Federal Reserve

Fed signals near-term rate rise despite inflation questions

Many policymakers conclude increase needed if economy stays on track

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YESTERDAY Sam Fleming in Washington

A number of the Federal Reserve's policymakers signalled in their latest meeting that they were preparing to lift rates again, even as a divided body of US rate-setters continued to agonise about the risks posed by persistently soggy inflation.

Faced with above-trend growth and a labour market that was operating at or beyond full employment, many Fed policymakers said in their October 31 to November 1 meeting that another increase in the Fed's target range would probably be needed "in the near term" if the economy stays on track.

However that was not the unanimous view, and minutes to the latest meeting revealed a central bank that is still struggling to get to grips with the implications of sub-target inflation. Many policymakers warned inflation may remain below target for longer than they had expected, as they flagged up the risk of persistent drags on price growth. A number said they were worried a fall in longer-term inflation expectations could make it harder to return inflation to target.

Weighing into the debate over further rate rises is the risk that the long spell of low interest rates could stoke up excesses in financial markets. Several participants in the latest meeting flagged up worries about the issue, expressing concerns about "a potential build-up of financial imbalances".

Gold and Treasury prices slightly extended their gains following the release of the minutes, with the yield on the 10-year Treasury, which moves inversely to prices, at 2.3294 per cent from the 2.3347 per cent it stood at before their publication. US stocks were little changed.

The Fed has been steering a careful path towards a further rate increase as soon as December, even as chair Janet Yellen describes the inflation shortfalls in 2017 as something of a mystery. The weak inflation figures come despite a private sector hiring streak that has driven unemployment down to the lowest levels since the early 2000s and increasingly buoyant corporate investment prospects.

The Fed kept its key rate at 1 to 1.25 per cent at the end of the Federal Open Market Committee's latest two-day meeting, while continuing to flag that "gradual" rate rises lie ahead. The US central bank has lifted rates from near zero levels in a series of moves since late 2015, and this year began further reducing stimulus by starting to reduce the size of its $4.5tn balance sheet.

In the latest meeting policymakers said they are now expecting "appreciable" increases in business investment to support growth, possibly helped by Republican lawmakers' planned tax cuts.

"Consistent with their expectation that a gradual removal of policy accommodation would be appropriate, many participants thought that another increase in the target range for the federal funds rate was likely to be warranted in the near term if incoming inflation left the medium-term outlook broadly unchanged," the latest minutes recorded.

Within the core group of active rate-setters on the Federal Open Market Committee, "several" said they were "reasonably confident" that the economy and inflation would evolve in a way that justified an additional firming of rates in the near term. But other members of the committee stressed their concerns about the outlook for inflation expectations, declaring the importance that incoming data dispels their worry about low inflation.

Given the persistent inflation disappointments, two participants in the meeting floated the idea of changing the way the Fed targets inflation, shifting to a system where the central bank seeks to keep the price level close to a gradually rising path.

Looming changes in the central bank's leadership are further clouding the policy outlook. Chair Janet Yellen has said she will step down from the board of governors on the swearing-in of Jay Powell as her successor. Her term as chair is due to expire at the start of February.

The Fed's powerful board also lacks a vice-chair following the early retirement of Stanley Fischer, and a number of other board seats are vacant. Bill Dudley, the president of the New York Fed, will step down in the middle of 2018, and the Richmond Fed needs to appoint a new president.

The Fed's next meeting — and the final one of 2017 — is on December 12-13.