10th week supplemental material

Fed Will Likely Raise Rates After Strong Jobs Report

The central bank has acted to prevent the economy from overheating by lifting short-term interest rates

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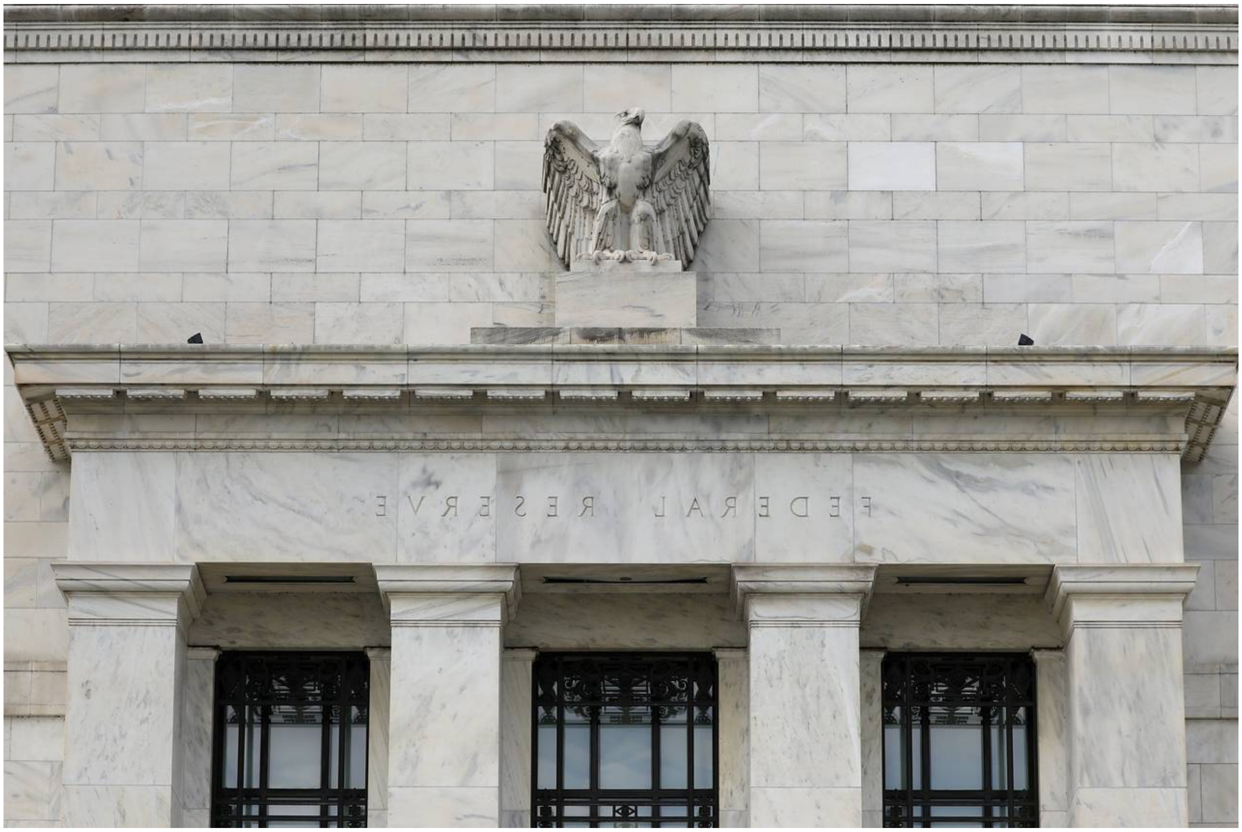

The Federal Reserve is likely to stick to its gradual pace of raising interest rates. PHOTO: REUTERS

WASHINGTON—Robust hiring and wage gains last month leave the Federal Reserve all but certain to raise interest rates in December and on course to continue gradually lifting them next year.

Employers added 250,000 jobs in October, the Labor Department said Friday. Workers' average hourly earnings rose 3.1% from a year earlier—the fastest growth since 2009—while the unemployment rate held at 3.7%, matching the lowest level in 49 years.

The figures show the labor market has continued to strengthen a decade into the second-longest expansion on record. This has happened despite cautious efforts by the Fed in recent years to prevent the economy from overheating by lifting short-term interest rates.

While rising wages and low unemployment are great news for workers, Fed officials worry that labor shortages could eventually drive up wages and prices enough to cause inflation to accelerate. That would force the central bank to raise interest rates more aggressively to keep inflation under control, potentially tipping the economy into recession.

For now, though, Fed officials are likely to stick to their gradual pace. They have signaled they are likely to leave their benchmark interest rate unchanged in a range between 2% and 2.25% at their policy meeting next week.

The policy makers indicated in September they expected to lift the rate by one percentage point through 2019. Under that scenario, they forecast unemployment to fall to 3.5% by the end of next year and hold there through 2020, with inflation rising to just 2.1%.

For that to happen, though, job growth would have to slow from its recent pace. Economists estimate gains of just around 145,000 jobs a month would keep the unemployment rate steady.

Central bank officials estimate a sustainable unemployment rate in the long term is 4.5%. Below that, in theory, inflationary pressures could build. But they have also noted this so-called natural rate has changed over time and is hard to pinpoint in the short-term.

Fed Chairman Jerome Powell, in an August speech, highlighted the imprecision of estimating such economic variables. As a result, he said the Fed should avoid giving them too much sway over monetary policy, especially when inflation is behaving well.

The silver lining from the Fed's standpoint is that inflation has remained tame this year, right around its 2% target, even with unemployment rate falling and companies grousing about labor shortages.

While officials may harbor uncertainty over how low the unemployment rate can go without triggering runaway price increases, they are also wary of getting caught by surprise. History has shown the process of bringing down high inflation to be a costly one.

Fed Vice Chairman Richard Clarida suggested in a speech last month that inflation and the public's expectations of future inflation will play an increasingly important role in his policy preferences going forward.

"If strong growth and employment gains were to continue and be accompanied by stable inflation, inflation expectations, and expectations for Fed policy, that situation, to me, would argue against raising short-term interest rates by more than I currently expect," he said.