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Bernanke Says Stimulus Should Be Paired With Other Measures

By [MAYA JACKSON RANDALL](#)

President-elect Barack Obama's administration and the Congress will need to take more steps to revive the ailing U.S. economy, and the focus should be on strengthening the financial system, Federal Reserve Chairman Ben Bernanke said Tuesday.

"The Federal Reserve will do its part to promote economic recovery, but other policy measures will be needed as well," Mr. Bernanke said in a speech at the London School of Economics. "The incoming administration and the Congress are currently discussing a substantial fiscal package that, if enacted, could provide a significant boost to economic activity.

"In my view, however, fiscal actions are unlikely to promote a lasting recovery unless they are accompanied by strong measures to further stabilize and strengthen the financial system," he added.

Mr. Bernanke said the government may need to provide more capital injections to financial firms to help stabilize the markets considering the worsening of the economy's growth prospects. Additionally, guarantees may become necessary "to ensure stability and the normalization of credit markets," he said, according to a prepared text of his London speech.

He added that the U.S. Treasury could move forward with its original plan to remove troubled assets from institutions' balance sheets. If such a decision were made, the government could purchase the assets or provide asset guarantees, Mr. Bernanke said. Under the latter, the government would agree to absorb part of the prospective losses on certain portfolios of assets, presumably in exchange for warrants or some other form of compensation, he explained.

Meanwhile, Mr. Bernanke also said efforts to reduce preventable foreclosures could help strengthen the housing market and increase financial stability.

The Fed chairman said even though there's concern about putting substantial government resources toward the financial industry, the move is necessary in the

current crisis.

"This disparate treatment, unappealing as it is, appears unavoidable," he said.

Additionally, Mr. Bernanke said that even with the federal funds target rate near zero, the Fed still has policy tools at its disposal.

In that vein, the Fed chief highlighted policy communication as one tool, saying the Fed can still influence longer-term interest rates by informing the public's expectations about the future course of monetary policy.

He also pointed out that the Fed has already launched several programs over the past year to help boost liquidity in the markets and said the Fed still has room to provide support to credit markets.

Recently, the Fed and Treasury jointly announced a plan to lend against AAA-rated, asset-backed securities collateralized by student loans, auto loans, credit cards and loans guaranteed by the Small Business Administration. Mr. Bernanke said this program should be operational next month and added that the Fed's credit risk exposure to that program will be minimal because the collateral will be subject to a "haircut" and the Treasury is providing \$20 billion of capital as supplementary loss protection.

Mr. Bernanke added that if the asset-backed securities lending program is successful, it could be expanded to accommodate higher volumes or additional classes of securities.

Meanwhile, he noted that the Fed is also considering purchasing longer-term Treasury securities as an additional way to improve mortgage market conditions.

Also during his speech at the London School of Economics, Mr. Bernanke took time out to describe how the Fed would go about unwinding some of its various credit programs, addressing concerns that the Fed's balance sheet expansion will be inflationary.

"We see little risk of inflation in the near term," Mr. Bernanke said. "Indeed, we expect inflation to continue to moderate."

And when the economy has started to bounce back and the Fed needs to unwind programs, he said it'll be done smoothly.

He pointed out that while a large portfolio of the Fed's assets are short term, the Fed does hold significant quantities of longer-term assets such as mortgage-backed securities.

"We would not anticipate disposing of more than a small portion of these assets

in the near term, which will slow the rate at which our balance sheet can shrink," he said. Additionally, now that the Fed has authority to pay interest on bank reserves, it's easier to manage the balance sheet, he said.

And other tools are available to improve control of the federal funds rate while credit programs are winding down, Mr. Bernanke said. He noted that the Treasury, for instance, could resume use of a program to sell bills and place the funds at the Fed.

"The issuance of these bills effectively drains reserves from the banking system, improving monetary control," Mr. Bernanke said. "We will take all necessary actions to ensure that the unwinding of our programs is accomplished smoothly and in a timely way, consistent with meeting our obligations to foster full employment and price stability," said Mr. Bernanke.

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