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Fed signals recession

Bernanke keeps key lending rate low

By Jeannine Aversa
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WASHINGTON — The Federal Reserve signaled Wednesday that the weak economy likely will keep prices in check despite growing concerns that the trillions it's pumping into the financial system will ignite inflation.

Fed Chairman Ben Bernanke and his colleagues held a key bank lending rate at a record low of between zero and 0.25 percent. And they pledged again to keep it there for "an extended period" to help brace the economy.

Fed policymakers also 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.

And they offered no new assurances that they would step up their 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. So did the Fed's observation that commodity prices are rising.

The mention of higher prices 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 fell after the Fed's announcement.

Still, the Fed said inflation will remain "subdued for some time." And overall, Fed policymakers delivered a slightly more encouraging assessment of the economy.

"The Fed is sending the message that the economy is making progress toward a path of recovery, that the credit markets appear to be healing and inflation is not going to be a problem," said economist Lynn Reaser, vice president of the National Association for Business Economics. "The bogeyman of deflation also was removed from the Fed's primary risk list," she added.

The Fed in March launched a $1.2 trillion effort to drive down interest rates to try to revive lending and get Americans to spend more freely again. It said it would spend up to $300 billion to buy long-term government bonds over six months and boost its purchases of mortgage securities. So far, the Fed has bought about $177.5 billion in Treasury bonds.

The Fed is on track to buy up to $1.25 trillion worth of securities issued by Fannie Mae and Freddie Mac by the end of this year. Nearly $456 billion worth of those securities have been purchased.

With signs economic and financial conditions are stabilizing, the Fed is wise to keep a steady-as-she goes course, said Sung Won Sohn, economist at the Martin Smith School of Business at California State University, Channel Islands. The Fed's actions are "bearing fruit," he said.

Fed policymakers noted that the "pace of economic contraction is slowing" and that conditions in financial markets have "generally improved in recent months." Those observations about the recession and financial conditions were stronger than after the Fed's last meeting in April.

Economists predict the economy is sinking in the April-June quarter but not nearly as much as it had in the prior six months, which marked the worst performance in 50 years. The economy is contracting at a pace of between 1 and 3 percent, according to various projections.

Economists predict the Fed will hold its key banking rates at a record low through this year and into part of next year to spur lending.