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Bernanke Presses China on Imbalances, Echoing Obama

By SEWELL CHAN and JACK EWING

Ben S. Bernanke, the Federal Reserve chairman, argued Friday that currency undervaluation by China and other emerging markets was at the root of “persistent imbalances” in trade that “represent a growing financial and economic risk.”

Mr. Bernanke, in a speech at a European Central Bank conference in Frankfurt, warned that a “two-speed global recovery,” with the richest countries lagging behind fast-growing emerging markets like China and India, was hampering the cooperation the worldwide recovery needs, echoing a main point the Obama administration made — with limited success — when leaders of the Group of 20 economic powers gathered last week in South Korea.

Not only the United States is suffering from undervalued currencies, Mr. Bernanke said. Emerging countries with flexible exchange rates, like Brazil, are “carrying a double burden,” he said. They suffer disproportionately from the imbalances created by export countries with undervalued currencies. “It isn’t just advanced vs. emerging” countries, Mr. Bernanke said, said during the panel discussion led by Jean-Claude Trichet, president of the European Central Bank.

For the last two weeks, the Fed has been criticized for its Nov. 3 decision to inject $600 billion into the banking system through next June, resuming an effort to lower long-term interest rates.

Those attacks continued Thursday. Speakers at a conference in Washington, organized by the libertarian Cato Institute, warned that the Fed’s monetary policy could lead to asset-price bubbles like the housing boom that crashed in 2007.

Defending the policies Friday before an audience of central bankers and economists in Frankfurt, Mr. Bernanke said "there is considerable evidence" that securities purchases by the Fed have achieved their goal of raising asset prices. "We don't want to overpromise," he said during a question-and-answer session. "The effects are moderate — meaningful, but moderate."

The mood of the conference was amiable, but there was a hint of tension when Agustín Carstens, governor of the Bank of Mexico, asked what the United States would do to reduce its trade deficit. "Deficit countries have to do their part," Mr. Bernanke conceded. He said that the United States needs to further raise its savings rate and cut government borrowing. He added that a cheaper dollar will not be enough. "It would be difficult for exchange rates by themselves to restore balance," he said.

Mr. Bernanke's speech argued that unemployment in the United States is at "unacceptable" levels, and gingerly waded into the fiscal policy debate roiling Washington.

"In general terms, a fiscal program that combines near-term measures to enhance growth and strong, confidence-inducing steps to reduce longer-term structural deficits would be an important complement to the policies of the Federal Reserve," Mr. Bernanke said.

He did not, however, express a view on extending the Bush-era tax cuts, the most contentious fiscal policy choice facing the White House and the lame-duck Congress.

Even so, by defending the Fed's actions, calling for global rebalancing and hinting that more fiscal stimulus might be needed, Mr. Bernanke's remarks amount to an endorsement of crucial elements of President Obama's economic approach.

But that endorsement, in turn, could further stoke criticism by Congressional Republicans, who say the Fed is defying voters' skepticism about large-scale government intervention in the economy and setting the stage for inflation later, and by foreign officials, who fear the Fed is trying to weaken the dollar to make American exports more competitive.

Mr. Bernanke, a Republican economist who was first appointed by George W. Bush, reiterated his argument that the Fed felt compelled to act because inflation is so low (about half of the Fed's target of roughly 2 percent) and unemployment so high (stuck at nearly 10 percent for the last 18 months or so).

"In sum, on its current economic trajectory the United States runs the risk of seeing millions of workers unemployed or underemployed for many years," he will say. "As a society, we should find that outcome unacceptable."

Mr. Bernanke said that the Fed's first, $1.7 trillion round of asset purchases, which lasted from December 2008 to last March, helped stabilize the economy. By resuming the purchases, the Fed "seeks to support the economic recovery, promote a faster pace of job creation and reduce the risk of a further decline in inflation that would prove damaging to the recovery."

(In the speech he also argued that "quantitative easing," the term markets have used to describe the bond-buying strategy, was an "inappropriate" phrase because it usually referred to policies that aim to change the quantity of bank reserves, rather than affect interest rates, as the Fed is trying to do.)

The text includes indirect responses to domestic and overseas critics. He also argued that the Fed "remains unwaveringly committed to price stability" and that buttressing growth was "the best way to continue to deliver the strong economic fundamentals that underpin the value of the dollar."

The speech addresses the anxieties of Brazil, Thailand and other emerging economies, which fear that a surge of foreign capital will drive up prices and interest rates.

If exchange rates were allowed to move freely, Mr. Bernanke argued, emerging markets would raise interest rates — and allow their currencies to appreciate — even as advanced economies like the United States maintained expansionary monetary policies. That would curb the emerging markets' trade surpluses and shift demand toward domestic consumption and away from export-led growth.

Instead, Mr. Bernanke said, currency undervaluation in big surplus economies has led to unbalanced growth and "uneven burdens of adjustment."

Since "the ultimate purpose of economic growth is to deliver higher living standards at home," the speech stated, surplus countries should satisfy domestic needs instead of focusing mainly on exports.

Without naming China explicitly, Mr. Bernanke warned that its "pursuit of export-led growth cannot ultimately succeed if the implications of that strategy for global growth and stability are not taken into account."

Before Mr. Bernanke departed for Frankfurt, other Fed officials rallied to the central bank's defense.

In a speech at Case Western Reserve University, Sandra Pianalto, president of the Federal Reserve Bank of Cleveland, defended the asset purchases, saying that the recovery had been "exceptionally gradual " and that she did not expect unemployment to fall below 8 percent before 2013.

Even so, she tried to reassure inflation-fearing skeptics, saying: "The main variable the Federal Reserve can control over time is the price level. Ensuring price stability is our job."

At a speech in Chicago, Narayana R. Kocherlakota, president of the Minneapolis Fed, also defended quantitative easing.

He said that in normal times, if the Fed let banks create more money, that could spur inflation. But, he said, that "this basic logic isn't valid in current circumstances" because banks were sitting on nearly $1 trillion in excess reserves held at the Fed.

"This means that they are not using a lot of their existing licenses to create money," he said. "Q.E. gives them $600 billion of new licenses to create money, but I do not see why they would suddenly start to use the new ones if they weren't using the old ones."

Still, he said the effects of the Fed's new policy "are likely to be relatively modest."