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### Fed likely to leave rates steady as it straddles slow economic growth, inflation concerns

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A dark brown rectangular advertisement for the University of Phoenix. On the right side, there is a profile photograph of a woman with dark hair, wearing a white turtleneck. To the left of the photo is a white checklist with five items, each preceded by a checkmark: 'Grocery Shopping', 'Meet with Timmy's Teacher', 'P/U Girls from Soccer', 'Check on Mom', and 'Earn Degree'. Below the checklist, the text reads 'Improve your life without interruptions.' At the bottom left is the University of Phoenix logo, which includes a stylized eagle and the text 'University of Phoenix' and 'Thinking ahead.' At the bottom right is a yellow button with the text 'CLICK HERE'.

WASHINGTON (AP) \_ An ugly brew of rising unemployment, spiking foreclosures and gyrating energy prices is plaguing the country and making life difficult for Federal Reserve Chairman Ben Bernanke as he tries to right the economy.

Bernanke and his central bank colleagues are faced with dueling problems: weak economic growth and advancing inflation. To treat one risks aggravating the other. So the Fed is widely expected when it meets Tuesday to leave a key interest rate alone.

"It is caught between a rock and a hard place. The (Fed) will stand pat," predicted Sung Won Sohn, an economics professor at California State University Channel Islands.

If Sohn and other economists prove correct, the Fed's rate will stay at 2 percent. And, in turn, the prime lending rate for millions of consumers and businesses would stay at 5 percent. The prime rate applies to certain credit cards, home equity lines of credit and other lines.

With inflation worries growing, the Fed in June halted a nearly yearlong string of rate reductions, one of its most aggressive campaigns to shore up the wobbly economy. Additional rate reductions would aggravate inflation, and some don't think additional cuts would provide much relief to the economy's biggest problems: the collapsed housing market and credit troubles.

President Bush recently signed into law Congress' housing rescue package. The plan would make it easier for thousands of people at risk of losing their home to refinance into a cheaper, government-backed mortgage.

The Fed, meanwhile, has taken a number of extraordinary steps to ease credit problems so that banks, investment houses and others will keep on lending. The free flow of credit is like oxygen to the economy. Without it, people

find it difficult to make big-ticket purchases like homes and cars and businesses are less inclined to expand and hire workers.

The unemployment rate zoomed to a four-year high of 5.7 percent in July as businesses hunkered down to ride out the slump. Nearly half a million jobs have disappeared so far this year. More losses are expected. The jobless rate could hit 6.5 percent by the middle of next year.

With employment deteriorating, a growing number of economists worry that people will clamp down on their spending, throwing the economy into a tailspin later this year. Hopes for a second-half rebound have largely fizzled.

The economy grew at a slower-than-expected 1.9 percent pace this spring despite some oomph from tax rebate checks. It shrank late last year.

Terry Connelly, dean of Golden Gate University's Ageno School of Business, described the condition of the economy as "moving from pneumonia to anemia." Because of that, the Fed can't afford to boost rates to fend off inflation concerns. That would slow things down even more. "It is not yet time to prescribe a sedative," he said.

Consumer prices in June rose at the second-fastest pace in a quarter century. Wholesale prices went up sharply, too.

However, energy prices have calmed down some in recent weeks, giving the Fed more leeway to hold rates steady. Oil prices closed at \$125.10 a barrel on Friday. That's down from a record high above \$147 a barrel reached last month.

Still, many expect the Fed at its meeting Tuesday to keep up its tough anti-inflation talk. That's aimed at controlling inflation expectations of consumers, investors and businesses. If those groups think prices will keep on rising, they'll act in ways that can make inflation worse.

With any luck, the Fed might be able to leave rates steady through most — if not all of — this year.

The Fed has signaled that its next move on rates is probably up — although the timing is far from clear.

Charles Plosser, president of the Federal Reserve Bank of Philadelphia, last month said the Fed probably will need to boost rates "sooner rather than later" even if employment and financial conditions haven't revived. He's among the Fed's members who has a reputation for being extra-vigilant about inflation dangers.

Another — Richard Fisher, president of the Federal Reserve Bank of Dallas — opposed the Fed's decision in June to leave rates unchanged. He preferred a rate increase then to fend off inflation.

Once inflation takes off, it can be difficult for the Fed to break. Inflation eats into paychecks, whittles away the values of investments and bites into corporate profits. Paul Volcker, Fed chairman in the 1980s, broke inflation's grip by raising interest rates to the highest levels since the Civil War. That approach, however, plunged the country into a painful recession in 1981-82.

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