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Fed Sees Little Risk Of Inflation

By REUTERS

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WASHINGTON/PARIS (Reuters) - Senior U.S. Federal Reserve officials said on Thursday inflation is not an immediate threat as a weak economic recovery and a grim outlook for jobs keep price pressures in check.

Charles Plosser, head of the Federal Reserve Bank of Philadelphia and Richard Fisher, his counterpart at the Dallas Fed, said the U.S. recovery was underway but noted risks to growth remain.

"The gears are starting to click but very, very slowly," Fisher told reporters after a speech at the CATO Institute. "The economy is still quite flaccid."

The U.S. central bank slashed interest rates to near zero last December and has kept them there since to foster recovery from the deepest recession since the 1930s.

After their last meeting on November 3-4, Fed policymakers reiterated a pledge to keep rates extraordinarily low for an extended period.

Plosser, one of the Fed's biggest anti-inflation hawks, said after a speech in Singapore the ailing commercial real estate market remains a problem as falling prices threaten small and medium-sized U.S. banks.

While inflation is not a threat for now, the United States will have to look very hard at reversing course on rates as the economy strengthens, he said.

Plosser later told CNBC he was growing more confident a U.S. economic recovery was building, and less concerned about the risk of a double-dip recession, but it was not quite time to raise rates.

Fisher and Plosser are not currently voters on the Fed's policy-setting Federal Open Market Committee and will not rotate into voting slots until 2011.

Their colleague James Bullard, president of the St. Louis Fed, was also pessimistic about prospects for U.S. employment.

Bullard told Reuters on the sidelines of a meeting in Paris he was "losing faith" in there being an increase in jobs by the end of 2009. He expected to see some net hiring in the first part of 2010. The U.S. economy lost 190,000 jobs in October, sending unemployment to 10.2 percent, a 26-1/2 year high.

The sanguine nature of the central bankers' views on inflation reaffirmed investor expectations near-term rate hikes are not in the cards.

POLICY RISKS

With overnight rates near zero, the Fed this year tried to drive down other borrowing costs and jump-start growth by buying $300 billion (180 billion pounds) in longer-term U.S. government debt, $175 billion in housing agency debt and $1.25 trillion in mortgage-backed securities.

Fisher acknowledged the pitfalls of such unconventional policy actions.

"It would be disingenuous of me to deny that these measures carry great and unprecedented risks," he said. The Fed has said it will slow its MBS purchases and aims to complete them by the end of March 2010.

One such threat is a continued depreciation of the U.S. dollar, which fell to a 15-month low this week and is causing concern among top officials in Asia and Europe.

Fed Chairman Ben Bernanke on Monday surprised investors by commenting directly on the dollar's value. He said the focus on the Fed's dual mandate of price stability and jobs growth will help the dollar to be "strong.

The dollar has fallen 7 percent so far this year and likely has become a funding vehicle for bets on higher-yielding currencies in growing emerging markets, a pattern known as the "carry trade."

Plosser told reporters in Singapore he was not worried about dollar weakness.

"There's no particular reason you wouldn't expect the dollar to go back to where it was before the panic set in -- that is essentially all it has done at this point. I don't view that as anything particularly of concern," he said.

Expectations of a protracted period of lower U.S. rates has sent waves of capital overseas in search of higher returns.

Asia, which was last in and first out of the financial crisis, has absorbed a lot of this investment. That has given rise to asset bubble fears and worries policymakers will tighten capital controls.

So far, Brazil and Taiwan have taken action to curb capital inflows. But Plosser downplayed the threat of asset bubbles in Asia.

"For the most part, the flows are not such that I consider them to be threatening or inconsistent with fundamentals," Plosser said. "The prospects for economic growth are stronger in Asia than in the U.S., and you would expect some of those flows."

(Additional reporting by Kristina Cooke in New York, Kevin Plumberg in Hong Kong and Nopporn Wong-Anan in Singapore; Editing by Andrew Hay)