Bernanke Sees 'Formidable Headwinds' for U.S. Economy

By Craig Torres and Shobhana Chandra

Dec. 7 (Bloomberg) -- Federal Reserve Chairman Ben S. Bernanke said the U.S. economy faces "formidable headwinds," including a weak labor market and tight credit that are likely to produce a "moderate" pace of expansion.

"The economy confronts some formidable headwinds that seem likely to keep the pace of expansion moderate," Bernanke, 55, said today in a speech to the Economic Club of Washington. He said inflation remains "subdued" and might even move lower.

Treasuries advanced as traders pared bets the central bank will increase interest rates before August. Bernanke, in response to a question after his speech, repeated the Fed's statement that rates are likely to remain low for an "extended period."

The yield on the benchmark two-year Treasury note fell seven basis points to 0.76 percent at 3:35 p.m. in New York. The Standard & Poor's 500 Index was down 0.2 percent to 1,103.92 after rising as much as 0.4 percent.

"Bernanke suspects we will grow below normal recovery standards, and that pace could be around awhile," said Gregory Miller, chief economist at SunTrust Banks Inc. in Atlanta. "Fed policy may stay where it is, essentially zero, for some time. There are serious risks out there."

Job Losses

Payrolls have declined by more than 7.2 million jobs since the start of the recession in December 2007. Employers cut the fewest jobs in November in 23 months, and the unemployment rate unexpectedly fell, a Labor Department report showed last week. Payrolls declined by 11,000, and the jobless rate fell to 10 percent in November from 10.2 percent the previous month.

In response to a question from the audience about the direction of interest rates, Bernanke said: "Right now we are still looking at the extended period given that conditions remain low rates of utilization, subdued inflation trends, and stable long-term inflation expectations."

"Obviously there has been some signs of strength recently, we will want to factor that in as we talk about this next week."

U.S. central bankers meet for their final two-day meeting of the year on Dec. 15-16. At their last meeting in November, policy makers repeated their pledge to keep interest rates low for an "extended period."

The consumer price index, minus food and energy, rose at a 1.7 percent annual pace in October, up from 1.5 percent the previous month. The core inflation rate rose at a 1.4 percent pace in August, the lowest rate since February 2004.

"Tight' Credit

"Despite the general improvement in financial conditions, credit remains tight for many borrowers," and the job market "remains weak," Bernanke said in his prepared remarks.

The Fed chairman said the U.S. central bank has the tools and commitment to keep price increases in check, and that inflation could subside further.

"Elevated unemployment and stable inflation expectations should keep inflation subdued, and indeed, inflation could move lower from here," Bernanke said. "The Federal Reserve is committed to keeping inflation low and will be able to do so."

The Fed chairman credited the U.S. central bank with pulling the economy "back from the brink," and suggested that growth is unlikely to be strong enough to lower unemployment at a rapid pace. The speech was his first since his appearance at a Senate Banking Committee hearing last week on his nomination to a second term.

'Modest' Growth

"We still have some way to go before we can be assured that the recovery will be self-sustaining," the Fed Chairman said. "My best guess at this point is that we will continue to see modest economic growth next year -- sufficient to bring down the unemployment rate, but at a pace slower than we would like."

The Fed has channeled liquidity to banks and markets for asset-backed securities and the commercial paper market, helping to unfreeze bank funding markets. The London interbank offered rate, or Libor, for three-month loans in dollars between banks was 0.25 percent today, down from 1.42 percent at the start of the year.

The central bank is also purchasing $1.25 trillion in mortgage-backed securities. Costs on 30-year fixed-rate mortgages fell to 4.71 percent Dec. 3, the lowest since mortgage buyer Freddie Mac in McLean, Virginia, began compiling the data in 1971.

The Fed chairman cited the benefits of the central bank's regional structure, saying it is "well suited" to be the lead regulator for supervising the largest financial institutions.

Held Hostage

"No firm, by virtue of its size and complexity, should be permitted to hold the financial system, the economy, or the American taxpayer hostage," Bernanke said. "All systemically important financial institutions, not only banks, should be subject to strong and comprehensive supervision on a consolidated, or firm-wide, basis."

The former Princeton University scholar and self-described Great Depression buff is defending the central bank against efforts in Congress to curtail its authority and independence.

A Senate proposal would remove bank supervision from the Fed, and House legislation would increase oversight of monetary policy. Legislation pending in both chambers would limit the Fed's ability to lend to troubled institutions and remove the central bank's rule-writing authority on consumer financial products.

The Fed chairman has prompted concern among lawmakers about taxpayer-sponsored bailouts and rescues that he says were used only to save households and the economy from financial collapse.

The House on Nov. 19 advanced a proposal to remove a three- decade ban on congressional audits of Fed interest-rate decisions, a measure backed by Ron Paul, a Republican from Texas.

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