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U.S. ECONOMY

Fed Keeps Interest Rates Unchanged; Signals No More Increases Likely This Year

Eleven of 17 officials didn't think an increase would be needed at all this year—up from two in December

Federal Reserve Board Chairman Jerome Powell speaking at a news conference in Washington on Jan. 30. **PHOTO:** SAUL LOEB/AGENCE FRANCE-PRESSE/GETTY IMAGES

By Nick Timiraos

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WASHINGTON—Federal Reserve officials indicated they are unlikely to raise interest rates this year and may be nearly finished with the series of increases they began more than three years ago now that U.S. economic growth is slowing.

The Fed left its policy rate unchanged Wednesday in a range between 2.25% and 2.5%. Chairman Jerome Powell suggested the central bank was likely to leave it there for many months.

"It may be some time before the outlook for jobs and inflation calls clearly for a change in [interest rate] policy," Mr. Powell said at a news conference after the central bank's two-day meeting.

In response, the yield on the benchmark 10-year Treasury note fell to 2.537% from 2.614% Tuesday, ending the session at its lowest level since January 2018. U.S. stocks, which rose immediately after the release of the Fed's policy statement and projections, ended the day lower. The Dow Jones Industrial Average fell 0.5% to 25745.67.

The Fed also announced that in May it would slow the pace at which it is shrinking its $4 trillion asset portfolio and end the runoff of its Treasury holdings at the end of September, exactly two years after it began the process.

After a period of exceptional market volatility late last year—brought on by concerns over slowing global growth, trade tensions and the Fed's policy stance—leaders of the central bank signaled early this year a reversal from their December plans to keep raising rates.

Mr. Powell cited mild inflation pressures, a sharp pullback in financial risk-taking and clear threats to U.S. growth in explaining the Fed's new wait-and-see stance after its meeting in late January.

Projections released Wednesday underscored the turnabout. They showed 11 of the 17 Fed officials who play a role in interest-rate policy didn't think the bank would need to raise rates at all this year, up from two in December. The remaining six officials projected between one and two increases would be needed in 2019.

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By contrast, most Fed officials in December had projected between one and three rate rises would be appropriate this year.

"They faced this wall of market opposition coming out of the December meeting," said Nathan Sheets, chief economist at PGIM Fixed Income and a former senior Fed economist. "There's enough uncertainty out there that they're not going to fight the markets."

The Fed projections suggest more of its officials judge they may have reached the end of their rate-increase cycle. "There are many plausible scenarios where they're done and a smaller number of scenarios where they're not," Mr. Sheets said.

He sees the economy eventually strengthening as uncertainty clears, warranting another rate increase. "But the bar for that move is high," Mr. Sheets said. "We can't tell how much the softness reflects some extraordinary global shocks that will abate slowly or a softer underlying engine in the economy."

The Fed's shift has came as inflation fell shy of the officials' estimates last year that it would rise above their 2% target.

In a particularly revealing admission, Mr. Powell said he was discouraged that inflation hadn't risen in a more sustainable fashion.

"I don't feel we have convincingly achieved our 2% mandate in a symmetrical way," he said. "It's one of the major challenges of our time, to have downward pressure on inflation" globally.

Mr. Powell also said he wasn't significantly worried that the Fed's policy shift on rates would fuel destabilizing asset bubbles.

Fed officials believe 2% inflation is consistent with a healthy economy. They see inflation much lower than that as a sign of weak economic demand. Also, because short-term interest rates haven't returned to higher levels, the Fed has less room to cut rates in a future downturn. Higher inflation can provide a greater cushion to reduce nominal rates in a downturn.

Mr. Powell's candor shows "they want to see higher inflation, and they're not convinced they can achieve that," said Michelle Meyer, an economist at Bank of America.

Since 2015, the Fed raised rates on the theory that declining unemployment would eventually generate stronger price pressures. This framework dictated that, even with inflation running below the Fed's 2% target, the probability of higher future inflation demanded pre-emptive rate increases.

The new projections show the officials continue to revise downward their thinking about the point at which the unemployment rate is consistent with stable prices. The officials' median rate for this metric fell to 4.3% Wednesday—down from 4.5% a year ago and 4.8% in 2016.

This revision suggests the economy can employ more people without risking an acceleration in inflation.

Other changes to the forecast show officials no longer believe they will need to raise rates to slow economic growth to a level that will prevent overheating. They revised lower their projection for gross domestic product growth and revised higher their projection for the unemployment rate at year's end.

On the asset-portfolio front, the Fed has been shrinking its holdings to $4 trillion from $4.5 trillion when it began the process in October 2017.

Announcing the coming end of the runoff marked another significant pivot for Mr. Powell, who in December had said the process was on "autopilot" and running smoothly. Markets reacted poorly to the comment.

The Fed currently allows $30 billion in Treasurys and $20 billion in mortgage bonds to mature every month without replacing them; the actual amounts have been slightly lower because the Fed's stock of maturing bonds is smaller in most months.

Beginning in May, the Fed will slow to $15 billion the amount of bonds it allows to mature every month, and will stop the runoff of the Treasury holdings in October. The central bank will continue to allow the mortgage holdings to mature, and they will reinvest maturing principal below the $20 billion cap into new Treasury securities.

The same factors prompting the end of the runoff will one day require the portfolio to grow again. The Fed said Wednesday it hasn't decided when that will occur. At issue is gauging demand for deposits held by banks at the Fed, known as reserves.

With the balance sheet at a fixed size, reserves will very slowly decline as other liabilities, namely currency, continue to grow. At some point, reserves could grow scarce enough to raise the rate banks charge in overnight money-market accounts, which would lift the Fed's benchmark rate.

Fed officials said Wednesday they will allow the balance sheet to resume growing by purchasing more Treasurys before reserves fall to such a level.

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