CENTRAL BANKS

Fed Raises Interest Rates, Signals One More Increase This Year

Benchmark federal-funds rate increased to a range between 2% and 2.25%

Federal Reserve Chairman Jerome Powell spoke Wednesday after the interest-rate vote. **PHOTO:** ANDREW HARRER/BLOOMBERG NEWS

By Nick Timiraos

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The Federal Reserve said it would raise short-term interest rates by another quarter-percentage point, and central-bank officials signaled they expected to lift them again later this year and through 2019 to keep a strong economy on an even keel.

The policy makers voted unanimously Wednesday to lift their benchmark federal-funds rate to a range between 2% and 2.25%. Most expected to raise rates one more time this year, according to new projections released after the conclusion of their two-day rate-setting meeting

The increase, which drew a rebuke from President Trump, is the third this year and the eighth since the Fed began to lift rates in late 2015 after keeping them pinned close to zero after the 2008 financial crisis. The Fed's action marks the first time it has lifted its benchmark rate above 2% since 2008.

It also is the first time in a decade the fed-funds rate will rise above inflation, measured by the Fed's preferred gauge, which excludes volatile energy and food categories. So-called core prices rose 2% in July.

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"These rates remain low," Fed Chairman Jerome Powell said in a news conference. "This gradual return to normal is helping to sustain this strong economy for the longer-run benefit of all Americans."

Mr. Trump, in a press conference later Wednesday, said he was "not happy" about the Fed raising rates. But he added, "They are raising them because we are doing so well." And he said higher rates weren't all bad because they could help Americans who rely on interest savings for income.

Mr. Powell said the central bank decision was guided by economic theory and evidence—not politics: "That's who we are. That's what we do. And that's just the way it's always going to be for us."

Stocks erased gains and closed lower Wednesday. The S&P 500 fell 0.3%. The yield on the benchmark 10-year U.S. Treasury note fell to 3.059% from 3.102%. Yields fall as bond prices rise, and Treasury yields are near their highest levels in seven years.

The Fed's actions ripple through the economy over time by raising borrowing costs for businesses and consumers. Rising mortgage rates appear to have contributed to a somewhat slower pace of home sales this year. Higher borrowing costs steal pricing power from sellers, who have benefited from strong price gains in recent years.

Even if the Fed raises its benchmark rate to 3% next year, "we don't think that's a hindrance to the economy," said John Augustine, chief investment officer at Huntington Private Bank in Columbus, Ohio. "We don't see that lifting mortgage rates substantially. We don't see that as a threat to credit line borrowing."

The big question now is how much higher officials think they need to raise rates to keep the economy from overheating. The Fed targets a 2% inflation rate, which it sees as a sign of healthy demand. It wants to avoid economic growth that becomes unsustainable, leading to a boom and then bust.

Projections released after Wednesday's meeting show that most Fed officials expect they will raise rates by one percentage point through next year, and most officials penciled in at least one more quarter-point increase for 2020.

That would leave the benchmark rate slightly higher than 3.25%. Because this is modestly above the so-called neutral rate most officials project is required to balance supply and demand over the long run, such a setting would deliberately restrict growth.

Mr. Powell has stressed the uncertainty of estimating this neutral setting. To that end, the Fed dropped from its postmeeting statement on Wednesday a sentence that for years had described its rate stance as "accommodative," meaning officials were pressing on the gas pedal to spur more growth.

Dropping the language doesn't signal that officials believe rates are no longer low enough to stimulate growth, Mr. Powell said. Instead, the change reflects how Mr. Powell wants to move away from providing overly precise estimates of inherently uncertain settings.

Economic projections released after the meeting envision an unusually favorable set of conditions, in which the unemployment rate holds below 4% over the next three years but inflation never rises far beyond the Fed's 2% target.

Whether the Fed realizes this "Goldilocks" economy that is neither too hot nor too cold could depend on whether inflation behaves as expected.

The risk that inflation climbs higher and faster than anticipated could require the Fed to raise rates "a little bit quicker," Mr. Powell said. He quickly added, "We don't see that. We really don't see that."

Wednesday's interest-rate projections show two different schools of thought about how the Fed might proceed.

One camp of officials says so long as unemployment keeps falling farther below the level they project is consistent with low and stable inflation, the Fed will need to raise rates to prevent the economy from overheating. This is an uncontroversial strategy, because it is what the central bank always does at this point in an expansion.

Another camp argues for a relatively radical departure from this norm. These officials say if inflation doesn't appear to be accelerating beyond 2%, the Fed could stop raising rates after reaching a neutral setting that neither spurs nor slows growth.

The Fed's projection that the economy could stay in a sweet spot for years also depends on forces outside of its control, including trade policy. The Trump administration has promised to ratchet up tariffs on Chinese imports.

"If this, perhaps inadvertently, goes to a place where we have widespread tariffs that remain in place for a long time, a more protectionist world, that's going to be bad for the United States's economy," said Mr. Powell.

A separate risk is that strength in the U.S. economy forces the Fed to push rates higher even though growth elsewhere slows, sending the dollar up and putting more stress on emerging markets.

"I worry...less about the risk of a trade war and more about the financial strains that mount with widening economic and policy divergence among advanced economies," said Mohamed El-Erian, chief economic adviser at Allianz SE, the German insurance giant.

One such peril is that turmoil in emerging markets spills into China amid rising trade tensions with the U.S. In 2015 and 2016, officials held back planned rate increases due to upheaval in global markets, mostly emanating from China.

Mr. Powell didn't say whether problems in emerging markets could derail the Fed's rate-increase plans, but neither did he dismiss such worries. Given their large share of global output, "the performance of the emerging market economies really matters to us in carrying out our domestic mandate," said Mr. Powell.

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