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Fed says US economy favours 2015 rate rise

By Sam Fleming in Washington

The Federal Reserve is on course to raise interest rates this year in a decision that would signal the extent of the country's recovery from the "trauma" of the financial crisis, Janet Yellen said.

The Fed chair described the US economy's prospects as "favourable" as hiring pushes the country towards maximum employment, adding that factors that have been holding back inflation were likely to subside. In a prepared statement before testifying to Congress, Ms Yellen singled out risks to the US from the Greek debt talks and China's attempts to tackle its high debt, weak property markets and "volatile" financial conditions.

But she struck a positive tone discussing the progress the US has made since it was clobbered by the financial crisis, saying that employment has swelled by 12 million since its recession-induced trough and predicted that factors restraining inflation recently were likely to ebb.

Her positive snapshot of the economy will reinforce suggestions by some leading policymakers including William Dudley of the New York Federal Reserve that a rise will be on the table as soon as September.

US growth faltered in the first quarter but has seen stronger indicators in recent months, intensifying expectations that the Fed will pull the trigger as soon as September.
In response to her remarks, the euro dropped by 0.33 per cent to $1.0974 against the dollar, which was up by 0.36 per cent on the day against the yen, at Y123.80.

The Federal Open Market Committee has been divided over when to start the process, with different policymakers advocating either one or two rises this year, or none, in their latest policy meeting.

"Looking forward, prospects are favourable for further improvement in the US labour market and the economy more broadly," Ms Yellen said. "If the economy evolves as we expect, economic conditions likely would make it appropriate at some point this year to raise the federal funds rate target, thereby beginning to normalise the stance of monetary policy."

If that decision is indeed made, it will "signal how much progress the economy has made in healing from the trauma of the financial crisis", Ms Yellen added.

Ms Yellen did not mention a given month for the first move in rates, saying the committee would determine the timing of the first increase on a meeting-by-meeting basis.

The Fed chair said growth was likely to strengthen over the remainder of the year after a weak first three months of the year, highlighting the benefits of low oil prices and strong hiring, as well as the diminishing influence of the high dollar.

Low core inflation readings largely reflect influences that are "likely to be transitory", she added, pointing to the recent stabilisation in energy prices.

Ms Yellen singled out a pickup in consumer spending and strong sales of cars in May and June as evidence that US households now have the confidence and means to make big purchases. Housebuilding had picked up "somewhat" even if demand was being restrained by a limited availability of mortgages to many types ofhomebuyers.

"Low oil prices and ongoing employment gains should continue to bolster consumer spending, financial conditions remain generally supportive of growth, and the highly accommodative monetary policies abroad should work to strengthen global growth," she said.

In addition, "headwinds" hitting the US including the dollar surge and impact of lower crude prices on oil industry investment were likely to diminish.

Ms Yellen painted a picture of a steadily improving labour market, with unemployment more than 4.5 points down from its 10 per cent peak in 2009 and noticeable declines in the number of people stuck in long-term unemployment and in the number of people working part-time because they can't find a full-time post.

That said, there remained slack in the labour market, as indicated by "relatively subdued" wage growth, the Fed chair said, arguing that the jobs market had further to go before attaining full health. "While labour market conditions have improved substantially, they are, in the FOMC's judgment, not yet consistent with maximum employment."

Recent turbulence in Europe and China has raised concerns that US growth could once again be knocked by overseas factors, and Ms Yellen said overseas developments did indeed “pose some risks” to US growth. The high level of the currency was still holding back exports, as was weak growth in several trading partners, she said.

However, Ms Yellen added that overseas growth could yet pick up more rapidly than people anticipated, providing more support for the US recovery.

She argued it was the expected path of interest rates, not the initial step, that would matter most for the economy, as she reiterated that hikes were likely to happen at a gradual pace.

Answering questions from Congress, Ms Yellen said that the Fed had already taken the problems in Greece and China into account when officials prepared their rate forecasts back at the central bank’s June meeting. The issues there were “not new” she said, in a suggestion that the turbulence had not thus far overturned the Fed’s policy assumptions.
Asked about calls from the International Monetary Fund for the Fed to wait until 2016 before lifting rates, Ms Yellen said that an advantage to starting rate rises “a little bit earlier” was that it could help ensure the Fed takes a gradual path towards tighter monetary policy as it gauges the impact of the rises on financial and economic conditions.

“If we wait longer it certainly could mean that when we begin to raise rates we might have to do so more rapidly,” she said.

In a separate report to Congress on monetary and financial developments, the Fed said it continued to judge vulnerabilities in the financial system to be “moderate”.

It added that there were “notable” valuation pressures in fixed income markets and that prices in the commercial real estate sector had been rising. Borrowing by lower-rated companies was continuing at a “rapid rate”, the Fed said.