

# Looming Fed decision on interest rates is mostly symbolic

By JOHN REID BLACKWELL | Richmond Times-Dispatch | Posted: Saturday, September 5, 2015 10:30 pm

The Federal Reserve Bank has kept interest rates at a historic low of near zero for almost seven years now, an unprecedented effort to help support the U.S. economy during its slow climb out of the recession.

Now, the prospect that the Federal Open Market Committee, the Fed's policymaking committee may finally increase the central bank's target interest rate, either at its next meeting Sept. 17 or later this year, has unnerved investors and contributed to recent stock market gyrations.

But beyond all the chatter, many experts say a small increase in the target interest rate would have little real impact on the economy, unless it spooks investors so much as to send stocks into a lasting tailspin.

The Fed is widely expected to bump rates upward by only one-quarter of a percentage point, a small step that has a more symbolic than tangible impact, some analysts say.

"I think the practical effect of a quarter-point hike is very limited at this point," said George L. Smith III, a senior vice president at Richmond-based brokerage Davenport & Co.

"The media has hyped this looming event so much, the psychological impact outweighs the practical impact," he said.

Like many other analysts and economists, though, Smith said he thinks there is a little justification for an interest rate increase at this point because the economy is not overheating and inflation is well under control.

The Fed's mission is to keep interest rates at a level that will balance economic and job growth while keeping inflation in check so that prices for goods and services remain stable.



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Jeffrey Lacker, president of the Federal Reserve Bank of Richmond, addressed the Retail Merchant Association during the Economic Forecast Breakfast at the Westin Hotel Richmond, Friday 9/4/2015. Lacker laid out a case for raising the interest rate when the Federal Reserve meets.

Some Fed observers think the one advantage of a rate increase now would be to simply get it over with, without further delaying what everyone knows will happen sooner or later.

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**Jeffrey M. Lacker**, president of the Federal Reserve Bank of Richmond who is a voting member on the Federal Open Markets Committee this year, has been one of the more vocal proponents of increasing rates sooner rather than later.

In a speech he gave Friday before the local Retail Merchants Association, Lacker said he won't make a final decision on how he will vote until he has heard his colleagues' opinions when the FOMC meets.

But he clearly laid out a number of reasons he thinks increasing rates now is justified.

Those include a declining national unemployment rate, an increase in household spending, and an inflation rate that is hovering around the Fed's target goal of 2 percent.

Lacker said the recent volatility of the stock market has only "limited implications" for monetary policy.

"That might seem to contradict the widespread conjecture about the Fed delaying lift-off due to market turbulence," he said. "But I would point out that the Fed has a history of overreacting to financial market movements that seem unconnected to economic fundamentals."

He also warned that a delay in increasing rates now could result in larger rate jump later if inflation pressures arise.

"Progress has been slow and uneven," Lacker said of the economy. "But this economy has worked its way back from the dislocations of the Great Recession."

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**A small increase** now is "not significant enough to cause either a small business or an individual undue hardship in serving debt," said James Cox, managing partner at Harris Financial Group in Chesterfield County.

If the Fed waits too long to take action, though, consumers and businesses could be hurt in the long run, if the central bank raises rates later in larger increments or more frequently, Cox said.

The Fed typically raises or lowers rates in increments of one-quarter or one-half of a percentage point. That influences what banks and other lenders charge for borrowing money, and thus impacts the cost of buying cars and houses and the cost of starting or expanding a business.

The Fed's most recent report on the economic situation — known as the Beige Book — indicated that the economy in Virginia grew moderately in August, with improving retail sales and labor

demand.

The Fed noted that residential mortgage demand picked up in central Virginia, particularly for lower-priced homes.

A report in mid-August by the Home Building Association of Richmond and Commonwealth Partnerships, a Henrico County marketing firm, showed that new-home sales in central Virginia rose 2 percent in the first half of the year from the same period a year ago, and the number of permits increased 13 percent. Prices for new homes were up 3 percent.

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**Yet Craig Toalson**, chief executive officer of the Home Building Association of Richmond, isn't too keen on the idea of the Fed increasing rates at all right now.

Toalson said historically low interest rates have helped the homebuilding industry claw its way back toward normality, though it still has a long way to go and is only about halfway back to what the organization considers a healthy market.

A 25-basis-point interest rate increase would still leave rates at unusually low levels, but it could still be enough to negatively impact buying decisions and stymie the recovery, Toalson said.

“When our builders build one house, they touch 50 other local businesses,” he said. “It is not just one builder that is affected, but also those other businesses and their employees, and their employees’ ability to make a wage and buy things and put it back into the economy.”

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**Automobile sales** also have been healthy. Even a small increase in rates might make potential car buyers a bit more reluctant to make big-ticket purchases, said Michael Allen, director of public affairs for the Virginia Automobile Dealers Association.

Buyers tend to look at what their payments will be on a monthly basis, he said. Interest rates have a big impact on that.

“If the rates go up, depending on the amount, the tendency is to push buyers towards less expensive vehicles,” he said.

Mark Creery, president of Data Directions Inc., a custom software development and project management firm based in Hanover County, said he does not foresee much direct financial impact on his business if the Fed bumps rates slightly, even though the company does have some variable rate loans.

“Where it does tend to make a difference is in sentiment,” he said, especially if business owners and consumers think a rise in rates is the start of a series of increases.

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**Some other business** owners said they would expect to see mixed results from a small increase in rates now.

One purpose of keeping interest rates low is to make it cheaper for businesses to borrow and expand or make investments in their operations. That's exactly what Franco's Fine Clothier has done.

"What we have done while rates have been low is we have taken advantage of that cheaper money and renovated both of our stores," said Kevin P. Reardon, co-owner of the business, which has a store in the Short Pump Town Center and on Lakeside Avenue. "We've put a little bit back into the business. I think a lot of people are still trying to do that."

Reardon said he would not want to see interest rates go up "too much, too fast."

Sarah Paxton, vice president and co-owner of the Richmond home furnishings retailer LaDiff, said she thinks a small increase in rates could spark more economic activity if people anticipate that it is the start of a trend.

"People are going to want to lock in a rate before it goes higher," she said.

Andrew Thornton, co-owner and president of LaDiff, also argued that higher rates would be beneficial for savers. "For the people who are living on fixed income, we need to get back to them having some kind of resources," he said.

A 25-basis-point increase would create a "slight bump" in costs for James River Transportation, said Stephen Story, the company's president. He said he is more concerned about regulatory costs for the company, which operates a fleet of charter buses, vans, limousines and other vehicles.

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**Chris Singleton**, managing partner at Kanawha Capital Management LLC in Henrico County, said rates are so low now that there should be room for them to rise without stifling loan demand or aggravating debt-service burdens.

"However, there will be a threshold at which higher interest rates begin to have a negative impact, but we are nowhere near that point," he said.

One positive effect of an interest rate increase would be to improve interest earnings for individual and business savings accounts.

"Savers and businesses like banks and insurance companies have been somewhat penalized by low short-term interest rates for a long period of time — and it would undoubtedly help them," said Smith of Davenport & Co.

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**For banks** and banking customers, the impact of a rate increase would be very small, said Bruce Whitehurst, president and chief executive officer of the Virginia Bankers Association.

For borrowers and savers, the extent of the impact depends on whether they have fixed- or variable-rate loans or deposits.

“We have been in an extraordinarily low-interest-rate environment for going on eight years now, much longer than anybody expected. If you are a saver and particularly accustomed to having some interest income, you are looking for the positives of the rate increase,” which means more interest earned on savings, he said.

“If you are a borrower, a 25-basis-point increase does not substantially increase the cost of borrowing,” he said. “Short- and long-term rates are lower than they have been in our lifetime.”

“I think it is more than safe to say that banks are prepared for the potential of a rate increase,” Whitehurst said. “And I would imagine from a layman’s view, not an economist’s view, that a modest increase by the FOMC this fall would certainly not only not be a surprise to anybody watching, but is probably already built into financial market expectations.”

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**Insurer Genworth** Financial Inc., for instance, is among the Richmond-area companies that have reported negative impact from unusually low interest rates.

Genworth’s long-term care insurance business has been particularly hurt by a low-interest-rate environment, and the company’s earnings and stock price have suffered, resulting in job cuts as it looks to reduce costs.

Yet a small increase in rates won’t automatically translate into any sort of substantial rewards for those who save. And any gains in savings could be offset by losses if the stock market reacts negatively, experts said.

“I don’t know how welcome or helpful a rate increase would be if it comes alongside a market disruption,” Smith said.

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**What matters more** than the long-anticipated small increase in rates is how quickly the Fed moves to continue lifting rates over the next year or two, said Dean Croushore, an economics professor at the University of Richmond and a former economist for the Federal Reserve Bank of Philadelphia.

“The first raise is not that crucial,” he said. “What gets priced into the financial markets is people’s anticipation of the path over the next year or two.”

“What is going to matter is the cumulative effect of a sequence of moves” in rates, he said. “That is

what people should be focusing on.”

The Federal Open Markets Committee “is going to be one of the most exciting and entertaining FOMC meetings in a while,” with strong arguments for going either way on rates, Croushore said.

“I suspect it will be a close decision,” he said. “It is going to be one of those things that everybody is going to get excited about for a day, and then they think about it and realize, this is not what matters so much as the long run does.”