Bernanke Signals Fed Ready to Ease on EU Risk

By Scott Lanman and Joshua Zumbrun - Dec 14, 2011

Federal Reserve Chairman Ben S. Bernanke signaled he’s concerned Europe’s crisis will hobble a 2 1/2-year U.S. expansion that may need another boost from the central bank.

The Fed’s policy-setting panel, which met in Washington yesterday, said the economy “has been expanding moderately,” compared with the Nov. 2 assessment that growth “strengthened somewhat.” At the same time, the central bank added a reference to “apparent slowing in global growth,” and said that “strains in global financial markets continue to pose significant downside risks to the economic outlook.”

Bernanke and his colleagues may be considering more measures to aid growth and improve public understanding of Fed policy, which could be unveiled as soon as their next meeting taking place Jan. 25-26, said Julia Coronado, chief North America economist at BNP Paribas. The Fed reiterated that it expects joblessness to drop “only gradually.”

“They still see downside risks, so I still think they’re tilted toward easing,” said Coronado, a former Fed researcher who is based in New York. She said she expects a new round of asset purchases in the second quarter, or as soon as the January or March meetings should the economy deteriorate faster.

The “recent strength in data” allows Fed officials to “be a little more patient than they otherwise might be,” Coronado said.

**Consumer Confidence**

Improvement in some U.S. statistics suggests growth may be accelerating. The index of leading economic indicators rose 0.9 percent in October, the most since February. A consumer confidence index from the Conference Board rose in November to the highest since July. Manufacturing expanded in November at the fastest pace in five months, according to the Institute for Supply Management’s factory index.

The Federal Open Market Committee, in its statement yesterday after a one-day meeting, reiterated that interest rates would stay near zero through at least mid-2013 and maintained its $400 billion portfolio shift toward longer-term Treasuries, the September action dubbed Operation Twist. Chicago Fed President Charles Evans dissented for the second straight meeting, preferring additional easing.

Policy makers acknowledged “some improvement in overall labor market conditions” after the unemployment rate unexpectedly fell by 0.4 percentage point in November to 8.6 percent. That level is still “elevated,” while business fixed investment “appears to be increasing less rapidly” and the housing market “remains depressed,” the FOMC said.

**Dollar Strengthens**

Stocks fell, Treasuries gained and the dollar strengthened against the euro as the Fed dashed some investors’ expectations for additional easing yesterday. The Standard & Poor’s 500 Index dropped 0.9 percent to 1,225.73. Yields on 10-year U.S. government bonds declined to 1.97 percent from 2.01 percent, while the dollar rose 1.1...
percent to $1.3037 per euro.

Bernanke, at the prior FOMC meeting Nov. 1-2, asked a subcommittee on communications to consider a statement about the Fed’s longer-run goals and strategy, minutes of the gathering showed. The subcommittee is also examining how to include FOMC policy makers’ own expectations for monetary policy along with their forecasts of the economy.

“They probably hammered out the final details” yesterday of a communications overhaul to be unveiled at the January meeting, Coronado said. Officials will probably publish their forecasts for the federal funds rate and specify circumstances in the labor market and U.S. growth that would warrant tighter monetary policy, she said.

Two-Day Meeting

Bernanke, who turned 58 yesterday, give his next press scheduled press conference Jan. 26, following a two-day FOMC meeting.

Keith Hembre, chief economist and investment strategist at Nuveen Asset Management, said he is forecasting a slowdown in growth next year that makes a third round of bond-buying a “distinct possibility.”

Right now, “it’s probably premature to be pushing even further for more accommodation, given that you could make a case that there’s been some response by the economy to the steps that have been taken,” said Hembre, whose company is based in Minneapolis and oversees about $207 billion.

Fed officials may be betting that they won’t need to ease further should their foreign-currency swap lines providing cheap loans to overseas banks help alleviate the crisis in Europe, said Hembre, a former Fed researcher.

Three-month loans to the European Central Bank from the Fed surged last week to $50.7 billion from $400 million after the Fed, ECB and four other central banks lowered borrowing costs by a half-percentage point in a coordinated action.

Inclined to Ease

Europe’s turmoil and the rotation onto the FOMC next month of policy makers who may be more inclined to ease make the odds of a third round of asset purchases before July more than 50 percent, said Tom Luster, a portfolio manager at Eaton Vance Corp. in Boston.

“It would seem to me that at a minimum you have a pretty significant recession in Europe, which is likely to affect us directly,” said Luster, who oversees $6.2 billion as director of investment-grade fixed income.

Philadelphia Fed President Charles Plosser, Dallas Fed President Richard Fisher and Narayana Kocherlakota of the Minneapolis Fed, who all dissented from the August and September decisions to ease policy, don’t have FOMC votes next year, along with Evans.

In their place will be Cleveland Fed President Sandra Pianalto, Atlanta’s Dennis Lockhart, San Francisco’s John Williams and Jeffrey Lacker of the Richmond Fed. Lacker is the only official with a history of dissents. Williams is voting for the first time.

Tad Rivelle, who oversees about $67 billion as head of fixed-income investments at Los Angeles-based TCW Group Inc., put it this way: “Does the U.S. economy have enough momentum to keep stumbling forward, or will
“the problems from across the pond restrain us?” he said on Bloomberg Radio’s “The Hays Advantage” with Kathleen Hays.

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