Global Tumult Could Prompt Fed Rate Pause

By Jon Hilsenrath And Ben Leubsdorf

Worries about global turbulence and soft spots in the domestic economy weighed on Federal Reserve officials when they gathered at their June policy meeting, trepidations that could cause them to wait longer before raising short-term interest rates.

Several Fed officials have said publicly since the June meeting that a first interest-rate increase in nearly a decade could be warranted as early as September. But minutes of the June 16-17 gathering, released Wednesday, showed underlying unease about taking that big step.

The Fed left broad guideposts in the minutes about how the decision will unfold but avoided giving obvious clues about when a move might happen. Instead, the central bank kept its options open and expressed caution about proceeding.

Officials, the minutes said, "would need additional information indicating that economic growth was strengthening, that labor market conditions were continuing to improve, and that inflation was moving back toward the Committee's objective" of 2% before raising interest rates.

Among the Fed's worries, the minutes noted, were "uncertainty about whether Greece and its official creditors would reach an agreement and about the likely pace of economic growth abroad, particularly in China and other emerging market economies." They also expressed concern about the slow pace of U.S. consumer spending.

Since that meeting, Greece has defaulted on a loan from the International Monetary Fund and China's stock market has descended into a tailspin, developments that are likely to intensify the Fed's caution.

Fed officials knew Greece was entering a critical stage with creditors at the time of the meeting. "Many participants expressed concern that a failure of Greece and its official creditors to resolve their differences could result in disruptions in financial markets in the euro area, with possible spillover effects on the United States."

The Fed has held its benchmark short-term rate, the federal-funds rate, near zero since December 2008. Many Fed officials suggested early in the year it might begin raising rates by midyear, but they held off after the economy shrank in the first quarter. Attention later turned to the possibility of a September rate increase, but global developments have raised doubts in markets about whether the Fed will act by then.

On the Chicago Mercantile Exchange, traders during the past month have been buying September fed funds futures contracts, demand that has been driven by a sense that a rate increase by then has become less likely. The expected fed-funds rate for September is 0.155% in futures markets, not far from the 0.12% rate where it has generally resided since 2008.

Lewis Alexander, an economist at Nomura Securities, said he sees a 40% chance the Fed will raise rates by September and a 60% chance it will move after that. In April, he saw a 50% chance of a rate increase by September or even sooner.

Though concerned about China and Greece, officials now aren't panicking. Much of Greece's bad debt is held by the International Monetary Fund and official institutions in Europe, which insulates global markets from any fallout. China is more of an unknown. Fed officials have consistently expressed confidence in Beijing's abilities ability to manage the troubles of the world's second-largest economy.

"I visited China recently, and I arrived fully cognizant of the concerns people highlight—slower growth, the unsustainability of the current export-driven model, debt buildup, bubbles in the equity and housing markets, the risk of falling investment, and the overall international implications of those risks," John Williams, president of the Federal Reserve Bank of San Francisco, said in a speech Wednesday. "But I have to say that, after talking to officials and academics there, I was a lot less concerned about China's near-term economic outlook on my return flight than I was heading over."

He and other officials are trying to weigh an apparently improving outlook for the U.S. economy against the threats it faces from abroad. The Fed has said it would raise rates when officials become confident inflation will rise to 2%, after running below the central bank's target for more than three years, and when they see more improvement in the job market.

Despite concern about developments abroad, some officials worried that if the Fed waits too long before raising rates it might need to move abruptly later, which could cause financial instability, the minutes said.



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Fed chief Janet Yellen, shown in June, and other officials have been monitoring events in Greece and China.