Fed Signals Resolve on Rates

Cheap Credit Still Needed Despite Recent Employment Gains, Bernanke Says

By JON HILSENRATH And KRISTINA PETERSON

Federal Reserve Chairman Ben Bernanke said the central bank’s easy-money policies are still needed to confront deep problems in the labor market, moving to reinforce his plan to keep interest rates low for years.

His comments, at a conference near Washington of the National Association for Business Economics, were striking after several months of improvement in the jobs market. The comments also ran counter to a view that has emerged in financial markets recently that the Fed could back away from its low-interest-rate policies by next year.

Federal Reserve Chairman Ben Bernanke spoke Monday at an economic-policy conference near Washington.

Stock prices rose sharply after the Fed chief's comments. The Dow Jones Industrial Average finished the day up 1.2% at 13241.63. Markets in Asia opened higher Tuesday, with Tokyo gaining 1.7% by late morning.

The unemployment rate fell to 8.3% in February from 9% six months ago. But Mr. Bernanke amplified a warning he gave Congress a few weeks ago that rapid improvement in the job market might not be sustainable without stronger economic growth, which he said the Fed's low-interest-rate policies can help foster.

More progress on unemployment, Mr. Bernanke argued, seemed likely to require "more-rapid expansion of production and demand from consumers and businesses, a process that can be supported by continued accommodative policies," Mr. Bernanke said Monday.

Mr. Bernanke's comments also prompted a shift in the market for futures contracts tied to the Fed's key short-term interest rate—the federal funds rate. In recent weeks, investors in this market had started to trade on expectations the Fed would raise rates as early as 2013, even though the Fed has been saying since January it expects to wait until late 2014. After Mr. Bernanke's remarks, these markets indicated investors had become a bit more convinced the Fed would move in early 2014.

Investors tracking the labor market's gains had begun to expect interest rates to start climbing, said Liz Miller, president of Summit Place Financial Advisors. But Mr. Bernanke shifted that view. "What we heard from Ben Bernanke this morning was still a supportive monetary policy commitment, even in the face of improvements in the unemployment rate.”

One question Mr. Bernanke didn’t answer: Whether the Fed will launch another bond-buying program, known as quantitative easing, to push long-term interest rates even lower. The Fed clearly has left the door open to another program, but the public comments of officials indicate it hasn't decided whether or how to proceed.
Mr. Bernanke’s comments Monday suggested another round of bond buying is still on the table if the economy slows or unemployment starts rising again, but it isn’t a sure thing.

The Fed chairman took on some thorny economic issues in making his case for low rates. Among them is the question of whether the nation’s still-high unemployment rate represented a so-called cyclical problem that can be resolved simply by encouraging economic growth with low interest rates, or a fundamental structural problem in the labor markets that growth itself and the Fed can’t fix.

Stocks rose after Federal Reserve Chairman Ben Bernanke said continuing easy monetary policy was necessary to create jobs and positive German business confidence data was released, Kilgore reports on Markets Hub. (Photo: AP/Seth Wenig)

Mr. Bernanke came down on the side of those who argue the problem is predominantly cyclical and low interest-rate policies are helping to alleviate it. But many economists disagree with him, and he acknowledged the matter isn’t settled.

The debate about cyclical and structural unemployment has been going on for a couple of years. Economists generally say cyclical unemployment is caused when weakness in the overall economy pushes down demand for goods and services and therefore the need for workers that provide them. Structural unemployment reflects deeper problems, such as a gap between the skills workers have and those that employers want. Structural problems don’t necessarily disappear as the economic recovery gains traction.

Mr. Bernanke—in making his case for primarily cyclical unemployment—pointed out that newly unemployed workers and long-term unemployed workers all experienced diminished prospects of getting new jobs during and after the downturn. That suggests the job market hasn’t punished one group of people disproportionately to others. Instead, he said, there weren’t enough jobs for a wide range of workers in a wide range of industries. “The fact that labor demand appears weak in most industries and locations is suggestive of a general shortfall of aggregate demand, rather than a worsening mismatch of skills and jobs,” he said.

But some economists disagree and the stakes are high. “You could be seeing a policy error in the making,” said Wells Fargo economist John Silvia, who lists an array of factors that he says point to structural problems in the job market, which he says faster economic growth can’t resolve.

Employment of college graduates is up 5.8% in this recovery, while employment of high school dropouts is down 3.9%, according to Labor Department data. This suggests that low-skill workers are having a harder time finding work.

Mr. Silvia also notes that unemployment is especially high in certain occupations, such as construction. It is also high in places, such as Nevada, where many people can’t move because they owe more on their mortgages than their homes are worth. He worries that the Fed’s low-interest-rate policies might cause inflation and do little to resolve deeply embedded unemployment problems.
Mr. Bernanke also sounded wary about the job market's prospects. The economy has added an average of 245,000 jobs a month over the past three months. While recognizing that and other improvements, he concluded that "we cannot yet be sure that the recent pace of improvement in the labor market will be sustained."

The Fed chairman said the pace of improvement in the labor market recently has been "something of a puzzle," given the lackluster rate of economic growth. The economy grew just 1.7% last year and seems to be off to a slow start in 2012.

He said "what we may be seeing now is the flip side of the fear-driven layoffs that occurred during the worst part of the recession, as firms have become sufficiently confident to move their work forces into closer alignment with the expected demand for their products."

The cautious tone echoes comments Mr. Bernanke made last week when he warned against repeating the mistakes of the Great Depression by raising interest rates too quickly. He reiterated that the slow pace of recovery has been frustrating. His comments also echoed warnings he gave to Congress this month in which he highlighted his worry the improvements in the job market may not be sustained.

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