Fed's options are open

Yellen makes case for low rates, but leaves herself an out

Paul Davidson
@PDavidsonusat
USA TODAY


AP

Federal Reserve Chair Janet Yellen said Friday the rapid fall in the unemployment rate likely overstates the health of the labor market, and the Great Recession may have "caused persistent changes" in the job landscape.

Yet, speaking at the Fed's annual symposium in Jackson Hole, Wyo., she balanced that view by going further than she had previously in citing risks that inflation could accelerate more than the Fed anticipates.

As a result, markets were unmoved by her even-handed outlook, which neither affirmed nor cast doubt on the Fed's tentative plans for raising interest rates.

The jobless rate has fallen to 6.2% from a high of 10% in fall 2009. Still, Yellen said, "It speaks to the depths of the damage that five years after the end of the recession, the labor market has yet to fully recover."

> **"The decline in the unemployment rate over this period somewhat overstates the improvement in overall labor market conditions."**

Debate is heating up among Fed policymakers about when to begin raising its benchmark short-term interest rate, near zero since the 2008 financial crisis. While most policymakers expect the first rate hike in mid-2015, some argue the improving job market and rising inflation should lead to an earlier increase.

Yellen is considered one of the Fed's most pro-growth policymakers, meaning she's more concerned with lowering unemployment than heading off inflation, which is still below the Fed's annual 2% target. But on Friday, she provided fodder for both policymaking factions, saying the Fed's interest rate moves will depend on the course of the job market and inflation.

On the one hand, she said, the percentage of people participating in the labor force, 62.9% in July, is near 36-year lows. And while much of the decline is due to Baby Boomers retiring, Yellen said even those retiring or on disability could return to the workforce as the job market improves. That could push up unemployment again — a reason to maintain low interest rates longer.

At the same time, Yellen said inflation could heat up unexpectedly. Despite tepid wage increases of 2% a year, Yellen said that may be because employers were hesitant to cut pay during the recession. They thus don't have to boost pay now to attract workers. Eventually, however, "wages could begin to rise at a noticeably more rapid pace."

That could lead to an earlier increase in interest rates.

> **"Wages could begin to rise in a noticeably more rapid pace once pent-up wage deflation has been absorbed."**

> **"It speaks to the depths of the damage that, five years after the end of the recession, the labor market has yet to fully recover."**