Los Angeles Times

Fed signals it will go slow on lifting key interest rate

By JIM PUZZANGHERA and DON LEE
December 18, 2014

The American economic outlook, bolstered by robust job growth and a sharp drop in gasoline prices, was boosted a little more with the Federal Reserve's signal that it would take as long as three years to raise interests to once-normal levels.

Fed officials, concluding their last meeting of the year Wednesday, issued a statement that essentially left their easy-money policy in place, indicating that their key interest rate would stay near zero for at least a few more months.

And the longer they take in lifting rates, the longer consumers are likely to enjoy lower mortgage and credit card rates and businesses get cheaper borrowing costs. In addition, the Fed continued to give a more upbeat view of the economy, particularly the job market.

Fed Chairwoman Janet L. Yellen said in a news conference after the two-day meeting that Russia's weakening economy, hampered by international sanctions and plummeting oil prices, weren't a serious threat to the American economy. Indeed, she saw the plunge in oil prices as a positive for the U.S.

Yellen noted that policymakers could bump up rates any time depending on shifts in economic data, but she took pains to assure markets that the central bank was likely to maintain a highly supportive monetary policy for a long time.

Investors cheered and stocks surged, recouping some of the losses in recent days, even as three Fed policymakers dissented and some analysts expressed concerns that Yellen and her colleagues were moving too slowly to return interest rates to more normal levels.

“When are rate hikes coming, for gosh sake? This waiting around is getting ridiculous,” said Chris Rupkey, chief financial economist at the Bank of Tokyo-Mitsubishi in New York, clearly annoyed at the Fed's muddled statement.

Mark Zandi, chief economist at Moody's Analytics, viewed the move as positive, though he noted that the Fed took “a baby step” when the markets were expecting “a man-sized step” toward higher interest rates.

“They're making this transition very gracefully, at least so far,” he said. “I think the man on the street should be pretty happy with the way things are going.”

The Fed's benchmark rate has been near zero since December 2008 in an attempt to fight the Great Recession and boost the sluggish recovery.

Yellen acknowledged that the economy still has a way to go before it regains full health, saying the Fed would “be patient” in deciding when to raise interest rates.

And when it does, she said, the Fed would inch rates up so gradually that they wouldn't get near the longer-run average of 3.75% until the end of 2017.

Financial markets rallied. The Dow Jones industrial average jumped 288 points, or 1.7%, to close at 17,356.87.

The Fed's upbeat view of the economy was focused on the job market heading into the new year.

“Employment is rising at a healthy rate and the U.S. economy is strengthening,” Yellen said. “The pace of job growth has been strong recently, with job gains averaging nearly 280,000 per month over the past three months.”

Yellen said the Fed wasn't worried about Russia's economy because American companies do relatively little trade with the country and banks here have limited exposure.

And plunging oil prices that have resulted in gasoline prices dropping to an average of $2.51 a gallon nationwide are “certainly good for families, for households,” Yellen said.

“It's putting more money in their pockets, having to spend less on gas and energy,” she said. “And so in that sense, it's like a tax cut that boosts their spending power.”

As expected, the Fed's policy statement dropped the words “considerable time” in describing how long the Fed would wait before lifting rates. Instead policymakers said they would be patient in starting to normalize monetary policy.

Yellen was vague about the timing of the coming increase. She said the Fed was unlikely to act at its January or March meeting, but left the door open after that.

The last time the Fed raised rates after a prolonged period, in 2004, the central bank began using the word “patient” five months before the rate hike. According to forecasts released by the Fed, most of its policymakers expect to raise rates in 2015.

The incremental language change frustrated some analysts who believe that the economy already is strong enough to handle a rate hike.

“Is the economy normal? Yes,” Union Bank's Rupkey said. “Are interest rates normal? No.”

He said the Fed “pulled a fast one.” Diane Swonk of Mesirow Financial called the Fed's language a “bit of a bait and switch.”

And **Bernard Baumohl of the Global Economic Outlook Group** said: “We got a gallimaufry of sentiments in five paragraphs that delicately tiptoes around the issue of when short term rates should begin to normalize.”

But other economists said the Fed may have wanted to move very gingerly because of the recent turmoil in financial markets. “They were nervous of piling on when the piles are already fragile,” Zandi said.

Yellen conceded that she has been surprised that the housing sector had not performed better. Home building has been well below expectations and sales have been particularly weak among younger adults. Yellen attributed housing's weakness to the still-tight credit conditions and the slow pace of new household formation, both of which she hopes will improve as economic and employment growth continues.

Jack Ablin, chief investment officer at BMO Private Bank in Chicago, isn't counting on housing to give the economy much of a boost next year. But overall, he feels good about the economy heading into next year.

Ablin and other economists also think next year could finally bring meaningful wage gains for workers. With the unemployment rate falling, the labor market is tightening. And low costs for capital and for commodities mean that businesses will have more to spend for labor, Ablin said.

Two Fed policymakers seemed to believe that the central bank wasn't moving fast enough on rates. They were among an unusually large number of dissents in the 7-3 vote on the policy statement.

Dallas Federal Reserve Bank President Richard Fisher and Philadelphia Federal Reserve Bank President Charles Plosser both voted no, saying they wanted the Fed to indicate that it would act more quickly to raise rates.

The other no vote came from Minneapolis Federal Reserve Bank President Narayana Kocherlakota, who opposed indicating that a rate hike was coming because inflation remains low.

Yellen said the weighty issue of deciding when to start reversing the Fed's last remaining stimulus effort led to the dissents.

“At a time like this, where we are making consequential decisions, I think it's very reasonable to see divergences of opinion,” Yellen said.

Fed officials are grappling with what they consider undesirably low inflation in the U.S.

On Wednesday, the Labor Department reported that the consumer price index declined 0.3% in November. That was the largest drop in six years, fueled by a steep fall in gasoline prices. Overall, consumer prices rose just 1.3% in the 12 months that ended Nov. 30, well below the Fed's 2% target for annual inflation.

The Fed said Wednesday that the low inflation rate partly reflected the decline in energy prices. So-called core inflation, which excludes volatile energy and food prices, was up 1.7% for the year ended Nov. 30.

The last time the Fed hiked its key short-term rate was in June 2006, when it raised the benchmark to 5.25%. The following year, as the economy began tumbling toward the Great Recession, the Fed began slowly lowering the rate.

By December 2008, the Fed dropped the rate to near zero, where it has stayed as the economy struggled through the recession and the slow recovery.

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