Bernanke Urges 'Strong Measures' to Stabilize Banks (Update3)

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By Craig Torres

Jan. 13 (Bloomberg) -- Federal Reserve Chairman **Ben S. Bernanke** warned that a fiscal stimulus won't be enough to spur an economic recovery and that the government may need to buy or guarantee banks' tainted assets to revive growth.

"Fiscal actions are unlikely to promote a lasting recovery unless they are accompanied by strong measures to further stabilize and strengthen the financial system," Bernanke said in the text of a speech today at the London School of Economics. "More capital injections and guarantees may become necessary to ensure stability and the normalization of credit markets."

Bernanke's remarks indicate he may be seeking to influence deliberations among lawmakers and President-elect **Barack Obama's** economic aides on how to deploy the next $350 billion of the financial-rescue fund approved in October. While some Democrats have focused on offering aid to troubled homeowners, the Fed chief's comments show he's more concerned about a continued choking off of credit to companies and households.

The Fed chairman recommended three approaches on troubled assets. Public purchases of the bad assets are one possibility, as was originally planned under U.S. Treasury Secretary **Henry Paulson's** Troubled Asset Relief Program, or TARP.

The government could also agree to absorb, in exchange for warrants or a fee, part of the losses on a specified portfolio of troubled assets, he said. Regulators used that method recently with their bailout of Citigroup Inc.

'Bad Banks'

Another measure "would be to set up and capitalize so- called bad banks, which would purchase assets from financial institutions in exchange for cash and equity in the bad banks," he said.

While the U.S. Treasury has already channeled $350 billion in taxpayer funds to recapitalize banks and rescue companies including American International Group Inc. and Citigroup, financial stocks have been hammered in recent days amid deepening concern about credit losses.

The **Standard & Poor's 500 Financials Index** has lost 14 percent in the past four trading days. Citigroup yesterday slumped 17 percent to $5.60.

U.S. stock-index futures slipped today, indicating the **Standard & Poor's 500 Index** may fall for a third day. **Futures** on the S&P 500 expiring in March retreated 0.2 percent to 866 at 8:47 a.m. in New York. Dow Jones Industrial Average futures fell 15 points, or 0.2 percent, to 8,429. Nasdaq-100 Index futures declined less than 0.1 percent to 1,205.75.

Toxic Assets

Bernanke's warning about toxic assets is "a call to use the second half of TARP for what it was intended for," said Christopher Low, chief economist at FTN Financial in New York. "It was sold as something to get the mortgage market functioning again, which is something Congress would like to see because that gets back to homeowners."

Obama asked President **George W. Bush** yesterday to inform Congress of the intent to release the second half of the $700 billion bailout fund. **Lawrence Summers**, the incoming White House economic director, pledged changes in how the TARP will be used, without offering specifics in a letter to congressional leaders.

Obama is pressing Congress for a stimulus plan of about $775 billion, including tax cuts and spending on everything from roads and schools to the energy network, to help pull the world's largest economy out of a slump that's in its second year.

Economists slashed forecasts for U.S. growth and projected the Fed won't be able to start raising interest rates until 2010, according to a Bloomberg News survey published today. The economy will shrink 1.5 percent this year, a half percentage point more than projected last month, according to the median of 59 forecasts in the survey taken from Jan. 5 to Jan. 12.

Reduce Losses

Bernanke also said that efforts to reduce preventable foreclosures "could strengthen the housing market and reduce mortgage losses" and increase financial stability.

The Fed chairman said the favorable treatment that financial institutions are receiving from the government is "unavoidable" because the economy needs credit to grow. Still, aid should be accompanied by stronger supervision and regulation, he said.

"Financial firms of any type whose failure would pose a systemic risk must accept especially close regulatory scrutiny of their risk-taking," he said. "It is unacceptable that large firms that the government is now compelled to support to preserve financial stability were among the greatest risk-takers during the boom period."

Bernanke reiterated his call for a regulatory procedure for resolving a large, failing nonbank institution. The absence of such a process hampered policy makers during the failures of Bear Stearns Cos. and Lehman Brothers Holdings Inc. last year.

Inhibiting Loans

"A continuing barrier to private investment in financial institutions is the large quantity of troubled, hard-to-value assets that remain on institutions' balance sheets," Bernanke said. "The presence of these assets significantly increases uncertainty about the underlying value of these institutions and may inhibit both new private investment and new lending."

The Fed chairman's speech also presented a narration of the central bank's response to the crisis so far, and he said the U.S. central bank still has "powerful tools" to influence growth and prices.

Bernanke has expanded the size and types of assets on the Fed's balance sheet more than any other chairman in the institution's history. During the past year he increased the Fed's holdings by more than $1 trillion, in part with credits that banks and brokers considered too risky.

He said the Fed can continue to use communication to guide markets on how the central bank's economic outlook is likely to shape their policy.

Near Zero

The central bank cut its main interest rate to as low as zero last month and pledged to expand its assets if necessary. The Fed plans to buy as much as $600 billion of bonds and mortgage-backed securities sold by federally chartered mortgage finance companies.

The **Federal Open Market Committee** is also considering purchases of longer-term Treasury securities. "In determining whether to proceed with such purchases, the committee will focus on their potential to improve conditions in private credit markets, such as mortgage markets," Bernanke said.

Fed officials will begin a program next month to bolster securitization markets for consumer credit. The

Term Asset-Backed Securities Loan Facility, the Fed's newest emergency program to increase liquidity, will finance up to $200 billion in securities backed by loans to small businesses, students, credit-card holders and car buyers. The facility has $20 billion of support from the U.S. Treasury.

If the program proves successful, "its basic framework can be expanded to accommodate higher volumes of additional classes of securities as circumstances warrant," Bernanke said.

The Fed will "unwind" its emergency lending programs "when credit markets and the economy have begun to recover," Bernanke said. Policy makers can then return to the "traditional means of making **monetary policy**," setting a target for the federal funds rate.

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