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U.S. ECONOMY

Federal Reserve Keeps Interest Rates Steady, Sees Long Pause

Officials indicate comfort with leaving policy on hold through next year, while keeping eye on economy

'Our economic outlook remains a favorable one,' Fed Chairman Jerome Powell said. **PHOTO:** ANDREW HARRER/BLOOMBERG NEWS

By Nick Timiraos

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WASHINGTON—The Federal Reserve held interest rates steady and signaled no appetite to raise them soon.

After lowering rates at their three previous meetings to guard the U.S. economy from the effects of trade tensions and a global slowdown, Fed officials on Wednesday indicated comfort with leaving monetary policy on hold through next year while keeping an eye on those risks.

"Our economic outlook remains a favorable one," said Fed Chairman Jerome Powell. The rate-setting committee voted 10-0 to leave the central bank's benchmark rate in a range between 1.5% and 1.75%, the first unanimous vote since May.

New projections released after the meeting showed most officials think rates are low enough to stimulate growth. If their favorable outlook holds, most expect they could leave rates unchanged through 2020. In that scenario, most see the Fed raising rates once or twice after that.

But Mr. Powell's remarks and language in the committee's official policy statement indicated a lower threshold for the Fed to cut rates again than to raise them.

Stocks rose after the Fed's announcement and Mr. Powell's press conference. The S&P 500 closed up 0.3%, slightly higher than before the Fed's announcement. The yield on the benchmark 10-year Treasury declined to 1.786% from 1.833% on Tuesday.

Mr. Powell also said that the Fed's recent market interventions to keep short-term rates stable are working but that the central bank could do more if needed to address any end-of-year strains.

"Our operations have gone well so far. Pressures in money markets over recent weeks have been subdued," Mr. Powell said.

He added: "We stand ready to adjust the details of our operations as necessary to keep the federal-funds rate in the target range."

Fed officials lifted rates four times in 2018 and a year ago expected to continue raising them this year because they anticipated that strong economic momentum, including very low unemployment, would push inflation higher.

Mr. Powell and his colleagues scrapped those plans early in 2019 when it became clear prices weren't rising as expected. Stocks had tumbled and corporate bond issuance dropped late last year over signs of a global growth swoon and investors' concern that higher interest rates could trigger a recession.

That kicked off an introspective examination of the Fed's guiding framework. Central to the Fed's thinking is how it perceives progress in achieving its twin goals of maximum employment and inflation near 2%. The jobless rate declined to 3.5% in November from 10% in 2009, but the Fed's preferred measure of inflation reached the central bank's 2% goal for only a few months last year.

"As you can see, inflation is barely moving, notwithstanding that employment is at 50-year lows—and expected to remain there," Mr. Powell said. "And so the need for rate increases is less."

The Fed chairman has faced a difficult landscape this year that included a public lashing from President Trump, who named him to a four-year term that began in February 2018. Mr. Trump has made clear his desire for lower interest rates to help boost exports by weakening the dollar against other currencies.

The central bank has also been divided over the outlook for an economy buffeted by rising trade tensions, a drop in business investment and a global manufacturing slowdown. Officials began weighing rate cuts in June and reduced their benchmark rate in July when trade uncertainty damaged the growth outlook, fanned fears on Wall Street of recession and raised worries of a more persistent shortfall in inflation.

Rate cuts in July, September and October marked an especially intense period for monetary policy and divided the 17 officials who participate in policy deliberations. Some wanted to wait for more evidence that a global manufacturing downturn was infecting the broader U.S. economy, which has been buoyed by solid consumer spending.

Others feared that because they had less room to cut interest rates if the economy weakened, they should act sooner than in past periods. Also, data revisions this year suggested the economy wasn't as strong as officials had thought last year, when they were raising rates.

On Wednesday, Mr. Powell signaled satisfaction with those moves and played down any sense of urgency about reversing them soon. "I would want to see a…significant move up in inflation that's also persistent before raising rates to address inflation," he said.

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Mr. Powell has faced criticism for uneven performances at some news conferences, which he started holding after every meeting this year—twice as frequently as his predecessors. On Wednesday, Mr. Powell "projected more confidence than at any presser before," said former Dallas Fed President Richard Fisher. "He is visibly in command of the ship."

The Fed is in the middle of a year-long review of its inflation-targeting strategy, and Mr. Powell's remarks illustrated how that process could already be influencing his leadership of the committee.

Currently, the Fed seeks to keep inflation at around 2%, which it regards as a sign of healthy growth. But inflation has mostly held under the target since it was adopted eight years ago, prompting Mr. Powell to push his colleagues to consider new strategies.

In his opening remarks Wednesday, Mr. Powell began laying out a public case for regarding too little inflation as a problem though central banks have traditionally focused on preventing too much of it

"Inflation that runs persistently below our objective can lead to an unhealthy dynamic" in which households expect lower inflation, leading to lower actual inflation. This could make it harder for the Fed to lower interest rates to stimulate growth in a downturn, he said, “resulting in worse economic outcomes for American families and businesses.”

The strategy review could already be influencing how officials are thinking about setting policy. Officials are debating whether to encourage periods of inflation above 2% to compensate for past misses, and Mr. Powell said several officials penciled in a modest overshoot of the 2% inflation target as appropriate policy in the projections released Wednesday.

When pressed, Mr. Powell said the Fed might need to take action if inflation held persistently below 2%. “Just saying words is not itself credible,” he said.

The comments suggested that low inflation, if it persists, could prompt the Fed to cut interest rates sometime next year, said Diane Swonk, chief economist at the accounting firm Grant Thornton. “If you believe what he said up there, you need to cut” if inflation remains low, she said.

The Fed has also made a major U-turn this year on its $4 trillion asset portfolio. Officials stopped shrinking their holdings in July and later concluded that a spike in money-market rates in mid-September was evidence they had allowed bank deposits held at the Fed, called reserves, to fall too low.

To add reserves back into the banking system, the Fed began buying $60 billion in short-term Treasury bills in October. They have also scaled up daily and weekly lending operations to flood the financial system with liquidity ahead of another anticipated cash crunch at the end of the year.

Mr. Powell held open the prospect Wednesday that the Fed could purchase slightly longer-dated Treasury securities if needed to keep markets functioning around these deadlines.

Some big banks could have incentives to scale back lending in money markets to slim down their balance sheets and avoid potential higher capital charges. Meanwhile, rising budget deficits have left bond dealers with more government bonds to sell and less spare capacity, as a result, to lend in money markets.

This has raised questions over whether the Fed’s interventions, which arrested market volatility in mid-September, will be as effective over the end of the year. “The reality is they don’t know, and they know they don’t know,” said Scott Minerd, chief investment officer at money manager Guggenheim Partners LLC.

—Michael S. Derby contributed to this article.

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