FINANCIAL POST

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Fed says U.S. decline slowing; no further debt buying

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Karen Bleier/AFP/Getty Images

The Federal Reserve refrained from increasing purchases of Treasuries and mortgage securities, signalling the worst of the recession may be over.

"The economy has continued to contract, though the pace of contraction appears to be somewhat slower," the Fed's Open Market Committee said in a statement after a two-day meeting in Washington. "Household spending has shown signs of stabilizing, but remains constrained by ongoing job losses, lower housing wealth and tight credit."

Chairman Ben Bernanke is watching for signs of a slowing contraction as the Fed's loans and bond purchases reduce the cost of credit for households and businesses. Consumer spending rebounded in the first quarter, while the slump in housing and inventories pushed the economy to its worst performance in five decades, the Commerce Department reported earlier Wednesday.

"The committee will continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets," the Fed statement said.

Bonds fell after the Fed failed to commit to increase its buying of long-term Treasuries. The yield on the benchmark 10-year note jumped to 3.11% at 2:22 p.m. in New York, from 3.02% late Tuesday. The Standard & Poor's 500 Index remained higher at 875.11, a gain of 2.4% from Tuesday.

The FOMC kept the federal funds rate target at a range of zero to 0.25% for the third straight meeting and repeated its intentions to keep the target rate low.

Wednesday's decision was unanimous. At the previous FOMC meeting in March, policy makers agreed to buy US$300-billion of long-term Treasury debt within six months while increasing purchases of mortgage-backed securities to US$1.25-trillion this year from US$500-billion and doubling purchases of housing-agency debt to US$200-billion.

The Fed panel said the economy "is likely to remain weak for a time," and officials expect "a gradual resumption of sustainable growth in a context of price stability."

The Fed's strategy appears to be easing credit for banks, corporations and households. The three-month London interbank offered rate, or Libor, for dollars fell to 1.03% Wednesday, the lowest level since June 2003, the British Bankers' Association said. The TED spread, the difference between what the Treasury and banks pay to borrow dollars for three months, has narrowed to 0.91 percentage point, from as high as 4.64 percentage points on Oct. 10.

Companies have raised a record US$468-billion in U.S. bond sales this year. The average cost of a 30-year fixed-rate mortgage fell to 4.80% last week, down from 6.03% a year ago, according to data from Freddie Mac.

The Fed released its decision hours after the government reported the U.S. economy contracted at a 6.1% annual pace in the first quarter, reflecting declines in housing and a record slump in inventories. The economy contracted at a 6.3% annual rate in the past three months of 2008.

Mr. Bernanke said in an interview with CBS's "60 Minutes" program that aired March 15 that the Fed's efforts so far had brought down mortgage rates, among evidence of "green shoots" in some markets.

A month later, the Fed chief gave a speech saying there were signs that the "sharp decline" in the economy was slowing, indicating a potential "first step" toward a recovery. His outlook is partly supported today by a 2.2% gain in consumer spending in the first quarter, the most in two years. Consumer spending accounts for 70% of the economy.

Officials cut the benchmark lending rate to as low as zero in December and switched to using direct bond purchases and loans to support credit markets.

"The Fed is following an extraordinarily expansionary policy," William Poole, a senior fellow at the Cato Institute in Washington and former president of the St. Louis Fed, said before policy makers issued their statement. "There is I think accumulating evidence that we may not be all that far from a bottom" of the contraction. Poole spoke in an interview with Bloomberg Radio.

The public won't get full details on whether Fed officials adjusted their outlooks until May 20, when the central bank releases minutes of this week's meeting. That report will include a new round of quarterly economic projections of growth, inflation and unemployment from the Fed's five governors and 12 district-bank presidents on the FOMC.

Policy makers have lowered their projections for 2009 gross domestic product several times, forecasting in January an average range of contraction of 1.3% to 0.5%. A year ago, officials foresaw growth this year ranging from 2.1% to 2.7%.

The recession that began in December 2007, triggered by the housing collapse and credit crisis, has wiped out 5.1 million jobs from the U.S. economy, pushing the unemployment rate to a quarter-century high of 8.5%.

"There's been lots of talk about 'green shoots,'" Robert Eisenbeis, a former Atlanta Fed research director who is now chief monetary economist for Vineland, N.J.-based Cumberland Advisors, said before Wednesday's meeting concluded. "You can find a lot of dead leaves too."

Even so, economists expect the annual pace of the contraction to slow in the second quarter to about 2%, the median estimate in a Bloomberg News survey. That should pick up to a 0.4% annual growth rate in the third quarter, according to the same survey, conducted March 30 to April 8.

Reports last week showed that orders for U.S. durable goods in March fell less than forecast and sales of new houses were higher than projected.

Separately, about 140 Fed staff members are coordinating capital tests on the 19 largest banks to assure they can continue to lend if the economy worsens. Results of the exams are scheduled for release the week of May 4. Mr. Bernanke said in an April 14 speech in Atlanta that the U.S. "will not have a sustainable recovery" without a stabilization of the financial system and credit markets.

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