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Fed lowers GDP forecast, mulls more action

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The Federal Reserve on Wednesday slashed its forecast for growth, raised projections for unemployment and said it was mulling the possibility of buying more mortgage debt to spur a struggling recovery.

While members of the US central bank's policy-setting panel voted 9-1 to hold a steady course, one official urged more stimulative action now and Fed Chairman Ben Bernanke said Europe's debt crisis posed big economic risks.

At a news conference after a two-day meeting, Bernanke said buying more mortgage-backed securities was an option to help the economy and added that the US central bank was still looking for ways to give clearer guidance on its policy path.

"While we still expect that economic activity and labor market conditions will improve gradually over time, the pace of progress is likely to be frustratingly slow," he said.

"Moreover, there are significant downside risks to the economic outlook," Bernanke said. "Most notably, concerns about European fiscal and banking issues have contributed to strains in global financial markets, which have likely had adverse effects on confidence and growth."

He said the US central bank was "closely" monitoring developments in Europe. Group of 20 political leaders are meeting in Cannes, France, on Thursday and Friday, with the euro zone debt crisis expected to dominate talks.

One analyst speculated that concern about potential instability in Europe -- especially after a shock decision by Greece to hold a referendum on a bailout package that had been agreed to -- likely played into the Fed's decision.

"The Fed probably wanted to preserve its ammo until there was more clarity on how the European sovereign debt crisis unfolds," **said Bernard Baumohl, chief global economist for The Economic Outlook Group,** in Princeton, New Jersey.

The Fed's decision had little impact on financial markets. US stocks held early gains, prices of 10-year Treasury notes were little changed on the day and prices for MBS tracked the larger debt market.

WEAK SIGNALS

In fresh quarterly projections, the Fed lowered forecasts for growth and raised forecasts for unemployment for this year, 2012 and 2013. Policymakers do not see the jobless rate, now at 9.1%, falling to a level they consider consistent with full employment even by the outer edge of their forecasting horizon, the final quarter of 2014.

Officials now expect the world's largest economy to grow by a tepid 2.5% to 2.9% next year, down from the rosier 3.3% to 3.7% they were expecting in June, with inflation muted over the forecast horizon.

They see the unemployment rate going no lower than 8.5% to 8.7% by the end of 2012, up from the more sanguine 7.8% to 8.2% range envisioned in June.

Fed officials believe the economy will have reached full employment when the jobless rate drops to between 5.2% and 6%, with a growing number seeing it at the top of that range. In their forecast, the unemployment rate would still be at 6.8% to 7.7% at the end of 2014.

Bernanke has called the lofty level of US unemployment a national crisis and some officials at the central bank have urged new steps to foster stronger growth.

Charles Evans, president of the Chicago Federal Reserve Bank, dissented on Wednesday because he wanted to ease policy at this meeting, while three officials who had voted against an easing in September supported the consensus.

DEBATE CONTINUES

Evans has suggested the Fed keep interest rates near zero until the unemployment rate reaches 7%, unless inflation threatens to rise above 3%.

Bernanke indicated that there was a range of different approaches to the Fed's policy framework that were under debate, including the idea put forward by Evans. However, he was dismissive of an approach recommended by several economists -- targeting nominal GDP -- and said the Fed would continue to keeps its focus on inflation and employment.

"We are not contemplating at this time any radical change in framework," he said.

The US central bank's debate over the course of policy comes against a troubled global backdrop and with the US economy far from full health.

Greece's call for a referendum on the latest euro zone debt deal dashed hopes Europe had finally come to grips with its debt crisis, sending global equity markets into a tailspin.

The US recovery remains anaemic and could be knocked off course if Europe fails to quell its crisis. The economy grew at a 2.5% annual pace in the third quarter, a significant improvement over the second quarter but still too soft to put a dent in unemployment.

Faced with a still-weak recovery, the Fed in September embarked on a program to sell

$400 billion in short-term Treasuries and invest the money in longer-dated bonds, an effort to keep long-term rates down.

It also dipped back into the mortgage market by reinvesting proceeds of its real estate bond holdings back into MBS.

While Bernanke left open the possibility that the Fed could expand its holdings of mortgage debt, he stopped short of pledging action.

"I do think that purchases of mortgage-backed securities is a viable option. Certainly, something we would consider if the condition were appropriate," Bernanke said.