

Mark Felsenthal: 2/17/08

WASHINGTON (Reuters) - Federal Reserve Chairman Ben Bernanke told Congress on Thursday the central bank will act as needed to help the struggling U.S. economy, but it has to be mindful that growth should pick up later in the year.

The Fed "will be carefully evaluating incoming information bearing on the economic outlook and will act in a timely manner as needed to support growth and to provide adequate insurance against downside risks," Bernanke told the Senate Banking Committee.

He said the outlook for the economy had worsened in recent months and risks to growth had picked up.

However, the central bank chairman also said he expects sluggish growth to give way to a somewhat stronger expansion later this year and the likely effects of fiscal and monetary stimulus now put in place had to be considered in determining the appropriate level of interest rates.

"Our policy stance must be determined in light of the medium-term forecast for real activity and inflation, as well as the risks to that forecast," he said.

Bernanke painted a somber picture of risks facing the economy and financial markets saw his comments as keeping the door open to more interest rate cuts from the Fed, which has already lowered benchmark borrowing costs by 2.25 percentage points since mid-September. The federal funds rate now stands at 3 percent.

U.S. short-term interest rate futures prices pared losses to imply a 20 percent chance the central bank will drop rates by three-quarters of a percentage point in March, up from 6 percent earlier. A half-point cut is fully expected.

"Policy-makers are clearly ready to provide further monetary easing to support growth," said Steve Malyon, a currency strategist for Scotia Capital in Toronto.

Stock prices stayed moderately lower and government bond prices were steady at lower levels, but the dollar dipped against the euro and the yen.

WEIGHT ON CONSUMER SPENDING

Bernanke predicted a further drop in home building and related activities was likely, and said a softer jobs market, higher energy prices and falling home values could be expected to weigh on consumer spending in the near term.

At the same time, he noted that inflation had moved up as a result of soaring prices for oil and food and the weaker dollar, adding that inflation risks bear close watching.

"To date, inflation expectations appear to have remained reasonably well anchored, but any tendency of inflation expectations to become unmoored or for the Fed's inflation-fighting credibility to be eroded could greatly complicate the task of sustaining price stability and reduce the central bank's flexibility to counter shortfalls in growth in the future," he said.

Bernanke's appearance before Congress, flanked by Treasury Secretary Henry Paulson and Securities and Exchange Commission Chairman Christopher Cox, comes at a time of turmoil.

U.S. economic growth slowed to a meager 0.6 percent annual rate in the fourth quarter of 2007, house prices have been falling, and in January the job market shrank for the first time in 53 months.

Large financial institutions have reported substantial losses from investments tainted by delinquent mortgages, and banks' withdrawal from lending has amplified the slowdown.

The White House and Congress put together a \$168 billion fiscal stimulus plan, which was signed into law by President George W. Bush on Wednesday. The plan offers tax rebates to households and incentives for businesses to invest.