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Bernanke May Move to Boost Confidence Amid Financial Turmoil

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By Jeannine Aversa

Aug. 8 (Bloomberg) -- Federal Reserve officials tomorrow may move to bolster investor confidence after an unprecedented downgrade to America's credit rating and concern the U.S. may be headed for a recession sent global share prices tumbling.

Chairman Ben S. Bernanke and his colleagues may prolong a pledge to maintain record monetary stimulus, said economists at JPMorgan Chase & Co., BNP Paribas and Goldman Sachs Group Inc. The Fed could do so by making a commitment to hold its $2.87 trillion balance sheet steady for an "extended period." The Fed also may replace shorter-term securities with longer maturities to reduce rates on longer-term debt.

"Those steps are all about bolstering confidence," said Michael Feroli, chief U.S. economist at JPMorgan Chase in New York and a former Fed economist. "It wouldn't do tons to alter economic and financial conditions, but the perception that the Fed will act and do something is reassuring."

The drop in global stocks, further fueled by concerns over Europe's debt crisis, adds to pressure on the Fed, which is confronting a slowing U.S. economy and unemployment stuck above 9 percent. Policy makers plan to hold a one-day meeting tomorrow and release a statement at around 2:15 p.m.

"The mounting worries threaten to tip an already fragile recovery into recession," said Julia Coronado, chief economist for North American for BNP Paribas in New York.

The Standard & Poor's 500 Index tumbled 5.8 percent to 1,129.88 at 2:40 p.m. in New York, its biggest decline since December 2008. The benchmark Stoxx Europe 600 Index dropped 4.1 percent to 228.98 at the 4:30 p.m. close in London, for its biggest retreat since March 2009.

Treasuries Surge

Treasuries surged as investors sought the safety of government debt. Yields on 10-year notes fell 22 basis points, or 0.22 percentage point, to 2.34 percent, according to Bloomberg Bond Trader prices.

Other options for the Fed include pledging to hold its key interest rate near zero until a specified date, which would strength its current promise to keep rates low for an "extended period." The Fed could also reduce the 0.25 percent interest rate it pays banks on excess reserves parked at the central bank, a move that might spur growth by encouraging banks to lend.

The Fed's regularly scheduled meeting comes two days after central bankers and finance ministers from the Group of Seven pledged to "take all necessary measures to support financial stability and growth." The officials said they would pump money into the global economy and take other steps if warranted.

ECB Purchases

The G-7 statement followed a pledge by the European Central Bank to "actively implement" its bond-purchase program. The ECB started buying Italian and Spanish assets today in its riskiest attempt yet to tame the continent's sovereign debt crisis.

While Fed officials are likely to weigh whether to undertake a third round of government bond purchases to spur growth, Feroli and other economists said they probably won't announce a new program tomorrow.

Such a step could backfire because it could panic investors by signaling the economy is in worse shape than the Fed thought, said Lynn Reaser, chief economist at Point Loma Nazarene University and a board member of the National Association for Business Economics.

The Fed in June completed a $600 billion Treasury bond- purchase program aimed at lowering long-term borrowing costs on everything from car loans to mortgages and boosting share prices.

Economy Slows

Even with the purchases, the economy grew in the first six months of this year at the weakest pace since the recovery started in 2009. After nearly stalling at a 0.4 percent annual pace in the first three months of this year, the economy expanded at a 1.3 percent rate last quarter, the government reported on July 29.

Unemployment fell to 9.1 percent in July from 9.2 percent in June as people gave up looking for work, an Aug. 5 Labor Department report showed. Consumers cut spending in June for the first time in almost two years, the Commerce Department said Aug. 2.

The Aug. 5 decision by Standard & Poor's to cut the U.S. AAA credit rating for the first time threatens to deal a further blow to consumer confidence, said Mark Spindel, chief investment officer at Potomac River Capital, which manages $300 million in Washington.

Blow to Confidence

"This is an upper-cut to confidence at the worst possible moment," Spindel said. "The downgrade mattered less. It is the patch we have taken to get here: the meager recovery, the dysfunctional political environment and the pathetic growth in employment, consumption and income that don't seem to be moving back to sustainable levels," he said.

Amid the turmoil, Bernanke needs to ensure the Fed's reluctance to embark on a third round of Treasury purchases doesn't "underscore the sense that monetary policy is out of ammunition, because it isn't," said Vincent Reinhart, a scholar at the American Enterprise Institute in Washington a former monetary affairs director at the Fed. "They've got a big balance sheet. They can make it bigger if they want. They just don't want to right now," he said.

--With assistance from Scott Lanman and Craig Torres in Washington. Editors: Christopher Wellisz, James Tyson

To contact the reporter on this story: Jeannine Aversa in Washington at javersa@bloomberg.net