Powell: Fed 'fully committed' to bringing inflation down after interest rate bump

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·Reporter

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Federal Reserve Chairman Jerome Powell pledged to Americans that the central bank will continue to lever interest rates as much as needed to slow the rapid inflation weighing on the U.S. economy.

"I'd start by assuring everyone that we're fully committed to bringing inflation back down and also sustain the economic expansion," Powell told reporters on Wednesday afternoon.

The Fed once brushed off rising prices as a "transitory" phenomenon, hoping that the inflation was the result of pandemic-induced supply chain disruptions that would fade by late 2021. Instead, all major measures of inflation showed the pace of inflation continuing to rise through the beginning of this year. The Personal Consumption Expenditures Index showed prices rising by 6.1% in February, the fastest annual pace seen since 1982.

Acknowledging that inflation is no longer transitory, the Fed Wednesday took the first major steps in reversing its pandemic-era stimulus — by increasing short-term interest rates by 0.25%. The Fed had held interest rates at near zero since the depths of the pandemic.

Hiking rates will make it slightly more expensive to borrow.

“As we raise interest rates, that should gradually slow down demand for the interest-sensitive parts of the economy. And so what we would see, is demand slowing down but just enough so it’s better matched with supply and that will bring inflation down over time,” he said.

The problem is that 0.25% is not enough to achieve that goal. The Fed’s own estimates suggest that any interest rate below 2% is not restrictive to the U.S.’s economic potential.

Fed officials projected a strong likelihood of another six interest rate hikes through the end of this year, which would imply interest rates 1.75% higher than they were at the start of the year.

The path to higher rates comes with uncertainty. The central bank has had a history of tightening policy and triggering a recession, which is an elevated risk given the international backdrop.

"There's going to be a key question as to how smoothly the Fed can navigate its future rate increases in an environment where there's a lot of instability, and that instability has been exacerbated by the situation in Ukraine,” EY-Parthenon Chief Economist Gregory Daco told Yahoo Finance after the Fed decision.

Another challenge: Interest rate increases do not immediately quell inflation. Because the Fed’s monetary policy operates through the banking system, businesses and households may not see the impact of higher borrowing costs until much later.

“I think monetary policy starts to bite on inflation and on growth with a lag of course. So you would see that more in 2023 and 2024,” Powell said.

The central bank now projects prices to rise by 4.3% (as measured in PCE) over the course of 2022, well above the 2.6% pace it had projected in December. In 2023, the Fed hopes to bring that pace down to 2.7% and then to 2.3% in 2024.

All of those measures are above the Fed’s inflation target, which is 2%. For the 16 policymakers sitting on the Fed’s policy-setting committee, pushing inflation back toward 2% remains the goal.

“As I looked around the table at today’s meeting, I saw a committee that’s acutely aware of the need to return the economy to price stability and determined to use our tools to do exactly that,” Powell said.

The next policy-setting meeting is scheduled for May 3-4.

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