MarketWatch

June 20, 2011

Bernanke to tell investors, public: Don't jump

Central bank chief will have to soothe nerves, analysts say

By Greg Robb

WASHINGTON (MarketWatch) — What the Federal Reserve will do on Wednesday is of little debate. What Federal Reserve Chairman Ben Bernanke will say is a different matter.

The Federal Open Market Committee, which on Tuesday starts a two-day meeting, is widely expected to make the formal decision to end the current program of buying $600 billion of Treasury securities on June 30. It is also expected to maintain its existing policy to reinvest principal payments from maturing securities to not let its balance sheet shrink, and to keep the target range for the federal funds rate at between 0% and 0.25%.

That decision, due at., should hold few surprises, though the accompanying statement will be eyed. But the fireworks will start at 2:15 p.m., when Bernanke holds his second post-rate-decision press conference.

Bernanke's challenge this week will be to calm financial markets, Corporate America and Main Street, all jittery about what's in store for the U.S. economy.

A recent soft patch of economic data has only added to existing concerns about the fate of the U.S. once the Fed's Treasury bond purchase program, frequently called QE2, comes to an end.

A stock market that has slumped for six weeks out of seven, a sky-high unemployment rate of 9.1% and the biggest 12-month inflation rise since Oct. 2008 has provided ammunition of all sorts for the Fed's many critics.

"What Bernanke needs to do is build confidence in the economy. He has got to be able to step up there and say things are going to get better," said Robert Brusca, chief economist at FAO Economics.

Bernard Baumohl, managing director of The Economic Outlook Group, said that Bernanke will need solid arguments to convince investors.

“I don’t think he is going to be a cheerleader. I think he’s going to have to be practical and realistic,” **Baumohl** said.

“He’s got to be straight,” agreed Scott Anderson, senior economist at Wells Fargo.

Baumohl said Bernanke will try to soothe markets by saying there is not going to be any fundamental change to policy in either direction for the foreseeable future.

While the hurdles to a third round of bond purchases are high, the same is true for an exit from the current ultra-low policy stance, **Baumohl** said.

“He will convey the message that the Fed is going to take a wait-and-see approach, **Baumohl** said.

But Bernanke will stress that the end of the QE2 program is not the equivalent of pulling the plug on the economy, said Michael Moran, chief economist at Daiwa Securities in New York.

In another step to build confidence, Bernanke will pledge to very closely monitor conditions to see if any of the threats facing the U.S. economy materialize such as a financial crisis in Europe, **Baumohl** said.

On inflation, Bernanke is likely to be a bit more hawkish than previous meetings, said Maury Harris, chief economist at UBS Securities, in a comment echoed by a number of analysts.

Core consumer price inflation, excluding food and energy prices, rose 0.3% in May, the biggest gain since June 2008. Many see core inflation rising near 2% year-over-year by the end of the year.

“Bernanke will have to acknowledge that,” Harris said.

Mike Englund. chief economist at Action Economics, said the public is so upset about higher energy prices that Bernanke is not likely to “pop the cork” about the recent small drop in gas prices.

“It is hard to be optimistic about $98 per barrel price of oil,” he said.

Ray Stone, economist at the forecasting firm Stone & McCarthy Research Associates, said he was intrigued by some news reports that the Fed might adopt a formal inflation target. Atlanta Fed President Dennis Lockhart this month backed an inflation target, and Bloomberg News reported that Fed officials were seriously discussing it. The Wall Street Journal said action isn’t likely at this meeting.

At the moment, the Fed has an implicit target of roughly 2% inflation.

But with inflation moving higher while Fed policy is accommodative, an inflation target might be one way for the Fed to stress it remains vigilant, said economists at Barclays Capital Research.

Stone said the odds are “less than 50-50” that the Fed would adopt a formal target “but I wouldn’t be knocked out of my chair if they did it,” he said.

The Fed also is expected to cut its economic growth forecast, which currently calls for growth between 3.1% and 3.3% this year.