Fed raises key interest rate and foresees 3 hikes in 2017

BY MARTIN CRUTSINGER
ASSOCIATED PRESS

WASHINGTON — The Federal Reserve has raised a key interest rate in response to a strengthening U.S. economy and expectations of higher inflation, and it foresees three more rate hikes in 2017.

The Fed's move will mean modestly higher rates on some loans.

Wednesday's action signaled the Fed's belief that the economy has improved over the past year after a rough start to 2016 and can withstand slightly higher borrowing rates. Its expectation of three rate increases in 2017 is up from two in its forecast three months ago.

The central bank said in a statement after its latest policy meeting that it's raising its benchmark rate by a quarter-point to a still-low range of 0.5 percent to 0.75 percent. The Fed had most recently raised the rate last December from a record low near zero set during the 2008 financial crisis.

Responding to a question at a news conference, Chair Janet Yellen said she didn't think the economy needed stimulus from President-elect Donald Trump's proposed tax cuts and infrastructure spending — the kind of fiscal support that Yellen and her predecessor, Ben Bernanke, had called for in the past.

Yellen said such policies would be unlikely to maximize employment, since the unemployment rate — 4.6 percent, a nine-year low — is now slightly below the Fed's own long-term target.

"My predecessor and I called for fiscal stimulus when the unemployment rate was substantially higher than it is now," she said.

The Fed chair stressed that she wasn't providing advice or guidance to the incoming Trump administration. And she downplayed any expectations that Trump's economic program could lead to faster rate hikes resulting from higher inflation.

The Fed's move Wednesday, only the second rate hike in the past decade, came on a unanimous 10-0 vote. The central bank also released updated forecasts that showed modest changes to its outlook for growth, unemployment and inflation, mainly to take account of a stronger economy and job market.

James Marple, senior economist at TDBank, said the Fed's forecast of three rate increases next year, up from two, was the "only real surprise" Wednesday.

"The move up is a signal that the Fed has become more confident in the economic outlook and that inflation will increasingly track closer to the 2 percent target," Marple said.

It's hardly guaranteed that the Fed's forecast for three hikes in 2017 will prove accurate. Last year at this time, for example, the Fed predicted it would raise rates four times in 2016. It turns out it's raising them just once.

Wednesday's rate increase should have little effect on mortgages or auto and student loans. The Fed doesn't directly affect those rates, at least not in the short run. But rates on some other loans — notably credit cards, home equity loans and adjustable-rate mortgages — will likely rise soon, though only modestly. Those rates are based on benchmarks like banks' prime rate, which moves in tandem with the Fed's key rate.

After the Fed's announcement, several major banks announced that they were raising their prime rate from 3.50 percent to 3.75 percent.

"This single quarter-point move in interest rates will go largely unnoticed at the household level, but coupled with last year's hike, the cumulative effect could mount quickly if the Fed quickens the pace of rate hikes in 2017," said Greg McBride, Bankrate.com's chief financial analyst.

Mortgage rates have been surging since Trump's presidential victory last month on expectations that his economic program would accelerate economic growth and inflation.

Stock investors appeared disappointed by the Fed's forecast of three rate increases in 2017. The Dow Jones industrial average closed down about 118 points — 0.6 percent — a sign that stock investors are pricing in additional Fed rate hikes. The yield on the 10-year Treasury rose to 2.57 percent from 2.47 percent.

Yellen attributed the Fed's higher number of estimated rate hikes for 2017 to a lower unemployment rate and possibly some changes in federal budget policy beginning next year. But she emphasized that any changes to the Fed's projections were "modest."

She said Fed officials, during their meeting, discussed Trump's economic plans as well as the surge in stock prices, bond yields and the dollar that's followed his election.