Fed's Lacker hopeful, warns don't ignore inflation
Thu Mar 26, 2009 4:29pm EDT
By Alister Bull

CHARLESTON, South Carolina (Reuters) - The Federal Reserve must not ignore inflation as it battles the U.S. recession, a top Fed policy-maker said on Thursday, saying also that clarifying banks' capital needs was more important than removing their bad debts.

"Such a large increase in the monetary base cannot be left in place indefinitely without creating quite sizable inflation pressures," Richmond Federal Reserve President Jeffrey Lacker told an audience of local business leaders in Charleston.

"Choosing the right time to withdraw that stimulus will be a challenge and I believe it will be very important to avoid the risk of waiting too long," said Lacker, who is a voting member of the Fed's policy-setting committee this year.

Lacker also said that when it came to restoring confidence to financial markets, a stress-test of the country's top lenders, to be completed next month, may be more important than the effort to cleanse toxic assets from bank balance sheets.

He told reporters that it was not clear how many bad assets would actually be moved from bank balance sheets to public-private investment programs announced on Monday.

But he did not think the scale of the toxic asset plan was the right way to gauge whether it would restore confidence in the banking system after the worst financial crisis since the Great Depression.

"I'm not sure our success...will depend on how much flows into this...I think it depends on the success of the stress tests," he told the reporters.

The top 19 U.S. banks are being subjected to a tough assessment of how their capital buffers will stand up if the economy turns out to be even weaker than expected.

Lacker said this would help clarify how much more capital they will need and answer questions about further government intervention to prop up the ones in the worst shape, paving the way for private investment as that threat recedes.

"We are not going to get through this crisis...until markets believe the problem of further capital injections by government is nil...The stress-testing exercise is the most important part of it," he earlier told students during remarks at the College of Charleston.

The Fed, which has already cut interest rates almost to zero, last week announced it would buy up to $300 billion of longer-dated Treasury securities and an additional $850 billion of agency mortgage debt to help offset a deepening recession. This comes on top of a more than doubling in the Fed's balance sheet to almost $2 trillion since September.

"I am confident that we can prevent outright deflation by expanding our monetary policy stimulus if need be. But at the same time, it is not premature to be concerned with the behavior of inflation when the recession is over and the recovery has begun," he said in the speech.

Lacker said he voted for this powerful stimulus because some economic data since the previous meeting in January had been worse than he had expected, and because the U.S. monetary base contracted by around $200 billion over that period.
"I thought it was important to step up the level of stimulus we were providing," he told reporters.

The decision for the Fed to buy longer-dated Treasuries was one that Lacker had lobbied for and he had dissented at a Fed meeting in January in favor of this approach.

It was also a pure monetary policy action, he said, and different from credit market interventions also undertaken by the Fed in recent months to aid financial sectors that appeared to be broken, which he called more like fiscal policy.

"The good news right now is that credit and monetary views yield complementary policy implications, because policies that provide targeted Fed credit also add reserves to the monetary base," he said. "The more difficult choices will come down the road, if improvements in credit conditions and the overall economy do not coincide."

Lacker told the reporters that he welcomed a joint statement from the Fed Board of Governors in Washington and U.S. Treasury on Monday to clarify the Fed's role in protecting financial and monetary stability.

But he said it could have been more specific in distancing the Fed from influencing credit allocation within the economy, and cited its current support for the commercial paper market.

It was not all doom and gloom. Highlighting increases in U.S. retail sales, lower gasoline prices and steady wages, Lacker said he thought it reasonable to expect the economy to turn the corner later this year and begin a gradual recovery.

"This may be a sign that consumers are responding in the manner suggested by economic theory and basing their immediate consumption plans on less adverse longer-run income prospects. This is a key element in the case for the economy bottoming out this year," he said in the speech.

http://www.reuters.com/article/topNews/idUSTRE52P5RB20090326

Fed's Lacker: Stress Tests May Need To Be Modified
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By Meena Thiruvengadam
Of DOW JONES NEWSWIRES
CHARLESTON, S.C. -(Dow Jones)- Stress tests currently being conducted on the U.S.'s largest banks may need to be modified should economic conditions weaken more than expected, Richmond Federal Reserve President Jeffrey Lacker said Thursday.

The tests, set to be completed in April, are designed to measure the sufficiency of bank capital under baseline and adverse economic scenarios.

Lacker, taking questions from reporters after a speech to the Charleston Metro Chamber of Commerce, said the tests "at this point" appear to be sufficient.

"If conditions become worse than we expect them to get, we'll have to revisit those assumptions," he said. "As economic conditions evolve, the tests you might want to apply ought to evolve as well."

The Richmond Fed is involved in conducting the tests, however Lacker said he was unable to comment on potential results.

Banks have made their initial submissions, he said.

Earlier Thursday, Lacker said the stress tests are crucial to easing the fear that has frozen financial markets.

"The stress test exercise is the most important part of it," he said, while speaking to students at the College of
Bank stress tests key to easing fear: Fed's Lacker
Thu Mar 26, 2009 10:48am EDT
CHARLESTON, South Carolina (Reuters) - Stress testing of the top 19 U.S. banks is crucial to identifying additional capital needs and easing the fear that has frozen financial markets, a top Federal Reserve official said on Thursday.

Richmond Federal Reserve Bank President Jeffrey Lacker told students at the College of Charleston some banks needed to raise fresh capital but are finding this hard to do because of concern the U.S. government may step in and dilute investors' interests.

"We are not going to get through this crisis ... until markets believe the probability of further capital injections by the government is nil ... The stress test exercise is the most important part of it," he said.

Fed's Lacker: Treasury buying ought to lower rates
Thu Mar 26, 2009 10:19am EDT
CHARLESTON, S.C., March 26 (Reuters) - The Federal Reserve decided to purchase longer-dated U.S. Treasury securities to help drive general borrowing costs lower in a way that was neutral across credit markets, a Fed policy-maker said on Thursday.

Federal Reserve Bank of Richmond President Jeffrey Lacker, addressing students at the College of Charleston, also said that it would be tough task to prevent inflation that could arise in the future from this powerful monetary stimulus, announced at the Fed's policy-setting meeting last week.

"Whether it has an inflationary impact or not depends on our skill," in unwinding the Fed's balance sheet expansion once the recovery gets underway, he said.
The head of the Federal Reserve district that includes South Carolina said the Palmetto State’s ailing economy will likely take longer to recover than the national economy, citing the dramatic slowdown in exports and manufacturing.

Jeffrey Lacker, president of the Federal Reserve Bank of Richmond, said the state took a dramatic hit in the sector that makes durable goods, which the government defines as big-ticket items that last more than three years.

"I think its economy could remain weaker than the national economy for some time, just because of the concentration in durable goods and, as result of that, its dependence on business investment spending, which I think is going to be weak for a year or two," he said in an interview with The Post and Courier.

On the upside, he noted that monetary trends could bode well for exports.

"The value of the dollar is going to have a lot to do with exports going forward, and I think there's reason to believe toward the end of the year we'll see export markets firming up a bit," he said.

Lacker said a turnaround at the national level will require shell-shocked consumers and business start spending discretionary dollars again.

"Once that happens, then you'll see people who've been waiting on the sidelines with investment projects or new initiatives come back into the market, dip their toes into the water ... and we'll see spending bottom out and then start expanding," he said.

Lacker, whose Fifth District is made up of the Carolinas, Virginia, Maryland, Washington, D.C., and most of West Virginia, is in town to speak at the Charleston Metro Chamber of Commerce's economic outlook conference Thursday afternoon. He also is addressing students at the College of Charleston.

He sat down with The Post and Courier to field a few questions about the economy

Some excerpts.

**On housing:** The "recovery in housing will be on the sluggish side."

**On the Fed's hands-on role in industry bailouts:** Lacker is concerned partly because when the Fed "gets involved in large-scale lending to a particular market segment ... it inevitably exposes us to the risk of political pressure ... to direct lending to other favored groups."

**On the debt the nation is amassing from the stimulus:** Lacker says it will make it more challenging for the government to deal with other pressing financial shortfalls, namely Social Security and Medicare. The new debt "puts us behind the eight-ball in addressing those fiscal imbalances up ahead."

**On Gov. Sanford's proposal to use federal stimulus funds to pay down state debt:** Lacker smiled but declined to comment.