CRAIN'S DETROIT BUSINESS

Detroit and Southeast Michigan's premier business news and information website

Metro Detroit economists: Fed interest rate hike long overdue

Sam Valenti: 'Most unique chapter in the Federal Reserve's history'

Photo by Andrew Harrer/Bloomberg Janet Yellen, chair of the U.S. Federal Reserve, speaks during a news conference Wednesday following a Federal Open Market Committee meeting in Washington, D.C. The Federal Reserve raised interest rates for the first time in almost a decade in a widely telegraphed move while signaling that the pace of subsequent increases will be gradual and in line with previous projections.

With one local executive calling it "the most unique chapter in the Federal Reserve's history," officials said Wednesday that the quarter percent hike would begin a "gradual" tightening cycle.

By Tom Henderson

The decision Wednesday by the **U.S. Federal Reserve Bank** to raise the federal-funds interest rates by a quarter of a percent came as no surprise to local economists and wealth advisers, who said it was something that should have happened much sooner.

"The market was so ready for a rate increase that if the Fed hadn't raised rates, the market would have tanked. The reaction would have been, `Ohmigod, what does the Fed know that we don't?'," said Jim Robinson, the CEO of Grosse Pointe-based **Robinson Capital LLC**.


Jim Robinson

Seven years ago to the day, the Fed took rates to zero percent to stimulate the economy and try to keep the Great Recession from turning into a depression. The last time the Fed raised interest rates was in 2006.

The federal-funds rate is the rate at which banks and credit unions trade balances held at the Federal Reserve with one another, usually overnight. It is the benchmark by which all other interest rates are set.

While generally the rate had been described as zero percent, the Fed officially sets rates in a quarter-percent range, so the lowest it can go is zero to 0.25 percent. Wednesday's action raised it to 0.25 to 0.5 percent.

"The committee judges that there has been considerable improvement in labor market conditions this year, and it is reasonably confident that inflation will rise over the medium term to its 2 percent objective," the Fed said at 2 p.m. in its policy statement, which was adopted unanimously.

The Fed said the hike would begin a "gradual" tightening cycle, and that in deciding its next move it would put a premium on monitoring inflation, which has remained below its target of 2 percent.

"In light of the current shortfall of inflation from 2 percent, the committee will carefully monitor actual and expected progress toward its inflation goal. The committee expects that economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate," the Fed said.

The Fed projected a target interest rate by the end of 2016 of 1.25 to 1.50 percent, which would mean quarterly rate hikes of a quarter point.

Members of the Federal Reserve, including chairman Janet Yellen, have been talking about a likely rate increase this month since September, when a widely anticipated rate hike was postponed over market volatility in China.

Ninety percent of respondents to a Dec. 9 poll of Wall Street professionals by **Reuters** said they expected a rate hike Wednesday.

"Because it wasn't a surprise, there won't be a major negative reaction by financial markets," said Peter Schwartz, a principal in **Gregory J. Schwartz & Co.** of Bloomfield Hills.

"It's overdue. Certainly this is an interventionist Fed, but economic recovery has been too tepid and too regulated. Given how regulated the economy has been, it's amazing how resilient it has been. It would have been even more resilient if it hadn't been so regulated."

Robinson said the Fed was overly worried about China and made a mistake in waiting until now to start raising rates. "They should have moved earlier. At least six months ago," he said.

The important thing about Wednesday's news wasn't the rate announcement itself, he said, but the guidance Yellen gave in her afternoon news conference that the Fed would like to see the rate at 1.25-1.50 percent by the end of 2016.

"At last March's meeting, the Fed gave guidance that it expected the rate to be one and seven-eighths by the end of 2016, and that spooked the market. Later, they lowered it to one and five-eighths and then to one and three-eighths. The market would prefer to see something closer to 1 percent."


Photo by Valenti Capital LLC Sam Valenti III

Sam Valenti III, the CEO at **Valenti Capital LLC**, a Bloomfield Hills-based wealth-management firm, and the executive chairman of Bloomfield Hills-based **TriMas Corp.**, has long been an opponent of the Fed's zero-rate policy. He said it made sense when the recession hit but long outlived its usefulness.

"This was the most unique chapter in the Federal Reserve's history. This was true flying without instruments, invent as you go to sustain a vast amount of debt in the system, and there had to be winners and losers," he said.

"The losers were people who espoused thrift, retirees, pension plans. All of them were hurt terribly. Without an ability to make any interest on their savings made it hard for thousands to live on their pensions. We complain about underfunded pension plans, but a big reason for that was that interest rates were so low for so long.

"The free market was good for some things, but the Fed decided it was not good at the pricing of debt, and now we have more debt than we had when the recession began."

Frank Migliazzo, managing director of wealth management for **Merrill Lynch** in Troy, said his parent company, **Bank of America**, had projected the rate increase to happen earlier, "but the Fed has had it tough. There's been a lot of uncertainty back and forth."

He said the market rallied on the news because it was seen as further confirmation that the U.S. economy was finally humming along.

But he said from the point of view of a wealth adviser, a quarter-point rise is not cause for joy. Interest rates continue to be very low and the world economy still faces challenges.

"It's going to continue to be challenging to find different ways to help our clients achieve growth," he said.

The Dow Jones Industrial Average was up modestly 40 minutes after the Fed announcement. It opened the day at 17,531 and was at 17,614 at 2:40 p.m. It closed up 224 points at 17,749.

“The Federal Reserve move to increase rates is a positive sign for the U.S. economy, to be welcomed, not feared,” said Kurt Rankin, an economist with Pittsburgh-based **PNC Bank**.

He said the Fed will take baby steps over the next two years and thought it likely there would be fewer than four rate increases next year.

“We have liftoff!” said Tony Bedikian, managing director of global markets for Rhode Island-based **Citizens Bank**, who framed in an email one way to look at how long it has been since the Fed raised rates:

“It’s been nearly 10 years since the last time the Fed raised the federal funds rate. To put that in context, it’s been 10 years since the last 'Star Wars' movie was released.”

Crain's wire services contributed to this report.