

Fed Official Flags Conditions for a Rate Hike

BY NICK TIMIRAOS

Boston Fed President Susan Collins flagged the possibility that the central bank might need to raise interest rates if inflation pressures broaden in coming months, even though that isn't currently her most likely outlook for the American economy.

In an interview on Wednesday, Collins said that she expects inflation pressures from the Iran war to eventually subside and that the current shock has masked evidence that underlying inflation was still headed down. "But the probability around that has declined, and some of the other scenarios are less benign than that and certainly could feature higher, more persistent inflation," which could require rate hikes, she said.

Collins pointed to three factors that could help determine whether the Federal Reserve would need to raise rates. Most important, she said, are households' and businesses' expectations of future inflation, which have drifted to the high end of their historical range.

Collins said she was also watching whether price pressures spread beyond energy to other goods and services, and the extent to which tariffs continue to pass through the price chain. Wages aren't a significant source of inflation, she said.

Rising inflation mechanically reduces the inflation-adjusted level of the Fed's policy rate, making policy less restrictive without any action by officials.

Asked whether the Fed might need to raise rates simply to prevent its policy setting from getting easier in real terms, Collins said it was "one of the things to consider."

Inflation-adjusted or "real" rates are "something to watch carefully," she added.

But she emphasized that she looks at financial conditions broadly, not the Fed's benchmark short-term rate alone. She characterized those borrowing conditions as having supported the economy's recent resilience.

Collins, who doesn't have a vote on the Fed's rate-setting body this year, said she supported removing language at last month's meeting suggesting the next rate move would be a cut. Three Fed presidents dissented against the committee's decision to retain the so-called easing bias.

"It's appropriate to have somewhat more agnostic communications," she said.

Collins tied the statement language question directly to the inflation-expectations point: The public will expect the Fed to maintain low inflation over time, she said, only if the Fed maintains credibility through both its rate decisions and its communications.

"How we talk about policy as well as the actual rate decisions play a role in influencing that context," she said.