# Easy Does It

By Editor Test *Wed, Nov 21, 2012*

*“We will want to be sure that the recovery is established before we begin to normalize policy,” Fed chairman Ben Bernanke said in a speech yesterday.*

Two years ago, a leading life insurance executive told *RIJ* that his company could weather ultra-low interest rates for about five years. Yesterday, in a speech in Manhattan, Fed chairman Ben Bernanke reiterated his intention to keep rates low until at least 2015.

Bernanke told members of the New York Economic Club that his policy is justified by the “headwinds,” such as weakness in housing, bank lending, and public sector expenditures, that the U.S. economy still faces four years after the nadir of the financial crisis.

As for the so-called “fiscal cliff” (an expression rendered memorable by *chiasmus*, a figure of speech evident in the reversal in “cliff” of the “f” and “c” sounds in “fiscal”), Bernanke said that the goal of long-term deficit reduction would be best served by avoiding big spending cuts and tax increases in 2013.

“Fortunately, the two objectives are fully compatible and mutually reinforcing,” Bernanke said. “Preventing a sudden and severe contraction in fiscal policy early next year will support the transition of the economy back to full employment; a stronger economy will in turn reduce the deficit and contribute to achieving long-term fiscal sustainability.

“At the same time, a credible plan to put the federal budget on a path that will be sustainable in the long run could help keep longer-term interest rates low and boost household and business confidence, thereby supporting economic growth today.”

**Low rates to continue even after recovery**

In his speech, Bernanke explained the rationale behind his policy of buying mortgage-backed securities, which lifted prices in that sector this fall:

“Our purchases of MBS, by bringing down mortgage rates, provide support directly to housing and thereby help mitigate some of the headwinds facing that sector. In announcing this decision, we also indicated that we would continue purchasing MBS, undertake additional purchases of longer-term securities, and employ our other policy tools until we judge that the outlook for the labor market has improved substantially in a context of price stability.

Although it is still too early to assess the full effects of our most recent policy actions, yields on corporate bonds and agency MBS have fallen significantly, on balance, since the FOMC’s announcement. More generally, research suggests that our previous asset purchases have eased overall financial conditions and provided meaningful support to the economic recovery in recent years.

In addition to announcing new purchases of MBS, at our September meeting we extended our guidance for how long we expect that exceptionally low levels for the federal funds rate will likely be warranted at least through the middle of 2015. By pushing the expected period of low rates further into the future, we are not saying that we expect the economy to remain weak until mid-2015; rather, we expect—as we indicated in our September statement—that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the economic recovery strengthens. In other words, we will want to be sure that the recovery is established before we begin to normalize policy.

**Rationale for buying Treasuries**

A footnote to the published text of Bernanke's speech noted specifically that his policy of purchasing Treasuries helps reverse the flight to Treasuries from riskier assets.

"One way in which our asset purchases affect the economy is through the so-called portfolio balance channel. Because different classes of financial assets are not perfect substitutes in investors' portfolios, changes in the supplies of various assets available to private investors may affect the prices and yields of those assets.

"Thus, the Federal Reserve's purchases of Treasury securities, for example, should raise the prices and lower the yields of those securities; moreover, as investors rebalance their portfolios by replacing the Treasury securities sold to the Federal Reserve with other assets, the prices of those other assets should rise and their yields decline as well.

"An increase in our asset purchases may also act as a signal that we intend to pursue a persistently more accommodative policy stance than previously thought, thereby lowering investors' expectations for the future path of the federal funds rate and putting additional downward pressure on longer-term interest rates."