Daily Journal • Daily Messenger

Thursday, June 25, 2009

Fed says recession easing, inflation is tame

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Associated Press

WASHINGTON — The Federal Reserve sought Wednesday to defuse fears that the trillions it's spending to revive the economy could spark inflation later on. But Wall Street didn't seem to buy it.

Fed Chairman Ben Bernanke and his colleagues said that despite an easing of the recession, the economy remains frail enough to keep inflation at bay.

Fed policymakers held a key bank lending rate at a record low of between zero and 0.25 percent and pledged to keep it there for "an extended period" to help brace the economy. The Fed made no new commitment to expand its purchases of government bonds and mortgage securities, to try to drive down rates on consumer debt. That rattled bond investors who fear the prospect of higher interest rates.

But Wall Street zeroed in on the Fed's new observations about the risks of deflation and inflation.

Fed policymakers dropped language they had used in the statement at their last meeting in April that the weak economy could trigger deflation — a destabilizing and prolonged bout of falling prices and wages. This also spooked bond investors, who took the Fed's decision not to mention deflation to mean inflation might arise later.

The Fed acknowledged that energy and other commodity prices have risen recently. But policymakers predicted that idle factories and the weak employment market would make it hard for companies to ratchet up prices. The Fed said it expects inflation will "remain subdued for some time."

The mere mention of higher prices, though, hit the Treasury market because the value of returns on fixed-income investments can erode quickly if inflation occurs. The yield on the benchmark 10-year Treasury note, which moves opposite its price, rose to 3.69 percent from 3.63 percent Tuesday.

Stocks also lost ground after the Fed's announcement. The Dow Jones, which had been up, closed down 23.05 points.

T.J. Marta, market strategist and founder of Marta on the Markets, a financial research firm, said the Fed's words "disappoints (inflation) hawks and "angers bond vigilantes."