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WEDNESDAY, JUNE 6, 2012 - 08:41

By *Brai Odion-Esene*

Fed's Lockhart: Consider More Ease If No Contd,Moderate Grwth

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FORT LAUDERDALE (MNI) - Atlanta Federal Reserve Bank President Dennis Lockhart Wednesday said the central bank should consider additional measures to support the recovery should it appear that the current pace of moderate growth "is no longer realistic."

For now current monetary policy "remains accommodative and supportive of the ongoing recovery," Lockhart said in remarks prepared for the Broward Workshop in Fort Lauderdale. He did caution, however, that "material risks" to the economic outlook are gathering.

Lockhart said his baseline forecast is for the recovery process to be "slow and drawn out," meaning the most reasonable expectation is moderate growth, a slow and possibly halting decline of unemployment, with inflation staying close to the FOMC's 2% target.

Economic indicators so far in 2012 have been underwhelming, Lockhart said -- describing the May employment report as "clearly a disappointment" -- and "there continues to be a halting and tenuous character to the recovery."

So what does this mean for monetary policy?

Lockhart, a voter on the Fed's policymaking Federal Open Market Committee this year, said that, "Should it become clear that something resembling my baseline scenario of continued, though modest, growth is no longer realistic, further monetary actions to support the recovery will certainly need to be considered."

"In addition, the situation we face requires that the FOMC maintain a state of readiness to respond to financial or economic instability should the need arise," Lockhart continued, adding that he is confident the FOMC has the capacity and tools to promote stability.

Lockhart warned that "material risks to the economic outlook are gathering, and highlighted Europe as a particular concern.

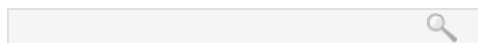
"I am giving more weight and higher probability to a negative influence on our economy coming from Europe than I did as recently as the last FOMC meeting in late April," he said.

Aside from the likely impact the recession in Europe would have on U.S. exports, Lockhart said the greater concern related to the financial system.

"Reduction of direct exposures within our domestic financial system can only go so far to insulate the U.S. economy from spillover in the event of financial sector instability in Europe, in my view," he said. "The global financial system is too integrated, too networked to expect that problems could be isolated to Europe."

Lockhart said another connected global risk is the apparent slowdown occurring in a number of large emerging economies -- notably China, India, and Brazil.

Noting that the United States' recent export strength is substantially related to strong economic performance in emerging market economies, he said a growth slowdown in emerging economies "would aggravate the effects of the European slowdown by further limiting the role of exports in the U.S. recovery."



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In addition, while the intensity of concern has receded somewhat, Lockhart said the risk of conflict related to Iranian nuclear proliferation in the Middle East has not gone away.

"Sudden developments would likely be felt in oil markets," he said.

But the downside risks are not just international.

Lockhart highlighted the housing sector as a headwind to the U.S. economy, and said it is also a risk in that "a large further drop in home values could undermine my outlook for the economy."

And with the threat of a large fiscal adjustment coming at the start of next year, Lockhart said while estimates of the seriousness of the so-called "fiscal cliff" vary, "most indicate that the immediate (that is, 2013) impact on the economy would be negative and large."

So the U.S. economy is in recovery but working against some strong headwinds was Lockhart's assessment, with an "uncertainty drag" on confidence and economic activity.

This uncertainty, he said, is holding back the hiring and capital plans of U.S. businesses.

Still, "the economy itself is in a better condition to withstand threats to stability than it was at the time of the financial crisis in 2008 and 2009," Lockhart said. "I still think it is prudent to acknowledge a degree of fragility, but in its fundamentals, the U.S. economy has made substantial progress toward resilience."

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