Fed Refrains From Taper, Seeks More Evidence of Sustained Growth

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Sept. 18 (Bloomberg) -- The Federal Reserve unexpectedly refrained from reducing the $85 billion pace of monthly bond buying, saying it needs to see more signs of lasting improvement in the economy.

"Conditions in the job market today are still far from what all of us would like to see," Chairman Ben S. Bernanke said at a press conference today in Washington after a two-day meeting of the Federal Open Market Committee. "The committee has concern that rapid tightening of financial conditions in recent months would have the effect of slowing growth."

Bernanke and his policy making colleagues held back from paring record accommodation as rising borrowing costs show signs of slowing the four-year expansion. Treasury yields have jumped since May, when Bernanke first outlined a possible timetable for a reduction in the asset purchases that have swelled the Fed's balance sheet to $3.66 trillion.

Stocks and Treasuries soared. The Standard & Poor's 500 Index climbed 1.3 percent to an intraday record of 1,727.36 at 3:11 p.m. in New York. The yield on the 10-Year Treasury note dropped 15 basis points to 2.70 percent.

Bernanke said a decision on tapering asset purchases depends on economic data, and there is no set timetable.

"There is no fixed calendar schedule, I really have to emphasize that," Bernanke said. "If the data confirm our basic outlook" for growth and the labor market, "then we could begin later this year."

The Fed chairman has orchestrated the most aggressive easing in the Fed's 100-year history, pumping up the balance sheet from $869 billion in August 2007 and holding the main interest rate close to zero since December 2008.

Rate Outlook

The central bank today left unchanged its guidance that it will probably hold its target interest rate near zero "at least as long as" unemployment exceeds 6.5 percent, so long as the outlook for inflation is no higher than 2.5 percent.

Bernanke added in his press conference that the first interest-rate increase may not come until the jobless rate is "considerably below" 6.5 percent.

Most Fed policy makers expect the first increase in the nation's benchmark lending rate to occur in 2015, according to projections released today.

The federal funds rate target will be 2 percent at the end of 2016, according to the median of estimates by five governors on the Fed's board and 12 reserve bank presidents. That rate compares with their median estimate of 4 percent for where the rate should be at a time of full employment and stable prices.

Fed officials' forecast U.S. gross domestic product to increase 2 percent to 2.3 percent this year, 2.9 percent to 3.1 percent in 2014, and 3 percent to 3.5 percent in 2015, according to the central tendency forecasts.

June Forecasts

In June, they had estimated 2.3 percent to 2.6 percent growth in 2013, 3 percent to 3.5 percent expansion in 2014 and 2.9 percent to 3.6 percent growth in 2015. The central tendency forecasts exclude the three highest and three lowest projections.

"They feel the risks are too great to taper now, and the economy is not growing as fast as they had hoped," said John Silvia, chief economist at Wells Fargo Securities in Charlotte, North Carolina. "They are going to take a few more months and maybe start in December."

The Fed said that inflation had been running below its longer run objective of 2 percent. The central bank's preferred gauge of inflation climbed 1.4 percent in the year through July. It has not breached 2 percent since March 2012.

George Dissents

Kansas City Fed President Esther George dissented for the sixth meeting in a row, repeating that the policy risks creating financial imbalances.

Economists had forecast the FOMC would dial down monthly Treasury purchases by $5 billion, to $40 billion, while maintaining its buying of mortgage-backed securities at $40 billion, according to a Bloomberg News survey.

The yield on the 10-year Treasury note climbed almost 1 percentage point through yesterday since Bernanke's comments in May, when he first outlined a timeline for tapering, with yields on Sept. 6 exceeding 3 percent on an intraday basis for the first time since July 2011. That compares with 1.61 percent on May 1, and a record-low 1.38 percent in July 2012.

The average interest rate on a 30-year fixed home loan was 4.57 percent last week, compared with a record-low 3.31 percent in November 2012, according to Freddie Mac. The rate soared 35 percent in 10 weeks ended July 11, the most ever for a comparable period, the data show.

Stock Market

The Fed's asset purchases have fueled gains in asset prices. The Standard & Poor's 500 Index has climbed more than 20 percent since Aug. 31, 2012, when Bernanke made the case for further monetary easing at the central bank's annual forum in Jackson Hole, Wyoming.

Officials have also credited the program, which began last September, with reducing the unemployment rate, which is the lowest since December 2008. Officials have said that they would maintain bond purchases until the labor market has "improved substantially."

At the same time, recent data on payrolls, housing and retail sales have lagged behind economists' forecasts. An increase in interest rates triggered by Bernanke's May 22 comments that the Fed may step down the pace of purchases in the "next few meetings" threatens to further slow growth.

More costly home loans threaten to restrain the housing revival that has been a mainstay of the expansion. A report today showed builders began work on fewer homes than forecast by economists in August.

Job Gains

U.S. companies created 169,000 jobs last month, fewer than economists projected, and increases in the prior two months were revised down. The unemployment rate fell as workers left the labor force. August and July were the weakest back-to-back months for payroll gains in a year.

Employment growth has nevertheless improved since the bond purchases began. The U.S. has added an average of 160,000 jobs over the past six months, compared with 97,000 originally reported for the half-year before the Fed decided to start the third round of purchases a year ago.

Faster employment gains may be needed to spur the consumer spending that accounts for 70 percent of the economy. Retail sales last month rose less than forecast, with purchases climbing 0.2 percent, the smallest gain in four months, the Commerce Department reported last week.

"The U.S. consumer is still very cautious," Julia Coronado, chief economist for North America at BNP Paribas SA in New York and a former Fed economist, said in a Bloomberg Television interview. "The labor market is OK, but it's not great, and wage growth is subdued, so it is not a very buoyant background for the U.S. consumer."

Bright Spots

Homebuilding and manufacturing remain bright spots for the economy.

Companies such as Hovnanian Enterprises Inc. have said the recent rise in mortgage rates will temporarily restrain the housing recovery rather than end it.

Homebuilder confidence held this month at the highest level in almost eight years, even as mortgage rates rose. The National Association of Home Builders/Wells Fargo confidence index registered 58 this month, matching August's revised reading as the strongest since November 2005.

Such optimism has found fuel from a recovery in home prices that pushed up the S&P/Case-Shiller index of values in 20 cities by 12.1 percent in June from a year earlier.

Factories turned out more cars, appliances and home furnishings in August, propelling the biggest increase in U.S. industrial production in six months. Output at factories, mines and utilities rose 0.4 percent after no change the prior month, the Fed reported this week.

Auto Sales

Cars and light trucks sold last month at the fastest annualized rate since 2007, according to researcher Autodata Corp. Sales at General Motors Co., Ford Motor Co., Toyota Motor Corp. and Honda Motor Co. all exceeded analysts' estimates.

Texas Instruments Inc., the largest maker of analog chips, is among companies with a brighter outlook as global markets stabilize.

"Orders continue to be quite solid" this quarter, Chief Financial Officer Kevin March said at a Sept. 11 conference. "We continue to see strength in three of the four regions of the world," with Asia, Japan, and the Americas expanding, he said.

Bernanke, whose term ends in January, has led the most aggressive easing campaign in the Fed's 100-year history as he sought to pull the nation out of the financial crisis and then to ensure that a recovery could be sustained and unemployment reduced.

The 59-year-old former Princeton University professor pushed the benchmark interest rate close to zero in December 2008 and embarked on three rounds of large-scale asset purchases that have more than tripled the size of the Fed's balance sheet.

Vice Chairman Janet Yellen, a supporter of Bernanke's policies, is the top candidate to succeed him after former Treasury Secretary Lawrence Summers withdrew from contention, according to people familiar with the process.

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