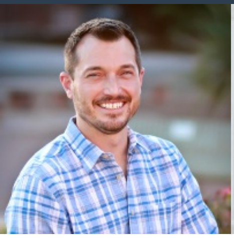


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# Janet Yellen Facing a Whole New World

Fed Chair **Janet Yellen**'s semiannual testimony before Congress this week comes as the banking industry is about to undergo a dramatic makeover.

Consequently, the central bank leader can expect to face a barrage of questions on what role she believes **the Fed** will play as banks stake out a new place in the post-financial crisis world.

**President Donald Trump** is pushing for **a Dodd-Frank makeover,** one that would see substantial loosening of the changes made under the reform act passed in 2010. Republicans are joining him in an effort not so much to relax the capital buffers instituted after the crisis but rather to get banks in the business of greasing the U.S. economic machine.

Yellen took the reins early in the implementation of those changes. With her term about to expire and multiple replacements likely on the way for her organization, she'll likely be asked what she sees ahead and how the Fed fits into the new landscape.

"The Republicans are feeling their oats in terms of pushing their agenda, which goes very much contrary to what the board's been doing for the last few years," said Christopher Whalen, senior managing director and head of research at Kroll Bond Rating Agency.

Hardly a darling of the right, Yellen has helmed the Fed during a time when regulators have been **criticized** for holding the reins too rightly on banks. With a Republican in the Oval Office and the party controlling both houses of Congress, her influence on policy going forward likely will be limited.

"She'll defend the Fed's position in what they have done to date. But ultimately, it's not her job to tell them what to do," Whalen said. "The institutional memory of the Fed during that battle of Dodd-Frank is when they came very close to having all their regulatory powers stripped away. They're going to have to be very aware of the political winds, because they've clearly changed."

## Tarullo leaves gap

The winds aren't just shifting in Congress. They're also going to be blowing in a different direction for the Fed soon.

## National Average Mortgage Rates


| | Rate | Change | Points |
|---|---|---|---|
| **Mortgage News Daily** | | | |
| 30 Yr. Fixed | 7.45% | -0.07 | 0.00 |
| 15 Yr. Fixed | 6.86% | -0.05 | 0.00 |
| 30 Yr. FHA | 6.95% | -0.05 | 0.00 |
| 30 Yr. Jumbo | 7.64% | -0.04 | 0.00 |
| 5/1 ARM | 7.50% | -0.05 | 0.00 |
| **Freddie Mac** | | | |
| 30 Yr. Fixed | 7.17% | -0.27 | 0.00 |
| 15 Yr. Fixed | 6.44% | -0.32 | 0.00 |
| **Mortgage Bankers Assoc.** | | | |
| 30 Yr. Fixed | 7.24% | +0.11 | 0.66 |
| 15 Yr. Fixed | 6.75% | +0.11 | 0.64 |
| 30 Yr. FHA | 7.01% | +0.11 | 0.94 |
| 30 Yr. Jumbo | 7.45% | +0.05 | 0.56 |
| 5/1 ARM | 6.64% | +0.12 | 0.87 |

Rates as of: 4/26

## Recent Housing Data

| | | Value | Change |
|---|---|---|---|
| Mortgage Apps | Apr 24 | 196.7 | -2.67% |
| Building Permits | Mar | 1.46M | -3.95% |
| Housing Starts | Mar | 1.32M | -13.15% |
| New Home Sales | Mar | 693K | +4.68% |
| Pending Home Sales | Feb | 75.6 | +1.75% |
| Existing Home Sales | Feb | 3.97M | -0.75% |

| | | Value | Change |
|---|---|---|---|
| Builder Confidence | Mar | 51 | +6.25% |

Daniel Tarullo announced Friday he **will leave in early April** after serving as the Fed's de facto banking regulator since the crisis.Though the move was highly anticipated, confirmation that a key central bank regulator was heading out the door rekindled the bank-led Trump rally in the stock market.

"The elimination of Daniel Tarullo as a force within the Fed and American banking is a very **positive step** toward real deregulation in core banking," Bove, vice president for equity research at Rafferty Capital Markets, said in a note to clients. "It suggests that the banks will be able to operate more freely in the financial markets in obtaining funds and manufacturing products. This is a big, big plus."

In addition to Tarullo's exit, the terms of both Yellen and Vice Chair Stanley Fisher expire in 2018, giving Trump the ability to shift the Fed away from a regulatory regime that focuses on high capital levels and sharp restrictions on risk-taking.

Going forward, Republicans will be looking for an environment that still ensures big Wall Street banks **behave themselves** but allows smaller institutions a freer hand.

"The new supervisory emphasis will likely reshape the way in which the Fed implements **Dodd-Frank** requirements to relieve smaller banks of some of the associated compliance burdens and costs," William Lee, head of North America economics at Citigroup, said in a note. "The riskiness of bank activities may play a growing role in setting capital levels, rather than stress test results."

Wall Street is expecting GE Energy Financial Services CEO David Nason to take over as the vice chair of supervision, a position mandated under Dodd-Frank but one that former President Barack Obama never filled, opting instead to let Tarullo essentially do the job without the title. Others under consideration include former BB&T chief John Allison, FDIC vice chair and former Kansas City Fed President Thomas Hoenig, and former SEC commissioner Paul Atkins.

## Where Yellen fits

As the sands shift, Yellen will give her **first congressional testimony** during the administration of a president who derided her during the campaign and said she should be "ashamed" of the way she has run the Fed.

Trump has avoided any **direct** criticism of Yellen since winning the election in November. Wall Street's eyes, then, may be as fixated this week as much on what the Fed chair has to say as on Trump's Twitter feed, which the president has used to castigate his enemies.

**Trump cannot fire Yellen**, but if he doesn't like what he hears it could strengthen his resolve not to reappoint her when her term officially expires.

Yellen "may give some signals about how much she will push back against the Trump administration's regulatory agenda," Keefe, Bruyette & Woods analysts said. "Yellen's role in determining the speed at which the Trump administration can enact its financial regulatory agenda (and possibly its ultimate outcome) is among the biggest unknowns in forecasting how financial regulation will change in the next two years."

There are **multiple subplots** as well.

Kroll's Whalen said a movement afoot on Capitol Hill to break off from the global Basel banking standards could draw some questions as well.

And of course there will be the usual inquiries about monetary policy: When the Fed moves again and how quickly will be paramount. Fed officials in December indicated three hikes are likely this year and next, though the market currently expects only two for 2017.

In addition to the banking regulatory changes, some members of Congress are expected to push for the Fed to take a **rules-based approach to rates**, increasing or decreasing only when certain economic data targets are hit. Even then, the Fed likely would get enough leeway to move as it chooses as long as it provides an explanation.

However, Wednesday's hearing could generate the most news for the future of banks.

"The opportunity to rein in the Fed will exist," Bove said. "More importantly, the Tarullo regulations can be eased. The ability of banks to acquire raw material and make loans based on free market considerations will be enhanced. The Fed's stranglehold on the banking industry and its ability to function freely will be eased."

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