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Fed Says Economy 'Expanding Moderately'; Policy Unchanged

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Dec. 13 (Bloomberg) -- Federal Reserve policy makers said the economy in the U.S. is maintaining its expansion even as the global economy slows, while refraining from taking new actions to lower borrowing costs.

"The economy has been expanding moderately, notwithstanding some apparent slowing in global growth," the Federal Open Market Committee said in a statement at the conclusion of its meeting today in Washington. "While indicators point to some improvement in overall labor market conditions, the unemployment rate remains elevated."

Chairman Ben S. Bernanke and colleagues have been trying to determine whether there's more the Fed can do to spur the economy after two rounds of large-scale asset purchases and three years of near-zero interest rates. Policy makers are also discussing how they can release more information and improve public understanding of the Fed's broader objectives.

Today's statement reiterated the warning at the Fed's two previous meetings that "Strains in global financial markets continue to pose significant downside risks to the economic outlook." Bernanke said last month that the sentence refers to the European debt crisis.

The Fed left unchanged its statement that economic conditions are likely to warrant "exceptionally low" interest rates "at least through mid-2013." The central bank lowered its target overnight interest rate to a range of zero to 0.25 percent in December 2008.

Stocks Pare Gains

Stocks pared gains after the statement. The Standard & Poor's 500 Index rose 0.1 percent to 1,237.03 at 2:25 p.m. in New York after rising as much as 1.1 percent. The yield on the 10-year Treasury note fell to 1.97 percent from 2.01 percent late yesterday.

The central bank said it would continue its exchange of $400 billion of short-term debt with long-term securities to lengthen the average maturity of its holdings, a move dubbed Operation Twist. The Fed also did not alter its policy of reinvesting its portfolio of maturing housing debt into agency mortgage-backed securities.

"Inflation has moderated since earlier in the year, and longer-term inflation expectations have remained stable," the Fed said today. By one measure, inflation has decelerated, based on the personal consumption expenditures price index excluding food and energy, the principal indicator the Fed tracks. That gauge rose 0.07 percent in October from September, the second- slowest gain in 2011, following a 0.01 percent increase the prior month.

Evans Dissents

Chicago Fed President Charles Evans dissented for the second meeting in a row, supporting "additional policy accommodation," according to the statement. "There is simply too much at stake for us to be excessively complacent while the economy is in such dire shape," Evans said in a speech last week in Muncie, Indiana.

Economists forecast the central bank today would retain its pledge to hold interest rates near zero through mid-2013 and forgo launching a new round of asset purchases, according to a Dec. 7-9 survey of 41 analysts.

None of the economists surveyed forecast that a third round of quantitative easing, also called QE3, would be announced at today's meeting. Thirteen percent saw such a move at the Fed's January meeting, and 21 percent anticipated purchases would be announced in March.

"They took cognizance of the fact that there is moderate improvement in the economy, but not enough to change course," said Gerald O'Driscoll, a former Dallas Fed vice president and now senior fellow at the Cato Institute in Washington.

Improvement in Data

Improvement in some U.S. statistics signals growth may be picking up. The index of leading economic indicators rose 0.9 percent in October, the most since February. A consumer confidence index from the Conference Board rose in November to the highest since July. Manufacturing expanded in November at the fastest pace in five months, according to the Institute for Supply Management's factory index.

U.S. economic data have outperformed expectations by the most in nine months. The Citigroup Economic Surprise Index, a daily measure of whether data reports are better or worse than economists' projections, improved to 85.7 on Dec. 2, the highest since March 9. The index is calculated on a three-month rolling basis and weighted for the importance of the indicator.

Retail Sales

A report on retail sales today was an exception. Purchases in November rose 0.2 percent, less than forecast by economists and the slowest pace in five months, indicating that faster job growth may be needed to spark the biggest part of the economy.

The Fed in recent months has been joined by counterparts around the world in trying to stimulate economies and limit effects of Europe's turmoil. The European Central Bank and its counterparts in the U.K. and China have all taken steps to ease monetary policy since the Fed began Operation Twist in September.

Last week, European leaders agreed after all-night talks to make loans of as much as 200 billion euros ($264 billion) to the International Monetary Fund to counter the crisis and tightened rules to curb future debts. Whether the euro is saved may hinge on support from investors, central bankers and credit-rating companies.

Fed policy makers have been stepping up their warnings about Europe's debt crisis. Fed Vice Chairman Janet Yellen said Nov. 29 that Europe needs to take "forceful" steps to quell fiscal and financial turmoil, and San Francisco Fed President John Williams said the same day that Europe represents the biggest risk to the global economy.

Swap Lines

The next day, the Fed led six central banks in announcing a half percentage-point cut in the cost of emergency dollar funding for financial companies. The money comes from the Fed's currency-swap lines. The action triggered a stock and bond rally, and the following week, the ECB's three-month dollar lending through the swap lines surged to $50.7 billion from $400 million.

News of the central banks' swap line agreement helped propel global stocks to their biggest three-day rally since March 2009. The Standard & Poor's 500 Index climbed 7.6 percent from Nov. 28 to Nov. 30, the day of the announcement. The MSCI World Index climbed 7.9 percent in that period.

The move means European banks will pay about 0.60 percent to borrow dollars, less than what U.S. banks would pay to use the discount window, the Fed's century-old lender-of-last-resort program.

Discount Rate

The Fed raised the discount rate to 0.75 percent in February 2010, a move it described at the time as a "normalization" of lending terms and not a tightening of monetary policy.

Any further easing by the Fed may be criticized by U.S. politicians, especially Republicans seeking the party's nomination to challenge President Barack Obama in 2012. Former House Speaker Newt Gingrich said during a debate last month that Bernanke is a "large part of the problem" for the economy and "ought to be fired as rapidly as possible."

Updated economic forecasts released by the Fed last month were thrown into question by November's unexpected drop in the unemployment rate to 8.6 percent, about where Fed policy makers projected it to be in late 2012. Payrolls increased by 120,000 after a 100,000 gain the prior month that was larger than previously estimated, Labor Department figures showed Dec. 2.

Still, economists see the U.S. expansion slowing to a 1.9 percent annual pace in the first quarter from 2.8 percent in the three months ending Dec. 31, based on the median estimate in a Bloomberg News survey this month.

Apparel Chain

Chico's FAS Inc., a women's apparel chain based in Fort Myers, Florida, said last month that customers are holding back on spending. The typical female Chico's customer is "particularly sensitive to economic uncertainty, and we believe this had a significant effect on how she shopped with us in the quarter just ended," Chief Executive Officer David F. Dyer said on a Nov. 22 conference call.

"We remain in a slow-growth economy for business in North America, and that's really driven by high unemployment and fear of the future," Ronald L. Sargent, CEO of Staples Inc., the Framingham, Massachusetts-based office-supply chain, said on a Nov. 15 conference call.