Bernanke Seeks Sustained Job Gains Before Paring Bond Purchases

By Craig Torres - May 23, 2013

Federal Reserve Chairman Ben S. Bernanke and his fellow policy makers, expressing concern that federal budget cuts are blunting the recovery, signaled little appetite for reducing record stimulus without what he called “real and sustainable” progress in reducing unemployment.

“What we are looking for is increased confidence that the labor market is improving and that that improvement is sustainable,” Bernanke told lawmakers yesterday. “And as we see that, we will in steps respond to that by reducing the amount of accommodation in a way that’s appropriate.”

Bernanke’s testimony to the Joint Economic Committee of Congress and comments by Federal Reserve Bank of New York President William C. Dudley showed caution over trimming the central bank’s bond purchase program too soon. The burden is on the economy to show durable job gains in the face of falling government spending, they said. Many Fed officials said more labor market progress is needed before paring $85 billion in monthly asset purchases, minutes of their last meeting showed yesterday.

“There is no urgency to do anything now,” said Roberto Perli, a partner at Cornerstone Macro LP in Washington and a former member of the Fed’s Division of Monetary Affairs. “They will keep going at this pace and wait until the September meeting to decide.”

U.S. stocks initially extended gains while Treasuries rallied on Bernanke’s remarks that an early end to its bond buying would put the economic recovery at risk. Treasuries turned lower and equities retreated as Bernanke, responding to a question from Representative Kevin Brady, the Texas Republican who chairs the committee, said the flow of purchases could be reduced “in the next few meetings” if the Fed is confident gains in the economy can be sustained.

Treasury Yields

The Standard and Poor’s 500 Index fell 0.8 percent in New York yesterday to close at 1,655.35. Ten-year Treasury yields jumped 11 basis points to 2.04 percent, topping 2 percent for the first time since March.

The Fed has said it will maintain bond purchases until a labor market beset by 7.5 percent unemployment has “improved substantially.”

That’s a departure from previous quantitative-easing programs, which had specified end-dates and amounts. In the past three years, the Fed planned to cut accommodation early in the year, only to boost it again after growth lagged behind its forecasts.

“They want to wait and see if for the first time in three years we don’t go through a summer slowdown,” Perli said. He said officials might not have enough data to make a decision until September. They next meet June 18-19.

Third Round

Since the Fed began a third round of bond purchases in September, the economy has added an average of 193,000 jobs per month, compared with gains averaging 141,000 over the previous six months.

“Despite this improvement, the job market remains weak overall,” Bernanke said. He pointed to historically high rates of long-term unemployment and declining labor-force participation.

“High rates of unemployment and underemployment are extraordinarily costly,” he said. “Not only do they impose hardships on the affected individuals and their families, they also damage the productive potential of the economy as a whole.”
Given the jagged pattern of the almost four-year recovery, basing policy on a current trend is difficult for policy makers, said Stephen Oliner, a resident scholar at the American Enterprise Institute in Washington.

"It is going to take a certain amount of evidence to accumulate before the committee is confident enough to say, 'We have seen enough'" to begin reducing the pace of purchases, he said.

Oliner, who was a member of the central bank's forecasting division for more than 20 years, said the team has difficulty predicting turning points in the economy. "They don't have very much confidence in their ability to do that, which is entirely well founded," Oliner said.

Dudley, in an interview with Michael McKee that aired on Bloomberg Television yesterday, said he was wrestling with uncertainty about his own forecast as federal tax increases and budget cuts pose hurdles for growth.

"I don't really understand really well how the tug-of-war between the fiscal drag and the improving economy are going to sort of work their way out over the next couple months," Dudley said. "Three or four months from now I think you're going to have a much better sense of is the economy healthy enough to overcome the fiscal drag or not."

**Endangering Recovery**

Bernanke, in his prepared remarks yesterday, said raising interest rates too soon would endanger the recovery.

A "premature tightening of monetary policy could lead interest rates to rise temporarily but would also carry a substantial risk of slowing or ending the economic recovery and causing inflation to fall further," he said.

The unemployment rate is far above the Fed's 5.2 percent to 6 percent estimate of the rate that corresponds to efficient use of labor resources. The personal consumption expenditures price index rose 1 percent for the year ending March, below the central bank's 2 percent goal.

Fed officials meeting April 30 and May 1 were also cautious about reducing stimulus too early.

"Most observed that the outlook for the labor market had shown progress since the program was started in September," the minutes said. "Many of these participants indicated that continued progress, more confidence in the outlook, or diminished downside risks would be required before slowing the pace of purchases would become appropriate."

Fed officials have left the benchmark lending rate near zero since December 2008 and have expanded the balance sheet to $3.35 trillion, compared with $879 billion on May 9, 2007.

"There is a desire to pull back, and a general nervousness with continuing to blow up the balance sheet," Oliner said. "But they can't be done until they see improvement in the labor market which was the reason for starting the program."

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