future.

The Fed's recent actions raise concerns that it's losing sight of this constraint. Consider its increasing focus on the supposed risks of global warming to the financial system. In March, John Cochrane, a distinguished economist at Stanford, powerfully argued before this Committee that "climate change poses no measurable risk to the financial system."

Put simply, neither the warming of the earth's temperature nor severe weather events are a threat to the stability of the financial system. Experience bears this out. In the last 11 years—a time period that included four of the five costliest hurricanes in U.S. history—we haven't found one bank failure caused by any weather event. In fact, we're not aware of any bank failure in the modern era due to weather.

Nevertheless, the Fed recently joined the Network of Central Banks and Supervisors for Greening the Financial System. The network's stated aim is to use financial regulation to "mobilize mainstream finance to support the transition toward a sustainable economy." In other words, to direct credit away from the fossil fuel sector.

Such actions are inconsistent with the Fed's mandate and authorities. As Chair Powell himself has said, "society's broad response to climate change is for others to decide—in particular, elected leaders."

If Congress believes current environmental laws don’t adequately address global warming risks, changes should be enacted through the legislative process by those accountable to voters—not by financial regulators who have neither expertise nor accountability.

This principle extends to other issues as well. I’m troubled that regional Fed banks are focusing on politically-charged issues, like racial justice activism, that are outside the Fed’s mission and expertise. This week I sent letters to three regional Federal Reserve Banks about this behavior and requested information from them.

Instead of seeking to tackle issues that are outside the Fed’s mandate and authorities, the Fed should focus on supervising the risks within its domain. For example, the Fed’s recent Financial Stability Report highlights several risks that should be monitored—such as high asset prices. However, the report fails to consider a primary cause of these risks: the Fed’s own excessively accommodative monetary policy.

Our economy experienced a significant shock last year, but it was met with unprecedented monetary and fiscal support. And the economy is now in full recovery mode. As a result, I don’t understand the justification for the Fed maintaining its policy of near-zero interest rates and $1.4 trillion in bond purchases per year, amounting to roughly half of new Treasury debt issuance since the beginning of the pandemic. Let’s not kid ourselves: we are effectively monetizing about $1 trillion of federal debt per year.

This is especially troubling because the warning signs of inflation are getting louder. We may be seeing asset bubbles forming already, and history is replete with examples where the bursting of bubbles led to financial instability. As President Clinton’s Treasury Secretary Larry Summers noted yesterday, the Fed needs to start “explicitly recognizing that overheating, and not excessive slack, is the predominant near-term risk for the economy.”

I'm concerned that the Fed’s current approach almost guarantees that it will be behind the curve if inflation becomes problematic and persistent—for two reasons. First, the Fed has announced it will allow inflation to run above its two percent target level. Second, the Fed insists that the inflation we’re experiencing now is transitory. But you can only know something is transitory when it comes to an end. What if it does not come to end?

Another side effect of the Fed's asset purchases is the regulatory implications of such an abundance of reserves in the banking system. When the Fed purchases Treasuries or agency securities, the aggregate level of reserves rises correspondingly. As a result, reserves in the banking system have risen by over $2 trillion dollars and bank leverage ratios have experienced pressure from absorbing these riskless reserves that the Fed is creating.

Last year, the Fed recognized this problem and issued temporary relief that allowed banks to accommodate a surge of reserves. That relief has expired and there are signs that it was needed. The Fed recently stated that it will address this problem on a permanent basis. I urge you to do so swiftly.

Let me conclude with this: the Fed doesn't need to exceed its mandate and authorities to find risks to address. The siren calls of politically-charged endeavors should be ignored, in order to preserve the credibility and independence of the Fed. There are plenty of risks within its reach, including those to which it may be contributing.