FED RATE HIKE NOT LIKELY TO SPOOK ECONOMY

RISING TIDE
SPECIAL REPORT

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A Federal Reserve interest rate hike Thursday could shake markets but is likely to cause just a ripple in the solidly growing economy, analysts say.



And some economists say rates are so low that a small bump might spur growth. The Fed's benchmark short-term rate has been near zero since the 2008 financial crisis.

Many experts say it's a toss-up whether the Fed will pull the trigger Thursday after a two-day meeting. Waiting could allow tumbling unemployment to eventually trigger an undesirable pickup in inflation.

But acting amid market turmoil and global economic weakness could jeopardize the 6-year-old recovery.

A quarter of a percentage point boost in the fed funds rate likely would marginally push up borrowing costs for consumers and businesses, including mortgages, car loans and corporate bonds, tempering such borrowing and economic activity. Such long-term loans, however, probably would rise only a tenth of a percentage point or so, says Mark Zandi, chief economist of Moody's Analytics.

Assuming the Fed follows through on its vow to lift rates gradually, by about a percentage point over the next 12 months, that would likely shave about 0.15 percentage points off economic growth the subsequent year, Zandi estimates. For example, an economy that grew at a solid average of 2.75% at an annual rate over the past four quarters instead would expand by 2.6%, assuming that pace continued.

Similarly, monthly job growth, which has averaged a healthy 212,000 so far this year, would be trimmed by about 30,000 and the unemployment rate would be nearly a tenth of a percentage point higher than it would be otherwise.

"It would have a meaningful but modest effect on growth," Zandi says. A similar impact would occur annually for three years as the Fed nudges its key rate back to a normal level of about 3.75%. The goal, however, is to head off a bout of inflation that ultimately could do far more damage to the economy than gently rising interest rates.

A sharper rate hike cycle the Fed began during the housing bubble in 2004 contributed to progressively slower economic growth in the following years.

Yet moving this month may carry larger risks. Diane Swonk, chief economist of Mesirow Financial, says it could have a bigger negative effect on growth if it spooks markets that are now betting the Fed will hold off. That could trigger another stock sell-off that saps consumer and business confidence and spending, shaving quarterly growth by as much as 0.2 percentage points or more at an annual rate by the end of 2015, she says.

Some economists say a rate increase might goose the economy. Economist Joseph LaVorgna of Deutsche Bank says interest rates are so low that raising them modestly would have a negligible effect on 30-year mortgages and other rates.

Meanwhile, he says, the move would increase the interest income of retirees and other bank depositors, prod banks to lend more by widening their profit margins and proclaim the economy healthy enough to shift from crisis-era interest rates.

"It will lift 'animal spirits,'" LaVorgna says.

Mike Englund, chief economist of Action Economics, says a rise in the fed funds rate and other short-term rates could cut long-term borrowing costs for consumers and businesses by eliminating uncertainty about the prospects for those rates.

"A right-sized policy may be a net stimulus for the economy," he says.