Fed goes slo-mo on interest rate hikes

'Extraordinarily slow' pace is expected

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The Federal Reserve is finally raising its starting pistol, but it's likely to jog, not sprint, around the track.

The Fed signaled Wednesday that it's poised to increase its near-zero benchmark interest rate within months, dropping a pledge to "be patient" as it considers pulling the trigger for the first time since 2006.

While the wording change was expected, economists were surprised by the leisurely pace of increases Fed policymakers are projecting, and some believe they'll eventually be forced to shake a leg.

"The pace of the rate hikes (is) expected to remain extraordinarily slow by historical standards," says Chief Economist Scott Anderson of Bank of the West.

Fed policymakers predict they'll hoist the central bank's federal funds rate from the current 0.125% up to 0.625% by year's end and to 1.875% by the end of 2016, based on their median forecast. That's a clip of a bit more than a percentage point a year, or about a quarter-point hike every other meeting. A similarly unhurried gait is projected for 2017.

By contrast, the Fed raised rates at about twice that pace in hiking cycles in 1994, 1999 and 2004.

Typically, the Fed raises rates to keep a lid on inflation in a surging economy and labor market, and lowers rates to spur activity and push down unemployment. In previous cycles, low unemployment and rising inflation went hand-in-hand.

This time, despite strong job growth, inflation remains stubbornly weak, in part because of low oil prices, and prospects for a sharp upturn are dim as the near-normal unemployment rate of 5.5% falls even further, Fed Chair Janet Yellen told reporters.

Low unemployment should force employers to raise wages to attract workers, pulling up inflation. But a large supply of discouraged workers who had stopped looking for jobs means unemployment can continue to drop and firms can boost pay slowly. Wage growth has been meager.

Another reason rates are expected to climb gradually is that other major global economies are lowering interest rates amid sluggish growth even while the Fed prepares to raise rates, Anderson says. That's strengthening the dollar and hurting U.S. exports and the economy.

But Paul Ashworth of Capital Economics attributes the Fed's paltry rate-hike forecasts to an effort to calm markets that might have sold off in response to its decision to remove its "patient" pledge.

The strategy worked. On Wednesday, stocks rallied and Treasury yields fell. But like several other economists, Ashworth expects wage growth to pick up more rapidly than the Fed believes, forcing it to raise rates somewhat more briskly next year.

TAKING IT SLOW

How much the Fed's benchmark short-term interest rate rose in the 12 months after it began past rate-hike cycles and the Fed's latest projections for the end of 2015 and 2016. The Fed's target range is now at 0% to 0.25%.

1994	1999	2004	2015
FEB. 1994	JUNE 1999	JUNE 2004	(Fed projections)
3%	4.75%	1%	DEC. 2015
FEB. 1995	JUNE 2000	JUNE 2005	0.625%
6%	6.5%	3.25%	DEC. 2016
Change: 3 percentage points	Change: 1.75 percentage points	Change: 2.25 percentage points	1.875%
			Change: 1.25 percentage points

SOURCE: FEDERAL RESERVE