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Fed's Lockhart says more rate cuts may be needed

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By Verna Gates

MONTGOMERY, Alabama (Reuters) - Recent U.S. economic news has been worse than expected and may warrant further interest rate cuts by the Federal Reserve, one of its top policy-makers said on Thursday.

"Negative information has been exceeding expectations. I think these circumstances call for policy-makers to be prepared to respond pragmatically," Federal Reserve Bank of Atlanta President Dennis Lockhart told a University of Alabama economic conference.

"In my view, pragmatism in the face of growing weakness in the general economy may very well require additional moves to lower the federal funds rate."

Lockhart is not a voting member of the Fed's interest rate setting committee this year.

He also joined Fed Chairman Ben Bernanke and a chorus of U.S. lawmakers in saying a federal fiscal stimulus plan could help bolster a flagging economy.

"There have been recent recommendations in the range of $75 billion, $100 billion in terms of tax reductions to try to address the weakening of the economy. In general, I view those recommendations as sensible providing that they can be delivered in a timely fashion," he said in a question-and-answer session following his speech.

If they are delayed until the second half of 2008, when he believes the economy will begin to strengthen again, they could be counterproductive, Lockhart added.

The Fed has already slashed its key interest rate by a full percentage point since mid-September to shield the economy from a housing slump and credit crunch and investors expect it to cut again by 50 basis points at its next scheduled policy meeting on January 29-30. Lockhart did not challenge this view.

"Implicit in my view is the forecast that inflation will moderate, allowing policy to focus on the very apparent near-term risks to the broad domestic economy," he said.

However, Lockhart stressed that he was not expecting the worst and that although he anticipated the housing market would take most of this year to recover, growth would rebound.

"My base case outlook sees a weak first half of 2008 -- but one of modest growth -- with gradual improvement beginning in the year's second half and continuing into 2009.

"This outcome assumes that the housing situation doesn't weaken more than expected and that financial markets stabilize," Lockhart said.

He also said the Fed believes that monetary policy and liquidity injections are better tools to ease a financial sector credit crunch than by reducing bank reserve requirements to encourage institutions to keep lending.

Such a move would not be in keeping with efforts to move the U.S. banking sector towards the new Basel II bank capital accord, he said.

(Writing by Alister Bull and David Lawder, Editing by Chizu Nomiyama)