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Statement by

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Chair

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before the

Committee on Banking, Housing, and Urban Affairs

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Chairman Johnson, Ranking Member Crapo, and members of the Committee, I am pleased to present the Federal Reserve's semiannual *Monetary Policy Report* to the Congress. In my remarks today, I will discuss the current economic situation and outlook before turning to monetary policy. I will conclude with a few words about financial stability.

Current Economic Situation and Outlook

The economy is continuing to make progress toward the Federal Reserve's objectives of maximum employment and price stability.

In the labor market, gains in total nonfarm payroll employment averaged about 230,000 per month over the first half of this year, a somewhat stronger pace than in 2013 and enough to bring the total increase in jobs during the economic recovery thus far to more than 9 million. The unemployment rate has fallen nearly 1-1/2 percentage points over the past year and stood at 6.1 percent in June, down about 4 percentage points from its peak. Broader measures of labor utilization have also registered notable improvements over the past year.

Real gross domestic product (GDP) is estimated to have declined sharply in the first quarter. The decline appears to have resulted mostly from transitory factors, and a number of recent indicators of production and spending suggest that growth rebounded in the second quarter, but this bears close watching. The housing sector, however, has shown little recent progress. While this sector has recovered notably from its earlier trough, housing activity leveled off in the wake of last year's increase in mortgage rates, and readings this year have, overall, continued to be disappointing.

Although the economy continues to improve, the recovery is not yet complete. Even with the recent declines, the unemployment rate remains above Federal Open Market Committee (FOMC) participants' estimates of its longer-run normal level. Labor force participation appears weaker than one would expect based on the aging of the population and the level of unemployment. These and other indications that significant slack remains in labor markets are corroborated by the continued slow pace of growth in most measures of hourly compensation.

Inflation has moved up in recent months but remains below the FOMC's 2 percent objective for inflation over the longer run. The personal consumption expenditures (PCE) price index increased 1.8 percent over the 12 months through May. Pressures on food and energy prices account for some of the increase in PCE price inflation. Core inflation, which excludes food and energy prices, rose 1.5 percent. Most Committee participants project that both total and core inflation will be between 1-1/2 and 1-3/4 percent for this year as a whole.

Although the decline in GDP in the first quarter led to some downgrading of our growth projections for this year, I and other FOMC participants continue to anticipate that economic activity will expand at a moderate pace over the next several years, supported by accommodative monetary policy, a waning drag from fiscal policy, the lagged effects of higher home prices and equity values, and strengthening foreign growth. The Committee sees the projected pace of economic growth as sufficient to support ongoing improvement in the labor market with further job gains, and the unemployment rate is anticipated to continue to decline toward its longer-run sustainable level. Consistent with the anticipated further recovery in the labor market, and given that longer-term inflation expectations appear to be well anchored, we expect inflation to move back toward our 2 percent objective over coming years.

As always, considerable uncertainty surrounds our projections for economic growth, unemployment, and inflation. FOMC participants currently judge these risks to be nearly balanced but to warrant monitoring in the months ahead.

Monetary Policy

I will now turn to monetary policy. The FOMC is committed to policies that promote maximum employment and price stability, consistent with our dual mandate from the Congress.

Given the economic situation that I just described, we judge that a high degree of monetary policy accommodation remains appropriate. Consistent with that assessment, we have maintained the target range for the federal funds rate at 0 to 1/4 percent and have continued to rely on large-scale asset purchases and forward guidance about the future path of the federal funds rate to provide the appropriate level of support for the economy.

In light of the cumulative progress toward maximum employment that has occurred since the inception of the Federal Reserve's asset purchase program in September 2012 and the FOMC's assessment that labor market conditions would continue to improve, the Committee has made measured reductions in the monthly pace of our asset purchases at each of our regular meetings this year. If incoming data continue to support our expectation of ongoing improvement in labor market conditions and inflation moving back toward 2 percent, the Committee likely will make further measured reductions in the pace of asset purchases at upcoming meetings, with purchases concluding after the October meeting. Even after the Committee ends these purchases, the Federal Reserve's sizable holdings of longer-term securities will help maintain accommodative financial conditions, thus supporting further progress in returning employment and inflation to mandate-consistent levels.

The Committee is also fostering accommodative financial conditions through forward guidance that provides greater clarity about our policy outlook and expectations for the future path of the federal funds rate. Since March, our postmeeting statements have included a description of the framework that is guiding our monetary policy decisions. Specifically, our decisions are and will be based on an assessment of the progress--both realized and expected--toward our objectives of maximum employment and 2 percent inflation. Our evaluation will not hinge on one or two factors, but rather will take into account a wide range of information, including measures of labor market conditions, indicators of inflation and long-term inflation expectations, and readings on financial developments.

Based on its assessment of these factors, in June the Committee reiterated its expectation that the current target range for the federal funds rate likely will be appropriate for a considerable period after the asset purchase program ends, especially if projected inflation continues to run below the Committee's 2 percent longer-run goal and provided that inflation expectations remain well anchored. In addition, we currently anticipate that even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the federal funds rate below levels that the Committee views as normal in the longer run.

Of course, the outlook for the economy and financial markets is never certain, and now is no exception. Therefore, 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. If the labor market continues to improve more quickly than anticipated by the Committee, resulting in faster convergence toward our dual objectives, then increases in the federal funds rate target likely would occur sooner and be more rapid than currently envisioned. Conversely, if economic performance is disappointing, then the future path of interest rates likely would be more accommodative than currently anticipated.

The Committee remains confident that it has the tools it needs to raise short-term interest rates when the time is right and to achieve the desired level of short-term interest rates thereafter, even with the Federal Reserve's elevated balance sheet. At our meetings this spring, we have been constructively working through the many issues associated with the eventual normalization of the stance and conduct of monetary policy. These ongoing discussions are a matter of prudent planning and do not imply any imminent change in the stance of monetary policy. The

Committee will continue its discussions in upcoming meetings, and we expect to provide additional information later this year.

Financial Stability

The Committee recognizes that low interest rates may provide incentives for some investors to “reach for yield,” and those actions could increase vulnerabilities in the financial system to adverse events. While prices of real estate, equities, and corporate bonds have risen appreciably and valuation metrics have increased, they remain generally in line with historical norms. In some sectors, such as lower-rated corporate debt, valuations appear stretched and issuance has been brisk. Accordingly, we are closely monitoring developments in the leveraged loan market and are working to enhance the effectiveness of our supervisory guidance. More broadly, the financial sector has continued to become more resilient, as banks have continued to boost their capital and liquidity positions, and growth in wholesale short-term funding in financial markets has been modest.

Summary

In sum, since the February *Monetary Policy Report*, further important progress has been made in restoring the economy to health and in strengthening the financial system. Yet too many Americans remain unemployed, inflation remains below our longer-run objective, and not all of the necessary financial reform initiatives have been completed. The Federal Reserve remains committed to employing all of its resources and tools to achieve its macroeconomic objectives and to foster a stronger and more resilient financial system.

Thank you. I would be pleased to take your questions.