

set to hike rates, Fed wrestles

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The Federal Reserve is caught between the unusual tandem of low unemployment and sluggish inflation, a dilemma that poses challenges as policymakers weigh interest rate decisions beginning this week.

The Fed almost certainly will raise its key short-term rate by a quarter percentage point to a range of 1% to 1.25% at a two-day

meeting that concludes Wednesday, marking its third such hike since December. The move will likely trigger a similar increase in rates for credit cards, adjustable-rate mortgages and home equity loans, Bankrate said.

Many economists believe the Fed will stick to its forecast of another rate increase in 2017 after Wednesday's meeting, and Fed Chair Janet Yellen will lay out a plan to begin gradually shrinking its \$4.5 trillion balance sheet as early as this fall. That's expected to nudge up long-term rates.

But wage growth, and inflation

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more broadly, have been stubbornly low despite tumbling unemployment. The 4.3% jobless rate should force employers to bid up salaries to attract workers. That's happening, but not as rapidly as expected.

Partly as a result, the Fed's preferred measure of annual inflation has retreated further below its 2% target.

with low inflation

Several Fed officials believe the decline was temporary and related to wireless prices. And Barclays economist Michael Gapen said low unemployment should push up wage growth soon.

Similarly, economic growth was feeble in the first quarter but many economists blame measurement problems.

Noting most Fed officials share that view, he said, "I think they will look through" the weak inflation and meager first-quarter growth and maintain their forecast of one more hike this year and three in 2018.

But there are risks to that outlook. A shadow supply of part-time workers and discouraged Americans on the sidelines could continue to curb pay increases, Gapen said. He predicted the Fed will hold rates steady in September to assess whether inflation and the economy are picking up.

He expects the Fed that month to instead announce its first step in reducing the \$3.5 trillion in Treasury bonds and mortgage-backed securities it purchased after the financial crisis. The Fed plans to stop reinvesting proceeds as those assets mature.