Fed Reserve Signals on Stimulus Turn Market Attention to Congress

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World financial markets displaying a "taper tantrum" over suggestions from the Federal Reserve that the central bank may ease its economic stimulus efforts are not likely to find much to cheer them from Congress.

Many economists, business executives and investors credit the central bank with keeping the U.S. economy out of a depression since the fiscal collapse of 2008. This week, the idea that the Fed may begin to ease its unprecedented monetary policies, even though it's because the economy looks stronger, sent financial markets into a dive.

That may be in part because elected officials don't appear close to picking up the ball with fiscal policy if the Fed leaves the field. Members of Congress and the White House already seem worlds apart on the next looming fiscal fights over major spending priorities and on the need to raise the debt ceiling to keep the government from defaulting on its bills.

Republicans have made it clear they intend to use the fight as leverage on broader spending and entitlement issues, while the White House and many congressional Democrats have said they won't negotiate over the debt increase.

"It's too soon," said economist Jared Bernstein, a senior fellow at the left-leaning Center on Budget and Policy Priorities. "Those of us in Washington who worry about the economy and the residual damage from the Great Recession look to [Fed Chairman Ben S.] Bernanke as one of our only friends, and now he's talking about pivoting."

Bernstein points to the stalemate in Washington as a significant concern for the economy. "If Congress took a do-no-harm oath vis-a-vis the economy, that would be the best I could expect out of this group I'm sorry to say," Bernstein said. "In a rational world, with a functional Congress, they'd be trying to help the economy."

Bernanke tried, unsuccessfully, to calm market jitters about the bank's eventual exit strategy from its quantitative easing program. The bank has been buying up Treasury and mortgage-backed securities at a price tag of $85 billion a month. Bernanke indicated at his Wednesday press conference that if the economy and unemployment levels continue to improve, the Fed could reduce its asset purchases as soon as later this year.

Fed governors and bank presidents offered a rosier forecast this month for the future unemployment rate, predicting it could be 6.5 percent to 6.8 percent by next year, down from the current 7.6 percent. Bernanke said the various economic measures for scaling back the Fed's efforts were merely "a threshold, not a trigger."

"The key point I've tried to make today is that our policies are tied to how the outlook evolves, and that should provide some comfort to markets because they will understand, I hope, that we will be providing whatever support is necessary," Bernanke said on Wednesday.

House Speaker John A. Boehner, R-Ohio, insisted in an interview with CNBC the policies Bernanke has overseen carry much of the blame for the stock market reaction.

"You can't continue to deflate our money and deflate it and deflate it [and] have the equity markets go up without some change," Boehner said.

But Boeher acknowledged that the bank's efforts came "in the absence of the government doing its part to help improve our economy."

Bernanke said the political stalemate, including the sequester cuts, has been an ongoing "headwind" for the economy, pointing to a Congressional Budget Office estimate that fiscal tightening had cost the economy "something on the order of 1.5 percentage points of growth."

Given that "very heavy headwind," he said, "the fact that the economy is still moving ahead at least at a moderate pace is indicative that the underlying factors are improving."
Congress Is Challenged

Some lawmakers say the Fed's statement amounts to a challenge to Congress.

Sen. Amy Klobuchar, D-Minn., the vice chairman of the Joint Economic Committee, in a statement to CQ Roll Call said Capitol Hill needs to do its part for the economy. "Now is the time for both sides to come together and reach a deal that puts us on a long-term budget path of economic growth and fiscal responsibility that gives businesses and families the certainty they need," she said.

Mark Calabria, a former GOP Senate Banking Committee aide who is now the Cato Institute's director of financial regulation studies, said Wall Street expects deals to be completed even as lawmakers launch political barbs across the aisle. Market have grown accustomed to dramatic, last-minute deal-making in Washington, after all, and were calm leading up to the fiscal-cliff deal at the start of the year and at the onset of sequestration in March.

"It's like the first time you go into combat and get shot at," Calabria said. "Not that you ever get used to it, but now there's less tension and concern than there's been in the past. I think the markets are starting to get adjusted to this, that Congress is going to wait until the last minute."

Bernstein is concerned, however, that any deals that extend fiscal tightening amid tightening monetary policy would undermine economic growth.

He said the concept of tapering is not an unreasonable one but that the timing Bernanke has indicated would be "premature."

"It's wrong to think that the Fed is going to continue with an outsized balance sheet and interest rates at zero forever," he said. "But for them to do that too soon risks turning the only tailwind we really have into a headwind."