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Fed likely to quit buying bonds, putting Congress in debt corner

Bernanke seeks to allay criticism at news conference

By Patrice Hill - April 27, 2011

The Federal Reserve likely will make life more difficult for Congress this week by affirming the June end of its controversial $900 billion bond-buying program that has financed a large part of the government's record $1.6 trillion budget deficit this year.

The move to force the Treasury to find other buyers for the nation's burgeoning debt comes even as Fed Chairman Ben S. Bernanke seeks to allay criticism in Congress of the Fed's secretive ways by holding a first-ever news conference Wednesday to discuss its decisions after a two-day meeting.

The hoopla over the press conference in the run-up to the meeting appeared to overshadow the likely end of the much-criticized program to try to boost the economy by driving down long-term interest rates with Treasury securities purchases.

But analysts say the Fed's move will trigger a significant reckoning for legislators and an administration that has gone on a debt-financed splurge of spending and tax cuts since 2008.

Euler Hermes economist Daniel C. North said the Fed's plans are even more foreboding for Congress than the warning legislators got last week from Standard & Poor's Corp. that the United States could lose its coveted AAA credit rating if it doesn't move quickly to rein in the budget deficit.

"S&P gave a polite wake-up call. The Fed could trip a fire alarm" by ending its $600 billion of Treasury bond purchases as well as stopping the reinvestment of another $300 billion in maturing mortgage securities into Treasurys, he said.

"That would tell Congress that the market for their debt just got a lot smaller, and that interest rates will continue upward, making it even harder for them to tame the deficit and the debt," he said.

Investment analyst Peter Leeds, who writes a penny-stocks newsletter, said he doubts the Fed will go through with its plans to end the program in June because too much is at stake for Congress and the economy.

"United States is broke. The last budget was paid for with 75 percent brand new U.S. dollars" churned out by the Fed to purchase the government's debt, he said. "In my opinion, the Fed will continue [the bond-buying program], because when they stop, it could derail the whole system."

Wall Street stocks would be hit hard by the end of the program, which has provided a lot of newly minted cash for investors to bid up stock prices. But the U.S. dollar likely would rally as global investors applauded the shutdown of the Fed's dollar-printing press, he said.

With the dollar touching new lows against other currencies in recent days, causing a surge in the price of oil and other imported goods and commodities, the dollar may need the boost, Mr. Leeds said.

But the price of the Fed's action would be to "shock and potentially derail the recovering economy."

Jeffrey Kleintop, chief market strategist at LPL Financial, also thinks the Fed will put off announcing the end of the program until its next meeting in June, out of lingering concern about the economy and financial markets.

Paul Robinson, an analyst at Barclays Capital, said the end of the bond-purchasing program comes as no surprise to the markets, and he doesn't expect the Treasury to have that much trouble finding buyers once the Fed exits the market.

"The markets have limited reason to worry" because U.S. banks and foreign buyers continue to show a strong interest in purchasing Treasurys, he said.

Bernard Baumohl, chief global economist at the Economic Outlook Group, said the markets are expecting the Fed to end the so-called "quantitative easing" program in June, but he does not expect Mr. Bernanke to emphasize that at the ballyhooed press conference Wednesday.

The Fed will not "dramatically reverse course" until "there is concrete evidence the economy is on a sustained growth path," he said.

Still, the usually quiet meeting of the Fed's monetary policy committee, whose gathering every six weeks in the past has generated little fanfare, is likely to get tremendous publicity this time because of Mr. Bernanke's willingness to discuss it with the press for the first time, he said.

"The media buildup is starting to rival that of the upcoming royal wedding in England," he said.

The Fed's recent decision to hold such press conferences four times a year was meant to allay the "fierce criticism" it got from Congress for its performance handling the 2008 financial crisis, **Mr. Baumohl** said.

Both conservative legislators like Rep. Ron Paul, Texas Republican, and liberal lawmakers like Sen. Bernard Sanders, Vermont independent, have lit into the Fed for maintaining secrecy over the momentous decisions it made behind closed doors to rescue failing Wall Street banks in 2008.

"The Feds image took a beating," **Mr. Baumohl** said. The press conference, "whose ostensible purpose is to add more transparency regarding Fed policy, is really designed to help repair its image with the general public."

It follows recent appearances by Mr. Bernanke on CBS' "60 Minutes" news show and at the National Press Club, where he took questions from reporters.

Mr. Baumohl expects the Fed chairman to use the press conference "discreetly as a platform to place more pressure on Congress to reduce the swelling budget deficits. ... But those who hope Bernanke will say something that violently shakes the markets will be disappointed."