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Fed Moves on Long-Term Interest Rates to Spur Growth

By BINYAMIN APPELBAUM

WASHINGTON — The **Federal Reserve** announced a new plan Wednesday to stimulate growth by purchasing \$400 billion in long-term **Treasury securities** with proceeds from the sale of short-term government debt, defying Republican demands to refrain from new actions.

In extending its campaign of novel efforts to shake the economy from its torpor, the Fed said that it was responding to evidence that there was a clear need for help.

“Growth remains slow. Recent indicators point to continuing weakness in overall labor market conditions and the unemployment rate remains elevated,” the Fed said in a statement that listed its reasons for worry about the anemic condition of the American economy. “Household spending has been increasing at only a modest pace in recent months.”

The central bank said in a statement that the program was aimed at reducing the cost of borrowing for businesses and consumers, including the cost of mortgage loans. It hopes that the lower rates will encourage companies to build new factories and hire more workers, and consumers to start spending again on homes and cars and clothes and vacations.

Specifically, the Fed said that by June 2012 it would sell \$400 billion in Treasury securities with

remaining maturities of less than three years and purchase roughly the same amount of securities with maturities longer than six years. It said the result would move the average maturity of the bonds it holds to about 100 months from 75 months.

In the bond market Wednesday, the yield on 10-year Treasury notes did indeed fall after the announcement, to 1.88 percent from 1.94 percent, while the 30-year bond yield dropped to 3.02 percent from 3.20 percent. Stocks on Wall Street were down about 1.7 percent in afternoon trading.

Separately, the Fed said it would resume direct efforts to help the mortgage market by reinvesting the proceeds of its existing investments in mortgage-backed securities into new mortgage-backed securities, rather than putting the money in Treasuries.

Three members of the Fed's 10-member policy-making committee dissented from the decision: Richard Fisher, president of the Federal Reserve Bank of Dallas; Charles Plosser, president of the Federal Reserve Bank of Philadelphia; and Narayana Kocherlakota, president of the Federal Reserve Bank of Minneapolis. The members were the same who opposed the Fed plan announced in August to hold short-term interest rates near zero until at least 2013.

The new effort is an experiment without a direct precedent, although the Fed tried something similar in the 1960s. Essentially, by shifting its money into riskier investments, the Fed hopes to drive down rates without expanding the size of its portfolio, as it has done twice in recent years. By reducing the supply of long-term Treasuries, the Fed intends to force investors to accept lower rates of return on a wide range of riskier investments.

Economists project that the effort could reduce interest rates by a few tenths of a percentage point, a significant increment when multiplied by the vast extent of borrowing. The forecasting firm Macroeconomic Advisers estimated in advance of the Fed's announcement — based on its best guess about the details of such a program — that the Fed's efforts could add about 0.4 percentage points to economic output and create about 350,000 jobs.

The Fed already is engaged in an enormous effort to stimulate growth. The central bank has held short-term interest rates near zero since December 2008. To further reduce long-term rates, it has amassed more than \$2 trillion in government debt and mortgage-backed securities. And the Fed announced after the most recent meeting of its policy-making committee in August that it intended to hold short-term interest rates near zero until at least the middle of 2013.

The Fed had previously said only that it would maintain rates near zero for an “extended period,” and a new study by the Federal Reserve Bank of Cleveland found that the change in language had a significant impact. Specifically, by convincing investors that short-term rates would remain low, the Fed succeeded in lowering long-term rates — which are based in large part on expectations about the level of short-term rates throughout the longer period. Rates on the benchmark 10-year Treasury note, for example, declined by about 0.20 percentage points, the study found.

But the economy remains weak. Gross domestic product expanded by only 0.7 percent in the first half of the year, roughly the rate of population growth, meaning that Americans experienced no increase in average wealth. More than 25 million people were unable to find full-time jobs last month. Most of them could not find work of any kind. And concerns about the economic health of Europe and the political health of Washington have depressed measures of consumer confidence to the lowest levels since the depths of the 2008 crisis, endangering prospects for faster growth in the coming months.

At the end of August, Mr. Bernanke told an annual policy conference in Jackson Hole, Wyo., that the committee would meet for two days in September, rather than one, to consider additional action.

The Fed still has “a range of tools,” Mr. Bernanke said in a mid-September speech in Minneapolis, and, echoing his constant refrain in recent years, he added that the committee was “prepared to employ these tools as appropriate to promote a stronger economic recovery in a context of price stability.”

Investors expected the Fed’s move, modeled on a 1960s program called Operation Twist. Yields on the benchmark 10-year Treasury note hovered around the record low of 1.88 percent in recent days, reflecting market confidence that the central bank would act and uncertainty about the health of the

economy.

But studies have found the Fed's success in reducing rates through its rounds of asset purchases have not yielded the full measure of predicted benefits. Mortgages and small-business loans may be cheap, but because lenders remain cautious, the loans are not easy to get.

Fed officials convened to reach their decision in an environment of heightened political pressures. As Democrats and Republicans battle over the role of government in improving the economy, both parties have sought to influence the decisions of the central bank.

Republicans have been increasingly vocal in their insistence that the Fed should stop trying to bolster growth. They argue that the central bank's existing efforts are not helping and that new efforts could have negative consequences. Republican presidential candidates have made criticism of the Fed a central theme of the early campaign, and Republican leaders in the House and Senate sent a letter Tuesday to Mr. Bernanke warning against new measures.

"We have serious concerns that further intervention by the Federal Reserve could exacerbate current problems or further harm the U.S. economy," said the letter, signed by Senator Mitch McConnell of Kentucky, the Republican leader; Senator Jon Kyl of Arizona, the Republican whip; House speaker John A. Boehner of Ohio; and Representative Eric Cantor of Virginia, the majority leader.

Some Democrats, meanwhile, have accused the central bank of being too cautious. Representative Barney Frank of Massachusetts, the ranking Democrat on the House financial services committee, has proposed legislation removing the presidents of regional Federal Reserve banks from their seats on the Fed's policy-making committee. They tend to be more concerned about inflation and less concerned about unemployment.

The 12 presidents of regional banks, who are elected in part by local businesses, currently fill five seats on the committee on a rotating basis. Currently, there are 10 members on the panel with two vacancies. Mr. Frank has described the participation of the regional presidents as undemocratic, and

said that the dissent of three of the regional presidents from the August decision to announce an intent to keep short-term rates near zero — the largest number of dissents in about two decades — was “stark evidence” that they were constraining the Fed’s effectiveness.

The Fed normally announces its decisions publicly at 2:15 p.m. Eastern time on the day of their policy meetings, and financial trading often pauses as professional investors wait for and then digest and trade on the official word.

On Wednesday, however, the embargo lifted later than usual because the Fed’s supporting material, which must be copied and distributed to reporters waiting at the Treasury before the 10-minute timer begins, was much more voluminous than usual.

And so as not to keep the markets waiting too long, Fed officials trimmed the countdown clock to eight minutes from 10, finally lifting the embargo on the information at 2:23 p.m.



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