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ECONOMY

Fed Chairman Says Interest Rates Are Just Below Estimates of Neutral

'There is no preset policy,' says Jerome Powell, noting central bank will pay close attention to economic data

Federal Reserve Chairman Jerome Powell described interest rates as low by historical standards. PHOTO: DON EMMERT/AGENCE FRANCE-PRESSE/GETTY IMAGES

By Nick Timiraos

Updated Nov. 28, 2018 5:24 p.m. ET

Federal Reserve Chairman Jerome Powell ignited a market rally Wednesday by saying interest rates are "just below" broad estimates of a level considered neutral, a setting designed to neither speed nor slow economic growth.

Investors welcomed his remarks because they appeared to retreat from a comment he made in early October describing the Fed's benchmark rate as a "long way" from a neutral level—which implied to some listeners that Mr. Powell planned to keep raising rates for a while. His remarks Wednesday appeared to suggest to this audience that he might stop sooner or move more slowly.

Mr. Powell didn't provide any more guidance on the likely path for rates, and he noted they remain low by historical standards.

He offered nothing to dispel market expectations of another rate increase at the Fed's policy meeting on Dec. 18-19.

"There is no preset policy," he said. "We will be paying very close attention to what incoming economic and financial data are telling us."

Mr. Powell's October remark came during an unscripted moment at a moderated discussion in Washington. He tried to dismiss as premature questions over whether the Fed would need to raise rates above neutral to a level aimed at slowing growth. Some listeners thought his tone conveyed greater conviction about continuing rate increases.

On Wednesday, Mr. Powell pointed to the range of neutral-rate projections submitted by 15 Fed officials at their policy meeting in September, varying from 2.5% to 3.5%. The Fed's benchmark federal-funds rate since then has been between 2% and 2.25%—or just below the lowest estimate.

His clarification Wednesday didn't otherwise indicate any substantive change in the Fed's policy plans.

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For example, he didn't discuss how recent changes to the economic outlook—including weaker housing sales, rising market volatility and a plunge in oil prices—might influence the Fed's policy path. He will have an opportunity to do that next week in testimony on Capitol Hill.

Many Fed officials still believe more rate increases will be needed to prevent the economy from overheating. Some want to see evidence that job growth is slowing, holding the unemployment rate at its current low levels, before they pause rate increases.

If the Fed, as expected, raises the fed-funds rate next month to a band between 2.25% and 2.5%, that would leave it touching the bottom of the range of neutral estimates but four more quarter-percentage-point increases from the top.

"Powell said nothing to suggest that he or the majority of the FOMC think they'll be able to stop at the bottom of the range, after just one more hike," said Ian Shepherdson, chief economist at Pantheon Macroeconomics.

Still, Mr. Powell's observation appeared to soothe anxious investors. It followed several weeks of market volatility that some investors had blamed on uncertainty over the Fed's intentions, among other things.

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Traders are betting on a gentler course of interest-rate increases following Fed Chairman Jerome Powell's latest remarks. Federal-funds futures recently showed the market pricing in a 7.2% chance of the Fed raising rates at least three times next year, down from 11.5% earlier Wednesday and 17.6% one month ago, according to CME Group.

"It removes concerns of a Fed dead set on tightening up to a point where rates would intentionally slow down the economy," said Roberto Perli, an analyst at Cornerstone Macro, in a report Wednesday.

While the speech had "cleaned up after Powell's sloppy language last month," markets may have reacted too strongly to the comments, said Ed Al-Hussainy, senior rates analyst at Columbia Threadneedle Investments. "We now run a larger risk" that communications at the Fed's December meeting will be more hawkish than markets expect, he said.

One irony of the market reaction to Mr. Powell's word choices is that he has spent considerable energy during his tenure as Fed chairman trying to emphasize the uncertainty of these estimates and to fashion a more plain-spoken approach to central-bank communications.

Mr. Powell repeated a relatively upbeat view of the economic outlook, including low unemployment and stable inflation.

"There is a great deal to like about this outlook," Mr. Powell said. But turning to financial stability, the main topic of his speech, he added, "We know that things often turn out to be quite different from even the most careful forecasts."

The Fed's current pattern of raising rates gradually—roughly once a quarter over the past two years—is an effort to balance two risks.

"We know that moving too fast would risk shortening the expansion," Mr. Powell said. "We also know that moving too slowly—keeping interest rates too low for too long—could risk other distortions in the form of higher inflation or destabilizing financial imbalances."

Mr. Powell flagged rising indebtedness and deteriorating loan quality among some U.S. businesses as top vulnerabilities within the U.S. financial system, but otherwise described such

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risks as moderate.

"Over the past year, firms with high leverage and interest burdens have been increasing their debt loads the most," Mr. Powell said. "In addition, other measures of underwriting quality have deteriorated, and leverage multiples have moved up."

It isn't clear that these conditions could trigger a recession on their own, he said, noting that the ratio of corporate debt to economic output didn't seem unusual. But he warned that any corporate debt buildup now could make the next recession more severe.

Compared with his recent predecessors, Mr. Powell, who became Fed chairman in February, has more regularly noted that the past few expansions ended with bursting financial bubbles rather than surging inflation.

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