FedFin Client Report

Wednesday, June 28, 2017

House FinServ Targets IOER as Payments Escalate

Client Report: **IOER5**

Executive Summary

In this report, we assess today's House FinServ Monetary Policy and Trade Subcommittee hearing at which Republicans took the Fed to task for post-crisis monetary policies in general and IOER in particular. Both Chairman Barr (R-KY) and Vice Chairman Williams (R-TX) charged that paying IOER is paying banks not to lend, diverting capital from the economy. While few Democrats attended today's hearing, Rep. Sherman (D-CA) also criticized IOER on these same grounds. While witnesses generally agreed with these assertions and no Members came to IOER's defense, one witness noted that removing IOER would likely drive banks to charge for deposits – a conclusion consistent with FedFin work. Both Republicans and Democrats also expressed significant concern about the distributional impacts of the Fed's unconventional monetary policy – a concern FedFin has addressed extensively in the past.

Analysis

Opening Statements

Chairman Barr blasted monetary policy as slow to react and post-crisis policy as creating a new normal of distortion. He argued that, as a result, the recovery is unnecessarily slow and Americans have lost trillions of dollars.

Ranking Member Moore (D-WI) argued that savers would be far worse off if the Fed had failed to take extraordinary action during the crisis. She defended Dodd-Frank, the CFPB, and the DoL Fiduciary rule.

Rep. Foster (D-IL) argued for more emphasis on the distributional effects of monetary policy and for the Fed to release additional data on it. He also called for an examination of the dual mandate with this in mind.

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Rep. Williams directly blamed IOER for sluggish growth. He argued that banks will not lend out reserves as long as they are paid above-market rates.

Testimony

Norbert Michel, Senior Research Fellow at the Heritage Foundation, stated that monetary policy has not worked for Main Street. He argued that the Fed's large balance sheet puts taxpayers at risk and that Congress cannot allow the Fed to continue to operate under the existing framework.

Paul Kupiec, Resident Scholar at the American Enterprise Institute, described the Fed as the most powerful federal agency and argued that Congress has a right to criticize it without being charged with undermining its independence. He said that since the crisis, the economy has underperformed and that low rates are having perverse distributional effects and hurting savers. On other hand, he argued that the largest banks have benefited from unconventional policies. While he recognized the FRB does not have a wealth-equality mandate, he said it is naïve to believe it will be insulated from the political backlash from the unintended effect of monetary policies. He pushed for more Congressional oversight and for the Fed Chair's Humphrey-Hawkins written testimony to be made publicly available before the hearings in order to subject it to expert opinion.

Karen Dynan, Nonresident Senior Fellow at the Peterson Institute for International Economics, argued that accommodative policy has resulted in a strong recovery. While she recognized that some savers have been hurt by low rates, she argued that many savers are also borrowers and that everyone has benefited from higher employment levels. She criticized provisions of the Choice Act, such as regular GAO audits and subjecting monetary policy to a rule, for undermining the Fed's ability to meet its mandates.

Alex Pollock, Distinguished Senior Fellow at the R Street Institute, argued that the Fed needs to be more accountable to Congress. He called for the Fed to be required to release a quarterly savings-impact analysis and argued that current policies hurt savers and discourage thrift.

Q&A

Chairman Barr and Rep. Williams attacked IOER as preventing lending and Rep. Williams expressed particular concern that IOER is being paid to large banks. Mr. Michel noted that IOER payments will continue to increase as interest rates normalize and described escalating payments as “almost a bailout.” He also argued that winding down the Fed’s balance sheet without ending IOER and reverse repos would contract the economy but said pairing back IOER would offset this. Rep. Sherman argued that excess reserves should not be incentivized while deserving businesses need loans. While in previous questioning Mr. Kupiec described IOER as problematic, he also said that banks will charge money for deposits without IOER which would drive large amounts of money out of the banking sector and into money market mutual funds. Mr. Pollock argued that stopping IOER would encourage banks to make loans which would generate inflation. Ms. Dynan said there is no evidence excess reserves are preventing lending but that it is important to examine why IOER payments are not being passed on to savers.

Reps. Kildee (D-MI) and Huizenga (R-MI) expressed concern regarding rising income inequality and asked how much Fed policy contributes to this. Mr. Kupiec said Fed policy unintentionally contributes to inequality largely through increasing asset prices.

Reps. Emmer (R-MN) and Love (R-UT) attacked the Fed’s dual mandate. Rep. Love said that a sole price stability mandate would end up increasing employment in the long run. Rep. Moore defended the importance of the duel mandate.

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