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Fed's Dudley:Rate Hike Is 'Very Small Technical Change'

By MICHAEL DERBY

SAN JUAN, Puerto Rico --Federal Reserve Bank of New York President William Dudley said Friday the increase in the discount rate done by the central bank late Thursday does not mean a tightening of monetary policy has begun.

"We made a very small technical change" by raising the discount rate, Dudley said. "The action yesterday was really an action about the improvement in banks" and reflected that these institutions no longer need this emergency source of cheap funding the way they did during the depths of the financial crisis, the official said.

The discount rate increase "is not at all a signal of any imminent tightening" in monetary policy, and the Fed's commitment to keep rates very low for an extended period "is still very much in place," Dudley said. He added any increase in the short-term rates that affect the economy is "off in the future."

The central banker's comments came as part of remarks given before the Center for the New Economy 2010 Economic Conference in San Juan, which he followed with audience and media questions. He is the vice chairman of the interest-rate setting Federal Open Market Committee.

The official spoke in the wake of the Fed's move to widen modestly the spread between what is now its 0% monetary policy stance and what it charges deposit-taking banks to borrow from its emergency discount window.

Fed officials, including Chairman Ben Bernanke, had flagged the possibility of lifting the rate, but the reality of the move caught some in markets off-guard, and drove some observers to believe the Fed was responding to a recovering economy with tighter policy. Central bankers see moving the discount window back toward its traditional relationship with the overnight fed funds rate as fitting in with the end of other emergency lending programs.

"I don't think we have a clear goal" what the spread between the discount rate will be in the end, and we will "wait and see" how the process plays out, Dudley noted. He also acknowledged the central bank would face challenges communicating its policies to financial markets, although he added that is always the case and not specific to the current environment.

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William C. Dudley, president of the Federal Reserve Bank of New York, gestures during his keynote presentation "The Challenges Ahead" at the Center for the New Economy 2010 Economic Conference in San Juan, February 19, 2010.

The official explained the central bank faces little pressure to move short-term lending rates higher right now. "There is just no inflation pressure in the U.S., so our focus has to be on growth and jobs," Dudley said. He was referring to the release of the January consumer price index earlier Friday, which showed a 0.1% drop in core consumer prices.

The policy maker also said Friday that he expects moderate U.S. economic growth and ongoing challenges for the labor sector. "The economy will keep expanding, but at a somewhat slower growth rate than during the second half of 2009 as the temporary boost from the inventory cycle fades and the effects of the stimulus bill gradually weaken," Dudley said.

"While the U.S. economy is growing, unemployment remains unacceptably high and certain impediments could restrict growth in the near term," Dudley said, flagging financial sector conditions as one notable headwind for hiring.

Still, Dudley counted as a plus improvement in finance. "The capital markets, except for certain securitization markets, are now generally open for business," Dudley said. He also noted big banks have been able to raise capital, putting them in a stronger position.

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