Fed signals slowdown in rate increase

Powell speech caps dovish turn

by Darrell Delamaide in Washington

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In a speech in late November, US Federal Reserve Chair Jay Powell made some surprising announcements. He said there was no 'pre-set path' for interest rate increases, and that rates were 'just below' the neutral rate of neither stimulating nor dampening the economy. As it turns out, he was simply channelling the Federal Open Market Committee meeting from three weeks earlier. This became apparent when, the day following Powell's speech, the minutes from the FOMC were released.

The Fed chief's address capped a dovish turn in the panel, rather than breaking new ground. The FOMC is not bowing to criticism from US President Donald Trump – though that may influence its thinking. Rather, the policy-makers are responding, as they always say they do, to new data. In fact, much of the early November meeting was devoted to a discussion of whether the consensus statement should be revised to emphasise this data dependency.

'Monetary policy was not on a pre-set course,' the minutes said. 'If incoming information prompted meaningful reassessments of the economic outlook and attendant risks, either to the upside or the downside, their policy outlook would change.'

Powell's speech used very similar wording: 'We also know that the economic effects of our gradual rate increases are uncertain, and may take a year or more to be fully realised. While FOMC participants' projections are based on our best assessments of the outlook, there is no pre-set policy path.'

There were clues along the way. A week after the November meeting, Philadelphia Federal Reserve President Patrick Harker said in an interview with The Wall Street Journal, 'At this point, I'm not convinced a December rate move is the right move.'

He added, 'We're not seeing the recent data telling us that inflation's moving rapidly past our target. I think we have some time to let this evolve.' Nonetheless, he favoured moving toward what he saw as the neutral rate, which he put at 3%.

Atlanta Fed chief Raphael Bostic was also cautious. 'I don't think we are too far from a neutral policy, and neutral is where we want to be,' he said at an event in Madrid the same week. 'We may not be there quite yet, but I am inclined to think a tentative approach as we proceed would be appropriate.'

To avoid leaving any doubt in the minds of his listeners, he added, 'I can think of no superior approach than to proceed cautiously and keep a keen eye on the data.'

St. Louis Fed chief James Bullard has advocated curtailing rate increases, and now his colleagues are coming around to his point of view. 'Whether there are cracks in the US economy's performance is one of the main challenges for the Fed going forward,' Bullard said in an interview with Reuters. 'I don't have any reason to doubt the economy will slow in 2019 and 2020. It would be much tougher for the Fed to continue to raise at this pace in a slowing economy relative to where we have been.'

Bullard will rotate back into a voting position in 2019, which means his dissent can be recorded if rate increases come faster than he likes. But he may not have to dissent. Fed fund futures indicate that markets don't see chances of another increase after December rising above 50% until June or July.

The clearest preview of Powell's remarks came just the day before his address, in a speech by the Fed's new vice-chair, Richard Clarida, at a conference in New York. The former Columbia University professor is now the ranking economic heavyweight on the board of governors.

It was Clarida who found the economic reason inflation is lagging behind the 2% target of the Fed, as measured by the personal consumption expenditure index it prefers. There is still slack in the labour market, he said, sounding one of Janet Yellen's favourite themes. Plus, productivity has started to accelerate, keeping inflationary pressures at bay even as unemployment sinks to record lows.

It's important to keep in mind that Clarida, a former assistant secretary of treasury for economic policy under President George W. Bush, is Trump's man in a way Powell, who was appointed by Barack Obama, can never be. Whether it is pressure from Trump or genuine conviction leading to the Fed's more dovish stance is irrelevant. The fact is, it is there.

Neel Kashkari, the FOMC's most radical dove (vying for that title with Bullard), brought the month to a close, saying again that the Fed should pause in raising rates as long as inflation is tame and job creation continues strong. 'There's still slack in the labour market,' he told CNBC.

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