Federal Reserve policy makers signaled they won’t be raising interest rates anytime soon while suggesting they would tighten credit at a faster pace once the liftoff has begun.

Fed Chair Janet Yellen and her colleagues yesterday stuck with a pledge to hold interest rates near zero for a “considerable time” after they end asset purchases, probably next month.

Even so, policy makers projected a steeper increase in borrowing costs next year, raising the median forecast for the benchmark rate at the end of 2015 to 1.375 percent from June’s estimate of 1.125 percent. In their first forecast for 2017, they projected the rate for the close of that year at 3.75 percent.

Forward Guidance

“There is a tension between the committee’s statement keeping the considerable period language versus the rate forecasts,” said Chris Rupkey, chief financial economist at Bank of Tokyo-Mitsubishi UFJ Ltd. in New York. “It is quite a balancing act of the high-wire kind that still leaves the market guessing about the Fed’s intentions.”

In preparation for the start of that monetary tightening next year, the Federal Open Market Committee filled in the details of how it will manage the transition to more expensive credit through the use of new tools to control all the money they’ve pumped into the financial system.

Market Response

Stock and bond prices rose initially in response to the Fed’s “considerable time” assurance, only to fall back later as investors focused on the faster pace of monetary tightening set out in policy makers’ economic projections. The Standard & Poor’s 500 Index added 0.1 percent at 4 p.m. in New York yesterday, trimming an earlier advance of as much as 0.6 percent. The yield on 10-year Treasury notes rose three basis points to 2.62 percent, a two-month high.

As they have at every meeting since last December, policy makers elected to reduce their monthly bond purchases by $10 billion, this time to $15 billion. They also said they expect to end the asset-buying program next month in what would amount to a first step toward an eventual tightening of credit.

In the run-up to this week’s meeting, a number of policy makers had voiced unease with retaining language suggesting that the Fed wouldn’t raise rates for a “considerable time” after asset purchases ended. They expressed a desire instead to make future rate moves dependent on changes in the
Potentially Volatile

“They acted to leave in considerable time rather than to cause a potentially volatile market reaction,” said Lindsey Piegza, the Chicago-based chief economist for Sterne, Agee & Leach Inc.

Yellen told reporters after yesterday’s policy meeting that the FOMC decided to keep the language because the economic outlook hadn’t changed all that much over the last few months.

Yet she spent a good part of her press conference arguing that the statement didn’t tie the Fed’s hands and that the central bank had the ability to raise rates sooner if economic conditions warranted it.

“I do feel we have the flexibility to move,” she said. “It is important for markets to understand that there is uncertainty and that the statement is not some sort of firm promise about a particular amount of time” before the first rate increase.

That was a marked shift from her first press conference as Fed chair in March, when she suggested that the term referred to a period of about six months.

Dissenting Votes

Dallas Fed President Richard Fisher and Philadelphia Fed President Charles Plosser dissented, in particular objecting to the suggestion in the statement that the central bank was nowhere close to tightening credit.

“It’s very natural that the committee should have a range of opinion about a decision as crucial as what is the right time to begin to normalize policy,” Yellen said. “I don’t consider two dissents to be an abnormally large number.”

She said FOMC participants probably had bumped up their forecasts of how fast interest rates will rise because they now see unemployment falling a bit faster and inflation rising slightly more quickly than they did before.

Most Fed policy makers expect the jobless rate to drop to 5.4 percent to 5.6 percent by the end of next year from 6.1 percent in August. Inflation, as measured by the personal consumption expenditures price index, is projected to be running at 1.6 to 1.9 percent at that time. It was 1.6 percent in July.

Yellen described the changes in policy maker forecasts for both the economy and interest rates as “quite modest.”

Mixed Signals

Some Fed watchers took the Fed to task for the mixed signals it delivered.

“How can you say in the same sentence you think rates will be higher next year but we are keeping rates low for a considerable time?” asked Torsten Slok, chief international economist at Deutsche Bank.
AG in New York. “There was some inconsistency in that message.”

“Yellen is trying to walk a fine line and that’s a perilous exercise,” said Thomas Costerg, an economist at Standard Chartered Plc in New York. “She always wants to downplay things and there’s a risk that will boomerang back.”

He said he suspected the debates inside the FOMC this week “may have been quite heated.”

Policy makers though did reach agreement on what they called “principles and plans” to govern their eventual exit from ultra-loose monetary policies. The strategy calls for the Fed to only slowly reduce its $4.42 trillion balance sheet and to concentrate instead on using new tools to mop up the money it’s pushed into the financial system.

**Balance Sheet**

Reducing the balance sheet back to levels the central bank would consider normal “could take to the end of the decade,” Yellen told reporters.

Policy makers said their main tool for tightening credit will be changes in the interest rate they pay commercial banks on deposits parked at the Fed. They will supplement that sparingly with a new instrument that allows the Fed to withdraw liquidity from money-market funds.

“The fact that they were able to produce an exit strategy suggests that the mechanics for tightening have advanced quite substantially,” said Dana Saporta, U.S. economist at Credit Suisse Group AG in New York. “The Fed has been making very incremental steps toward more hawkish policy, and they did continue that today.”

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