Fed's Plan to Taper Stimulus Effort Is Not Expected until Next Year

By BINYAMIN APPELBAUM

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WASHINGTON — Federal Reserve officials are in no hurry to retreat from their bond-buying campaign to stimulate the economy and are likely to postpone any cuts to the program until next year, according to public statements by Fed officials and interviews with some of them.

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Ben S. Bernanke

Job growth has strengthened in recent months, and Fed officials expect continued improvement in the coming year. The Fed's chairman, Ben S. Bernanke, predicted in June that the Fed would taper its purchases by the end of this year, and officials say they still could announce such a cut next week, when the Fed's policy-making committee is scheduled to hold its final meeting of the year.

But influential Fed officials see little harm in postponing the decision, particularly compared with the risks of pulling back too soon. Significant details of the eventual retreat also remain the subjects of unresolved debates, according to the public statements and interviews. And some officials argue that the slow pace of inflation is itself a reason for the Fed to maintain its stimulus campaign.

"Everything else equal, I would like to see a couple of months of good numbers," Charles L. Evans, president of the Federal Reserve Bank of Chicago, told Reuters on Friday, referring to the relatively strong jobs numbers in November.

Mr. Evans added that he was "certainly nervous" about the sluggish pace of inflation. Rising prices can help stimulate the economy, making it easier for companies to increase profits and for borrowers to repay debts. Inflation also encourages people and businesses to borrow more money and to spend it more quckly.

Low inflation reduces those incentives. It also means the economy is closer to deflation, or a general decline in prices, which has the opposite effect: freezing economic activity by discouraging both borrowing and spending.

Since January, the Fed has added $85 billion a month to its holdings of Treasury and mortgage-backed securities as part of a broader campaign to reduce borrowing costs for businesses and consumers and encourage risk-taking by investors.

Mr. Bernanke and his allies have repeatedly described the program as a safe and effective way to generate a little more economic activity at a time when the nation's primary economic problem is that millions of Americans cannot find jobs.

Almost from the outset, however, internal and external critics have questioned whether the bond purchases are helping the broader economy or merely enriching investors. And they have warned that the Fed's outsize role in financial markets is disrupting normal activity and may be encouraging excessive speculation.

In the face of those doubts, the Fed has appeared to play for time, repeatedly indicating that it is getting ready to pull back even as a strong majority of its policy-making committee has voted to extend the campaign at each meeting this year.

William C. Dudley, the president of the Federal Reserve Bank of New York and a key supporter of the bond purchase program, reflected the caution of this majority in a November speech in which he said, "I have to admit that I am getting more hopeful" given the recent improvement in economic data.

"I hope that this marks a turning point for the economy," Mr. Dudley said. But he continued, "We have seen such bursts in payroll growth before over the past few years and have been disappointed when the pickups proved temporary."

Officials including Mr. Dudley and Janet L. Yellen, the Fed's vice chairwoman — whom the Senate is likely to confirm as Mr. Bernanke's successor later this month — see recent job growth as outstripping the moderate pace of economic growth.

"The Yellen/Dudley prescription holds that it will take strong G.D.P. growth to convince them that these employment gains will continue," wrote Vincent Reinhart, a former head of the Fed's monetary policy staff and now the chief United States economist at Morgan Stanley. "We think the committee will use the December meeting to agree on a plan" most likely to be put into effect in March.

Agreeing on a plan also will take some work. The Fed wants to convince investors that tapering would not alter what it views as the centerpiece of its economic stimulus campaign, its commitment to hold short-term interest rates near zero. It has said that it will keep rates near zero at least as long as the unemployment rate remains above 6.5 percent, and probably quite a bit longer. The rate in November was 7 percent.

When Mr. Bernanke first described the Fed's tapering plans in June, investors ignored this distinction, driving up rates across the board. But the message has gradually taken hold. The movement of asset prices after recent good news, including the November jobs data, has reflected an expectation that the Fed is closer to tapering, but not to raising interest rates. "Markets are beginning to appreciate that they are separate tools," Mr. Bernanke said last month.

Some officials think the Fed still needs to underscore this distinction when it begins to taper its bond purchases. Others now regard such an effort as unnecessary, or contend that the Fed could act after it begins to taper if investors seem to be confused.

Proponents of underscoring the Fed's commitment to low interest rates are further fragmented about the best technique. Some, including Mr. Evans, would like to lower the threshold unemployment rate. Some would like to create a similar threshold for inflation. Some would like to make a symbolic cut in an obscure interest rate the Fed pays on bank reserves.

Instead of such concrete steps, the Fed also could seek to explain in greater detail how it will decide the timetable for increasing interest rates. This option commanded the broadest support at the Fed's meeting in October.

A shift among officials who pushed for tapering earlier in the year has made it easier for the Fed to postpone decisions. Some of those officials now say the Fed should commit to a date to end the program rather than beginning to taper as soon as possible, because they see this as the best way to reduce confusion among investors.

“The sooner we say we’re going to end this program once we’ve purchased X, the sooner we say that, the better,” Charles I. Plosser, president of the Federal Reserve Bank of Philadelphia, said on Friday. “It’s that constant uncertainty about what we’ll do at each and every meeting that I think we can eliminate this way, and we’ll be better off for it, and we’ll not sacrifice much of the benefits of the program.”

The sluggish pace of inflation also has made it easier to wait. Prices rose just 0.7 percent during the 12 months that ended in October, the Commerce Department reported on Friday. Excluding the volatile movements of food and energy prices, inflation was still just 1.1 percent over that period. That is significantly below the 2 percent pace the Fed regards as best for the economy.

James Bullard, the president of the Federal Reserve Bank of St. Louis, dissented from the Fed’s policy statement at the Fed’s June meeting because he said that the central bank should signal more strongly its determination to increase the pace of inflation. He said last month that he remained concerned, in part because he did not understand why inflation was falling despite the Fed’s enormous stimulus campaign.

“We don’t have a good story about why this is,” Mr. Bullard said at a Chicago conference. “You would have expected to see more inflation pressure by this point. We haven’t seen it. That’s what makes me worried more than anything.”

The Fed forecasts that inflation will rebound, and investors appear to share that expectation. But some Fed officials, including Mr. Bullard, are reluctant to taper before seeing those expectations edge closer to reality.

A version of this article appears in print on December 9, 2013, on page B1 of the New York edition with the headline: Fed Is Likely To Keep Foot On the Gas A Bit Longer .

http://www.nytimes.com/2013/12/09/business/economy/feds-plan-to-taper-stimulus-effort-not-expected-until-next-year.html?pagewanted=2&_r=0&exprod=myyahoo&pagewanted=all

http://www.nytimes.com/2013/03/03/business/the-minimum-wage-employment-and-income-distribution.html

In Fed and Out, Many Now Think Inflation Helps

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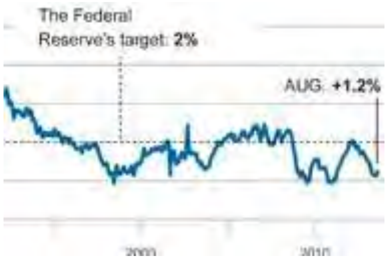
Mark Wilson/Getty Images

Ben Bernanke, chairman of the Fed, some of whose officials cite the slower pace of inflation as a reason to continue the stimulus.

By BINYAMIN APPELBAUM Published: October 26, 2013

WASHINGTON — Inflation is widely reviled as a kind of tax on modern life, but as Federal Reserve policy makers prepare to meet this week, there is growing concern inside and outside the Fed that inflation is not rising fast enough.

Multimedia



Graphic

Inflation Fails

Some economists say more inflation is just what the American economy needs to escape from a half-decade of sluggish growth and high unemployment.

The Fed has worked for decades to suppress inflation, but economists, including Janet Yellen, President Obama's nominee to lead the Fed starting next year, have long argued that a little inflation is particularly valuable when the economy is weak. Rising prices help companies increase profits; rising wages help borrowers repay debts. Inflation also encourages people and businesses to borrow money and spend it more quickly.

The school board in Anchorage, Alaska, for example, is counting on inflation to keep a lid on teachers' wages. Retailers including Costco and Walmart are hoping for higher inflation to increase profits. The federal government expects inflation to ease the burden of its debts. Yet by one measure, inflation rose at an annual pace of 1.2 percent in August, just above the lowest pace on record.

"Weighed against the political, social and economic risks of continued slow growth after a once-in-a-century financial crisis, a sustained burst of moderate inflation is not something to worry about," Kenneth S. Rogoff, a Harvard economist, wrote recently. "It should be embraced."

The Fed, in a break from its historic focus on suppressing inflation, has tried since the financial crisis to keep prices rising about 2 percent a year. Some Fed officials cite the slower pace of inflation as a reason, alongside reducing unemployment, to continue the central bank's stimulus campaign.

Critics, including Professor Rogoff, say the Fed is being much too meek. He says that inflation should be pushed as high as 6 percent a year for a few years, a rate not seen since the early 1980s. And he compared the Fed's caution to not swinging hard enough at a golf ball in a sand trap. "You need to hit it more firmly to get it up onto the grass," he said. "As long as you're in the sand trap, tapping it around is not enough."

All this talk has prompted dismay among economists who see little benefit in inflation, and who warn that the Fed could lose control of prices as the economy recovers. As inflation accelerates, economists agree that any benefits can be quickly outstripped by the disruptive consequences of people rushing to spend money as soon as possible. Rising inflation also punishes people living on fixed incomes, and it discourages lending and long-term investments, imposing an enduring restraint on economic growth even if the inflation subsides.

"The spectacle of American central bankers trying to press the inflation rate higher in the aftermath of the 2008 crisis is virtually without precedent," Alan Greenspan, the former Fed chairman, wrote in a new book, "The Map and the Territory." He said the effort could end in double-digit inflation.

The current generation of policy makers came of age in the 1970s, when a higher tolerance for inflation did not deliver the promised benefits. Instead, Western economies fell into "stagflation" — rising prices, little growth.

Lately, however, the 1970s have seemed a less relevant cautionary tale than the fate of Japan, where prices have been in general decline since the late 1990s. Kariya, a popular instant dinner of curry in a pouch that cost 120 yen in 2000, can now be found for 68 yen, according to the blog Yen for Living.

This enduring deflation, which policy makers are now trying to end, kept the economy in retreat as people hesitated to make purchases, because prices were falling, or to borrow money, because the cost of repayment was rising.

“Low inflation is not good for the economy because very low inflation increases the risks of deflation, which can cause an economy to stagnate,” the Fed’s chairman, Ben S. Bernanke, a student of Japan’s deflation, said in July. “The evidence is that falling and low inflation can be very bad for an economy.”

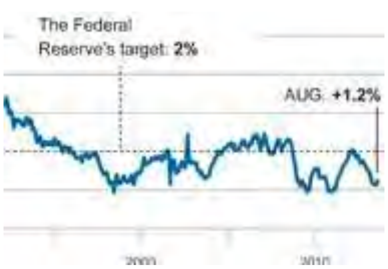
There is evidence that low inflation is hurting the American economy.

“I’ve always said that a little inflation is good,” Richard A. Galanti, Costco’s chief financial officer, said in December 2008. He explained that the retailer is generally able to expand its profit margins and its sales when prices are rising. This month, Mr. Galanti told analysts that sluggish inflation was one reason the company had reported its slowest revenue growth since the recession.

Executives at Walmart, Rent-A-Center and Spartan Stores, a Michigan grocery chain, have similarly bemoaned the lack of inflation in recent months.

Many households also have reason to miss higher inflation. Historically, higher prices have led to higher wages, allowing borrowers to repay fixed debts like mortgage loans more easily. Over the five years before 2008, inflation raised prices 10 percent. Over the last five years, prices rose 8 percent. At the current pace, prices would rise 6 percent over the next five years.

Multimedia



Graphic

Inflation Fails

“Let me just remind everyone that inflation falling below our target of 2 percent is costly,” Charles L. Evans, the president of the Federal Reserve Bank of Chicago, said in a speech in Madison, Wis., this month. “If inflation is lower than expected, then debt financing is more burdensome than borrowers expected. Problems of debt overhang become that much worse for the economy.”

Inflation also helps workers find jobs, according. to an influential 1996 paper by the economist George Akerlof and two co-authors. Rising prices allows companies to increase profit margins quietly, by not raising wages, which in turn makes it profitable for companies to hire additional workers. Lower rates of inflation have the opposite effect, making it harder to find work.

Companies could cut wages, of course. But there is ample evidence that even during economic downturns, companies are reluctant to do so. Federal data show a large spike since the recession in the share of workers reporting no change in wages, but a much smaller increase in workers reporting wage cuts, according to an analysis by the Federal Reserve Bank of San Francisco. There is, in practice, an invisible wall preventing pay cuts. The standard explanation is that employers fear that workers will be angry and therefore less productive.

“I want to be really careful about advocating for lower wages because I typically advocate for the other side of that equation,” said Jared Bernstein, a fellow at the left-leaning Center on Budget and Policy Priorities and a former economic adviser to Vice President Joseph R. Biden Jr. “But I think higher inflation would help.”

The Anchorage school board, facing pressure to cut costs because of a budget shortfall, began contract negotiations with its 3,500 teachers this year by proposing to freeze rather than cut wages. The final deal, completed last month, gives the teachers raises of 1 percent in each of the next three years.

Teachers, while not thrilled, described the deal as better than a pay cut. But it is likely, in effect, to cut the teachers' pay. Economists expect prices to rise about 2 percent a year over the next three years, so even as the teachers take home more dollars, those dollars would have less value. Instead of a 1 percent annual increase, the teachers would fall behind by 1 percent a year.

"We feel like this contract still allows us to attract and retain quality educators," said Ed Graff, the Anchorage school district superintendent.

In June, Caterpillar, the industrial equipment maker, persuaded several hundred workers at a Wisconsin factory to accept a six-year wage freeze. The company described the workers as overpaid, but it did not seek direct cuts.

The slow pace of inflation, however, minimizes the benefits. Seeking further savings, Caterpillar has since laid off almost half of the workers.