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## Bernanke's Low-Rate Fed Future Is Secure

The Federal Reserve chairman's reappointment increases the chances that the federal funds rate will stay below 1% for at least another year

By [Peter Coy](#)

It's remarkable, really. The Federal Reserve is holding short-term interest rates at the lowest levels in history—just zero to 0.25%. Critics argue these ultralow rates will trigger a dollar crisis or fuel a new round of foolish lending and financial speculation that will end once again in tears. Yet the engineer of these low rates, Fed Chairman Ben Bernanke, has managed to retain the confidence of the financial markets and fellow monetary policymakers. And on Aug. 25, President Barack Obama [said he will nominate](#) Bernanke for another four-year term as chairman, which would keep him at the helm until January 2014.

Obama's support solidifies the probability that Bernanke will be able to stick to his plan to keep short-term rates extremely low well into 2010. Traders in the money market are now expecting the federal funds rate to remain at 0.25% or below through next March before gradually drifting up to 0.75% by August 2010, according to data from Bloomberg Markets.

When it comes time to write Bernanke's legacy, the rescue of the financial system this year will be prominent. Just as important may be whether Bernanke has set the stage for stable growth or another investment bubble.

### NO SIGN OF FOMC DISSENT ON LOW RATES

Critics say Bernanke is repeating a mistake that [the Fed](#) made in 2002-04, when the federal funds rate bottomed out at 1%—which they say set the stage for the Great Recession of 2007-09. One of Bernanke's most relentless critics, Peter Schiff, president of brokerage [Euro Pacific Capital](#), says Obama is "rewarding failure," adding that "the cost [of low rates] will be a major currency crisis which undermines what remains of our economy." [John Lekas, president of bond investor Leader Capital Corp. Short Term Bond Fund, argues that the Fed will be forced to raise short-term rates drastically in the next two years to keep foreign creditors content and prevent a dollar collapse.](#)

But Bernanke has built a surprisingly strong consensus for sticking with low rates. For example, not a single member of the rate-setting Federal Open Market Committee, which includes several inflation hawks, has dissented from the low-rate policy at the most recent FOMC meetings in June and August.

Bernanke has managed to convince people that the danger of keeping rates low is outweighed by an even greater risk of pushing them higher, which might kill the economic recovery that seems to be taking shape. As a student of the Great Depression, he has made the point that tight-money policies by the Fed in 1936 throttled a recovery and caused the U.S. economy to plunge in 1937.

### THE MARKET ISN'T PRICING INFLATION

Professional Fed watchers say that Bernanke—like his predecessor, Alan Greenspan—will use data, not just monetary theory, to determine the right time to start raising rates. He would want to see actual evidence that the economy is overheating and that core inflation—that is, prices excluding the volatile food and energy components—is climbing out of the Fed's comfort zone. Since a lot of slack persists in the system, pricing pressures remain for now a distant concern. "The speed at which they hike rates is going to depend largely on what the economy does," not debates over monetary-policy theory, says Larry Kantor, head of research at [Barclays Capital](#) in New York.

Things could get dicey for Bernanke if the bond market were to start worrying about Fed-induced inflation. But that hasn't

happened yet: Yields on inflation-indexed Treasury bonds are indicating that the market expects inflation of only a little more than 2% annually over the next 30 years.

A similar serenity seems to greet fears that foreign creditors will suddenly boycott U.S. debt. If this were going to happen, it probably would have happened already because the U.S. government's fiscal predicament has been abundantly obvious, says JPMorgan Chase ([JPM](#)) Chief Economist Bruce Kasman. Moreover, Kasman notes, while the U.S. government is borrowing much more, consumers are borrowing so much less that the nation's net borrowing from the rest of the world has actually been decreasing—thereby relieving downward pressure on the dollar.

With an implicit endorsement from the bond vigilantes—and now an explicit one from the President—Bernanke has the license to pursue his zero-rate policy for as long as it takes the economy to get back on track.

[Coy](#) is BusinessWeek's Economics editor.

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