

Bernanke Affirms Bond Buying

By [JON HILSEN RATH](#) February 26, 2013

Market watchers were hoping for a dovish message from Fed Chairman Ben Bernanke ... and they got exactly what they wanted.

Federal Reserve Chairman [Ben Bernanke](#) came down firmly in favor of continuing the central bank's bond-buying programs, even as he acknowledged concerns that the efforts might encourage risk-taking that could someday destabilize markets or the economy.

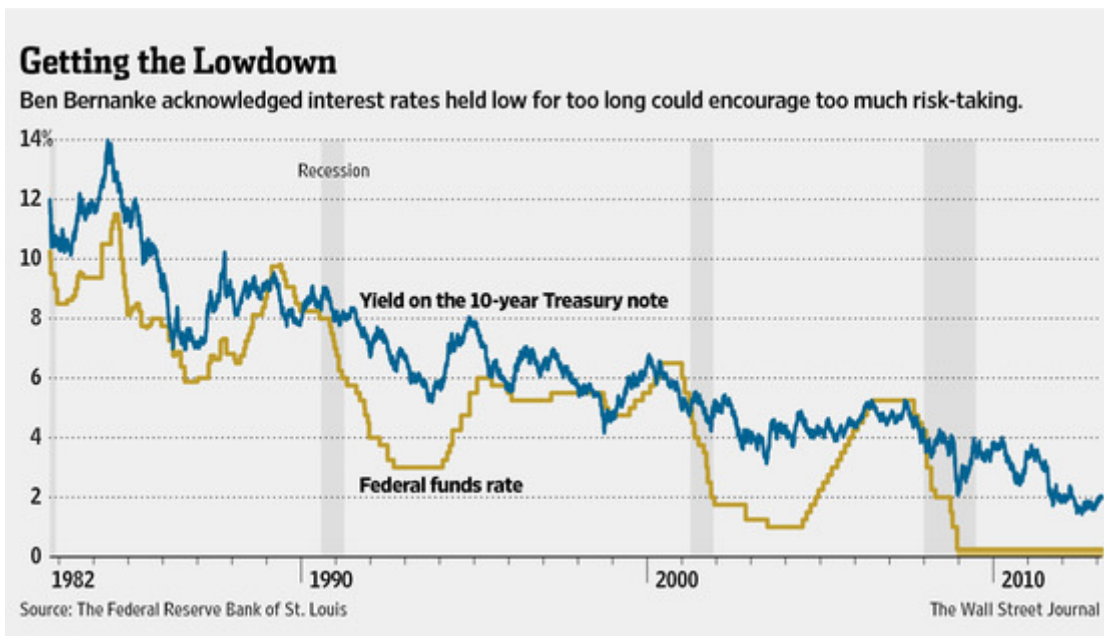
In his semiannual report to Congress Tuesday, Mr. Bernanke said the bond buying is helping the economy by holding down long-term interest rates and ought to be sustained. "Keeping long-term interest rates low has helped spark a recovery in the housing market and has led to increased sales and production of automobiles and other durable goods," he said.

The Fed has accumulated \$2.8 trillion of Treasury and mortgage securities. Mr. Bernanke's remarks signaled little change in the central bank's plans to purchase \$85 billion a month of long-term Treasury and mortgage debt. The Fed's next policy meeting is March 19-20.

Wall Street was relieved that the Fed isn't on the cusp of pulling back—at least not yet. "Bernanke stays the course," J.P. Morgan said in a note to clients. "Bernanke appears comfortable with continued, open-ended asset purchases at least for now," said Deutsche Bank.

The Dow Jones Industrial Average rose 115.96 points, or 0.8%, to 13900.13

Some Fed officials have been worrying that the central bank's ultralow interest rates could breed the sort of financial excesses that produced the financial crisis. The warnings have come not only from the Fed's contingent of policy "hawks," or those usually skeptical of easy-money policies. They also have come from middle-of-the-road officials, those generally supportive of the Bernanke approach, notably Jeremy Stein, a Harvard economist appointed to the Fed Board of Governors by President Barack Obama.



Stung by the Fed's failure to head off the latest financial crisis, Mr. Bernanke insisted he is taking such concerns seriously. The Fed's semiannual report to Congress included a section laying out what the central bank is doing to better monitor financial stability and made repeated references to the concerns expressed by Mr. Stein and others.

"Although a long period of low rates could encourage excessive risk-taking, and continued close attention to such developments is certainly warranted, to this point we do not see the potential costs of the increased risk-taking in some financial markets as outweighing the benefits of promoting a stronger economic recovery and more-rapid job creation," he said.

Fed studies estimate that between 2008 and 2012 its bond buying increased the level of economic output by 3%, both by making it easier for households and businesses to borrow and by boosting stocks and household wealth. The added growth, the Fed estimates, led to three million more jobs than would have been created in the absence of such monetary stimulus.

As has become common, Mr. Bernanke faced some hostile questioning in his testimony before the Senate Banking Committee on Tuesday.

In one testy exchange, Sen. Bob Corker (R., Tenn.) told Mr. Bernanke his easy-money policies were sparking a global currency war and creating "faux" stock-market wealth that would be reversed as soon as interest rates started rising. He accused Mr. Bernanke of "throwing seniors under the bus" by pushing down interest rates and reducing their returns on savings and of encouraging people to live beyond their means.

Obviously perturbed, Mr. Bernanke replied that his record of keeping inflation low and stable is better than that of any Fed chairman since World War II. Inflation, as measured

by the Commerce Department's personal-consumption-expenditure price index, has averaged about 2% during Mr. Bernanke's seven years in office. He added that he was looking out for people who were unemployed and that if he reversed course it could throw the economy back into recession.

At one point, Mr. Corker accused the Fed of subsidizing banks. "None of the things you said are accurate," Mr. Bernanke responded. "Oh yes they are," Mr. Corker replied.

Sen. Elizabeth Warren (D., Mass.) told Mr. Bernanke the Fed was being too easy on big banks, which she said benefit from a perception that they would be bailed out again in a crisis.

"The big banks are getting terrific breaks, and the little banks are getting smashed," Ms. Warren told Mr. Bernanke.

The Fed chairman said the central bank is trying to wipe out the advantages of big banks.

"The benefits of being large are going to decline over time, which means that some banks are going to voluntarily begin to reduce their size because they're not getting the benefit they used to get," he said.

QUESTIONS:

1. What is quantitative easing? When did the first round of quantitative easing take place, and why?
2. Explain briefly the short-run impacts of the Federal Reserve's quantitative easing policy on economic output, interest rates, and price levels. What is the main short-run concern of the Fed's current policy?
3. What are the long-run concerns of the Fed's dovish policy? Do you think that the Fed made a correct decision to continue its current quantitative easing policy?