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Bernanke: More bank bailouts needed

Fed chairman endorses economic stimulus, but also says more help for banks is needed to fix the economy.

By Chris Isidore, CNNMoney.com senior writer
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NEW YORK (CNNMoney.com) -- Federal Reserve Chairman Ben Bernanke said Tuesday that President-elect Barack Obama's proposed fiscal stimulus package could help the economy, but he added that additional bailouts of financial institutions may also be needed to bring about a sustained economic recovery.

Bernanke, speaking in London, said in his prepared remarks that the nearly \$800 billion plan being discussed by the incoming Obama administration and the newly elected Congress "could provide a significant boost to economic activity." He did not comment on or endorse any specifics of the nearly \$800 billion.

But Bernanke cautioned that the plan is "unlikely to promote a lasting recovery unless they are accompanied by strong measures to further stabilize and strengthen the financial system."

Bernanke suggested that more banks and financial firms are likely to need additional capital injections from the government, and that further guarantees of their debt could be necessary, in return for the federal government receiving further equity in the firms.

The Fed chairman also said that "removing troubled assets from institutions' balance sheets, as was initially proposed for the U.S. financial rescue plan," might also be needed to supplement any further investments in banks.

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In addition to the actions taken by the Treasury to help banks, the Fed has made many moves to try and stimulate the economy. It has lowered interest rates to near zero, and has also pumped more than \$1 trillion into the economy through various lending programs.

This has created some concerns about the Fed's balance sheet, and whether or not it can continue to fund more rescue efforts without causing long-term damage to the economy, such as sparking inflation.

Bernanke dismissed this risk, however, saying that inflation appears well-contained in the near term. And he said despite the fact the Fed is taking on much riskier assets than normal as collateral, he does not believe there is a major risk of having those loans go bad.

"The Federal Reserve has never suffered any losses in the course of its normal lending to banks" and Wall Street firms, he said.

Bernanke said that some of the steps taken by the Fed so far to pump money into banks will be unwound quickly once markets start to return to normal.

But he added that the Fed expects that in order to address problems in the credit markets, it will have to hold onto mortgage-backed securities it is in the process of currently buying for a long time.

Bernanke also reiterated that the Fed will probably need to leave its key interest rate near zero for an extended period of time. Still, even with rates near zero, he argued that the central bank still has many tools at its disposal to address the economic crisis.

He added that the Fed is in far better position to address economic problems than the Bank of Japan was when it left rates near zero for several years earlier this decade.

Regulation changes and more global cooperation needed

Bernanke also stressed the need for cooperation by central banks around the globe. He said that what the Fed, Congress, and other nations do in response to the worldwide economic crisis is crucial to determining how quickly a recovery takes place, but he conceded that the "timing and strength of the recovery are highly uncertain."

The chairman said it is also clear there will need to be changes in the regulation of financial institutions, both in the United States and in coordination with governments around the world.

But he added that he is a strong believer in free markets and the benefits they bring, despite the crisis in the global financial markets.

"What we've learned in this case is not necessarily that we need a lot more regulation," he said in response to a question following his speech. "We need to think what went wrong...We need to think very hard about how to fix it."

He concluded that while better regulation is necessary and will have to be addressed soon, it is not the most pressing need at this moment.

"It's good advice in general if there's a fire burning, you try to put it out first, and then think about the fire code," he said. ■

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