THE WALL STREET JOURNAL.
WSJ.com

MAY 25, 2010, 11:40 AM ET

Fed's Bullard: Europe Woes Unlikely to Trigger Another Recession

European financial troubles are unlikely to send the world back into recession, and the U.S. may actually benefit from unsettled markets over the near term as investors look for a safe place to preserve their wealth, a U.S. central bank official said Tuesday.

Because the trouble in Europe is rooted in government debt problems, there is good reason to think events "will probably fall short of becoming a worldwide recessionary shock," **Federal Reserve Bank of St. Louis** President **James Bullard** said. The official noted the world has seen these types of events before, and "there is nothing intrinsic about such crises that they need to become important shocks to the broader, global macroeconomy."

"It is always possible that "this time will be different" and maybe it will be, but that would be unusual given the historical evidence," the central banker said.

Bullard downplayed the likelihood these events will spread "contagion" throughout the global financial system. He noted that the pricing levels for default insurance on major U.S. and European banks may have moved "sharply higher," but it's not at "the extreme levels seen during parts of late 2008 and the first half of 2009."

The central banker said the key reason why he's not particularly worried the global economic recovery will be undone is the stance that's been taken by governments. Major nations "have made it very clear over the course of the last two years that they will not allow major financial institutions to fail outright at this juncture." Since these "too-big-to-fail guarantees are in place, the contagion effects are much less likely to occur," Bullard said.

The official also noted that bailout arrangements put in place by European governments buys "substantial time for European governments to enact fiscal retrenchment programs," and the process of adjustment will take "years, not weeks" to play out.

Bullard does not believe the hard-hit euro currency will collapse either, saying "even in an extreme case, I do not see any necessary impediments to the successful operation of a common currency."

But as this difficult process plays out, "the U.S. may actually be an unwitting beneficiary of the crisis in Europe" as investors flock to American markets as safe harbor for their money, he said.

Bullard's comments came from the text of a speech prepared for delivery before the **European Economics and Financial Centre** in London. The official is a voting member of the interest rate setting **Federal Open Market Committee**. He spoke on a day of considerable market strain, as investor confidence once again wilted and hopes that troubles now being seen in Europe will remain contained fell yet again. U.S. equity markets were under considerable downward pressure, building on the selling that's been going on for days. European stock markets have also been hard hit, while the euro was being pushed to levels that placed it near a four-year low relative to the dollar.

By and large, Fed officials have been fairly confident that European trouble would not kill off the U.S. recovery. The most ominous warning has come from Fed Governor Daniel Tarullo, who said last week "the European sovereign debt problems are a potentially serious setback" for the U.S., with the potential to strike at both the tender state of the banking sector, and on growth.

Many now believe that the rising risks to U.S. growth mean an already distant Fed interest rate hike will likely occur even later. Many now agree it won’t be until some time in 2011 when the Fed feels it can raise interest rates from their current zero% range.

In his speech, Bullard reaffirmed that he continues to expect a gradual U.S. economic recovery, saying the rebound “remains on track.” He added, “the economic situation in the U.S. and globally is not very different from median forecasts made at the depth of the recession in late 2008 and early 2009.”

Bullard also said in his speech that some of the volatility that has beset markets over recent months may become an enduring feature going forward. The response of governments to the financial crisis has upended traditional relationships between governments, central banks and markets, and it will take time for rule-based and regular regimes to reassert themselves. It will also take time to see how the process of regulatory reform affects the financial system, he said.