US Fed chairman gives grim economic forecast in Senate testimony

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Appearing before the Senate Banking Committee Tuesday, US Federal Reserve Chairman Ben Bernanke gave a bleak report on the American economy, while providing few clues to possible responses by Fed officials.

Bernanke's appearance was in accordance with the US central bank's legal requirement to submit to Congress an official Monetary Policy Report twice a year. The Fed released its semi-annual summary of US economic conditions and prospects on Tuesday to coincide with Bernanke's Senate testimony. The Fed chairman will appear Wednesday before the Financial Services Committee of the House of Representatives.

In his opening remarks to the Senate committee, Bernanke painted a gloomy picture of decelerating economic growth, declining job creation, a slowdown in manufacturing and business investment, a still-crippled housing market, stagnant consumer spending and a global environment dominated by the European debt crisis and slowing growth in the major "emerging" economies of Asia and Latin America.

The Fed chairman made clear that unemployment in the US, presently at 8.2 percent, with long-term unemployment at post-war record highs, will continue to remain at near-Depression levels for at least several years. He hinted that the Fed's policy-making Federal Open Market Committee (FOMC) might announce further monetary stimulus measures at its July 31-August 1 meeting, but refused to be pinned down on specifics.

In his opening remarks and in response to questions from Banking Committee members, Bernanke left do doubt that he opposed any spending programs to create jobs or provide serious relief for the millions who have been economically devastated by the crisis. Instead, he reiterated his previous demands that Congress quickly adopt a plan for major cuts in social spending and other deficit-reduction measures, timed for the medium-term rather than the immediate present so as to avoid a deflationary spiral and financial collapse.

He warned specifically against allowing some $600 billion in automatic spending cuts and tax increases to take effect at the beginning of the new year—the so-called "fiscal cliff"—saying that would likely plunge the US economy back into an official recession. Under the provisions of the deal reached last year between the Obama administration and congressional Republicans to raise the federal debt limit, across-the-board federal spending cuts will take effect January 1, 2013. At the same time, if no action is taken by then, all of the Bush-era tax cuts will expire, along with Social Security payroll tax cuts for workers and employers, and extended unemployment benefits.

In response to a suggestion by Tennessee Republican Bob Corker that Bernanke was proposing to "kick the deficit can down the road," the Fed chief exclaimed, "I'm not advocating an overall increase in fiscal spending or anything like that."

In his opening statement, Bernanke noted that "economic activity appears to have decelerated somewhat during the first half of this year." He continued: "After rising at an annual rate of 2.5 percent in the second half of 2011, real gross domestic product (GDP) increased at a 2 percent pace in the first quarter of 2012, and available indicators point to a still-smaller gain in the second quarter."

He pointed to a drop in average monthly payroll gains from nearly 200,000 in the fourth quarter of 2011 and first quarter of 2012 to 75,000 in the second quarter of this year. Growth in household spending, he said, had slowed in the second quarter, as had manufacturing output and business pending on equipment and

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software. “In part,” he told the committee, “slowing growth in production and capital investment appears to reflect economic stresses in Europe, which, together with some cooling in the economies of other trading partners, is restraining the demand for US exports.”

The Fed’s downwardly revised projection for GDP growth, he said, meant “the reduction in the unemployment rate seems likely to be frustratingly slow.”

The Monetary Policy Report released Tuesday set the Fed’s projection for US unemployment in the final quarter of this year at 8.0 to 8.2 percent, with the jobless rate remaining at between 7.0 percent and 7.7 percent at the end of 2014. According to Bloomberg News, even these dismal forecasts assume monthly payroll increases of about 150,000 to 200,000 jobs, far higher than the 80,000 new jobs reported by the Labor Department for June.

The report was more blunt than Bernanke’s opening statement in asserting that austerity at the federal as well as the state and local levels would be even more severe in 2013, noting that “budgets for state and local governments remain strained and federal fiscal policy is likely to become more restrictive in 2013.”

It also suggested that the European debt crisis, more austerity in the US and the global slowdown would likely result in even higher jobless rates than those currently projected by the Fed.

The Fed’s grim prognosis was buttressed by an update released Monday by the International Monetary Fund to the organization’s World Economic Outlook. The IMF cut its 2012 world growth forecast slightly to 3.5 percent and slashed its projection for 2013 to 3.9 percent from its previous estimate of 4.1 percent. These are all sharply lower than the 2010 growth rate of 5.3 percent.

The IMF downgraded its projections for US growth in 2012 and 2013. Most ominous were its sharply lower forecasts for China, India and Brazil, economies that largely powered whatever recovery there was from the crash of 2008. The IMF predicted China this year would grow by 8.0 percent, India by 6.1 percent and Brazil by 2.5 percent.

In response to questions from the senators, Bernanke noted that at its last meeting, the Fed’s FOMC had extended to the end of 2012 its so-called “Operation Twist”—the sale of shorter-term Treasury securities in the Fed’s portfolio and purchase of longer-term Treasuries. This program is designed to bring down long-term interest rates, including mortgage rates. He said the central bank had several options if it decided to increase monetary stimulus, including another round of securities purchases to expand the Fed’s balance sheet (so-called “Quantitative Easing”)—the equivalent of printing dollars.

The hearing was punctuated with questions on the expanding Libor rate-rigging scandal and the role of the Federal Reserve in failing to stop banks from manipulating the key global interest rate. Committee Chairman Tim Johnson, Democrat from South Dakota, began his questioning by asking Bernanke, “What did you know, when did you know it, and what did you do about it?”

Bernanke had a pro-forma, prepared response, which was not surprising since Johnson had advised him in advance of the question. Bernanke’s reply simply evaded the fact, revealed in documents released last Friday by the Fed at the request of a House subcommittee, that the then-president of the New York Fed and current Obama treasury secretary, Timothy Geithner, knew of the banks’ manipulation of the Libor rate as early as 2007 and did nothing to publicize the fraud or stop it.

Johnson dropped the issue and passed on to other matters.

Later, Senator David Vitter (Republican from Louisiana) asked Bernanke why the Fed did not investigate back in 2007 the two Wall Street banks it oversees that are among the nearly 20 international banks suspected of rigging Libor. Bernanke dodged the question.

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