Fed does the Twist: $400B plan to help economy

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WASHINGTON - The Federal Reserve said Wednesday it will shuffle $400 billion of its portfolio to try to drive down long-term interest rates and get the economy going. But economists doubted it would do much good, the stock market sold off, and the Fed itself was unusually divided over the strategy.

Lowering interest rates makes it cheaper for people and companies to borrow money and spend it throughout the economy, which has slowed sharply more than two years after the Great Recession. Consumer spending makes up most of the nation's economic activity.

But rates are already at historic lows. Americans, still feeling insecure about the future, might not be willing to take on more debt, even at lower rates. Others see no reason to jump into the housing market when prices are still falling. Others can't get credit.

"Frankly, I don't see it having any meaningful impact on the economy," said **Bernard Baumohl,** chief global economist with the Economic Outlook Group. "What the Fed did today was a distraction."

Yields on U.S. government debt were already among the lowest on record, and investors drove them down further after the Fed announcement. The yield on the 10-year Treasury bond, an indicator for mortgages and other long-term loans, closed at 1.86 percent, down from 1.93 percent the day before and the lowest since at least 1962.

Along with the strategy statement, the Fed gave a stormy overview of the economy — slow growth, high unemployment and a slumping housing market. The Fed has already said it will keep short-term interest rates super-low into 2013, a sign that the central bank was not optimistic about the next two years.

Three members of the Federal Open Market Committee, the policymaking arm of the Fed, dissented. There are 10 members in all, including Chairman Ben Bernanke, and usually no more than two dissent. The three have said the Fed's policies may be raising the risk of inflation.

The stock market fell quickly after the Fed announcement, which came just before 2:30 p.m. The Dow Jones industrial average, which was down about 20 points before the statement, finished the day down 283 points, or 2.5 percent.

"It's being viewed as perhaps an admission that this is a longer-term issue that the U.S. economy is facing and not one that's going to be solved over a couple of years," said Oliver Pursche, president of Gary Goldberg Financial Services.

The Dow closed at 11,124. It had appeared headed for 13,000 earlier this year, but investors grew worried this summer that a new recession is coming, and stocks have been extremely volatile since late July.

Wall Street had expected the Fed move for weeks, and had come to call it Operation Twist. In 1961, the Fed tried something similar and named it Operation Nudge, the idea being to nudge long-term interest rates lower. Chubby Checker's dance craze was sweeping the nation in the era of "American Bandstand," and the name Operation Twist stuck instead. Economists still argue about whether it worked, but most say it didn't help much.

This time, the Fed will sell $400 billion from its holdings of short-term U.S. government debt — Treasury bills and notes that mature in three years or sooner. It will use that money to buy Treasury notes and bonds with maturities of six to 30 years. The Fed said the shift would be complete by June.

By comparison, the Fed spent about $2 trillion on two rounds of bond-buying designed to lower long-term interest rates. Economists generally agree that the Fed succeeded in driving rates down and kept the economy from getting worse. The Fed's total portfolio is $2.9 trillion, almost all of it in Treasury securities and mortgage-backed securities.

In general, major loans throughout the economy, like mortgages, track those long-term Treasury securities. Already, the national average interest rate for the most popular type of mortgage, the 30-year fixed, is 4.09 percent, the lowest in six decades. Mark Zandi, chief economist at Moody's Analytics, said the Fed announcement could send it below 4 percent.

Frank Sorrentino, CEO of North Jersey Community Bank in Englewood Cliffs, N.J., said he didn't think the Fed decision would encourage anyone to buy a house or take out a car loan.

"I don't think Operation Twist really does a whole lot, at least not on Main Street," he said.

By lowering long-term interest rates slightly, Operation Twist will probably further pinch the budget for retirees and other savers who rely on interest income. Savers have been hammered by super-low rates the past three years.

The Fed appears to be the only U.S. institution with a realistic chance of doing much to help the economy. President Barack Obama has proposed a $447 billion package of tax cuts and public spending, but it is far from clear that the program can pass the Republican-controlled House.

Still, the central bank is under pressure to do more. In the first six months of this year, the economy grew at an annual rate of 0.7 percent, the slowest since the recession ended in June 2009. Job growth for August was zero. Economists peg the odds of a new recession at about one in three.

Bernanke has drawn criticism from Republicans running for president in 2012 and in Congress. On Monday, the four highest-ranking Republicans in Congress sent Bernanke a letter cautioning the Fed against taking further steps to lower interest rates. Their letter suggested that lower rates could escalate the risk of high inflation.

Texas Gov. Rick Perry, the front-runner in most polls for the Republican presidential nomination, has gone so far as to say Bernanke would be "almost treasonous" to launch more bond-buying. Former House Speaker Newt Gingrich, another 2012 hopeful, said Wednesday that he wanted the Fed to return to its "proper, limited role of stabilizing prices and preventing rampant inflation."

In recent years, inflation has been low by historical standards, but it has increased over the past year, primarily because of more expensive food and gas. Most economists say unemployment is a far bigger concern than inflation.

Joshua Feinman, global chief economist of DB Advisors, praised the Fed for pushing ahead with Operation Twist despite the criticism.

He said he expects the Fed to consider something bolder if things don't improve. The Fed could try a third round of bond purchases to drive down long-term interest rates, a strategy known as quantitative easing. The second round ignited a 28 percent rally in stocks from its announcement, in August 2010, through April.

"Their ammunition is depleted," Feinman said of the Fed, "but it's not all gone."