Bernanke Housing Plan May Prompt Calls to Extend Aid (Update1)

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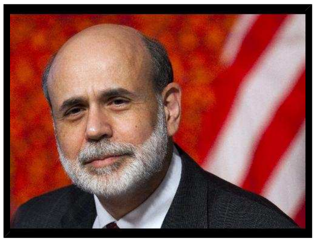
By Craig Torres



Nov. 3 (Bloomberg) -- Federal Reserve Chairman **Ben S. Bernanke** is gambling that come March, he can stop the purchases of mortgage-backed securities that have propped up the U.S. housing market. Congress may have other ideas.

The central bank says it must eventually withdraw its unprecedented economic stimulus to avoid a surge of inflation as a recovery takes hold. Plans to buy $1.25 trillion of housing debt are the centerpiece of its program to pull the nation out of the worst recession since the 1930s.

Bernanke, who convened a meeting of the Federal Open Market Committee today, is counting on private investors to fill the void left by the Fed when its purchases end. If he's wrong, he may come under pressure from politicians to maintain support for housing or even extend credit programs for small businesses and consumers. That would threaten the Fed's ability to conduct an independent monetary policy.

"The nightmare scenario for the Fed would be to see them try to sell their mortgage portfolio, and Congress steps in and tries to stop it on the grounds that the housing market hasn't fully recovered," said **Ethan Harris**, head of North American Economics at Bank of America-Merrill Lynch in New York. "The attempts to influence the Fed in the exit strategy will be pretty strong."

The Fed chairman has already come under pressure from lawmakers including Senate Banking Committee Chairman **Christopher Dodd** of Connecticut and Representative **Paul Kanjorski** of Pennsylvania, both Democrats, to aid car companies and provide more credit to commercial real estate.

'Perceived Difficulties'

"Whenever any sector has perceived difficulties, Congress may ask the Fed to invent a new program," said **William Poole**, a former president of the St. Louis Fed who is now a senior fellow at the Cato Institute, a Washington-based policy research group.

The FOMC will release a monetary policy statement around 2:15 p.m. tomorrow in Washington. A Labor Department report two days later may show the **jobless rate** rose to 9.9 percent in October, even as the economy returned to growth.

Fed officials say purchases of housing debt have helped lower borrowing costs, boosting the part of the economy that was at the epicenter of the economic crisis. The average rate on a **30-year mortgage** was 5.03 percent last week, down from 6.46 percent a year earlier, according to mortgage company Freddie Mac.

Rates on 30-year mortgages could be a full percentage point higher by March as the economy strengthens and the Fed stops its purchases, says **Nicholas Strand**, a mortgage-backed securities strategist at Barclays Capital Inc. in New York.

Home Sales Surge

Sales of new homes unexpectedly fell in September as the end of an $8,000 tax credit for first-time homebuyers approached. Concern the housing recovery may falter prompted Senate Democrats to agree to extend the credit and allow benefits for some people who already own homes.

"There is a question whether the housing market can survive when the fiscal props are pulled out," **Brian Bethune**, chief financial economist at IHS Global Insight in Lexington, Massachusetts, said in an interview.

The central bank is already the biggest buyer of mortgage- backed securities sold by Fannie Mae and Freddie Mac, with purchases exceeding new issuance by the two companies in September, according to the Mortgage Bankers Association.

Private Capital

"When the Federal Reserve stops buying mortgages, is there private capital to substitute?" **Laurence Fink**, chairman and chief executive officer of New York-based asset-management firm BlackRock Inc., said in an interview with the Financial Times' Martin Wolf broadcast on Bloomberg Television Oct. 28. "At the moment, it is not certain."

Purchases of mortgage securities are part of the unprecedented expansion of the Fed's powers under Bernanke, a 55-year-old **Princeton University** economist and self-described "Great Depression buff" who took the helm in 2006.

The Fed chairman told the House Financial Services Committee July 21 that "aggressive actions" by central bankers averted "the collapse of the global financial system."

Representative **Ron Paul**, saying the Fed has "operated without sufficient scrutiny or oversight," is sponsoring a bill that would open monetary policy to audits by Congress. The Texas Republican's bill has more than 300 co-sponsors.

"If the economy is performing poorly, it will be difficult to get back to independence in monetary policy," says **Vincent Reinhart**, a resident scholar at the American Enterprise Institute and former director of the Fed's Division of Monetary Affairs.

The Fed has already come under pressure to provide industrial finance twice in the past year.

Aid to Automakers

Last December, when legislators were considering bailouts for **General Motors Corp.** and Chrysler LLC, Dodd asked Bernanke in a letter "whether there is anything in your statute that prevents you from lending to any of these domestic auto- manufacturing companies."

Dodd was rebuffed by Bernanke, who said "questions of industrial policy are best resolved by Congress."

In July, Kanjorski and 41 other members of Congress asked Bernanke to help support the commercial mortgage-backed securities market by extending the Fed's Term Asset-Backed Securities Loan Facility through the end of 2010.

The Fed approved an extension until March of 2010 for existing CMBS deals and until June 2010 for new ones. Fed officials said they were already considering the extension when they received Kanjorski's letter.

Little Alternative

Paul Krugman, the Nobel-prize winning Princeton University economist, said Bernanke had little alternative to expanding the Fed's balance sheet.

"I'd love to see the Fed with a perfectly clean balance sheet," Krugman told reporters at a news conference in Buenos Aires on Oct. 27. "I'm sure Bernanke would like that as well. But the problem is in housing. The Fed probably should continue purchasing as long as we're in this situation."

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Last Updated: November 3, 2009 14:28 EST