

THE HILL



Election-year bind for Federal Reserve

By Peter Schroeder - 06/05/12 05:00 AM ET

With five months left until Election Day, Ben Bernanke and the Federal Reserve must weigh whether to launch another round of stimulus that could spur the economy but invite charges of politicking for President Obama.

The central bank's reputation, tested by the financial crisis, could take a massive hit if officials are perceived as trying to help Obama's bid for a second term.

But if they stand pat, officials risk a repeat of 1992, when the bank did not lower interest rates after a recession and allies of President George H.W. Bush bitterly accused Alan Greenspan of helping Bill Clinton win the White House.

"The Fed has got themselves in a situation where if they do anything really aggressive, I think they're going to get absolutely accused [of picking sides]," said Mark Calabria, director of financial-regulation studies for the Cato Institute. "They're going to be part of the election, whether they like it or not."

Experts say Fed officials are mindful of the election-year climate and determined to protect the bank's reputation. Given the political risks, experts say, the Fed will only act to boost the economy if officials feel they have an ironclad case for doing so.

"This is not the time for them to be acting based on hunches. They need to make sure that the data are all lined up behind their decisions," said Karen Dynan, vice president for economic studies at the Brookings Institution and a senior adviser at the Fed until 2009.

"They have to be cautious to make their case, but I don't think they will hold back from taking appropriate steps simply because of the election."

Longtime Fed watchers say that if the central bankers had a choice in the matter, they'd prefer to remain in the shadows before the election, lest their market-moving actions carry a political tinge. Any move this year risks undermining the bank's reputation for remaining above the fray.

"If [a policy change] were seen as a crass political move, then investors might begin to doubt Fed statements generally," said Vincent Reinhart, chief U.S. economist for Morgan Stanley, who previously headed the Fed's monetary-affairs division. Without a clear path forward, the

Fed is “less likely to act because some decisions that are at the margin are just too risky of the Fed’s political capital.”

But the Fed might not have the luxury of avoiding the spotlight.

Friday’s jobs report, which showed meager gains in May and fewer jobs than anticipated in March and April, has renewed concerns about the economy’s torpid growth. Add in growing criticism of the Fed, driven largely by Republicans skeptical of its expansionary policies since the downturn, and it proves a dangerous mix for the central bank.

Dynan said the blowback on Capitol Hill could be fierce if the Fed makes an aggressive move.

“They’re worried about Congress taking actions that will impinge on their independence over the long run,” said Dynan. “They have been working for decades to create this reputation as an independent body, making decisions that fulfill their mandate ... not making decisions because of the politics behind it.”

In the midst of all this, the Fed is caught in a political tug-of-war between the two parties. Some Democrats maintain the Fed has room to do more for the economy — and an obligation to act.

“I think they should seriously consider [further stimulus],” said Rep. Barney Frank (D-Mass.), who dismissed arguments of the Fed picking sides during election season as “nonsense.”

“The argument that they shouldn’t do something that’s good for the economy because of the election is literally bizarre,” he said.

Others suggested that the vocal GOP criticism is aimed at keeping the Fed from taking further action precisely because the election is looming.

“I’m sure that the Republicans will make a big deal if the Fed takes any steps — the goal is presumably to limit the extent to which the Fed will try to boost the economy,” said Dean Baker, co-director of the liberal-leaning Center for Economic and Policy Research, in an email. “That is probably good politics for the Republicans, even if it is not good for the economy.”

Republicans maintain that their critiques of the Fed’s policies are focused on the economy, warning that the easy-money moves are sowing the seeds of damaging inflation down the road. They also argue that the nation’s economic woes now are not a monetary problem, but a fiscal one for Congress to address.

When the Fed's policy-setting committee meets at the end of June, it will face an economic recovery that is far from a sure thing. The dismal jobs numbers, combined with the European debt crisis, appear to point to a sluggish economy in 2012.

Ever since the financial meltdown, the Fed has dug deep into its playbook to find ways to help the economic recovery. The Fed has embarked on two rounds of "quantitative easing" — large purchases of bonds aimed at spurring investment — as well as "Operation Twist," a portfolio rearranging targeting the same goal, which is set to wrap up at the end of the month.

It also lowered interest rates to near zero, adding that it expects to keep them there until the end of 2014 — the year Bernanke's term as Fed chairman expires.

Depending on how the election plays out, it could also mark the end of his time at the central bank, as GOP presumptive nominee Mitt Romney has said he would look for someone else to lead it.