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Divided Fed Lowered Growth Forecasts

Fed officials downgraded their assessment of the U.S. economy at their November meeting as they debated the benefits and costs of bond purchases, minutes showed.

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Federal Reserve officials downgraded their assessment of the U.S. economy at their last meeting three weeks ago as they debated the benefits and costs of a new bold step to support the recovery.

Minutes of the Fed's latest policy-setting meeting Nov. 2-3, released with the customary lag Tuesday, showed officials expect the economy to grow at a moderate pace next year, with unemployment staying disappointingly high and inflation uncomfortably low.

The minutes also showed Fed officials held an unusual video conference two weeks before their formal Nov. 2-3 meeting in which they took up hot button issues like whether to set targets for inflation or long-term interest rates.

No decisions were made during the video conference, held Oct. 15. Among the issues on the table was whether the Fed should target some interest rate that is longer in duration than the federal funds rate, which is an interest rate on overnight loans which is now just a little bit above zero.

Some noted that targeting the yield on a term security could be an effective way to reduce longer-term interest rates and thus provide additional stimulus to the economy, the minutes of the meeting said. However, they also worried that targeting a longer-term interest rate could force the Fed to buy undesirably large amounts of bonds to keep the interest rate at the target.

Though the Fed didn't take action in this direction, the revelation suggests it could come up later if the economy weakens again. The Fed maintained a target for long-term interest rates of around 2.5% in the 1940s and early 1950s as the U.S. emerged from war and depression.

Low prices and a stubbornly high jobless rate led Fed officials this month to resume a bond purchase program that was used to combat the financial crisis. The step was attacked by Republican lawmakers and foreign government officials, who said it could hurt the U.S. dollar and bring high inflation.

The minutes showed that, even though Fed officials voted with an overwhelming 10-1 majority to support the move, several worried about its consequences.

"Some participants noted concerns that additional expansion of the Federal Reserve's balance sheet could put unwanted downward pressure on the dollar's value in foreign exchange markets," the minutes showed. Several officials saw a risk the move could "cause an undesirably large increase in inflation."

The Fed projects U.S. gross domestic product, the broadest measure of economic activity, will rise at an annual rate of between 3.0% and 3.6% in 2011 after growing by around 2.5% this year. That compares with a previous June forecast that GDP would increase between 3.5% and 4.2% next year.

The economy grew at an annualized rate of just 2.5% in the third quarter, government data showed Tuesday, after rising by 1.7% in April to June. Since the recession ended in June 2009, the economy has been expanding at an average quarterly rate of less than 3.0%. That's too low to make a dent on unemployment and compares with a growth rate of nearly 8.0% that followed the previous deep U.S. recession in the early 1980s.

In fact, several Fed officials believed unemployment was more likely to rise than fall if the economy continues to grow so softly. "Participants agreed that progress in reducing unemployment was disappointing," the minutes showed.

The slow recovery should keep the unemployment rate, currently at 9.6%, around 9.0% at the end of next year, Fed officials predicted. In June, they had forecast the jobless rate would be around 8.5% in the last three months of 2011.

The upper range of the longer-run jobless rate was increased to 6.0% from 5.3%, indicating Fed officials believe the recession has caused some permanent damage to the labor market.

The weak economy is expected to keep inflation below the central bank's informal target of just under 2.0% all the way through 2013.

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