Yellen Makes It Clear That Fed’s Patience on Rates Has Limits

By Rich Miller - Dec 17, 2014

Federal Reserve Chair Janet Yellen restored clarity to the central bank’s monetary policy plans, saying it was on course to raise interest rates, though not right away, after officials issued a statement that some Fed-watchers found confusing.

Yellen told reporters following a two-day meeting that the Fed is likely to hold rates near zero at least through the first quarter. She also laid out the economic parameters that would need to be met for liftoff to begin later in the year and said that rates probably would be raised gradually thereafter. They may not return to more normal levels until 2017, she added.

“The statement was a bit clumsy, while I thought Yellen was very clear,” said Eric Green, head of U.S. rates and economic research at TD Securities USA in New York, who formerly worked at the New York Fed. “The second half of the year we are getting higher rates and the market has to price that in.”

The dollar and yields on Treasury securities rose in response, as investors in those markets processed the likelihood of rate increases by the Fed. The greenback gained against most currencies, with the Bloomberg Dollar Spot Index increasing to almost a five-year high. The yield on 10-year Treasuries rose eight basis points to 2.14 percent as of 5 p.m. in New York, according to Bloomberg Trader data.

FOMC’s Straddle

Yellen’s comments came after a Federal Open Market Committee statement that former Fed official Robert Eisenbeis also called “clumsy.” With investors focused on whether policy makers would retain their stated intention to hold rates near zero for a “considerable time,” the FOMC instead tried to straddle keeping the phrase in and taking it out.

The Fed said it can be “patient” in its approach to raising the benchmark lending rate from a range of zero to 0.25 percent, where it has been since December 2008. At the same time, policy makers said that language was “consistent” with their prior guidance that rates would be held near zero for a “considerable time” after they ended their asset purchases in October.

“The statement was muddled,” said Eisenbeis, who is now vice chairman and chief monetary economist for Cumberland Advisors in Sarasota, Florida.
The reluctance to drop the previous language completely reflects the difficulty the committee is having in moving away from giving time-based guidance on rates and toward letting economic statistics speak for themselves.

**Slow-Playing**

“They were worried that if they dropped ‘considerable time’ that markets would think rate hikes were imminent,” said Michael Gapen, chief U.S. economist at Barclays Plc. “What they are doing here is slow-playing the transition.”

The Fed meeting took place after a series of government reports showing that the U.S. economy is thriving. Payrolls rose by 321,000 last month, the biggest increase in almost three years, while retail sales increased 0.7 percent, the most in eight months. The reports suggest the U.S. is powering through a global slowdown that has seen Japan fall back into recession and that helped trigger a currency crisis in Russia.

The FOMC statement made no reference to the Russian turmoil or other global risks that have roiled financial markets. Yellen said officials discussed Russia at this week’s policy meeting and agreed it would have little impact on the U.S.

**Russian Exposure**

“U.S. banks’ exposure to Russian residents is really quite small in terms of relative to their capital,” Yellen said. “In terms of the portfolios of U.S. residents, there are Russian securities, but they account for a very small share.”

The Fed chief used her hour-long press conference to fill in some of the details on what the Fed intends to do with interest rates in 2015 and beyond.

“The statement that the committee can be patient should be interpreted as meaning that it is unlikely to begin the normalization process for at least the next couple of meetings,” which take place in January and March, she said.

She also described what economic conditions the Fed is looking for in deciding whether to begin raising interest rates for the first time since 2006.

“By the time of liftoff, participants expect to see some further decline in the unemployment rate and additional improvement in labor-market conditions,” Yellen said. “They also expect core inflation to be running near current levels” and want to be “reasonably confident” that overall inflation will rise back toward their 2 percent goal “over time.”

As measured by the personal consumption expenditure price index, the Fed’s preferred gauge, inflation stood at 1.4 percent in October, according to data issued by the Commerce Department in Washington. The core rate, which excludes food and energy costs, was 1.6 percent.
Transitory Impact

Yellen said policy makers expect inflation to ebb in coming months as the steep fall in oil prices feeds into gasoline and other products that consumers buy. That impact probably will be transitory, she said. She also played down the significance of a decline in inflation expectations as measured by trading in the Treasury debt market.

Most officials still see the first rate increase taking place next year, according to quarterly forecasts released after their meeting. At the same time, the forecasts show central bankers expect rates to rise more slowly over the next three years than previously anticipated, even as the jobless rate falls in 2015 to the level they consider full employment.

The benchmark rate will be 1.125 percent at the end of next year, compared with a 1.375 percent median estimate in September, according to the forecasts. The rate will be 2.5 percent at the end of 2016, and 3.625 percent at the end of 2017, according to the median.

Long Time

“Monetary policy will still be very accommodative for a long time” after rates begin to rise, Yellen said.

She said the committee would like to see “a short period of a very slight undershoot” of its maximum employment goal, so unemployment gets low enough to drive up wages and prices.

“Historically, we have seen as the economy strengthens and slack diminishes, that inflation does tend to gradually rise over time,” Yellen said. “I will be looking for evidence that I think strengthens my confidence in that view.”

The unemployment rate will average 5.2 percent to 5.3 percent in the final quarter of 2015, according to the Fed’s central tendency forecast. Full employment is pegged at 5.2 percent to 5.5 percent. Joblessness in November was 5.8 percent.

Three Fed presidents dissented from the FOMC statement: Narayana Kocherlakota of Minneapolis, Philadelphia’s Charles Plosser and Richard Fisher of Dallas. Kocherlakota said the decision “created undue downside risk to the credibility of the 2 percent inflation target.”

Plosser said the statement shouldn’t say the new forward guidance is consistent with the previous statement, and Fisher said the improvement in the economy has moved forward the date when it will be appropriate to raise rates.

Yellen wasn’t fazed by the dissents.

“At a time like this where we are making consequential decisions, I think it’s very reasonable to see divergences of opinion,” she said.
"There is tension between the hawks and doves that's growing," said Thomas Costerg, an economist at Standard Chartered Bank in New York. "Yellen was trying to get the middle road between the two."

“But the big picture remains the same,” he added. “They want to tighten next year, but there is no rush to hike rates.”

**Yellen Doesn’t See Fed Raising Interest Rates Before April**

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