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Fed Officials Hint at Quick Reversal

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Most economists now say rate increases won’t come until 2010, but some warn that the hikes could be very early in the year and might be surprisingly stiff. The federal funds rate has been at virtually zero since mid-December of 2008. Its last high point was 5.25 percent in August 2007. (MANDEL NGAN/AFP)

While the Fed has been careful to repeat that the benchmark rate would stay low — even at zero — for a very long time, various Fed officials this past week have been trying to “jawbone” the market in anticipation of a quick change of course.

It’s a time-honored tradition, and one that central bank chiefs employ at great risk: The market could interpret too much talk about rate changes as unwillingness to act.

So, instead of sending Fed Chairman Ben Bernanke out to drop hints of higher rates, the monetary authority instead has deployed its board members.

Fed Vice Chairman Donald Kohn on Wednesday joined the chorus, suggesting that a reversal in policy might come well ahead of more obvious signs of economic recovery.

His comments come after several Fed members, including inflation hawk Richard Fisher at the Dallas Fed, have made similar noises about coming changes.

"Tightening (monetary policy) while there's still slack in the economy is something that we have to do every time," Kohn told a monetary policy conference at the Cato Institute on Wednesday, reported by news wires.

"It's incumbent upon us to. . . be forward-looking in our story. Yes, there's slack, but it's going away. Yes, people are still unemployed, but people are being put back to work. And the alternative of not tightening and not beginning this process is to create a destabilizing round of inflation. . . If we can't tell that story we shouldn't be tightening."

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The federal funds rate has been at virtually zero since mid-December of 2008. Its last high point was 5.25 percent in August 2007.

Fed Gov. Kevin Warsh warned in a recent speech: "If policymakers insist on waiting until the level of real activity has plainly and substantially returned to normal — and the economy has returned to self-sustaining trend growth — they will almost certainly have waited too long."

When the time comes to boost rates, the Fed may need to act with "greater swiftness than is modern central bank custom," he said.

"The speed and force of the action ahead may bear some corresponding symmetry to the path that preceded it," he said. That would be the case if the economy were to turn up "smartly and durably," he added.

Warsh isn't the only one. The Fed will have to act quickly, and "perhaps aggressively" when the time comes to pull back its extraordinary support for markets to avoid stoking inflation, Philadelphia President Charles Plosser said in a speech of his own.

"The Fed will need courage. I believe we will need to act well before unemployment rates and other measures of resource utilization have returned to acceptable levels."

And Dallas Fed President Richard Fisher said in a speech: "When it comes time to tighten monetary policy, my colleagues and I will move with an alacrity that, if needed, will be equal in speed and intensity to that which we pursued monetary accommodation."

All this chatter from the Fed board members came just days after the Fed pledged to keep official interest rates at a record low near zero for an "extended period."

Many economists took that to mean for the rest of this year and into part of next year.

The conflicting comments have left financial market participants scratching their heads.

"It's all very confusing," Michael Feroli, an economist at JPMorgan Economics, who has been predicting the Fed wouldn't boost rates until early 2011, told The Associated Press.

"Now it seems sooner than that. Some are wondering if rate increases will come this year."

What seems to be happening is that the Fed is preparing financial markets for when it does ultimately raise rates, even though the actual move is probably months away.

Fed officials are clearly concerned with the nearly $2 trillion budget deficit for this year and a debt burden that now totals about 56 percent of GDP.

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