U.S. NEWS

Fed Dials Back Bond Buying, Keeps a Wary Eye on Growth

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By JON HILSENRATH and VICTORIA MCGRANE CONNECT

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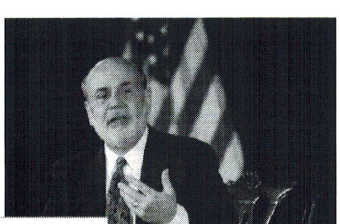
Ben Bernanke indicated that great progress has been made in recovering the U.S. economy and that the Federal Reserve is hopeful it will continue, during his final press conference as Fed chairman on Wednesday. (Photo: Getty Images)

Ben Bernanke gave the U.S. economy a nod of approval just a month before he leaves the Federal Reserve, moving the central bank to begin winding down a bond-buying program meant to boost growth with the recovery on firmer footing.

Markets across Asia breathed a sigh of relief after the U.S. Federal Reserve started gradually pulling back on its aggressive stimulus measures. The WSJ's Jake Lee spoke to HSBC economist Leif Eskesen.

The Fed has pulled back its stimulus efforts before, only to restart them when the economy disappointed, and new challenges loom, including a surprising slowdown in inflation. But Mr. Bernanke said in his final news conference as Fed chairman that the economy was getting to a point where it needs less help.

"Today's policy actions reflect the [Fed's] assessment that the economy is continuing to make progress, but that it also has much farther to travel before conditions can be judged normal," Mr. Bernanke said.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After months of wringing their hands about the implications of less Fed stimulus, investors resoundingly approved of the latest action to begin paring the $85 billion-a-month program. They were cheered in part because the move came with new Fed assurances that short-term interest rates would stay low long after the bond-buying program ends.

Ben Bernanke, the chairman of the Federal Reserve, speaks during his last press conference on Wednesday. *Associated Press*

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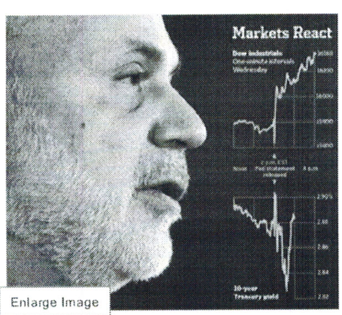
During his last scheduled conference as Fed Chairman, Ben Bernanke looks back on decisions that were made and the Fed's slowness in recognizing the crisis.



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The Dow Jones Industrial Average finished the day up 292.71 points, or 1.84%, at a record 16167.97. Yields on 10-year Treasury notes rose, as often happened with signs of improving growth, to 2.885%. Asian stocks rose early Thursday.

"Today's decision by the Fed is a vote of confidence in the sustainability of the economic recovery," Beth Ann Bovino, chief U.S. economist at the bond-rating firm Standard & Poor's, said in a note to clients after the decision. She pointed to a batch of stronger economic reports for October and November, in addition to reduced political uncertainty.

A budget accord, approved by the Senate on Wednesday, lays the groundwork for federal tax and spending policies in 2014 that do less to restrict economic growth than they did in 2013.

The Fed, which launched the latest round of bond buying in September 2012 in a bid to fire up the tepid recovery, will now buy $75 billion a month in mortgage and Treasury bonds as of January, down from $85 billion. That will include $35 billion monthly of mortgage securities and $40 billion of Treasurys, $5 billion less of each. It will look to cut the monthly amount of its purchases in $10 billion increments at subsequent meetings, Mr. Bernanke said.

Although the Fed expects to keep reducing the program "in measured steps" next year, the timing and the course isn't preset. "Continued progress [in the economy] is by no means certain," Mr. Bernanke said. "The steps that we take will be data-dependent."

If the Fed proceeds at the pace he set out, it would complete the bond-buying program toward the end of 2014 with holdings of nearly $4.5 trillion in bonds, loans and other assets, nearly six times as large as the Fed's total holdings when the financial crisis started in 2008.

Still, officials—worried that investors would quake at the thought of less Fed support—went to lengths to demonstrate that they would keep interest rates low for years to come, even after the bond-buying program ends.

The Fed has said it wouldn't raise short-term rates, which are now near zero, until the jobless rate gets to 6.5% or lower. It was 7% in November. In its official policy statement Wednesday, the Fed said it would keep rates near zero "well past" the point when the jobless rate hits the Fed's 6.5% marker.

In official projections released by the central bank, the vast majority of officials said they expected to keep short-term rates near zero until 2015 or later, even though they see the jobless rate hitting 6.5% next year.

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Mr. Bernanke's last day as chairman is Jan. 31. He will preside over one more policy meeting Jan. 28-29.

New challenges will confront his successor, Fed Vice Chairwoman Janet Yellen, who is expected to be confirmed by the Senate later this week to become the next Fed leader.

WSJ Global Economics Editor David Wessel joins our post coverage of the Fed's decision on interest rates to give his take on Federal Reserve Chairman Ben Bernanke's final press conference. (Photo: Getty Images)

"She fully supports what we did today," Mr. Bernanke said when asked whether Ms. Yellen could be expected to carry forward the plan he laid out.

Perhaps the biggest immediate challenge the Fed faces is inflation, which has drifted far below the central bank's 2% objective. The Fed's preferred inflation gauge, the price index for personal consumption expenditures, increased just 0.7% in October from a year prior, the Commerce Department said earlier this month. Fed officials said in their statement Wednesday that they are watching the inflation situation carefully.

WSJ's Jon Hilsenrath asks Federal Reserve Chairman Ben Bernanke if his successor Janet Yellen would continue the Federal Reserve's move to reduce its bond-buying program to $75 billion per month.

Slumping inflation could be a sign of building economic torpor, which officials want to avoid and could need to counteract with new easy-money policies. But if the Fed keeps current policies going too long, it could spark a new financial bubble.

Audio

Victoria McGrane has more on The Wall Street Journal This Morning.

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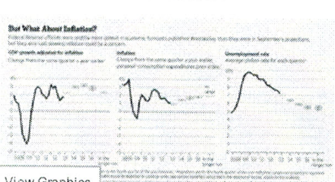
The bond-buying program aims to lower long-term interest rates to encourage borrowers to spend and invest. While pulling back on it, the Fed is shifting toward relying more on providing verbal guidance to the public about where short-term interest rates are likely to be in the future. One reason for the shift: Officials are more familiar with managing short-term rates than long-term rates.

The Fed's growing emphasis on assuring low short-term rates comes with its own risks. Some economists believe the Fed erred between 2003 and 2006 when it also kept short-term interest rates low and provided investors with assurances rates wouldn't move up swiftly. The policy during that period might have led to too much risk-taking and borrowing, though economists disagree on that point.

In their latest economic projections, also out Wednesday, 12 of 17 Fed officials who participated in the policy meeting said they expected their benchmark short-term rate to be at or below 1% by the end of 2015. Ten of 17 officials expected the rate to be at or below 2% by the end of 2016.

But What About Inflation?



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On the decision to pull back on the bond-buying program, nine of the 10 voting members of the Fed's policy-making committee supported the move. Boston Fed President Eric Rosengren dissented because he believes that with the jobless rate still elevated and inflation running below the 2% target, changes to the bond-buying program "are premature until incoming data more clearly indicate that economic growth is likely to be sustained above its potential rate."

Mr. Bernanke parted with a few reflections on his eight-year tenure as Fed chairman. On several occasions he noted that the Fed has battled headwinds to the economy that have made its job more difficult, including the combination of government spending cuts and tax increases that slowed growth in the short run. He wanted that fiscal austerity spread out over a much longer period.

When asked about the budget deal that cleared the Senate Wednesday, Mr. Bernanke said it's "certainly a better situation" than in October, when budget battles resulted in a government shutdown and fears of a federal debt default. The Fed held off on reducing the bond program in September in part because of worries about the consequences of these fiscal battles.

He took some blame for failing to foresee the 2008 financial crisis that has dominated his tenure at the central bank. "Obviously, we were slow to recognize the crisis. I was slow to recognize the crisis," he said. "That said, we've done everything we could think of" since then to strengthen the financial system and economy.

He and his wife plan to stay in Washington for some time after he steps down, he said.

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