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# Fed Chief Edges Closer to Using Rates to Pop Bubbles

*Bernanke Sees Monetary Policy as Potential Antidote, but Blames Lax Regulation -- Not Central Bank Policies -- for Housing Crisis*

By [JON HILSEN RATH](#) and [LUCA DI LEO](#)

ATLANTA -- Federal Reserve Chairman Ben Bernanke cracked the door open a bit more to the idea of raising interest rates if a new financial bubble emerges.

He also mounted a vigorous defense against critics who say it was the Fed's low-interest-rate policies over the past decade that caused the last housing bubble. Instead, he said, the problem was lax regulation, which permitted banks to issue a slew of exotic mortgages that households later had trouble paying.

"We must be especially vigilant in ensuring that the recent experiences are not repeated," Mr. Bernanke said in a speech Sunday at the American Economic Association's annual meeting here. Better regulation is his first line of defense against future crises. But the Fed also needs to "remain open" to using the blunt tool of higher interest rates to avert or pop future asset bubbles, Mr. Bernanke said, particularly if other approaches aren't working.

The Fed's views on asset bubbles are slowly changing. Earlier this decade, when Mr. Bernanke was a Fed governor, he and other central bank officials said financial bubbles weren't something the Fed could identify or pre-empt effectively. Its focus was on keeping inflation and unemployment low. Its bubble strategy was to mop up after a bubble burst with lower interest rates to prevent damage to the broader economy.

After a speech in November, Mr. Bernanke said, "never say never," when asked whether the Fed should instead use higher interest rates to pre-emptively prick future bubbles, and he later said he wouldn't rule it out. Sunday, he accepted that there might be situations that warrant such an approach, particularly if other methods aren't working, such as better regulation.

"We still have much to learn about how best to make monetary policy and to meet threats to financial stability in this new era," he said.

The Fed has pushed overnight bank-lending rates to near zero and has said it expects to keep them there for at least several more months because the economy remains weak and inflation low. Some private economists and officials in Asia and Europe have warned this could plant the seeds for a new bubble, though Fed officials have argued that market gains in the U.S. haven't gotten out of hand.

This year's meeting of economists from universities around the world and top government officials has been dominated by debate about the causes and consequences of the financial crisis.

While many economists here believe a recovery is under way, many are wary about its strength and staying power. Donald Kohn, the Fed's vice chairman, pointed to "lingering credit constraints" and cautious businesses and households as reasons to expect a slow rebound this year. While he said the Fed would need to begin withdrawing its stimulus from the economy "well before" it has returned to full strength, he gave no indication that a tightening was approaching any time soon.

Martin Feldstein, a Harvard University economist and former Reagan administration economist, is worried that consumer spending could wane as government stimulus wears off. "There is a significant risk the economy could run out of steam sometime in 2010," he warned.

Critics have said the Fed kept interest rates too low for too long earlier this decade, helping to fuel a housing bubble at the root of the recent financial crisis.

Mr. Bernanke acknowledged that monetary policy was accommodative not only in the U.S. but all over the world during this stretch. But he made a lengthy, professorial case -- detailed with 10 pages of charts -- against the idea that the Fed's interest-rate policies were the main problem.

For example, he noted that some countries such as Germany and Japan had looser monetary policies than the U.S. during this stretch, but didn't experience housing bubbles. Other countries such as Spain and Ireland had tighter policies but even bigger booms. Mr. Bernanke pinned the blame on lax supervision of toxic mortgages by the Fed and other bank regulators, as well as excessive money going into U.S. assets from Asian investors. "Borrowers chose, and were extended, mortgages that they could not be expected to service in the longer term," he said.

—Michael Derby contributed to this article.

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