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Money at work

The Fed Hits the Brakes: No Rate Hikes Projected in 2019

At its meeting on March 20, 2019, the Federal Open Market Committee (FOMC) maintained the benchmark federal funds rate at the target range of 2.25% to 2.50% that was set in December 2018. This in itself was not surprising. But other communications signaled a definite hiatus in the Fed's policy of raising interest rates and tightening the money supply.

The FOMC has raised the funds rate nine times since December 2015, with four increases in 2018 alone. As recently as September 2018, the committee projected three more increases in 2019. That dropped to two projected increases at the December meeting. But the March projections suggest that there may be no rate increases in 2019 at all.

The FOMC also indicated that it would slow its program of reducing excess reserves of Treasuries and other government securities that were built up during and after the recession in a policy known as quantitative easing. The reduction program will stop after September 2019 unless conditions change, reflecting the Fed's belief that there is no need for further tightening of the money supply.

The strongest communication to come out of the March meeting may be the unusually direct comments from Fed Chairman Jerome Powell:

"We don't see data coming in that suggest we should move in either direction," he said. "They suggest that we should remain patient and let the situation clarify itself over time… It may be some time before the outlook for jobs and inflation calls clearly for a change in policy."

Dual Mandate

Powell's reference to jobs and inflation reflects the Federal Reserve's dual mandate

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to foster maximum employment and price stability. The FOMsets monetary policy in accordance with the mandate, using two primary tools: the federal funds rate and the monetary supply.

The federal funds rate is the interest rate at which banks lend funds to each other overnight to maintain legally required reserves. The funds rate serves as a benchmark for many short-term rates set by banks, including the prime rate, which in turn influences consumer rates such as auto loans and credit-card rates. It can also influence longer-term rates.

Theoretically, lowering interest rates and increasing the money supply will stimulate the economy, which is why the Fed took these measures during the recession and extended them through the long, slow recovery. (The federal funds rate was near zero for eight years, from December 2007 to December 2015.)

On the other hand, raising rates and tightening the money supply are intended to slow the economy, primarily to control inflation. In theory, a strong economy with low unemployment should put workers in a position to demand higher wages, and higher wages allow businesses to raise prices on their products, which allows them to expand and pay higher wages.

A moderate level of wage and price inflation is considered integral to a healthy economy, and the Fed has set a goal of 2% annual inflation as optimal for economic growth. However, despite a strong labor market, wages and the broader economy have not grown as quickly as expected, and inflation has generally remained below the 2% target. Thus, raising rates has been more of a preventive measure and return to historical norms than a response to an overheated economy or runaway inflation.

The shift from further rate increases suggests that the Fed believes there is little to fear regarding high inflation. In fact, Powell said that the greater danger is low global inflation, calling it:

"One of the major challenges of our time."

While the Fed has raised rates steadily over the last three years — providing flexibility to drop rates if necessary — central banks in other countries have been slow to act due to sluggish economies and low inflation. Some have kept their benchmark rates below 0%, creating a risk of asset "bubbles" and placing them in a difficult position in the event of an economic downturn.

Market Reactions

The stock market rose moderately after the FOMC announcement, but stocks still closed with a small loss for the day. The market generally applauds lower interest rates, but investors continue to be jittery about the potential for global economic weakness. In the longer term, stable interest rates at current levels may be good for stocks, which began to rally on January 4, 2019 — when Powell first preached "patience" — and gained more than 15% through March 20.

The reaction in the bond market was stronger. The prospect of lower rates for an extended period — along with the Fed's decision to keep more Treasuries in its portfolio — made current yields more appealing. Investors rushed to buy Treasury securities and other bonds, driving prices up and yields down. The yield on the 10-year Treasury note fell to 2.52%, the lowest level in 15 months and just seven basis points (0.07%) above the yield on the three-month T-bill — nearing a "yield curve inversion" considered by some economists to predict a recession. Two days later, on March 22, the curve inverted for the first time since 2007, with demand for longer-term bonds driven by soft global growth.

Although pessimists have feared a new recession for years, Powell emphasized that the U.S. economy is "in a good place," and the official FOMC policy statement pointed to "sustained expansion of economic activity" in its expectations for future economic direction.

A potential pause in rate hikes this year does reflect some concern about economic growth, but it also suggests that the Fed believes the current level is a neutral rate where further movement up or down could have a negative effect. This is not necessarily cause for concern. It may just mean that the Fed is doing its job. ❖

The Cost of Caregiving

About 40 million family caregivers in the United States provide unpaid care to another adult. Caregiving for a loved one is a noble endeavor, and considering the high cost of professional long-term care, it may be the only alternative for some families. But "free" caregiving often comes with financial, physical, and emotional costs. If you are a family caregiver, or know someone who is, here are some suggestions to consider.

Preserve your own assets

More than three out of four caregivers incur out-of-pocket expenses, with average spending approaching $7,000 annually. Expenses can be even higher when the person being cared for requires longer hours of care, needs help with more daily activities and/or medical/nursing tasks, is suffering from mental illness or dementia, or lives at a distance from the caregiver.

Are Your Designated Heirs Up-to-Date?

Spring is a time when families often gather together. Although these gatherings may keep you busy, this could be a good time to think about the future and make sure that you have correctly designated family members and any others you wish as beneficiaries in your will, insurance policies, and financial accounts.

This is especially important if there have been changes in your life, such as the birth of a child or grandchild, a death in the family, a divorce, or a remarriage. But even if your family situation remains the same, it's a good idea to review your beneficiary designations to be sure they are complete and reflect your current wishes.

Beneficiary Forms May Override Your Will

A will is an essential legal document for designating your heirs and facilitating distribution of your assets if your estate goes through the probate process. However, the assets in most investment accounts, retirement accounts, and life insurance policies convey directly to the people named on the beneficiary forms — even if they are different from the people named in your will — and do not go through probate.

Fortunately, it's fairly easy to designate or change your account beneficiaries. A will may incur costs to update, but a new beneficiary designation form can be filed with the appropriate financial institution or insurance company.

Here are some issues to consider:

- Your current spouse must be the beneficiary of an employer-sponsored retirement plan unless he or she waives that right in writing. Without a waiver, any children from a previous marriage might not receive account proceeds.

- Designate secondary (contingent) beneficiaries in the event that the primary beneficiaries predecease you. Otherwise, proceeds would be distributed according to the default method specified in the account documents and/or state law.
- Some insurance policies, pension plans, and retirement accounts may not pay death benefits to minors. If you want to leave money to young children, you should designate a guardian or a trust as beneficiary. ❖

Although it's generous to help an aging parent or other relative financially, be realistic about your own present and future financial needs. It might make more sense to spend down an older person's assets, which could reduce the taxable estate and/or qualify him or her for long-term care benefits under Medicaid.

Take advantage of available benefits

Make sure the person you are caring for has all the benefits to which he or she is entitled. The Eldercare Locator (eldercare.gov), a public service of the U.S. Administration on Aging, and the Benefits CheckUp website (benefitscheckup.org) from the National Council on Aging are helpful places to start.

Talk to your employer

One out of three caregivers has changed work hours and 20% have reduced work hours; 22% have taken unpaid leave. Many companies include family care in their sick-leave policies, and you might be eligible for up to 12 weeks of unpaid leave under the Family and Medical Leave Act.

Educate yourself

Make sure you fully understand your loved one's condition, medications, and appropriate methods of care. Ensure that you are authorized to speak to physicians and health providers regarding the patient's treatment plan. Don't hesitate to call with questions, and keep a running list of issues for the next office visit.

Take care of yourself

Many caregivers suffer from physical or mental conditions that are caused or exacerbated by the strain of providing care. Take regular breaks to rest or enjoy a favorite activity. Ask for help from other family members and friends. Consider support groups. Don't be afraid to seek professional help for yourself.

More information on family caregiving is available from the Family Caregiver Alliance (caregiver.org), the Caregiver Action Network (caregiveraction.org), the National Institute on Aging (nia.nih.gov), and AARP Caregiving (aarp.org/caregiving). ❖

Consumer Nation: Can Confidence Drive the Economy?

In October 2018, The Conference Board Consumer Confidence Index® reached its highest level since September 2000, despite a steep stock market slide and potential headwinds from inflation and rising interest rates. Another measure, the University of Michigan Index of Consumer Sentiment, has also remained higher in 2018 than in any year since 2000.

Confidence dropped slightly in November, but remained at elevated levels not seen since the dot.com boom. However, all three major stock market indexes fell into negative territory for the year on November 20. So it's uncertain how long consumers will remain unruffled by market volatility.

Present and Future Conditions

The Consumer Confidence Index is derived from a questionnaire sent each month to more than 3,000 U.S. households. The survey asks consumers to rate current business and employment conditions in their regions and expectations for future conditions (six months hence) for business, employment, and household income. It also asks about plans for major purchases, but these responses are not included in calculating the index.

The University of Michigan Index is derived from three more detailed surveys that go to a smaller set of consumers and ask questions about overall economic conditions, personal finance, and buying intentions.

Some economists consider consumer confidence to be a lagging economic indicator, because consumer attitudes tend to change more slowly than the broader economy. On the other hand, consumer expectations for the future are a leading indicator that may help predict future economic direction.

Jobs and Wages

At the heart of high consumer confidence is a rosy outlook for jobs and wages. The 3.7% unemployment rate in September and October 2018 was the lowest since 1969, and there were a record 7.3 million open jobs in August 2018 — more jobs than unemployed individuals. Wage growth has finally begun to pick up speed, growing at an annual rate of 3.1% in October, the highest rate since 2009. Inflation edged higher to 2.5%, but even so, workers are beginning to see real wage increases.

Consumers may not be studying these statistics, but they express confidence in line with the numbers. In the November Conference Board survey, 46.6% of consumers said jobs were "plentiful," while only 12.2% thought they were "hard to get." Looking forward, 21.5% expected increased income in the next six months, while less than 8% expected a decrease.

Spending and GDP

Consumer spending accounts for about two-thirds of U.S. gross domestic product (GDP), so if consumer confidence leads to higher spending, it bodes well for the broader economy.

GDP grew by 3.5% in the third quarter of 2018, a drop from the 4.2% rate in the second quarter but still solid compared with previous quarters. Personal consumption expenditures (consumer spending) increased by 3.6%, slightly faster than the broader economy.

The November confidence survey suggested that robust spending may continue. More consumers planned to buy a major appliance in the next six months, and the percentage who planned to buy a new home held steady, despite a slowing housing market and the prospect of higher interest rates.

High consumer confidence is encouraging for the holiday season, the most important time of year for the struggling retail industry. The National Retail Federation projects that retail sales will increase between 4.3% and 4.8% this season (November and December), compared with an average of 3.9% over the last five years. The two-month holiday season accounts for about 20% of all retail sales and as much as 30% for some sectors.

A Virtuous Circle

When consumer confidence leads to higher spending, it typically propels corporate revenues, which may prompt businesses to invest in expansion, hire more employees, and/or raise wages. Businesses have been slow to invest and raise wages, but the recent numbers for unemployment, job openings, and wage increases suggest that the economy may have reached a tipping point. If so, the virtuous circle of spending, wage increases, and more spending can be a powerful economic engine. The danger in this cycle is that it can also drive inflation, which is one reason why the Federal Reserve has been steadily raising interest rates. Rising rates may help control inflation, but higher interest can cut into confidence and spending as it becomes more expensive to borrow. The University of Michigan surveys found that consumers expected both interest rates and inflation to increase, but still remained upbeat.

An extended stock market downturn could erode consumer confidence, but jobs and wages may be more important than investments to the average consumer. (And recent losses might be more palatable after the large gains from the long bull market.) It remains to be seen whether consumer confidence will be strong enough to push through these headwinds. To some extent, that may depend on whether wage increases continue to outpace inflation. For now, confident consumers are one of the greatest strengths of the U.S. economy. ❖

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ANY QUESTIONS?

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