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...e of the few ways for newcomers or smaller funds to get their names out. This is the season in which funds everywhere take pains to cast last year's per-

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...mine combination. Some of these products work by agitating the nervous system and diverting the body's attention from digesting food.

Since the late 1970s, dieters have

The "glycemic index," currently a hot diet concept, is a natural successor to this idea. It ranks carbohydrates depending on how they raise the body's

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TWSJ 2/16/2006

Blunt-Talking Bernanke Warns of Inflation Risks

654

Remarks to Congress Suggest Interest-Rate Boost Is Likely; Industrials Hit 5-Year High

By Greg Ip

WASHINGTON—Making his debut before Congress as Federal Reserve chairman, Ben Bernanke demonstrated continuity with Alan Greenspan's interest-rate policies but broke with his predecessor's style.

Mr. Bernanke told Congress yesterday that inflation still is at risk of quickening because of high energy prices and economic overheating. He thus endorsed the thinking of the Fed at its last meeting, headed by Mr. Greenspan, and suggested the string of rates increases begun under Mr. Greenspan's leadership in June 2004, isn't over.

But his succinct and often blunt answers to questions from members of the House Financial Services Committee and his refusal to comment on many politically contentious issues signaled a stylistic break with Mr. Greenspan, who often spoke opaquely about monetary policy and lucidly about almost everything else.

Markets expect the Fed, at its next meeting on March 27 and March 28, to raise its short-term interest rate target, now 4.5%, by a quarter of a percentage point, and put high odds on another increase on May 10.

Mr. Bernanke's testimony didn't alter expectations yesterday. Bonds rose, particularly long-term Treasurys, while stocks, after bouncing around during Mr. Bernanke's testimony, rose 30.58 points to close at 11058.97, the highest close since June 2001, after climbing 136 points Tuesday. (See related article on page C1).

Mr. Bernanke didn't explicitly say more rate increases are likely. Rather, he said, the Fed must "make ongoing, provisional judgments about the risks to both inflation and growth." That means Fed moves at its next meeting could hinge on information released in coming weeks.

In a statement after its last meeting, on Jan. 31, the Fed warned of potential risks from inflation and said more rate increases "may be needed." Mr. Bernanke, who didn't attend that meeting, endorsed that statement yesterday.

He said one risk is that higher energy prices could work their way into other costs. Another, he said, is "that, with aggregate demand exhibiting considerable momentum, output could overshoot its sustainable path, leading ultimately—in the absence of countervailing monetary policy action—to further upward pressure on inflation."

Some economists saw the warnings of potential economic overheating as more pointed than recent Fed statements. "New ground was broken," said Bruce Kasman, head of economic research at J.P. Morgan Chase.

With the unemployment rate down to

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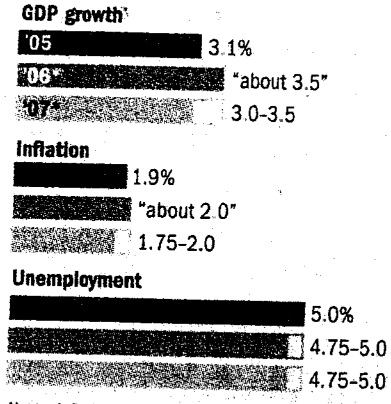
Room to Grow?

How the economy grew in 2005 and Fed officials' outlook for the next two years



Notes: Inflation figures reflect personal consumption expenditure index, excluding food and energy; Unemployment figures are fourth-quarter averages.
*Forecast
Source: Federal Reserve

INSIDE TODAY'S JOURNAL

Let the Good Times Roll?

New Orleans will kick off its traditional Mardi Gras processions Saturday, even though the city is broke and signs of Katrina's devastation are almost everywhere. Page B1

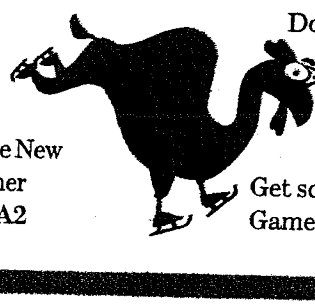
Derivatives: Replacing Pipes Before They Burst

Wall Street firms, called the Fourteen Families, gather at the New York Fed to prevent a crisis rather than respond to one. Capital, A2

Trade-Offs Affect the Poor

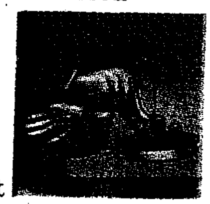
As federal Medicaid help thins and costs for the program consume about 17% of their general-fund budgets, states struggle to find savings—and governors face tough choices. A4

In Cold Pursuit Of Flying Camels



Don't know a skier's herringbone glide from a snowboarder's frontside grab? Get schooled in Winter Games terminology. A14

A Penny for His Thoughts, And His Estimates



Prosecutors say former Enron President Jeffrey Skilling at one point pulled a penny out of thin air to avoid falling short of Wall Street expectations. Outside Audit, C1

More Safety Cushions

The government proposes tighter rules on flame-proofing mattresses and sofas, a move that could lead to higher furniture prices. D1

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Bernanke Warns of Inflation

Continued From First Page

4.7%, many economists believe the economy is operating at full capacity and that growth in gross domestic product much above 3% would strain capacity and risk a wage-price spiral. Growth this quarter is expected to top a 4% annualized rate. This week, the Commerce Department reported strong retail-sales growth for January, after an earlier report that employers added 193,000 jobs that month.

Mr. Bernanke did cite some risks to continued growth. Given their current lofty levels, home prices and home construction could "decelerate more rapidly than currently seems likely," he said. He also said, "The possibility of significant further increases in energy prices represents an additional risk." Still, he seemed to view these risks as more hypothetical than the risk of higher inflation.

Mr. Bernanke, who was sworn in Feb. 1, had several missions yesterday, the first of two days of the Fed chief's semiannual testimony on the economy and monetary policy. He had to establish how much he shared the outlook of other Fed policy makers, while showing continuity with how Mr. Greenspan made monetary policy and displaying a different style.

Mr. Bernanke went even further than he did at his confirmation hearing in aligning himself with Mr. Greenspan's policy-making process, emphasizing the importance of considering all possible outcomes, not just the baseline forecast, and of "keeping an open mind about the

> Mr. Bernanke lived up to his reputation as being more direct than Mr. Greenspan.

many factors...at play in a dynamic modern economy."

As an academic, Mr. Bernanke worked extensively on economic modeling—statistical representations of the economy used to forecast movements in employment, inflation and other factors. Yesterday he noted, "Any model is, by necessity, a simplification of the real world." That sentence was almost a carbon copy of Mr. Greenspan's declaration in 2004 that "Every model...is a vastly simplified representation of the world that we experience."

Stylistically, Mr. Bernanke lived up to his reputation as more direct than Mr. Greenspan. One example came when he was asked whether the low level of long-term interest rates compared with short-term rates—resulting a flat or inverted "yield curve"—foreshadows a recession. In the past, that phenomenon often—but not always—has preceded a downturn.

Asked about the danger last year, Mr. Greenspan replied: "History suggests that that is usually or has been a forward indicator for softening economic activity....I suspect, however, that we have changed the structure of the flow of funds and the relationships amongst the various interest-rate tranches by maturity such that I'm not sure what such a configuration...would mean."

Mr. Bernanke's response to the same question: "The inverted yield curve is not signaling a slowdown."

Meanwhile, congressmen peppered Mr. Bernanke with questions ranging from how to index Social Security for inflation to the wisdom of extending President Bush's tax cuts. Mr. Greenspan had shown great willingness to comment on numerous nonmonetary policy issues. Mr. Bernanke said responding to many such questions wasn't appropriate for the central bank chief.

Asked by Alabama Democrat Rep. Artur Davis whether tax cuts ought to take into consideration the impact on income inequality, for instance, Mr. Bernanke said, "These are value judgments. There's no scientific way to answer your question...This is what the people have elected you to do, and clearly it's your responsibility."

His avoidance of such questions left some legislators dissatisfied, suggesting his attempt to stay out of political debates will continue to be tested. "You are our No. 1 economist," said David Scott, a Georgia Democrat. "You're not there to just sit on the middle of the fence and not do anything. These are serious issues."

Mr. Bernanke did attempt to offer nonpartisan economic prescriptions to some of these queries. He suggested there were more efficient ways to help low-income workers than raising the minimum wage, that reducing the deficit is important and that Congress should act soon to reform entitlements such as Social Security, whose costs are expected to balloon

Plain Speaker

Below are some of Ben Bernanke's succinct responses to questions from members of Congress yesterday, including some he didn't want to answer.

- **On the peculiar behavior of bond yields:** *"The inverted yield curve is not signaling a slowdown."*
- **On whether taxes are high enough:** *"Compared to what?"*
- **On regulation of the mortgage companies known as GSEs:** *"I have no vendetta against the GSEs."*
- **On central bank transparency:** *"Fresh air is good for the Federal Reserve."*
- **On racial discrimination in mortgage lending:** *"I don't think that there is massive discrimination, but I think that it does exist."*
- **On whether inequality should be considered when cutting taxes:** *"These are value judgments. It's what people have elected you to do, and clearly it's your responsibility."*

Mr. Bernanke lived up to his reputation as being more direct than Mr. Greenspan.

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The Fed yesterday released economic projections of members of the Federal Open Market Committee, the Fed's policy-making arm. They see economic growth of about 3.5% this year and 3% to 3.5% next year, inflation excluding food and energy at or a bit below 2% this year and next, and unemployment at 4.75% to 5% at the end of this year and next. Said Mr. Bernanke: "I am comfortable with these projections."