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Fed Announces Aggressive New Stimulus To Combat Unemployment

By Mark Gongloff

The Fed just hit the economy with a double-barreled blast of stimulus.

The Federal Reserve on Thursday announced a new round of bond buying, with the new wrinkle of basically leaving the program open-ended. It also stretched out its promise to keep short-term interest rates near zero by a year, "at least through mid-2015."

The moves will be controversial, particularly coming less than two months ahead of a heated presidential election. The Fed is already being accused of risking runaway inflation with its previous stimulus programs. And now it will likely come under fire for trying to boost the economy, which could benefit President Obama's re-election chances. In a statement, Obama's rival, Republican nominee Mitt Romney, called the Fed's actions "artificial and ineffective."

The Fed said it had no choice but to act in response to stubbornly high unemployment, sluggish economic growth and the risk of a fiscal-cliff recession at the turn of the year. The Fed hopes buying billions in mortgage bonds will boost the housing market, stock prices and other areas of the economy, helping speed up growth and bring down unemployment.

"I don't think it's a panacea. I don't think it's going to solve the problem," Fed Chairman Ben Bernanke said of the Fed's decision, in a press conference following the announcement. "But I do think it's going to have enough force to move the economy in the right direction."

As it was, some economists and market participants expressed disappointment that the Fed's new buying program was not bigger.

"Overall, the Fed has done all the markets were asking for," Paul Ashworth, chief U.S. economist at Capital Economics, wrote in a note. "The problem is that we doubt it will be enough to get the economy on the right track. It's only a matter of time before speculation begins as to when the Fed will raise its purchases."

Though financial markets had expected the Fed to act, they cheered the announcement nonetheless. The Dow Jones Industrial Average ended the day 206.51 points higher, up from a 12-point gain just before the Fed's announcement. At 13,539.86, the Dow closed at its highest level since December 2007, and within 640 points of its record-high close, set in October 2007.

Other financial assets reflected concerns about higher inflation, or at least about the devaluation of the dollar. Gold surged 1.5 percent to $1759 an ounce, its highest price in six months, while the U.S. dollar slumped against other major currencies.

Though critics warn that the Fed is toying with hyperinflation, Bernanke argued in his press conference that overall consumer price inflation has stayed more or less around the Fed's target of 2 percent per year despite the Fed's extraordinary efforts to boost the economy.

The Fed in its statement on Thursday said it plans to buy $40 billion in mortgage-backed securities every month and continue another program, called "Operation Twist," in which it trades short-term bonds for long-term bonds. Along with another program to reinvest income from bonds it already holds into buying more mortgage-backed securities, the Fed expects to add $85 billion to its balance sheet until the end of the year.

In an unusually aggressive step, the Fed also said it would buy more bonds, and consider other measures, if unemployment, currently at 8.1 percent, does not start falling more quickly:

"If the outlook for the labor market does not improve substantially, the Committee will continue its purchases of agency mortgage-backed securities, undertake additional asset purchases, and employ its other policy tools as appropriate until such improvement is achieved in a context of price stability," the Fed said.

In updated economic projections, the Fed said it doesn't expect unemployment to fall below 7 percent until 2015. If the Fed buys $40 billion in mortgage bonds every month between now and then, Capital Economics estimated, that could amount to $1.4 trillion in total bond-buying. That sounds like a lot, but it would basically match the total amount of the Fed's first round of bond-buying, but stretched out over about twice the length of time.

In his press conference, Bernanke sounded dire notes about the state of the job market, saying "the employment situation continues to be a grave concern."

Pointing out repeatedly that Fed action was not a "panacea," he also suggested that Congress do its part to help the job market. In particular, he warned of the "fiscal cliff" of tax hikes and spending cuts looming at the end of the year, which many economists have said could trigger a deep recession.

"I don't think our tools are strong enough to offset effects of major fiscal shock," he said.

One FOMC member, Richmond Fed President Jeffrey Lacker, dissented from the Fed's decision, disagreeing with more bond purchases and the extension of the low-rate promise. Quantitative Easing, another term for bond-buying, has been a controversial approach to monetary policy, with critics saying it raises the risk of inflation and financial bubbles while not helping the real economy. Last year, Texas Governor Rick Perry warned that Bernanke would be treated "pretty ugly" in Texas if he "prints more money."

In a recent *Wall Street Journal* poll, economists said they thought a $500 billion bond-buying program would only cut unemployment by 0.1 percent and raise annual gross domestic product by 0.2 percent. That's a negligible benefit, if those estimates are true.

"Investors and business leaders face a paralytic Congress and a gallimaufry of downside fiscal and geopolitical risks," **Bernard Baumohl, chief global economist at the Economic Outlook Group** in Princeton, wrote in an email. "Try as it might, the Fed cannot prompt the economy to do much more under these circumstances."

Bernanke himself has countered that he thinks previous rounds of QE created 2 million jobs and raised gross domestic product by 3 percent.

And the Fed's promise to keep rates low until 2015 could in effect be a small measure of stimulus all by itself, as it could nudge interest rates lower throughout the economy.

"The important part of the Fed decision is more about shaping expectations--we're here to help--than just printing money," Justin Wolfers, associate professor at the Wharton School, wrote in a tweet.

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