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No Fed Plans to Give More Support, Bernanke Says

By SEWELL CHAN

WASHINGTON — The chairman of the Federal Reserve, in saying that it had no immediate plans to provide additional support to the economy, dashed the hopes of some economists and executives who have been pushing for action to add momentum to the sluggish recovery.

The chairman, Ben S. Bernanke, said Wednesday that the recovery was continuing at a modest pace, though with a "somewhat weaker outlook."

He projected that the unemployment rate would remain well above 7 percent through the end of 2012, and the duration of President Obama's current term. That, too, was a discouraging note to Washington incumbents facing tough re-election fights.

Mr. Bernanke's statement that the Fed had no imminent plans to go beyond its current strategy of keeping short-term interest rates exceptionally low pushed stock prices down. The Dow Jones industrial average fell 1.07 percent, or 109.43 points, to close at 10,120.53.

In presenting the Fed's semiannual monetary policy report to Congress, Mr. Bernanke said that it would take "a significant amount of time" to restore the 8.5 million jobs lost in the United States in 2008 and 2009, and that "the economic outlook remains unusually uncertain."

He also warned that financial conditions, particularly the European debt crisis, had “become less supportive of economic growth in recent months.”

Testifying before the Senate Banking Committee, Mr. Bernanke for the first time publicly discussed additional monetary policy tools the Fed could use to prop up the economy, having lowered short-term interest rates as far as they can go and purchased nearly $2 trillion in mortgage-backed securities and Treasury debts to push long-term rates down.

First, he said, the Fed could signal to the markets that it intended to keep its benchmark federal funds rate, the rate at which banks lend to one another overnight, at zero to 0.25 percent for even longer than the “extended period” the Fed has been projecting.

Second, the Fed could lower the interest rate it pays on excess reserves, the deposits that banks keep at the Fed in excess of what they are required to keep, from its current level of 0.25 percent.

Third — and the mostly widely discussed option — the Fed could again expand the size of its balance sheet, which stands at about $2.3 trillion, by buying additional Treasury debts or mortgage-backed securities, or even other classes of assets, like municipal bonds.

On a smaller scale, the Fed could also reinvest the cash it received when the underlying principal on mortgage bonds on its books was repaid, a step that would also keep the Fed’s balance sheet from shrinking.

“We have not come to the point where we can tell you precisely what the leading options are,” Mr. Bernanke told Senator Richard C. Shelby of Alabama, the top Republican on the Banking Committee.

“Clearly, each of these options has got drawbacks, potential costs. So we’re going to continue to monitor the economy closely and continue to evaluate the alternatives that we have, recognizing, as I said, that policy is already quite stimulative.”

When Mr. Shelby asked whether the Fed was “running out of options,” Mr. Bernanke replied, “I think we do still have options, but they're not going to be the conventional options."

Mr. Bernanke told Senator Jim Bunning, Republican of Kentucky, that the Fed had no plans to take those actions "in the near term," but added, "I do think that there is some potential for some of those steps to be effective, and we'll continue to look at them."

Minutes from the June meeting of the Federal Open Market Committee, the Fed's main policy-making arm, indicated that a few officials had a new worry: deflation. Those officials believe that inflation — which is running at about half the Fed's desired range of 1.7 to 2 percent — has been so low that it could turn into a dangerous spiral of falling prices like the one that has plagued Japan since the mid-1990s.

"Forecasts are very uncertain, but I don't view deflation as a near-term risk for the United States," Mr. Bernanke told Mr. Shelby, noting that inflation expectations had remained stable.

"I think the Federal Reserve does have the capacity, the tools, should deflation occur — which, again, I don't believe is very likely — to reverse it, and we would be very assiduous in doing that," the chairman added. "I don't consider that to be a very high risk at this point."

Mr. Bernanke's testimony took a more cautious tone than he did in February.

The chairman noted weakness in the housing market, "with the overhang of vacant or foreclosed houses weighing on home prices and construction."

He called the slow recovery of the job market "an important drag on household spending." And he noted that the growth in private payrolls — about 100,000 jobs a month in the first half of the year — was "insufficient to reduce the unemployment rate materially."

The Fed expects the economy to grow this year by 3 to 3.5 percent, picking up only slightly, to 3.5 to 4.5 percent, in 2011 and 2012. The unemployment rate is projected to drop to 7 to 7.5 percent by the end of 2012 — still far higher than the 5 to 5.3 percent that the Fed now considers to be full employment.

Mr. Bernanke said of the committee's last meeting: "Most participants viewed uncertainty about the outlook for growth and unemployment as greater than normal, and the majority saw the risks to growth as weighted to the downside."

Hours before his testimony, Mr. Bernanke had looked on as President Obama signed into law a far-reaching overhaul of the financial regulatory architecture.

In his appearance before the senators, he said the new law, along with tougher standards for bank capital and liquidity now being developed by international regulators, "will place our financial system on a sounder foundation and minimize the risk of a repetition of the devastating events of the past three years."

As has become common, senators of both parties pressed Mr. Bernanke to weigh in on the fiscal questions that have bitterly divided Congress. Mr. Bernanke held to his view that additional small-scale fiscal stimulus could be beneficial to the economy now, if combined with medium-term measures to rein in the high deficits.

"I would be reluctant to withdraw that support too precipitously in the near term," Mr. Bernanke told the committee's chairman, Senator Christopher J. Dodd, Democrat of Connecticut. "At the same time, to maintain confidence and keep interest rates low, it's important that we have a strong and credible plan to reduce deficits over the coming years."

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