Bloomberg

Bernanke: No Plans Now for Bond Purchases

By Jeannine Aversa and Joshua Zumbrun - Jul 14, 2011

Federal Reserve Chairman Ben S. Bernanke told Congress that the central bank isn't currently ready to embark on a third round of government bond-buying to stimulate the economy.

"We're not prepared at this point to take further action," Bernanke said today, in response to a question from Senate Banking Committee Chairman Tim Johnson, a Democrat from South Dakota. Johnson asked Bernanke why the Fed wasn't immediately starting a new stimulus program given the weak economic recovery and rising unemployment.

Stocks fell, driving the Standard & Poor's 500 Index to the lowest level of the month. The S&P declined 0.7 percent to 1,308.89 at 3:17 p.m. in New York after rising as much as 0.7 percent. Gold futures pared gains after reaching a record $1,594.90 an ounce.

In House testimony yesterday, Bernanke said the Fed still has tools to spur growth, and that "we have to keep all the options on the table," driving share prices higher. Bernanke told Senators today that policy makers want to see if the economy rebounds as anticipated in the coming months, and that they are keeping a close eye on inflation.

Should the economy turn out to be weaker than expected, the central bank may provide more monetary stimulus, Bernanke said. A third round of quantitative easing, or QE3, is an option if a recent economic slowdown persists and deflationary forces re- emerge, he said.

Not Close

"Bernanke walked the market back a bit" by saying the Fed wasn't prepared to start a QE3 program "at this point," said Michael Gapen, senior U.S. economist at Barclays

Capital and a former Fed economist. “The market overly interpreted the chairman’s remarks yesterday” as a signal that QE3 is close at hand, Gapen said.

Bernanke said, “we just want to make sure that we have the options when they become necessary,” adding “at this point, we’re not proposing to undertake that option.”

Bernanke said the Fed faces conditions that are different today than they were last August, when he signaled a second round of large-scale asset purchases. At that time, the economy was in danger of stalling, he said, and the Fed was concerned the country may experience deflation, a widespread and prolonged drop in prices, wages and the values of assets such as homes and stocks.

“Today the situation is more complex,” Bernanke told lawmakers. “Inflation is higher. Inflation expectations are close to our target,” he said. “We are uncertain about the near-term developments in the economy. We’d like to see if, in fact, the economy does pick up, as we are projecting.”

Close to Target

Senator Richard Shelby of Alabama, the committee’s senior Republican, told Bernanke that he has concerns additional bond purchases will fuel inflation.

“It appears that the Fed may be going in the wrong direction,” Shelby said, referring to Bernanke’s testimony of today and yesterday leaving the door open to additional stimulus should the recovery appear to be fizzling out.

“The last thing our weak economy needs right now is an inflation scare,” he said.

Shelby criticized the Fed in November when it launched a $600 billon bond-buying program to rejuvenate the economy, saying the purchases, which ended last month, could trigger an inflation surge. Shelby also said bond buying by the Fed could prompt a wave of speculative buying on Wall Street, leading to asset-price bubbles.

Need for Flexibility

As he emphasized yesterday in testimony before the House Financial Services Committee, Bernanke told lawmakers today that the Fed must be flexible and prepared to shift in either policy direction. The Fed may tighten credit if inflation were to rise more than anticipated, he said.

"We're not proposing anything today," he said. "The main message I want to leave is that this is a serious situation. It involves a significant loss of human and economic potential."

The nation's unemployment rate rose to 9.2 percent in June, the third straight monthly increase. Employers added 18,000 new jobs, the fewest in nine months.

Bernanke yesterday predicted economic growth will pick up in the second half of this year at a pace above 3 percent. He estimated the economy expanded at a 2 percent rate during the first six months of this year, or slightly less than necessary to reduce the unemployment rate.

Bernanke also again urged Republicans in Congress and President Barack Obama to come to an agreement to boost the nation's $14.3 trillion borrowing authority. If a deal isn't reached before Aug. 2, the government won't be able to pay its bills. The U.S. risks losing its Aaa, credit rating.

"It's a very important asset and losing that credit rating is, again, I think a self-inflicted wound," Bernanke said.

To contact the reporter on this story: Jeannine Aversa in Washington at javersa@bloomberg.net; Joshua Zumbrun in Washington at jzumbrun@bloomberg.net

To contact the editor responsible for this story: Chris Wellisz at cwellisz@bloomberg.net