NATIONAL PRESS CLUB LUNCHEON WITH BEN BERNANKE

SUBJECT: BEN S. BERNANKE, THE CHAIRMAN OF THE FEDERAL RESERVE, WILL SPEAK AT A NATIONAL PRESS CLUB LUNCHEON TO DISCUSS CURRENT ECONOMIC CONDITIONS

MODERATOR: DONNA LEINWAND, PRESIDENT, NATIONAL PRESS CLUB

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DONNA LEINWAND: (Sounds gavel.) Good afternoon and welcome to the National Press Club. My name is Donna Leinwand, and I'm a reporter for *USA Today* and president of the National Press Club.

We're the world's leading professional organization for journalists. And on behalf of our 3,500 members worldwide, I'd like to welcome our speaker and our guests in the audience today. I'd also like to welcome those who are watching on C-Span.

We're celebrating our 100th anniversary this year, and we've rededicated ourselves to a commitment to the future of journalism through informative programming, journalism education, and fostering a free press worldwide. For more information about the Press Club, please visit our website at www.press.org.

We're looking forward to today's speech, and afterwards, I will ask as many questions from the audience as time permits. Please hold your applause during the speech so that we have time for as many questions as posse.

For our broadcast audience, I'd like to explain that if you hear applause, it may be from the guests and members of the general public who attend our luncheons, and not necessarily from the working press.

I'd now like to introduce our head table guests and ask them to stand briefly when their names are called. From you're right Greg Robb of Marketwatch; Craig Torres of Bloomberg; Lisa Zagaroli of McClatchy Newspapers; Darren Gersh of the Nightly Business Report; Marilyn Geewax of National Public Radio; Michelle Smith, spokeswoman for the Federal Reserve board of governors and a guest of our speaker.

Skipping over the podium, Angela Greiling-Keane, chair of the Speakers Committee and a reporter for Bloomberg News; skipping over our speaker for now, Alison Fitzgerald, Bloomberg News and Speakers Committee member who organized today's event. Thank you very much, Alison. Donald Kohn, vice chairman, Federal Reserve board of governors and a guest of our speaker; Steve Beckner, Market News International; and Linda Streitfeld, National Press Foundation. (Applause.)

For eighteen months, our guest today has been at the center of the biggest financial crisis and economic downturn since the Great Depression. He's also been at the center of U.S. efforts to ease the credit crunch, stabilize the U.S. banking system, and restart U.S. economic growth.

Since Ben Bernanke became chairman of the Federal Reserve two years ago, the S&P Index has declined 35%. (Laughter.) Unemployment rose to 7.6%, the highest rate since 1992, and the economy has sunk into a deep recession. Some economists say Bernanke, who taught himself calculus as a young man, and become a scholar of the Great Depression in graduate school is the right man to lead the U.S. out of the economic meltdown.

He's certainly taken some unorthodox steps. Under Bernanke's leadership, the Fed invoked emergency powers to stabilize financial institutions and help get credit flowing. The Fed has introduced several new lending programs giving investment banks and companies access to Fed credit previously available only to traditional banks. In December, for the first time ever, the interest rate-setting Federal Open Market Committee moved the benchmark interest rate to zero.

Critics worry he's left himself without any tools to right the economy as companies continue to shed jobs and more homes are lost to foreclosure. In fact, *The Wall Street Journal* this week reported that Bernanke's own childhood home was sold at auction after foreclosure.

Bernanke, who grew up in Dillon, South Carolina, was appointed as the Fed chair by former President George W. Bush in February, 2006, for a four-year term ending January 31, 2010. Before that, he chaired the President's Council of Economic Advisors and served as governor of the Federal Reserve Board. He was previously chairman of the economics department at Princeton University. Please join me in welcoming Federal Reserve chairman, Ben Bernanke to the National Press Club. (Applause.)

BEN BERNANKE: Thank you very much. I've actually been chairman for three years, and so those statistics are not quite as good as you made them out to be. (Laughter.) I'm very pleased to be here at the National Press Club and to talk to the working press. I have contacts with many of you. I hope that we can continue good, close relationships.

As you know, we live in extraordinarily challenging times for the global economy and for economic policymakers, not least for central banks. As you know, the recent economic statistics have been dismal with many economies, including ours, having fallen into recession. And behind those statistics, you must never forget, are millions of people struggling with lost jobs, lost homes, and lost confidence in their economic future.

As was already noted in examples that resonate with me personally, the unemployment rate in the small town in South Carolina where I grew up has risen to 14%. And I learned the other day that what had once been my family home has been recently put through foreclosure.

Traditionally the most conservative of institutions, central banks around the world have responded to this crisis with force and innovation. In The United States, the Federal Reserve has done and will continue to do everything possible within the limits of our authority to assist in restoring our nation to financial stability and economic prosperity as quickly as possible.

Policy innovation has become necessary, because conventional monetary policies, which focused on influencing short-term interest rates, have proven insufficient to overcome the effects of the financial crisis on credit conditions and on the broader economy. To further ease financial conditions, beyond what can be attained by reducing the short-term interest rate, the Federal Reserve has taken additional steps to improve the functioning of credit markets and to increase the supply of credit to households and businesses, a policy strategy that I have called credit easing.

In the first portion of my remarks, I will briefly outline the three principle approaches to easing credit that we have undertaken, over and above cutting the short-term interest rate. And I'll assess their effectiveness to-date.

Each of these policies involves the provision of credit or the purchase of debt securities by the Federal Reserve, which collectively have resulted in a substantial expansion of the Federal Reserve's balance sheet. The second portion of my remarks addresses some issues raised by those changes in the size of the Fed's balance sheet. In particular, I will discuss how the size of the balance sheet affects the ability of the Federal Open Market Committee, the body that sets monetary policy, to foster maximum sustainable employment and price stability, as well as the steps that have been taken to manage our balance sheet appropriately.

Finally, the expansion of the Federal Reserve's balance sheet has raised some concerns and led to some misconceptions about the credit risk being taken by the Fed. I will address the issue of credit risk today. And I would also like to talk about some steps that the Fed is taking to improve the transparency of our programs, consistent with our obligations in a democracy.

The Federal Reserve has responded forcefully to the crisis since its emergence in the summer of 2007. The FOMC began to ease monetary policy in September, 2007, reducing the target for the Federal funds rate, its policy instrument, by 50 basis points or one-half percentage point. As indications of economic weakness proliferated, the Committee continued to respond, bringing down its target for the Federal funds rate by a cumulative 325 basis points by the Spring of 2008. In historical comparison, this policy stands out as exceptionally rapid and proactive.

Monetary easing helps support employment and incomes during the first year of the crisis. Unfortunately, the intensification of financial turbulence last Fall led to further significant deterioration in the economic outlook. The Committee responded by cutting the target for the Federal funds rate an additional hundred basis points in October with half of that reduction coming as part of an unprecedented coordinated interest rate reduction by six major central banks on October the eighth.

In December, the Committee reduced its target further, setting a range of zero to 25 basis points for the target Federal funds rate. The Fed's monetary easing has been reflected in significant declines in a number of lending rates, especially shorter-term rates, thus offsetting to some degree the effects of the financial turmoil on the cost of credit.

However, that offset has been incomplete as widening credit spreads, more restrictive lending standards, and credit market dysfunction have worked against the monetary easing and led to tighter financial conditions overall. Thus, in addition to easing monetary policy, the Federal Reserve has made use of a range of additional tools to ease credit conditions and support the broader economy.

The additional components in the Fed's toolkit can be divided into three sets. The first set is closely tied to the central bank's traditional role, a provider of short-term liquidity to sound financial institutions. Over the course of the crisis, the Fed has taken a number of extraordinary actions to ensure that financial institutions have adequate access to short-term credit.

In fulfilling its traditional lending function, the Federal Reserve enhances the stability of our financial system, increases the willingness of financial institutions to extend credit, and helps to ease conditions in interbank lending markets, thereby reducing the overall cost of capital to banks.

In addition, some interest rates, including the rates on some adjustable rate mortgages, are tied contractually to key interbank rates such as the London Interbank Offered Rate, often known as LIBOR. To the extent that the provision of ample liquidity to banks reduces LIBOR, other borrowers will also see their payments decline.

Because interbank markets are global in scope, the Federal Reserve has also approved temporary bilateral liquidity agreements with 14 foreign central banks. These so-called currency swap facilities have allowed these central banks to acquire dollars from the Federal Reserve that they may then lend to financial institutions in their own jurisdictions. The purpose of these swaps is to ease conditions in dollar funding markets globally. Improvements in global interbank markets, in turn, promote greater stability in other markets such as money markets and foreign exchange markets.

Although the provision of ample liquidity by the central bank to financial institutions is a time-tested approach to reducing financial strains, it is no panacea. Today, concerns about capital, asset quality, and credit risk continue to limit the willingness of many intermediaries to extend credit, notwithstanding the access of these banks and other firms to central bank liquidity. Moreover, lending to financial institutions does not directly address instability or declining liquidity in critical non-bank credit markets such as the commercial paper market or the market for asset-backed securities, which, under normal circumstances, are major sources of credit for U.S. households and businesses.

To address these issues, the Federal Reserve has developed a second set of policy tools which involve the provision of liquidity directly to borrowers and investors in key credit markets. Notably, we have introduced facilities to purchase highly rated commercial paper at a term of three months and to provide backup liquidity for money market mutual funds. The purpose of these facilities is to serve, once again in classic central bank fashion, as backstop liquidity provider, in these cases, to institutions and markets that were destabilized by the rapid withdrawal of funds by short-term creditors and investors.

In addition, the Federal Reserve and the Treasury have jointly announced a facility, expected to be operational shortly, that will lend against triple-A rated asset-backed securities collateralized by recently originated student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Administration.

Last week, in conjunction with the Treasury, we announced that we were prepared to significantly expand this facility known as the Term Asset-Backed Securities Loan Facility or TALF, to encompass other types of newly issued triple-A asset-backed securities such as commercial mortgage-backed securities and private label mortgage-backed securities as well. If this program works as planned, it should lead to lower rates and greater availability of consumer, business, and mortgage credit.

The Federal Reserve's third set of tools for supporting the functioning of credit markets involves the purchase of longer term securities for the Fed's portfolio. For example, we are purchasing up to $100 billion dollars in the debt of government-sponsored enterprises, and up to $500 billion dollars in mortgage-backed securities guaranteed by Federal agencies by mid-year.

The Federal Reserve is engaged in continuous assessment of the effectiveness of its credit-related tools, and we have generally been encouraged by the market responses. Our lending to financial institutions has helped to relax the severe liquidity strains experienced by many firms, and has been associated with improvements in the interbank lending markets. For example, we believe the liquidity provision by the Fed and other central banks is the principle reason that liquidity pressures around the end of the year, often a period of heightened liquidity strains, were relatively modest. LIBOR has fallen sharply as well.

Our commercial paper facility has helped to stabilize that market, lowering rates significantly and allowing high quality firms access to financing at longer terms than a few days. And together with other government programs, our actions to stability the money market mutual fund industry have also shown some success as the sharp withdrawals from funds seen in September have given way to modest inflows.

And rates on 30-year conforming fixed rate mortgages have fallen nearly one percentage point since we announced the program to purchase GSE-related securities. Thus, taken together, these policies appear to give the Federal Reserve some scope to effect credit conditions and economic performance, notwithstanding the fact that the conventional tool of monetary policy, the Federal funds rate, is now about as low as it can go.

The various credit-related policies I've described have implications to the Federal Reserve's balance sheet. In the remainder of my remarks, I will discuss these implications as well as some related issues. The three sets of policy tools I focused on today — lending to financial institutions, providing liquidity directly to key credit markets, and buying longer-term securities — each represents a use of the asset side of the Fed's balance sheet. Specifically, loans that the Fed extends, either to financial institutions through the discount window and related facilities, or to our other borrowers and programs like our commercial paper facility, are recorded as assets on our balance sheet, as are securities acquired in the open market such as GSE securities as the ones we're purchasing.

The Fed's assets also include about $500 billion dollars of Treasury securities, and about five percent of our balance sheet or $100 billion dollars, consists of assets we acquired in the government interventions to prevent the failures of Bear Stearns and AIG.

I won't say much about those interventions today except to note that the failure of those companies would have posed enormous risks to the stability of our financial system and our economy. Because The United States has no well specified set of rules for dealing with the potential failure of a systemically critical non-depository financial institution, we believe that the best of the bad options available was to work closely with the Treasury to take the actions that we did to avoid those collapses.

The liability side of the Federal Reserve's balance sheet is relatively simple, consisting primarily of currency issuance that are reserve notes and reserves held by the banking system on deposit with the Federal Reserve.

The various credit-related policies I've described today all act to increase the size of both the asset and liability sides of the Federal Reserve's balance sheet. For example, the purchase of a billion dollars in GSE securities, paid for by crediting the account of the seller's bank at the Federal Reserve, increases the Fed's balance sheet by $1 billion dollars with the acquired securities appearing as an asset and the seller's bank deposit at the Fed being the offsetting liability. The quantitative impact of our credit actions on the balance sheet has been large. Its size has nearly doubled over the past year to just under $2 trillion dollars.

Some observers have expressed a concern that by expanding its balance sheet, the Federal Reserve will ultimately stoke inflation. The Fed's lending activities have indeed resulted in a large increase in the reserves held by banks, and thus, in the narrowest definition of the money supply, the monetary base.

However, banks are choosing to leave the great bulk of their excess reserves idle, in most cases on deposit with the Fed. Consequently, the rates of growth of broader monetary aggregates such as M1 and M2 have been much slower than that of the monetary base.

At this point, with global economic activity weak and commodity prices at low levels, we see little risk of unacceptably high inflation in the near-term. And indeed, we expect inflation to be quite low for some time.

However at some point, with(?) credit markets and the economy do begin to recover, the Federal Reserve will have to moderate growth in the money supply and begin to raise the federal funds rate. To reduce policy accommodation, the Fed will have to unwind some of its credit easing programs, and thus allow the balance sheet to shrink.

To some extent, this unwinding will happen automatically as improvements in credit markets should reduce the need to use said facilities. Indeed, where possible, we have tried to set lending rates and other terms at levels that are likely to be increasingly unattractive to borrowers as financial conditions normalize. In addition, some programs, those authorized under the Federal Reserve's so-called 13-3 authority, which requires a finding that conditions in financial markets are, "unusual and exigent" will, by law, have to be phased out once credit market conditions substantially normalize.

However, the principle factor determining the timing and pace of the process will be the Federal Reserve's assessment of the condition of credit markets and the prospects for the economy. A significant shrinking of the balance sheet can be accomplished relatively quickly, as a substantial portion of the assets that the Federal Reserve holds, including loans to financial institutions, temporary central bank liquidity swaps, and purchases of commercial paper, are short-term in nature and can simply be allowed to run off as the various programs and the facilities are shut down or scaled back. As the size of the balance sheet and the quantity of excess reserves in the system declines, the Federal Reserve will be able to return to its traditional means of making monetary policy, namely by setting a target for the Federal funds rate.

Importantly, the management of the Federal Reserve's balance sheet and the conduct of monetary policy in the future will be made easier by the recent congressional action to give the Fed authority to pay interest on bank reserves. Because banks should be unwilling to lend reserves at a rate lower than what they can receive from the Fed, the interest rate the Fed pays on bank reserves should help to set a floor on the overnight interest rate. Moreover, other tools are available or can be developed to improve control of the Federal funds rate during the necessary exit stage.

For example, the Treasury could resume its recent practice of issuing supplementary financing bills and placing the funds with the Federal Reserve. The issuance of these bills effectively drains reserves from the banking system, thereby improving monetary control. As we consider new programs or the expansion of old ones, the Federal Reserve will carefully weigh the implications for our exit strategy. And we will take all necessary actions to ensure that the unwinding of our programs is accomplished in a smooth and timely way and consistent with meeting our obligation to foster maximum employment and price stability and make monetary policy as appropriate for the economy.

Two other frequently asked questions about the Federal Reserve's balance sheet are, first, how much credit risk is the Fed taking in all these lending activities? And second, is the Fed informing the public adequately about these activities? To address the first question, for the great bulk of Fed lending, the credit risks are extremely low. The provision of short-term credit to financial institutions, our traditional function, exposes the Federal Reserve to minimal credit risk as the loans we make to financial institutions are generally short-term, over-collateralized, and made with recourse to the borrowing firm.

In the case of the liquidity swaps, the foreign central banks are responsible for repaying the Federal Reserve, not the financial institutions that ultimately receive the funds. And the Fed receives an equivalent amount of foreign currency in exchange for the dollars it provides to foreign central banks. The Treasury stands behind the debt and securities issued by the GSEs.

Our special lending programs have also been set up to minimize our credit risk. The largest program, the commercial paper funding facility, accepts only the most highly rated paper. It also charges borrowers a premium which is set aside against possible losses. And the TALF, the facility that I mentioned that will lend against securities backed by consumer and small business loans, is a joint Federal Reserve-Treasury program. And capital provided by the Treasury will help to insulate the Federal Reserve from credit losses.

The transactions we undertook to prevent the systemically destabilizing failures of Bear Stearns and AIG, which, as I noted, make up about five percent of our balance sheet, do carry more risk than our traditional activities. But we intend over time to sell the assets acquired in those transactions in a way that maximizes the return to taxpayers. And we expect to recover the credit that we have extended. Moreover, in assessing the financial risks of those transactions, once again, one must consider the very grave risks our nation would have incurred had public policymakers not acted in those instances.

And finally, I should remind you that all the Federal Reserve's assets pay interest. And the expansion of our balance sheet thereby implies increased interest income, income that will accrue to the benefit of the Federal budget. From the point of view of the Federal government, the Federal Reserve's activities do not imply greater expenditure or indebtedness. To the contrary — the Federal Reserve's interest earnings have always been and will continue to be a significant source of income for the Treasury.

On the second question of transparency, I firmly believe that central banks should provide as much information as possible, both for reasons of democratic accountability and because many of our policies are likely to be more effective if they are well understood by markets and by the public.

During my time at the Federal Reserve, the FOMC has taken important steps to increase the transparency of monetary policy, such as moving up the publication of the minutes of the policy meetings and adopting the practice of providing projections of the evolution of the economy at longer horizons, and four times per year rather than twice. Later today, with the release of the minutes of the most recent FOMC meeting, we'll be making an additional significant enhancement in Federal Reserve communications. To supplement the current economic projections by governors and reserve bank presidents for the next three years, we will also publish their projections of the longer-term values at a horizon, for example, of five to six years, of output growth, unemployment and inflation under the assumptions of appropriate monetary policy and the absence of new shocks to the economy.

These longer-term projections will inform the public of committee participants' estimates of the rate of growth of output and the unemployment rate that appear to be sustainable in the long-run in The United States, taking into account the important influences such as the trend growth rates of productivity in the labor force, improvement in worker education and skills, the efficiency of the labor market at matching workers and jobs, government policies affecting technological development or the labor market, and other factors.

The longer-term projections of inflation which will be disclosed today may be interpreted in turn as the rate of inflation that FOMC participants see as most consistent with the dual mandate given to it by the Congress, that is, the rate of inflation that promotes maximum sustainable employment while also delivering reasonable price stability. This further extension of the quarterly projections should provide the public a clearer picture of FOMC participants' policy strategy for promoting maximum employment and price stability over time. Also, increased clarity about the FOMC's views regarding longer-term inflation should help to better stabilize the public's inflation expectations, thus contributing to keeping actual inflation from rising too high or falling too low.

Likewise, the Federal Reserve's committed to keeping the Congress and the public informed about its lending programs and its balance sheet. For example, we continue to add to the information shown in the Fed's H-41 statistical release which provides weekly detail on the balance sheet and the amounts outstanding for each of the Federal Reserve's lending facilities. Extensive additional information about each of the Federal Reserve's lending programs is available online. The Fed also provides five monthly reports to the Congress on each of its programs that rely on the section 13-3 authorities. Generally, our disclosure policies are consistent with the current best practices of major central banks around the world.

In addition, the Federal Reserve's internal controls and management practices are closely monitored by an independent inspector general, outside private sector auditors, and internal management and operations divisions, and through periodic reviews by the government accountability office.

All that said, recent developments have understandably led to a substantial increase in the public's interest in the Fed's balance sheet and its programs. And so for this reason, we at the Fed have begun a thorough review of our disclosure policies and the effectiveness of our communication. Today, I would like to mention two initiatives.

First, to improve public access to information concerning Fed policies and programs, in coming days, we will unveil a new website that will bring together in a systematic and comprehensive way the full range of information that the Federal Reserve already makes available, supplemented by explanations, discussions, and analysis.

Second, and my request, board vice chairman, Donald Kohn, sitting a couple seats to my right, is leading a committee that will review our current publications and disclosure policies relating to the Federal Reserve's balance sheet and lending policies. The presumption of that committee will be that the public has a right to know, and that the nondisclosure of information must be affirmatively justified by clearly articulated criteria for confidentiality, based on factors such as reasonable claims to privacy, the confidentiality of supervisory information, and the need to ensure the effectiveness of policy.

Extraordinary times call for extraordinary measures. Responding to the very difficult financial and economic challenges that we face, the Federal Reserve has gone beyond traditional monetary policymaking to develop new tools to address the dysfunctions in the nation's credit markets. We have done so in a responsible way. The credit risk associated with our non-traditional policies is exceptionally low. And by carefully monitoring our balance sheet and developing tools to ...(inaudible) bank reserves when needed, we will ensure that policy accommodation can be reversed at the appropriate time to avoid any risks of future inflation.

We provide a great deal of information about our lending programs and our balance sheet to Congress and the public. But as I've discussed today, we will do more on this front, both expanding the information we provide and improving how we communicate that information. Increased transparency is the best way to demonstrate that the Federal Reserve's non-traditional policies are well-conceived, well-managed, and produce substantial public benefit. Thank you very much. (Applause.)

MS. LEINWAND: Okay, you mentioned that some of the bailouts of the corporations, the financial corporations were necessary to avoid larger crisis in the future. Was the decision to let Lehman Brothers fail a mistake? And why or why not?

MR. BERNANKE: Well, the word 'mistake' implies a choice or an option. We were determined to do everything we possibly could to prevent the failure of Lehman Brothers. Because I have said from the very beginning of this crisis that it is essential not to let large systemically critical institutions fail. And at the beginning when we helped Bear Stearns become acquired by JP Morgan, Congress and many others said, "Oh, let them fail. The market will take care of it. It's good for discipline."

And I think we knew better than that. And when time came to deal with Lehman Brothers-- And it was a critical week. We had Lehman. We had AIG. We had many other firms under tremendous pressure. We made every possible effort. We sent the Secretary of the Treasury, the head of the SEC and the Federal Reserve Bank of New York president in session in New York Fed, together with the heads of all the major financial firms in the city. And they worked through the weekend, trying to find a solution.

Unfortunately, the situation was neither like Bear Stearns, nor AIG. In the case of Bear Stearns, we had an acquirer. We had somebody willing to buy the firm. In the case of Lehman, we had some interest. Couple of firms said, "We're looking very carefully." And we had hoped that they would consummate the deal. But in the end, no buyer was available. No buyer was willing or able to make the deal.

In the case of AIG, we had a financial products sector that had lost lots of money, but was attached to a huge financial firm, specifically the largest insurance company in the world, that had enormous amounts of assets against which we could lend on a collateralized basis to provide the money needed to keep AIG going and to avoid what would have been a calamitous collapse of that firm.

In the case of Lehman Brothers, there was a need for substantial capital. There was a big hole. And this was before the Congress had passed the TARP legislation, before there was any authority for the Treasury to put capital into the firm. The Federal Reserve's only allowed to lend against well secured collateral. There was simply no way. At no time during the weekend did anyone ever come to me and say, "Here's a plan. Here's something that might work." We had all been quite used to be being very aggressive in these situations. There was never anything closely remote as far as I'm aware to a proposal or a proposition that would have allowed us to address it.

The only small silver lining from all this I think is that it put to bed this notion that people had, was that, you know, "We should let 'em fail." I think we need to have a commitment to maintaining the security of systemically critical institutions, that we need to address this issue now. And as we go forward, though, we need to also address the question of, too big to fail, which is a major problem. And we need to find ways that we don't get put in the situation in the future.

One way we can do that is to have a resolution regime that allows the government to come in and deal with, in a systematic way, a non-bank financial firm that is systemically critical. We did not have that for the non-banks like Lehman and Bear Stearns and AIG. And we were forced to improvise. But again, I very much regret the failure of Lehman. We worked very hard to try to avoid it. And the consequences, I think, certainly while there were many factors that led to the intensification of the financial crisis in September and the slowing of the economy, clearly that was part of the shock.

MS. LEINWAND: Is the President's economic stimulus a good idea? What would you have liked to see in the bill?

MR. BERNANKE: Isn't that a moot point at this juncture? Well, last October, I did testify before the budget committee. I did indicate at that point, I already saw that the economy was slowing significantly, and the Federal Reserve's capacity to continue to cut interest rates was obviously limited. And so at that time, I said that I thought it was appropriate for Congress to consider a fiscal stimulus. I do think it was appropriate and I do think some fiscal action is necessary.

I'm not really in a position to talk about individual components or to talk about the size of it. I think those are decisions that are left to the Administration and Congress. They've made a lot of tradeoffs. They've made a lot of tough decisions. I will say one thing though, which is this. That I view this whole process as being a two-legged approach. There's two parts to recovery. The first is fiscal or monetary stimulus that will get the economy moving and provide some impetus. But the second is, we have to continue these efforts. And consistent, for example, with Treasury Secretary Geithner's announcements last week, we must continue the efforts to stabilize the banking system and the financial system.

If we do not stabilize the financial system, the fiscal policy will not lead to a sustained recovery. Both of these parts are essential. And I just want to stress that we cannot do the fiscal part and not do the financial part and hope to have success.

MS. LEINWAND: The stimulus was proposed to have a provision that would have provided across the board refinancing of homes at four percent, providing immediate relief for millions. What happened to it?

MR. BERNANKE: That's an Administration question. I don't know the internal discussions on that. There have been today, as you know, I think just recently, the announcements made of the government's proposals, the Administration's proposals for mortgage relief. Included among that is something that has a similar effect, which is an opportunity for borrowers who are under water, and therefore normally could not refinance, nevertheless to refinance and get a lower interest rate.

I would also say that the Federal Reserve took a big step in that direction by our GSE purchase program, which, as I said, seems to have lowered mortgage rates on the order of one percentage point. And we expect to continue to do that. We've committed to doing $600 billion dollars of purchases including MBS and debt by the middle of the year. So we have done our part to lower mortgage rates. But we're going to need to see, not only lower mortgage rates, but more confidence in the economy before people will go out and start to buy houses in large numbers.

MS. LEINWAND: The way to get out of the financial downturn seems to be to spend. Yet spending is largely what got us into trouble in the first place. How do you address that conundrum?

MR. BERNANKE: Well, this paradox arises in lots of contexts. For example, Keynes talked about the paradox of thrift, the notion that when we all try to save more, because of the effects on aggregate demand in weakening the economy, we may end up not saving more at all.

The answer is that we do need to save more in the long-run. We do need to improve our balance sheets. We do need to take less risk. We do need to borrow less. But we need to get from where we were to that point in a less, you know, damaging way. And so the purpose of policy is not to put us back to 2005. Absolutely not. The purpose of policy is to prevent a deep and severe recession, and allow us to make the transition to consumption, savings, and borrowing rates which are consistent with our long-term income prospects.

So it's not inconsistent. Banks have to de-leverage. Households have to de-leverage. We have to repair our balance sheets. We have to improve our savings. But if that all happens too quickly and there's no offsetting form of spending from some other source, what you'll get is this very sharp decline in the economy and limited progress towards the goals of saving and wealth accumulation that people are looking for.

Somebody once called this the Augustinian principle, which says something, like, let me be moral, but not quite yet, let me be a big saver, and so on. But in the short-run, we need, as a country, to provide enough spending and enough support to avoid a more serious decline in the economy.

MS. LEINWAND: What can be done to provide relief to credit card holders? Isn't there something very wrong when banks can borrow at the Fed's window at less than one percent, but are charging credit card holders rates as high as 29%?

MR. BERNANKE: Well, what I can say about-- I can say about two things that the Fed is doing and has done for credit card holders. The first is that we have done just recently the most comprehensive and dramatic reworking of credit card disclosures and credit card rules in history. We both have completely reworked the monthly statement that you get, all of the opening accounts information, all the disclosures in a way that makes the penalties that are paid, the fees, much more transparent to the borrower so they can understand what they're paying, and that they can see every month exactly what their credit card is costing them.

We did that, by the way, something governments aren't usually good at. We did consumer testing. We went out and we did our disclosures. We took them to consumers in malls and we said, you know, "Do you understand this?" And we gave them little tests. And if things didn't work, we went back, tore it up, and tried again. And so our disclosures, which are intended to help people understand and manage their credit card accounts are consumer tested and should therefore be more effective.

In addition, we took a number of steps to ban a whole range of practices we called unfair and deceptive, including double-cycle billing, retroactive interest rate increases, and a whole range of practices that people consider to be and we consider to be unfair and deceptive. So we've taken very, very strong steps on the credit card regulation disclosure side.

In terms of credit availability, as I mentioned, we have set up this TALF, this Term Asset-Backed Security Loan Facility, which is intended to try to increase the availability of credit to households and businesses. Credit cards are financed typically by securitizations, which means that banks take the credit card receivables, fold them into a so-called asset-backed security, and then sell it to Wall Street. Now, these securitization markets have very substantially shut down during the crisis, which means that credit card credit is available only at high cost and at very tight terms.

This program we're starting and should start really any day now will provide a way for banks to get cheaper financing for their credit card credit, and competition will make them pass it on to give better availability and lower rates to consumers. So we are doing everything we can do at the Fed to try to expand the availability of credit, both to consumers, but also to small businesses who are also included, and students. Student loans are also included in this program.

MS. LEINWAND: Speaking of small businesses, credit markets for the small business sector are severely impaired. What can small businesses look forward to in the months ahead?

MR. BERNANKE: Well, downturns are very hard for small business, because small businesses have less reliable financing, and they have less reserves. And when times get tough, small businesses take it-- suffer more typically than large businesses. And no doubt, this recession is no different.

We can try at the Fed to help small businesses really in two ways, again. One, again, because the small businesses are so sensitive to the business cycle, the downturns, our extraordinary efforts to try to get the economy and the credit markets moving again, one of the main beneficiaries will be small businesses who see demand picking up, who see the economy stabilizing, who see consumers more confident. And that allows them to find profitable activities again.

So the general economic policies are, I think, really the bedrock of what we're trying to do. The other though is, again, we're doing our best to improve credit extension to small businesses. This program, which I mentioned, will take at a very low collateral rate, a very low margin, will take Small Business Administration loans, thereby funnel cash into the Small Business Administration's lending programs. This is not a Fed thing, but I understand the Administration is also proposing that the SBA increase its activity, increase its guarantees. That's a very important direction in order to allow credit to flow into this critical sector.

MS. LEINWAND: Should the U.S. and possibly the states be offering more bonds for investors who are skittish about the stock market to raise needed funds for the Federal stimulus package and to cover state budget deficits?

MR. BERNANKE: Well, there's no-- any shortage of state and local bond issuances because, as you know, another sector which has been very badly hit by the downturn is the states and localities. The decline in economic activity, the decline in housing values has hurt their tax bases. And so we see that California is fighting over a $42 billion dollar deficit in their state budget.

So we would expect to see quite a bit of issuance of municipal bonds and state/local bonds going forward. You know, it's hopefully that the actions that some of the money in the stimulus bill, which is directed towards states and localities, will provide some assistance there. But clearly, there's going to be an upsurge in borrowing and also a decline in spending at the state and local level.

We have not directly tried to address at the Fed, the state and local funding situation, in part because it seems more natural for the Federal government to be involved in that, and also because we have legal restrictions on our ability to lend to states and localities. But that being said, the work we've been doing generally on short-term money markets, the commercial paper market, the interbank market, and so on, seems to be reflected, at least some improvement, we've seen in last few months, in the state and local bond markets. And so we believe that if we continue our efforts to ease credit in broad range of markets, that the state and local markets will-- bond markets will benefit as well.

MS. LEINWAND: Why did you wait until after Congress passed the TARP before announcing your plans to begin buying commercial paper from non-financial corporations?

MR. BERNANKE: Well, look at the calendar. The financial crisis intensified in mid-September and got worse to the point where there was a huge global financial crisis in early October. During that interim, Congress passed the Emergency Economic Stabilization Act, which includes the TARP. And that TARP, the money there was very useful in helping to stabilize the banking system in early October. There was this critical moment. I think it was about the 14th of October, following a G7 meeting here in Washington, where not The United States but countries around the world took very strong actions in terms of capital, in terms of guarantees and other actions to try to stabilize the world banking system.

It was during this period that the commercial paper market and the money markets, money market mutual funds showed the worst stress. It was in those weeks that that stress appeared and those markets began to dysfunction. And we can't set these programs up immediately. It takes a bit of time to get them structured legally and to arrange for the market terms and to work with market participants and so on. But we got it going actually quite quickly. It's been now more than three months since the commercial paper facility has been functioning. And it seems to have had notable impact on both commercial paper rates and on the terms of finance available.

MS. LEINWAND: Given today's report that bank lending actually decreased after receiving TARP money, what do you think of adopting the Barron's Plan that suggests providing $200 billion dollars for the bank provided they write down all subprime mortgages by 25%?

MR. BERNANKE: Well, I think that would require a write-*up*. Subprime mortgages are already written down by much more than 25%. So I'm not quite sure I understand the suggestion. I will say that the Treasury plan that Secretary Geithner announced last week has, as a very basic component, a review of all the assets and liabilities of the major banks to try to assess, not only what is their true position, but how would they do under a more stressful scenario in which the economy does worse even than we expect it to do.

And the purpose of that exercise is to try to determine how much capital, how much other measures are needed to ensure that the banking system will be robust in the face of very difficult economic conditions. So the Treasury's plan, which has a number of important components, will be an attempt to try to stabilize the banks. And I would just reiterate what I said before, that if we don't stabilize the banking system and get the credit markets moving again, that the other programs we're doing are not going to be sufficient.

MS. LEINWAND: Do you agree with Alan Greenspan that banks may need to be nationalized?

MR. BERNANKE: Well I think as a general rule, it's very challenging for governments to manage banks for a protracted period. And there's the additional problem that if you have government-run institution, that you tend to lose the franchise value, that the counterparties and others don't want to deal with you because they don't know your future. So I think whatever actions may need to be taken at one point or another, I think there's a very strong commitment on the part of the Administration to try to return banks or keep banks private or return them to private hands as quickly as possible.

MS. LEINWAND: Could you tell us a little more about the stress tests? What are some of the conditions that would have to exist to trigger more Federal involvement or a takeover, or for a bank to be allowed to fail?

MR. BERNANKE: Well, I need to leave the details to Secretary Geithner and the Administration. The Federal Reserve is consulting on all these things. We've been working closely with the Treasury. But obviously the details and the decisions are the Treasury's to make.

But clearly what we want to do is assure ourselves that under stressed conditions, conditions worse than the current conditions, that banks have adequate capital, adequate financing to, not only be stable, but also to lend and contribute to economic recovery. And so this first stage, the analysis of the stress test, is kind of a diagnostic stage to figure out, you know, what's needed. And then the various other components, the capital program, the asset purchase program, the foreclosure mitigation, all those things, are part of the overall program to try to make sure that whatever that hole is, will be somehow filled and taken care of.

MS. LEINWAND: Bank of America chief, Ken Lewis, said he met with you in December to express concern about Merrill-Lynch's rising losses. What kind of leverage did you use to convince him to complete the acquisition of such a money-losing operation?

MR. BERNANKE: When the CEO of Bank of America came and told us about the situation, they were just a very short time, days or couple of weeks away from consummating the deal. The deal had already been voted by the shareholders. Essentially at that point, they were legally committed. We did not see any legal, realistic legal way to break the deal. And moreover, we felt that-- And I speak now as a supervisor of the bank, in consultation with other supervisors, including the OCC, the Richmond Fed, and others. We felt very strongly that an attempt to break that deal would have redounded very negatively on the bank, because of the uncertainly it would have created, because of the concerns it would have raised.

So it was our judgment, not withstanding pluses or minuses from a systemic perspective, it was our judgment that there really was no option at that point but to consummate the deal. I guess I think I should emphasize of course that the deal was consummated freely by the two companies in September and had gone through all the due diligence and all the valuations and the shareholder vote and everything else. And so I think that the two companies had adequate time to do due diligence and to clarify whatever issues remained between them.

MS. LEINWAND: Companies have been cutting jobs by the tens of thousands. How high do you foresee unemployment rising?

MR. BERNANKE: Well, we have different scenarios. You know, it's currently already in the mid-sevens. And so it's very likely to go, you know, above eight for sure. But we have different scenarios. And I guess I'd hesitate to say a number, because it might sound like a single forecast. I think it depends critically on policy. It depends critically on policy, both the fiscal and other actions, but also the financial actions that I've talked about. If we can take strong and aggressive action, including the Fed's actions to try to improve credit markets, I think we can break the back of this thing and that we will begin to see improvements in 2009.

If we fail to take adequate actions, the situation would continue to deteriorate. And then unemployment would obviously be higher in that case.

MS. LEINWAND: China increasingly holds U.S. Treasury notes. Do you think this trend will continue? Is this good for the U.S.? And are you concerned about a decline in bond buying by China?

MR. BERNANKE: Well, the purchases of Treasury securities remain very strong. We see continuing inflows into The United States to purchase those securities. The yields are quite low. So at the moment, the demand for the liquidity and the safety of U.S. Treasury securities remains quite strong.

That being said, and related to the question that was raised before about near-term risk versus longer-term, obviously in the near-term, we have large deficits. We're going to have to do a lot of borrowing. So it's very important to maintain the confidence of foreign investors and domestic investors in U.S. treasuries, that we do develop a credible plan for restoring fiscal balance in the medium-term, after this crisis is addressed. And I think that's a very important part of the plan. We don't want to look just at the next year. We want to look at the next five years and try to figure out, you know, once we have stopped the bleeding in this case, how are we going to return to more normal operations with a more stable Federal budget?

MS. LEINWAND: What will be the role of the rest of the world in providing financing for these borrowing needs? What will be the consequences for capital flight and downward exchange rate pressures in the rest of the world?

MR. BERNANKE: I'm not sure I got that one.

MS. LEINWAND: Yeah, I'm not sure I did either. So many of these are written in foreign language. (Laughter.)

MR. BERNANKE: Well, what I can say is this, that United States still has a trade deficit. And the mirror image of the trade deficit is the current account deficit. The current account deficit is the amount of financing we have to do every year in order to pay for the excess of our imports over exports. The U.S. trade deficit got very large and I think in many ways contributed to the current financial instability.

But the good news is (there's some good news here and there) some good news is that the U.S. current account and trade deficits are declining, partly because oil prices have come down (that's obviously very important) but also because there's a better balance between imports and exports. And I suspect that that improvement, not all of it that we've seen recently will be maintained. Because some of it just reflects the weakness of domestic demand, and therefore the weakness of demand for imports. But my guess is that over the next few years, we'll see improvements in the current account.

And the reason it's connected to the question is that, as the current account goes down, we get greater balance in supply and demand, we will need fewer dollars of financing from abroad, and our own domestic saving will be sufficient to finance our government deficits and our investment.

MS. LEINWAND: Under the new regulation for Wall Street, what should be done about regulators who simply fail to regulate, like the Fed's hands-off stance towards subprime mortgages?

MR. BERNANKE: Well, I'll drop the innuendos and the slurs and not get into that part. The lesson I think though is that you need to have alignment of knowledge, powers, and enforcement. And those things were not aligned in that case. The Fed, for example, had no direct supervisory authority over what was happening in most subprime lenders, and therefore could not directly see what was going on there. Moreover, if the Fed made rules, then the rules were not enforced by the Fed. They were enforced, supposedly by state regulators, 50 state regulators.

So I think that if you look throughout the whole system, there are many situations where either an area is not adequately covered or if it's covered, the supervision, the regulation, the enforcement are not equally aligned in a way that promotes responsible oversight. So I think that as we go forward with our regulatory forum, which I think is incredibly important and should start soon, we need to make sure that we eliminate gaps, that we clarify lines of responsibility, and that we make sure in particular that consumer protection is a big part of the overall mandate.

I would add, some might say late, but we did-- have in fact responded with very strong rules on mortgage lending along with the credit card lending. And we are committed to going forward with very strong consumer protection agenda.

MS. LEINWAND: Is the Fed considering purchasing Fannie, Freddie, and Ginnie MBS backed by multi-family loans as they are now doing for single-family loans?

MR. BERNANKE: We haven't discussed that issue. We are, right now, buying, as I mentioned before, $500 billion dollars in MBS and $100 billion dollars in debt. And we're obviously reviewing those programs to see what is effective and what will have the most benefit for the economy. I think it's very important to say that when we take these actions, like trying to address the mortgage market or the ABS market or the commercial paper market, it's not our intent to try to help some very narrowly defined, specific sector.

What we're doing here is saying, broadly speaking, the credit markets aren't working well. And in fact, going back to an earlier question, the comment was made that banks have reduced their lending, despite the TARP, et cetera. Well, even though banks have reduced their lending a bit, the real decline in credit extension is not the banks lending, but is the availability of credit through the securitization markets, the markets where formerly credit could be extended by selling securitized products to Wall Street.

So that's where the real decline in credit availability is coming. And that's why the TALF and other measures are trying to address that. So we're not aiming narrowly at this firm, that firm, this product, that product. What we're trying to do is say, what are the key credit markets that affect the entire economy, including the mortgage market? The mortgage market not only affects housing, but because housing is so central, it affects the whole economy.

So we're looking for areas where our policies can make a difference and where the difference in turn, in the improvement in the functioning of a given credit market, has broader macroeconomic consequences. And so those are the criteria. And that's why the focus on very narrowly defined segments is of second order importance, I think.

MS. LEINWAND: Okay, we are almost out of time. But before I ask the last question, we have some business matters to take care of. First of all, let me remind our members of future speakers. On February 23rd, Fred Smith, the CEO of FedEx, will discuss confronting the energy threat, electrification of transportation as the path forward. March 2nd, we have Vivian Schiller, the CEO of NPR who will discuss, local is the new global, the multi-platform evolution of public radio. And on April 7th, the Honorable Martii Ahtisaari, former President of Finland and 2008 Nobel Prize winner, will address a luncheon.

Second, I'd like to present our guest with the traditional NPC mug. (Applause.) And we're always asking you to predict things. So for my final question, after yesterday's historic news event, one question remains: do you think Alex Rodriguez still gets into the Hall of Fame? (Laughter.)

MR. BERNANKE: I love baseball. (Applause.)

MS. LEINWAND: I'd like to thank you for coming today. I'd also like to thank National Press Club staff members, Melinda Cooke, Pat Nelson, JoAnn Booz and Howard Rothman for organizing today's lunch. Also thanks to the NPC Library for its research.

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Thank you and we are adjourned. (Gavel sounds.)

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