Banking on Bernanke

Obama's pick to stay as Fed chairman faces criticism and a tough job, once again

By Robert Gavin, Globe Staff | August 26, 2009

Federal Reserve chairman Ben S. Bernanke unleashed more than $1 trillion into the US economy to tame a financial crisis that threatened to spiral into a second Great Depression. Nominated for a second term, the 55-year-old economist would still face a fragile recovery that could easily unravel into another recession, analysts said.

President Obama, taking time from his Martha's Vineyard vacation, said yesterday that he would nominate Bernanke for a second four-year term as the nation's top central banker. The nomination must be confirmed by the Senate.

Appointed by George W. Bush, Bernanke began his tenure in early 2006 in the unenviable position of following the legendary Alan Greenspan. Today, with Greenspan's legacy tarnished, analysts said, Bernanke has established his own place in history by staring down a global panic, preventing a collapse of the financial system, and extending the Fed's reach far deeper into the US economy.

"There was that possibility, with financial markets so interlinked today, that it might have been far worse than the Great Depression,'' said Robert Murphy, a Boston College economics professor. "But Bernanke has been a steady hand and taken approaches that we wouldn't even have dreamed about a few years ago.''

Obama's nomination ended months of speculation about Bernanke's future. Not only a Republican in a Democratic administration, Bernanke has come under criticism for bailing out Wall Street firms and large banks, extending the Fed's authority beyond what Congress envisioned when it established the system in the early 20th century, and risking inflation by essentially printing more than $1 trillion to keep credit flowing.

But Obama praised Bernanke for "bold action and outside-the-box thinking that has helped put the brakes on our economic free fall.''

Bernanke, who appeared by Obama's side yesterday, said the Fed's objective has remained the same - "to restore a more stable economic and financial environment in which opportunity can again flourish.''

Bernanke already has key support on Capitol Hill. Senator Chris Dodd of Connecticut, chairman of the Banking Committee that will hold Bernanke's confirmation hearing, said: "While I have had serious differences with the Federal Reserve over the past few years, I think reappointing chairman Bernanke is probably the right choice.''

Recent reports have suggested that the economy is on the mend. Job losses slowed considerably in July, while the broader economy's pace of decline slowed to a 1 percent annual rate in the second quarter following a 6.4 percent plunge in the first quarter. Home sales have increased in each of the past four months, according to the National Association of Realtors, while homes prices posted their first quarterly increase in three years, according to S&P/Case-Shiller home prices indexes. Consumer confidence rose in July, with the brightest outlook for the future since the recession began nearly two years ago, the Conference Board reported yesterday.

Stocks also rose modestly yesterday: The Dow Jones industrial average closed higher for the sixth consecutive day, adding 30.01 to 9,539.29.

Bernanke, a former Princeton professor and leading Great Depression scholar, still has critics - in and out of Congress. Senator Bernie Sanders, an Independent of Vermont, said Bernanke was "asleep at the wheel" as the crisis developed and more interested in helping Wall Street than struggling American workers. Dean Baker, codirector of the Center for Economic and Policy Research, a left-leaning Washington think tank, noted Bernanke, as Fed governor from 2002 to 2005, played a key role in the low-interest rate policies many economists say fueled the housing bubble, but as chairman did little to address it before it burst.

Mark Calabria, director of financial regulation studies at the Cato Institute, a libertarian Washington think tank, said Bernanke appears poised to follow the same easy-money policies that created the recent crisis. The Fed's benchmark interest rate is near zero, and the policy makers have signaled that it will remain there for some time. "We are looking at a large bout of inflation in the future,'' Calabria said, "and setting ourselves up to have the next crisis that is bigger and worse than this one.''

The great challenge for Bernanke and the Fed, others said, is to remove the stimulus from the economy at the right time.

If they wait too long, they risk sparking inflation. If they act too soon, they could choke off the recovery before it becomes entrenched.

These analysts agree that Bernanke should shoulder some blame for the policies that fueled the housing and credit bubbles. They also say that Bernanke underestimated the impact the housing collapse would have, reacting too slowly and timidly when the financial crisis emerged in the summer of 2007.

But ultimately, when the economy plunged following the failure of Lehman Brothers last fall, Bernanke and the Fed took creative, aggressive actions, including providing loans to bolster money market funds under pressure from investor runs, buying short-term debt to allow companies to finance day-to-day operations, and purchasing Treasury, mortgage-backed, and other securities to lower long-term interest rates and keep credit flowing.

"Each of these programs was a parachute deployed to get us to this landing,'' said Brian Bethune, US economist at IHS Global Insight in Lexington. "You can imagine what would have happened if those parachutes weren't deployed.''

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