At a pivotal point for the economy, the Federal Reserve pauses its interest rate hikes — but probably not for long

By **Jim Puzzanghera** Globe Staff, Updated June 14, 2023, 55 minutes ago

Federal Reserve Chair Jerome Powell delivers remarks at a news conference on May 3. ANNA MONEYMAKER/GETTY

WASHINGTON — The US economy is at a pivotal point after narrowly avoiding a disastrous government default, and Federal Reserve officials on Wednesday demonstrated that by holding their key interest rate steady for the first time in 15 months.

With the debt limit crisis over and encouraging data recently on inflation and jobs, the Fed paused the aggressive string of interest rate hikes it began in early last year to try to halt fast-rising prices. The benchmark rate remains between 5 percent and 5.25 percent, well above the near zero percent level before the increases started. And with the effects of those hikes still not fully felt throughout the economy, the Fed indicated it plans to raise the rate again later this year.

The Fed said in a statement Wednesday that holding the rate steady allows it to “assess additional information and its implications for monetary policy.” Fed officials would monitor incoming economic data and take into account the delayed effects of rate hikes as they move through the economy, such as higher mortgage rates causing home sales to slow and potentially reducing home building and construction jobs.

Fed Governor Philip Jefferson said on May 31 that holding the rate steady “should not be interpreted to mean that we have reached the peak rate” for this latest effort but would simply allow officials “to see more data” before deciding on their next move. In their quarterly projections also released Wednesday, Fed officials forecast the rate would be 5.6 percent by the end of the year in an indication of additional increases.

The Fed's rate is a benchmark for consumer and business loans from banks. Higher borrowing costs slow economic growth by reducing spending. That helps reduce inflation but also risks a recession if the slowdown goes too far. The Fed is trying to get that calculus correct and execute what's known as a soft-landing for the economy: raising interest rates just enough to bring inflation back to normal without triggering a recession.

There have been encouraging signs recently that the Fed could pull off that extremely difficult task.

"I'm rooting for a soft landing. I think everybody's rooting for a soft landing," said Karen Dynan, a Harvard professor and former Treasury Department chief economist during the Obama administration. "Given the developments this year, it smells a little more possible than it did at the start of the year."

The Marriner S. Eccles Federal Reserve Board Building in Washington, D.C. on July 31, 2022. AL DRAGO/NYT

The government reported this week that a key inflation measure continued to improve after hitting a four-decade high a year ago. The consumer price index rose 4 percent in May from a year earlier, well off the 9.1 percent annual rate it peaked at last June. Data released Wednesday morning also showed continued improvement in inflation at the wholesale level. And the labor market remains strong, with 339,000 jobs created in May and the unemployment rate, although rising, remaining below 4 percent.

“The economy’s on the right track,” said Boston College economist Brian Bethune. “I think there’s a window here for the Fed to pause. Inflation’s going in the right direction. The economy is still holding up pretty well...and it’s kind of what I would call more of a wait and see thing for two or three months to just observe how things are playing out.”

Avoiding a recession would be a boost to President Biden’s re-election campaign and he trumpeted the new inflation data on Tuesday. But the Fed, which operates independently from the White House, wants annual inflation to run at 2 percent, so there’s still a ways to go to get back to normal. And that means there’s still the risk of a recession before the 2024 election.

Dynan warned that core inflation, which removes food and energy prices to give a less-volatile reading, hasn’t eased for several months. The core consumer price index was 5.3 percent in May compared to a year earlier. That indicates consumer demand remains strong and the Fed still might need to raise interest rates more in the coming months, which could push the nation closer to a recession, she said.

“I think it’s probably a toss up as to whether we’ll see a recession later this year or early next year,” Dynan said. “It really depends on the path of inflation.”

Jim Puzzanghera can be reached at jim.puzzanghera@globe.com. Follow him on Twitter: @JimPuzzanghera.