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Fed Ready to Cut Interest Rates Again

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(01-11) 02:03 PST WASHINGTON (AP) --

Federal Reserve Chairman Ben Bernanke pledged Thursday to slash interest rates as needed to prevent housing and credit problems from plunging the country into a recession.

The Fed chief made clear the central bank was prepared to act aggressively to rescue a weakening economy. "We stand ready to take substantive additional action as needed to support growth and to provide adequate insurance against downside risks," he said.

Bernanke showed his hand in terms of the Fed's likely next move amid mounting concerns that the economy may be in danger.

Many economists now believe the Fed will slice its key interest rate by a bold one-half of a percentage point when the Fed meets next Jan. 29-30. Some, however, think the Fed will go with a more modest one-quarter point reduction, given concerns that high energy prices could spark inflation.

Wall Street was buoyed by Bernanke's words. The Dow Jones jumped 117.78 points to close at 12,853.09.

"The Federal Reserve is not currently forecasting a recession," Bernanke said, fielding questions after his speech. It is, however, "forecasting slow growth," he said.

To bolster the economy, the Fed lowered its key rate three times last year. Its last cut, on Dec. 11, left the rate at 4.25 percent, a two-year low. Still, Bernanke has come under criticism for not acting more aggressively to deal with the economy's problems.

Worries about the country's economic health have gripped voters, galvanized presidential candidates and spurred the White House and Congress to explore ways to stimulate the economy to avoid a recession. The White House is considering a tax cut.

Hiring practically ground to a halt in December, pushing the unemployment rate up to 5 percent, a two-year high, the government said in a report last week that rattled Wall Street and Main Street.

Bernanke, in a speech to a housing and economic forum in Washington, cautioned against reading too much into one report. But he said that if employment conditions were to continue to deteriorate, that would raise risks to the economy. The big worry is that consumers might cut back on their spending, sending the economy into a tailspin.

Incoming information suggests that the outlook for economic activity for this year has worsened and that the "downside risks to growth have become more pronounced," Bernanke warned.

A housing slump, weaker home values, harder-to-get credit and high energy prices all "seem likely to weigh on consumer spending as we move into 2008," Bernanke said.

Many analysts predict upcoming reports will show the economy grew at a feeble pace of just 1.5 percent or less in the final three months of last year and will be weak in the first three months of this year as consumers — major shapers of overall economic activity — tighten their belts. Major retailers reported Thursday weak sales for December, raising uncertainty about the economy's outlook.

In light of such risks to the economy's growth, "additional policy easing may well be necessary," said Bernanke.

Former Fed Chairman Alan Greenspan, who ran the Fed for 18 1/2 years, recently warned that the economy is "getting close to stall speed." Some economists said the odds of a recession are up to 50 percent.

The housing slump — aggravated by harder-to-get credit — has weighed heavily on national economic activity. Foreclosures have soared to record highs and financial companies have wracked up multibillion losses because of bad mortgage investments. The problems, which are expected to persist well into this year, have unnerved Wall Street. Financial markets remain fragile, Bernanke said.

The situation raises the biggest challenge yet to Bernanke, who took over the Fed in February 2006.

"Bernanke was very clear: He rang a siren call. The economy is ailing and it needs stronger medicine — a good shot of adrenaline," said Brian Bethune, economist at Global Insight. Bethune predicts a half-point cut on Jan. 30, followed by other reductions that would lower the Fed's key rate to 3.25 percent by the late spring.

"It's hard to imagine after hearing such strong comments from Bernanke that the Fed will not cut by half a percentage point," said Richard Yamarone, economist at Argus Research. "Anything less would roil the financial markets," he added.

Asked about a stimulus package being explored by the White House, Bernanke did not offer details. He did say he is interested in seeing "what emerges" and what options might be put on the table.

Galloping energy prices — oil recently surged past $100 a barrel before easing — can put a damper on economic growth and can also spread inflation through the economy if they force companies to boost the prices of many goods and services.

Bernanke acknowledged the situation could complicate the Fed's job of trying to keep the economy growing, while making sure that inflation is under control.

So far, he said, people and companies have "reasonably well-anchored" expectations about where they think inflation will head in the months ahead, Bernanke said. "However, any tendency of inflation expectations to become unmoored or for the Fed's inflation-fighting credibility to be eroded could greatly complicate" the Fed's task of maintaining stable prices, he said.

To help squeezed banks deal with credit problems, the Fed recently created a new auction facility for financial institutions to go to for short-term loans. The Fed in December provided $40 billion worth of loans to banks and will provide another $60 billion in two auctions in January.

Bernanke said these auctions will continue "as long as necessary" to help banks get over credit humps so that they will keep lending to people and companies. The auctions, Bernanke said, "may thus become a useful permanent addition to the Fed's toolbox."

Will the upcoming presidential elections color the Fed's decisions on interest rates? Bernanke offered a flat no. "Political considerations will play no role. We will be objective. We will be analytical, and we will do what is right for the economy."

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