

For release on delivery
2:00 p.m. EST
December 16, 2013

Remarks by

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Chairman

Board of Governors of the Federal Reserve System

at the

Ceremony Commemorating the Centennial of the Federal Reserve Act

Washington, D.C.

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Paul and Alan have me at a disadvantage. Each of us was asked to reflect on our own term in office. But they have the benefit of perspective, whereas my term still has a short time to run. Moreover, work on some of the Federal Reserve's most important challenges of the past few years--notably, achieving a full economic recovery from the crisis and putting in place a new financial regulatory system--is still ongoing. Nonetheless, I will offer a few thoughts on the past very eventful eight years.

The Federal Reserve's extraordinary response to the financial crisis and the Great Recession that followed was, in one sense, nothing new. We did what central banks have done for many years and what they were designed to do: We served as a source of liquidity and stability in financial markets, and, in the broader economy, we worked to foster economic recovery and price stability. However, in another sense, what we did *was* very new--it was unprecedented in both scale and scope, and it made use of a number of tools that were new, or at least not part of the standard central bank toolkit. We found that these new tools were necessary if we were to fulfill the classic functions of a central bank in the context of a 21st century economic and financial environment.

When the financial system teetered near collapse in 2008 and 2009, we responded as the 19th century British essayist Walter Bagehot advised, by serving as liquidity provider of last resort to stressed financial firms and markets.¹ But we did so in an institutional environment that was very different, and in many ways much more complex, than the one that Bagehot knew. For example, the recent crisis involved runs on financial institutions, as occurred in classic panics. But in 2008, rather than a run of retail bank deposits, the runs occurred in various forms of short-term, uninsured wholesale funding,

¹ See Walter Bagehot ([1873] 1897), *Lombard Street: A Description of the Money Market* (New York: Charles Scribner's Sons).

such as commercial paper and repurchase agreements. Moreover, although commercial banks suffered large losses and some came under significant pressure, the crisis hit particularly hard those nonbank institutions most dependent on wholesale funding, such as investment banks and securitization vehicles. Thus, the Fed lent not only to commercial banks, but also extended its liquidity facilities to critical nonbank institutions and key financial markets, such as the commercial paper market. To minimize the risk of strains abroad feeding back on U.S. dollar funding markets, the Fed also coordinated with foreign central banks to create a network of currency swap lines.

Beyond the provision of liquidity, the Fed worked with other agencies both here and abroad to help restore public confidence in the financial system. Notably, we led the development of stress-testing large banking organizations' capital adequacy. The first stress tests, in 2009, and the public disclosure of their results made it possible for large U.S. banks to once again attract private capital. Since 2009, the stress tests and disclosures, together with other regulatory and supervisory actions, have contributed to a doubling in capital held by the largest U.S. financial institutions and the resumption of more-normal flows of credit.

The Fed has also worked to draw the appropriate lessons from the crisis and to take the steps necessary to help avoid a similar event in the future. As those assembled here well know, the deliberations that led to the founding of the Federal Reserve were precipitated by a financial panic, the Panic of 1907. The preservation of financial stability was consequently a principal goal of the creators of the new central bank. In response to the Panic of 2008, the Federal Reserve has returned to its roots by restoring financial stability as a central objective alongside the traditional goals of monetary

policy. We have refocused our supervision of financial institutions to take a more “macroprudential” approach that fosters systemic stability as well as the stability of individual institutions. We also more extensively monitor the financial system as a whole and, in cooperation with other agencies, have put in place stronger oversight of systemically important financial firms, including higher capital and liquidity requirements, tougher supervision, and a process for the orderly resolution of failed firms.

We have also had to be innovative in finding ways to use monetary policy to help the economy recover from the deep recession that followed the crisis. Providing adequate monetary accommodation has not been a straightforward task because our principal monetary policy tool, the target for the federal funds rate, has been stuck near zero since the end of 2008. Consequently, we’ve had to find other ways to bring monetary policy to bear, notably including techniques designed to influence longer-term interest rates. For instance, the Fed, like several other central banks, has purchased longer-term securities to put downward pressure on longer-term interest rates, help ease financial conditions, and promote a stronger recovery.

A significant aspect of finding innovative ways to execute our duties as a central bank in a new, more complex environment has been the ongoing revolution in communication and transparency. Part of that effort has involved formally defining our goals under the mandate for maximum employment and price stability given to us by the Congress. Two years ago, we established 2 percent as our inflation goal, and we regularly communicate policymakers’ views of the level of unemployment expected to correspond to maximum sustainable employment over time. Additionally, our monetary

policy has come to rely more heavily on “forward guidance.” With our short-term policy rate about as low as it can practicably go, we have sought to ease financial conditions further and provide additional impetus to the recovery by communicating both quantitatively about the likely future path of our policy rate and qualitatively about the likely evolution of our balance sheet. Other central banks around the world have met the challenge of current conditions with similar innovations. And I would be remiss if I did not point out, especially with Paul and Alan here, that the Fed’s recent communications innovations owe a great deal to developments like the monetary targeting framework devised under Chairman Volcker and the post-Federal Open Market Committee statement and qualitative forward guidance introduced under Chairman Greenspan.

In summary, the financial crisis that the Fed confronted five years ago was in many ways analogous to the panics that central banks have faced for centuries. But, at the same time, the crisis and the deep recession that followed occurred in an economic and financial environment that was certainly different, and in many ways more complex, than in the past. The Federal Reserve found ways to carry out its traditional central bank functions in this environment, and we are working with other policymakers, domestically and internationally, to put in place a strengthened regulatory framework that will help preserve stability in the face of the complexity, interconnectedness, and innovation in our modern financial system.

One of my personal objectives since I became Chairman has been to increase the transparency of the Fed--to more clearly explain how our policies are intended to work and the thinking behind our decisions. As I already noted, improved communication can help our policies work better, whether through the disclosure of bank stress-test results or

by helping the public and market participants better understand how monetary policy is likely to evolve. Ultimately, however, the most important reason for transparency and clear communication is to help ensure the accountability of our independent institution to the American people and their elected representatives. Clarity, transparency, and accountability help build public confidence in the Federal Reserve, which is essential if it is to be successful in fostering stability and prosperity.