Bernanke Says Fed Has the Tools It Needs

By David Harrison

SAN DIEGO—The **Federal Reserve** has ample tools for fighting a potential recession even though its benchmark interest rate remains historically low, former Fed Chairman Ben Bernanke said.

In a paper presented at a conference in San Diego on Saturday, Mr. Bernanke said asset purchases and public communication—tools that he largely pioneered during the financial crisis—would be effective in jolting the economy in a downturn.

Under the current economic conditions, those methods, known as "quantitative easing" and "forward guidance," represent the equivalent of up to 3 percentage points of cuts in Fed interest rates, he said.

The former chairman's "relatively upbeat conclusion" means the Fed has far more weapons at its disposal than officials realize.

"The old methods won't do," Mr. Bernanke said. "If monetary policy is to remain relevant, policy makers will have to adopt new tools, tactics and frameworks."

During the financial crisis, Mr. Bernanke and his colleagues lowered the Fed's benchmark interest rate almost to zero. They also launched asset-purchase programs and relied on communication to encourage more borrowing and investment.

Critics said those programs would be difficult to unwind and would cause inflation to rise too fast.

That didn't happen, which suggests the tools are relatively safe, Mr. Bernanke said.

"It has become evident that the costs and risks attributed to the new tools, when first deployed, were overstated," he said.

"The case for adding the new tools to the standard central bank toolkit thus seems clear."

Subdued economic growth and inflation in the decade since the crisis have prevented Mr. Bernanke's successors from raising rates very far.

Economists say broad structural changes to the economy such as an aging population or technological advances will hold down interest rates for the foreseeable future.

Right now, the Fed's benchmark rate is in a range of 1.5% to 1.75%.

By contrast, rates peaked at 5.25% before the financial crisis.

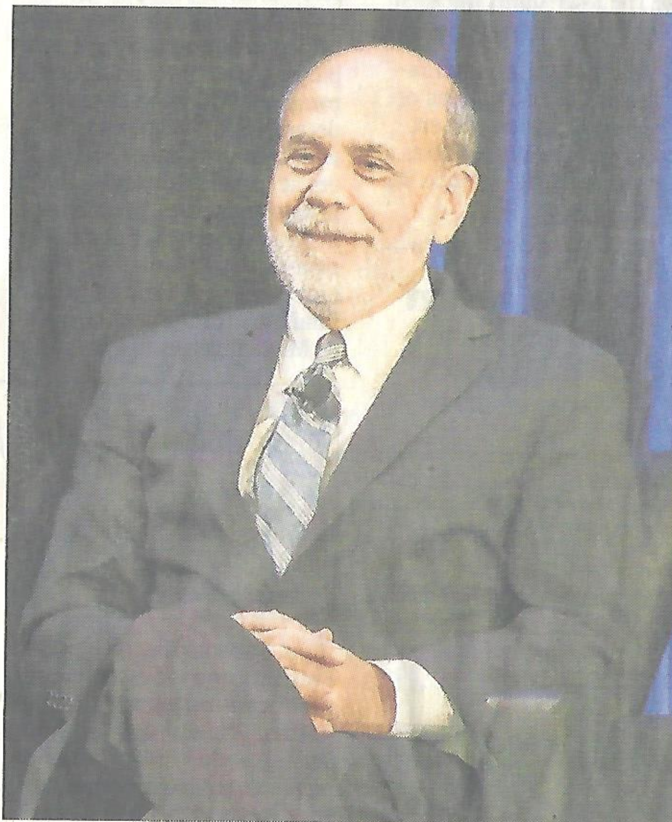
Such low rates mean officials have little room to make cuts to boost the economy in a crisis, a concern that has preoccupied Fed leaders for several years.

Mr. Bernanke's argument that quantitative easing and forward guidance together account for 3 percentage points of rate cuts could soothe the Fed's fears.

Another policy option, raising the Fed's 2% inflation target, could achieve similar ends, but implementing it would be difficult and could cause the public to lose confidence in policy makers, Mr. Bernanke said.

Under quantitative easing, the Fed buys longer-term government bonds, which raises their price and lowers their yield. That makes it easier for households and businesses to borrow and invest.

"The Fed has not used new tools other than QE and forward guidance, but, within the bounds of its legal authorities, it should not rule out other options," Mr. Bernanke said.



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Former Federal Reserve Chairman Ben Bernanke.

Williams Stresses Inflation Targets

SAN DIEGO—Federal Reserve Bank of New York President John Williams said on Sunday that low global interest rates are here to stay, which should lead central bankers to renew their commitment to inflation goals.

"There's been a process of going through the stages of grief about a low neutral rate," he said. "These factors are basically the hand we've been dealt for the next five to 10 years."

In that context, it is important for Fed officials to hold themselves accountable to their 2% inflation target and be transparent about how they are going to get there, he said. Making sure inflation expectations don't slip too far is also important, he said. Inflation expectations affect actual inflation in the future.

Recently, expectations of future inflation have started to fall, Mr. Williams said, partly because inflation has undershot the Fed's 2% target for the past few years. Demographic changes are also a factor. Older generations that still remember the high inflation years of the 1970s and 1980s are being replaced by younger ones with no personal experience of high inflation, Mr. Williams said.

Mr. Williams said he was hopeful the Fed could reach its inflation target.

Mr. Williams also said the Fed's response to inject liquidity into financial markets following a cash crunch in September had been successful.

The Fed's effort to stabilize the market for short-term loans among financial institutions "has worked exactly as we wanted," he said.