Fed Expands Operation Twist by $267 Billion Through 2012

By Jeff Kearns and Joshua Zumbrun - Jun 20, 2012 The Federal Reserve will expand its Operation Twist program to extend the maturities of assets on its balance sheet and said it stands ready to take further action to put unemployed Americans back to work. The central bank will prolong the program through the end of the year, selling $267 billion of shorter-term securities and buying the same amount of longer-term debt in a bid to reduce borrowing costs and spur the economy. “If we don’t see continued improvement in the labor market, we’ll be prepared to take additional steps if appropriate,” Fed Chairman Ben S. Bernanke said at a news conference in Washington following a two-day meeting of the Federal Open Market Committee. “Additional asset purchases would be among the things that we would certainly consider.” Policy makers moved to shore up the world’s largest economy as faltering growth leaves it vulnerable to fallout from the European debt crisis and looming fiscal tightening in the U.S. Fed officials today lowered their outlook for growth and employment, foreseeing a jobless rate of at least 7.5 percent at the end of 2013. The yield on the 10-year Treasury note rose to 1.65 percent at 4:35 p.m. in New York from 1.62 percent late yesterday. The Standard & Poor’s 500 Index fell 0.2 percent to 1,355.69 after declining as much as 0.9 percent. Easing Bias “Clearly, the bias is still towards even more easing,” said Julia Coronado, chief economist for North America at BNP Paribas in New York. “Our base case would still be that we’ll probably see some more easing before year end,” said Coronado, a former Fed economist. The continuation of Operation Twist “should put downward pressure on longer-term interest rates and help to make broader financial conditions more accommodative,” the FOMC said. Policy makers repeated their view that economic conditions will probably warrant keeping interest rates “exceptionally low” at least through late 2014. The FOMC has kept the main interest rate in a range of zero to 0.25 percent since December 2008. “Growth in employment has slowed in recent months, and the unemployment rate remains elevated,” the FOMC said. “The Committee expects economic growth to remain moderate over coming quarters and then to pick up very gradually.” Fed officials lowered their forecasts for growth and raised their predictions for unemployment in each of the next three years. Growth Outlook Policy makers now see 1.9 percent to 2.4 percent growth in 2012, down from their April forecast of 2.4 percent to 2.9 percent. The unemployment rate will end the year at 8 percent to 8.2 percent, up from 7.8 percent to 8 percent in April. Unemployment will end 2014 at 7 percent to 7.7 percent, up from a 6.7 percent to 7.4 percent in April, according to their so-called central tendency estimates, which exclude the three highest and three lowest forecasts. The Fed said today it will sell Treasury securities with remaining maturities of about three years or less. It will purchase securities with six years to 30 years remaining. The existing maturity-extension program was announced Sept. 21 and expires this month. Under that program, the Fed is selling $400 billion of short-term government debt and replacing it with the same amount of longer-term Treasuries. Borrowing costs have fallen since the Fed announced Operation Twist. The yield on the 10-year Treasury note fell to a record low 1.4387 on

June 1. Little Concern Today’s Fed statement and policy makers’ projections show that there is little concern over inflation. Inflation “has declined, mainly reflecting lower prices of crude oil and gasoline, and longer-term inflation expectations have remained stable,” the Fed said. Oil prices have slumped 23 percent to $84.03 a barrel yesterday since reaching a high of $109.77 a barrel in February. Central banks across the world are considering steps to stimulate their economies. Bank of England Governor Mervyn King and three other policy makers were overruled this month as they pushed to expand their bank’s bond-purchase program, meeting minutes showed today. European Central Bank President Mario Draghi left the door open for a rate cut at a June 6 press conference. Bank of Japan The Bank of Japan should be ready to “take appropriate actions without ruling out any options in advance” if the European crisis worsens, some of its board members said in May, according to minutes released today. The People’s Bank of China cut borrowing costs for the first time since 2008 earlier this month and loosened controls on banks’ lending and deposit rates. Europe’s debt crisis has intensified since the FOMC’s meeting in April, roiling financial markets. The Standard & Poor’s 500 Index was down by 4.3 percent as of yesterday from its 2012 peak on April 2. “The Federal Reserve is very much involved with talking with European leaders,” Bernanke said today. “We are prepared to work together if that can be done constructively, but at this point we’re mostly in consultation mode.” The Fed’s two rounds of asset purchases totaling $2.3 trillion and record-low interest rates since December 2008 have left the central bank short of its full-employment goal. The economy added 69,000 jobs in May, the fewest in a year, and the unemployment rate unexpectedly climbed to 8.2 percent from 8.1 percent, its first increase in almost a year. Companies are cutting back as the economy shows signs of slowing. FedEx Corp., operator of the world’s largest cargo airline, is restructuring its express business and retiring 24 jet freighters. Slowing Growth “We believe U.S. domestic and global economic conditions will be impacted by the European debt crisis, slowing growth in Asia and the uncertainty these issues create on the global economy and the demand for our services,” FedEx Chief Financial Officer Alan Graf said yesterday on an earnings call. Also taking a toll on the economy: concern that Congress will fail to reach a compromise in time to avoid $600 billion in tax increases and budget cuts next year. Among government contractors coping with delayed procurements and agency cost-cutting is Preferred Systems Solutions, a Vienna, Virginia-based engineering and information technology provider. “I’m feeling more of a pinch and squeeze than I ever have before,” said Scott Goss, president and chief executive officer. “As soon as they start these massive cuts, they’re going to impact the economy.” Economic data in recent weeks have pointed to slowing growth. Sales Fell Retail sales fell 0.2 percent for a second month in May, according to a June 13 report from the Commerce Department, as elevated unemployment and the smallest wage gains in a year prompted consumers to curtail their spending. Industrial production unexpectedly fell in May for the second time in three months as factories turned out fewer vehicles and consumer goods, data from the Fed showed last week. Fifty-eight percent of economists in a June 18 Bloomberg News survey said the FOMC would prolong Operation Twist, with an additional 8 percent predicting the Fed would announce the move at its meeting on July 31-Aug. 1. Richmond Fed President Jeffrey Lacker dissented for the fourth meeting in a row, saying he doesn’t support extending Operation Twist. He said last month he believes the central bank will probably need to raise the main interest rate next year. It was the first meeting for Governors Jeremy Stein and Jerome Powell, who joined the Fed last month, raising the Washington-based board to its full, seven-member strength for the first time since 2006.