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ECONOMY

Fed Holds Rates Steady, Signals Concern Over Sluggish Spending, Low Inflation

Rate-setting panel focuses on underlying slowdown in household spending and business investment

A man rides a bike in front of the Federal Reserve Board building on March 27. **PHOTO:** BRENDAN MCDERMID/REUTERS

By Nick Timiraos

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WASHINGTON—Federal Reserve officials agreed to keep their benchmark interest rate unchanged and signaled comfort that their wait-and-see posture had steadied the economy after fears of a slowdown had sent markets reeling at the end of last year.

Fed Chairman Jerome Powell, speaking at a news conference Wednesday, played down concerns that recent soft inflation might hint at broader economic weakness. He repeatedly highlighted individual price declines that could prove transitory and, in doing so, pushed back against some market hopes the Fed might be preparing to lower interest rates later this year.

“Overall the economy continues on a healthy path, and the committee believes that the current stance of policy is appropriate,” Mr. Powell said after officials ended their two-day policy-setting meeting. For now, “we don’t see a strong case for moving [rates] in either direction,” he said.

All 10 members of the central bank’s rate-setting committee, comprising the five Fed governors and five regional Fed bank presidents, voted to keep the benchmark federal-funds in a range between 2.25% and 2.5%.

Stocks fell, with the Dow Jones Industrial Average sliding 162.77 points, or 0.6%, to 26430.14, while the S&P 500 lost 22.10 points, or 0.8%. The yield on the benchmark 10-year U.S. Treasury note fluctuated but closed up at 2.511% from 2.505% a day earlier. Bond yields rise as prices fall.

While the Fed's monetary policy remains on hold for now, declining annual inflation could make for lively discussions inside the central bank if it persists.

So-called core inflation, which excludes the volatile food and energy categories, rose just 1.6% in March from a year earlier, down from 1.8% in January and 2% in December, the Commerce Department said Monday.

Fed officials said their 2% inflation target is symmetric, meaning they expect inflation will drift mildly above and below it at different times. They seek to keep inflation at that level because they see it as consistent with a healthy economy.

The Fed raised rates once every quarter last year, most recently in December. Market turmoil in late 2018, fueled in part by worries about a global-growth swoon, prompted the officials early this year to signal they were done raising rates.

Since then, global growth has improved, the U.S. economy expanded at a strong 3.2% annual rate in the first quarter and stocks climbed to new highs.

After the officials last met in March, Mr. Powell signaled greater frustration that inflation had struggled to stay on target. But Wednesday, despite evidence that core inflation had slipped even lower, he kept a calm bearing and pointed to idiosyncratic price declines in clothing, due to methodological changes, as well as in investment-management services.

"There's reason to think that these will be transient," Mr. Powell said. "We of course will be watching very carefully to see that that is the case."

Economists said other forces outside the Fed's control and unrelated to domestic demand are crimping inflation as well.

Among them, sluggish economic growth abroad may be damping prices for many globally traded goods. Technological improvements mean the capability of electronic products is rising faster than their prices, which government statisticians count as a price decline. Smartphones and online shopping are making bargain-hunting easier, sapping sellers' power to raise prices. And health care prices are rising more slowly because of the Affordable Care Act and other regulatory changes.

Because most Fed officials have said they expect inflation to hold close to 2%, any sustained undershooting of the target could unnerve the central bankers, particularly if it sends consumer and business' expectations of future inflation lower.

The officials worry that expectations can become self-fulfilling, leading price pressures to weaken further.

Mr. Powell noted that most of the central bank's forecasting errors on inflation "are on the downside." This creates a risk that "inflation expectations over time could be pulled down," he added.

In an interview last month, Chicago Fed President Charles Evans said that if an inflation shortfall was persistent, he would support cutting rates to take out insurance against the risk of economic softness.

On Wednesday, "we learned that an insurance cut is not imminent," said Julia Coronado, founder of MacroPolicy Perspectives LLC, a New York economics advisory firm. Mr. Powell "didn't close the door to such an idea, but he could have left it more open."

The central bank has faced other episodes of idiosyncratic price drops in recent years, such as one from a price war among cellphone network providers in 2017. Fed officials didn't change their policy plans as a result, and the declines ultimately proved temporary.

Even so, recurring low inflation spells, even if brought on by outside forces, poise a challenge for the Fed, which has been committed to raising inflation back to its 2% goal, said Ms. Coronado.

"It means you have to stimulate the other pieces of inflation with greater force," she said. "Are you willing to do that when the rest of the economy is humming along fine?"

Michael Gapen, chief U.S. economist at Barclays, said he largely agreed with the Fed's inflation outlook and expects core inflation to return to 1.8% or 1.9% later in the year, but not until after July. "We have a few more months for this to play out," he said. "It pushes out that day of reckoning."

Cutting rates could be complicated coming after President Trump has called repeatedly on the Fed to do so. Central bank officials have said politics never influence their decisions. But Mr. Trump's comments would put more pressure on them to explain any policy changes so that doubts about their independence don't erode their credibility in the markets.

On Tuesday, Mr. Trump called on the Fed to cut rates by 1 percentage point and to resume its crisis-era bond-buying program to stimulate growth.

Separately, Fed governors voted unanimously to reduce a different interest rate paid on bank deposits, known as reserves, maintained at the Fed. They lowered this rate of interest on excess reserves to 2.35% from 2.4%.

The change isn't likely to be economically meaningful and instead reflects a technical effort to improve the way the Fed's policy decisions are implemented in overnight money markets.

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