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Fed Appears to Hold Line on Rate Plan

Stock-market volatility and China's woes fail to alter policy makers' view of improving job market, economy

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JACKSON HOLE, Wyo.—Federal Reserve officials emerged from a week of head-spinning financial turbulence largely sticking to their plan to raise U.S. interest rates before the end of the year.

During the Federal Reserve Bank of Kansas City's annual economic symposium here, many policy makers signaled that stock-market volatility and China's woes haven't seriously dented their view that the U.S. job market is improving, and that domestic economic output is expanding at a steady, modest pace.

Inflation might remain low for longer thanks to falling oil prices and a strong dollar. Officials will continue to keep a close watch on markets and China. But they hope U.S. consumer-price inflation will start inching toward their 2% annual target as the economy's untapped capacity gets used up, leaving them in position to start raising rates after several months of forewarning.

"There is good reason to believe that inflation will move higher as the forces holding inflation down—oil prices and import prices, particularly—dissipate further," said Fed Vice Chairman Stanley Fischer in comments delivered to the conference, which ended Saturday.

The Fed has said it will raise rates when it is reasonably confident the inflation rate will rise again to 2%. Mr. Fischer's comments suggested he believed the economy is closer to that point, although he pointedly avoided sending a signal about whether the Fed will act at its next meeting.

Federal Reserve Vice Chairman Stanley Fischer, attending the Jackson Hole, Wyo., symposium, avoided sending a signal about whether the Fed will act to raise rates at its next meeting. *PHOTO: JONATHAN CROSBY/REUTERS*

"I will not, and indeed cannot, tell you what decision the Fed will reach by Sept. 17," Mr. Fischer said.

Inside the Fed, advocates for holding off a rate boost beyond this year aren't getting much traction. In Jackson Hole, Minneapolis Fed President Narayana Kocherlakota was an isolated voice among officials for sustaining near-zero interest rates. He has lost his share of battles over policy, including the decision last October to end the Fed's bond-buying program. "I've won some and lost some. I wish I had done a better job. I think we'd be better positioned policy-wise if I had done a better job of being persuasive," he said in an interview.

Fed officials want to see how markets perform in the next couple of weeks and what emerges from new economic data. Fed Chairwoman Janet Yellen, who didn't attend the Jackson Hole symposium, also needs to confer with officials to assess what kind of consensus she can build.

Earlier in the week, after two days of steep stock-market declines, New York Fed President William Dudley, in comments to the media, clearly backed away from a September move. Some outsiders, including Lawrence Summers, a former top economic adviser to President Barack Obama, pressed the Fed to delay a rate increase.

Officials gathering in Jackson Hole were comforted by the market's rebound and also its generally smooth functioning during a spasm of volatility. They noted investors were largely able to meet demands for cash to bolster funds they had borrowed for investments, in what is known as a margin call, without setting off a spiral of selling.

Federal Reserve Bank of Minneapolis President Narayana Kocherlakota was an isolated voice among officials at the economic symposium for sustaining low interest rates. *PHOTO: JONATHAN CROSBY/REUTERS*

Officials also said they saw few signs of stress in banks, brokers and others. “The dog that hasn’t barked in the wake of recent market turbulence has been any hint of distress at any major financial institution,” said Mark Carney, governor of the Bank of England.

The U.K.’s central bank also expects to stick to its plan to raise interest rates in the coming months, perhaps early next year.

A risk for the Fed is that it waits too long and sparks bubbles in the economy. Some critics say it has already distorted stock and bond prices, which could lead to future market instability.

Moving as planned, however, brings currency risk. If the Fed raises rates while other major economies proceed with efforts to reduce rates or add other financial stimulus to their economies, the U.S. dollar would likely continue rising. That would hurt exports and put downward pressure on inflation. Mr. Fischer said it was “plausible” that the dollar’s strength will impinge on growth perhaps into 2017.

The Fed doesn’t want U.S. inflation to run persistently below its goal. In the long run, officials believe a steady inflation rate makes it easier for businesses and households to plan.

For officials like Mr. Kocherlakota, a delay in returning to a 2% inflation rate is another reason to keep interest rates low. Though other officials don’t want to delay a first rate increase much longer, persistently low inflation is likely to reinforce their inclination to proceed with great caution after the first move.

Falling oil prices “might change the path of interest rates” after the Fed first raises them, Cleveland Fed President Loretta Mester said in an interview. She said she was already thinking about reducing her estimate of how high short-term interest rates will go in the coming years, to 3.5% from 3.75%, in part because the economy has been growing only slowly even with near-zero rates.

“We will most likely need to proceed cautiously in normalizing the stance of monetary policy,” Mr. Fischer said, adding, “The entire path of interest rates matters more than the particular timing of the first increase.”

A U.S. rate increase will ripple around the globe, including a raised risk of currency depreciation and capital outflows in emerging markets, though international officials say they are prepared. But financial-market turmoil could create additional complications overseas for a Fed move. “If it adds to already a high level of volatility, that will not be productive,” Reserve Bank of India Gov. Raghuram Rajan said in an interview. “But if it comes at a time when volatility is relatively low, I think we all know that it has to happen at some point.”

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