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Fed May Hesitate to Tighten in 2010 as Congress Debates Powers

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By Scott Lanman and Steve Matthews

Dec. 15 (Bloomberg) -- Proposals in Congress to trim the Federal Reserve's powers and subject it to greater scrutiny mean Chairman **Ben S. Bernanke** may have to think twice about raising rates in 2010 as long as unemployment stays high.

Bernanke and his colleagues on the Federal Open Market Committee meet for the last time this year under the shadow of proposals to audit the Fed's monetary policy decisions, strip it of bank-supervision authority and give politicians a role in choosing regional Fed bank presidents.

The FOMC tomorrow is likely to repeat its pledge to keep interest rates near zero for an "extended period," economists say, because inflation is slowing and unemployment remains near a 26-year high. While investors expect Bernanke to tighten policy well before the labor market fully recovers, he'll be under pressure from lawmakers to bring down a jobless rate that's forecast to remain above 10 percent through June.

"The Federal Reserve will recognize that they will be subject to much harsher criticism and political interference," said **Frederic Mishkin**, a former Fed governor who teaches at Columbia University in New York, citing the potential effect of Congressional audits. "It could have an impact on their ability to do what they need to do at that time."

Economists surveyed by Bloomberg News this month expect the Fed to start raising the overnight interbank lending rate in the third quarter of 2010 with a jobless rate of 9.9 percent, based on the median estimates of analysts. The Fed's rate will reach 1.75 percent by mid 2011, while the unemployment rate will average 9.2 percent that year, the survey showed.

Policy Statement

The FOMC will release a monetary policy statement at around 2:15 p.m. tomorrow in Washington.

Representative **Luis Gutierrez**, an Illinois Democrat and chairman of the subcommittee on financial institutions and consumer credit, said he expects Bernanke to cooperate with Congress in reviving the economy. Gutierrez and other lawmakers in coming months plan to discuss the timing of any tightening in private and public meetings with the Fed chief, including the chairman's semi-annual testimony in February.

"I fully expect that Mr. Bernanke, who has had grave difficulties as he has gone through his confirmation over in the Senate, will be cognizant that he needs to work in a coordinated fashion with the rest of us," Gutierrez said in an interview.

Since the FOMC cut its main interest rate a year ago almost to zero, the Fed has purchased more than $1 trillion of housing debt and Treasuries, President **Barack Obama** signed a $787 billion fiscal stimulus law and Congress extended the $8,000 tax credit for first-time buyers until April 30 from Nov. 30. Still, the jobless rate has climbed to 10 percent from 6.8 percent.

Withdrawing Stimulus

The Fed is already withdrawing stimulus. Central bankers ended their $300 billion of Treasury purchases in

October and are set in March to complete buying $1.43 trillion of housing- debt. Economists including Nobel Prize-winner **Paul Krugman** are calling for the Fed to increase asset purchases.

A Nov. 29-30 Rasmussen Reports survey of 1,000 U.S. adults found 38 percent said they had an unfavorable impression of Bernanke, compared with 21 percent who had a favorable view. Seventy-nine percent backed audits of the central bank, and 41 percent said the Fed chairman holds too much power. The margin of error was plus or minus 3 percentage points.

The House voted Dec. 11 to approve a proposal by Representative **Ron Paul**, a Republican from Texas, to end a ban on audits of monetary policy over Bernanke's warnings the measure threatens to compromise Fed independence.

Second-Guess Fed

The legislation would allow the Government Accountability Office after a policy meeting to "second-guess the Fed's decision in very short order with very few protections," Bernanke told the Senate Banking Committee on Dec. 3. In the Senate, a similar bill was introduced by Senator **Bernard Sanders**, a Vermont independent, and has 30 co-sponsors.

The banking committee is scheduled to vote Dec. 17 on the nomination of Bernanke by Obama to a second four-year term. Its approval would go to a vote before the full Senate. Four senators are trying to block or delay the floor vote.

Among policy makers "there is a need for political courage, but it is really lacking," said **Allan Meltzer**, a Fed historian and professor at Carnegie Mellon University in Pittsburgh. Should the Fed delay an increase in interest rates, "we will end up with fairly sizable inflation, not immediately but over a couple of years," he said. "The dollar will continue to sink."

'Quite Damaging'

Bernanke and other policy makers won't allow politics to color their interest rate decisions, said **Mark Gertler**, a New York University economics professor who co-wrote research with Bernanke. Still, "some of the things Congress has in mind could be quite damaging to the institution's ability to conduct monetary policy."

Since World War II, the Fed has waited an average of six months after unemployment peaked to begin raising interest rates, and the central bank held off longer when inflation was low, **Joseph LaVorgna**, a Deutsche Bank Securities Inc. economist, said in a research note last month. He forecasts the central bank will start raising interest rates in August.

The Fed will find it especially tough to tighten if unemployment remains high, said **Mark Calabria**, director of financial regulation studies at the Cato Institute in Washington and a former aide to Senator **Richard Shelby** of Alabama, the senior Republican on the banking committee.

"Monetary policy should not be subject to political influence," Representative **Brad Miller**, a North Carolina Democrat, said in an interview. "But my own view is that before we have pulled out of the decline that we're in, and I certainly don't think we will have by the middle part of next year, I don't think the Fed needs to raise interest rates."

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