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Fed's Ben Bernanke opens door to further economic stimulus

By Don Lee, Los Angeles Times
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Reporting from Washington-- Federal Reserve Chairman Ben S. Bernanke sought to reassure lawmakers and the nation that the central bank stood ready to spring into action if the economy stumbled further as the deadline loomed on the nation's debt limit, Europe's financial problems worsened and U.S. job growth stagnated.

The Fed chief's remarks to Congress came hours before Moody's Investors Service Inc. put its top rating of U.S. debt on review for possible downgrade, an action Moody's previously said it would take in mid-July if there was no significant movement on raising the debt ceiling.

Bernanke's testimony in his semiannual report to Congress on the economy and monetary policy gave an immediate lift to anxious investors grappling with widespread uncertainty.

But most of the gains dissipated by the end of trading Wednesday. And Moody's statement could unnerve financial markets further.

Although Bernanke left the door open to further monetary stimulus, including another round of bond purchases, analysts said it would take a significant deterioration in the economy and the job market for the central bank to act. And Bernanke suggested he did not consider that a likely scenario.

Bernanke stuck to the view that temporary factors were behind the recent slowdown in the recovery and that the economy would pick up speed in the coming months. The economy in the first half of this year probably slowed to an anemic annual growth rate of 2% or less after expanding at a rate of nearly 3% in the second half of last year.

"The apparent stabilization in the prices of oil and other commodities should ease the pressure on household budgets," Bernanke said.

The economy also figures to get a boost this summer as car manufacturers step up production after cutting back because of disruptions from Japan's earthquake and tsunami in March, he said.

"The anticipated pickups in economic activity and job creation, together with the expected easing of price pressures, should bolster real household income, confidence and spending in the medium run," the Fed chairman told the House Financial Services Committee.

Yet the Fed, as well as many private economists, has repeatedly overestimated future growth — and some think Bernanke did so again Wednesday.

"He's betting that factors slowing the economy are transitory. That's his hope," said **Bernard Baumohl,** chief global economist at the Economic Outlook Group.

But **Baumohl** sees fuel and food prices remaining relatively high, reflecting long-term geopolitical instability in the Middle East and continued high demand from developing countries such as China. "I believe there is a new normal," he said.

Bernanke did cite a number of head winds to economic growth, including the depressed housing market, limited credit for some consumers and small businesses and the belt-tightening at all levels of government.

The Fed chairman also said he expected no quick improvement in the stubbornly weak job market. The nation's unemployment rate, at 8.8% in March, has bounced up in subsequent months, to 9.2% in June. And job creation, which had accelerated earlier this year, ground to a near-halt in the last two months.

"The jobless rate will decline — albeit only slowly — toward its longer-term normal level," Bernanke said.

The latest forecast from Bernanke and his colleagues at the Fed, which they released three weeks ago, predicted that the unemployment rate would remain near 9% in the fourth quarter, about 8% around election time next year and in the range of 7% to 7.5% at the end of 2013.

If the jobless rate continues to climb closer to 10%, analysts say, it is likely to trigger the Fed to take action with additional monetary stimulus. So would worries over deflation, or a broad decline in wages and prices.

But with Fed officials themselves divided on whether further stimulus is needed or would be helpful, the bar would be high.

The central bank last month completed a $600-billion program to buy U.S. Treasury bonds to hold down rates, but it's unclear how effective the measure was in boosting growth. It may have helped to avert deflation and boost the stock market, but many economists worry that it will lead to increasing inflation later.

In Wednesday's hearing, lawmakers focused largely on the current debt-limit battle and the problems of weak job creation.

Bernanke restated that Congress needed to raise the debt ceiling in time and develop a budget that would narrow the deficit over the long haul but not make drastic immediate cuts that could hurt the recovery.

The Fed chairman painted a grim picture should the nation fail to meet the deadline and be forced to hold back payments to Social Security beneficiaries, something that President Obama said Tuesday was possible if the impasse was not broken.

"The arithmetic is very simple," Bernanke said. "The revenue that we get in from taxes is both irregular and much less than the current rate of spending" — about 40% less.

"The assumption is that as long as possible the Treasury would want to try to make payments on the principal and interest of the government debt because failure to do that would certainly throw the financial system into enormous disarray and have major impacts on the global economy," he said.

But even if the nation doesn't default on its debt to U.S. Treasury bondholders, Bernanke said, failure to meet Medicare, Social Security and other obligations to its citizens could have a devastating effect.

"It's possible that simply defaulting on our obligations to our citizens might be enough to create a downgrade in credit ratings and higher interest rates for us, which would be counterproductive, of course, since it makes the deficit worse," Bernanke said.