Economic and Market Insights
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By Scott Colbert, CFA
Commerce Trust Chief Economist, Director of Fixed Income
The Commerce Trust Company

Federal Reserve Will Likely Pause For Now, But Another Interest Rate Hike Is Lurking Before Fall Elections

Almost no one believes the Federal Reserve (Fed) will raise short-term interest rates another quarter-point at its April policy meeting this week given the rough impact of last year's first hike on U.S. and global markets late in 2015.

And the forward-looking markets will also be discounting a rate hike in June with the Fed funds futures market implying only a 20% probability of a rate bump by midyear. However, we believe there remains a reasonable chance that Chairperson Janet Yellen's committee might try again if current conditions persist, namely the recent marked easing in global financial conditions, the firming up of energy and commodity prices, a stock market that could be pushing towards a new all-time high and, most importantly, our continued labor expansion with some signs of modest wage growth.

Taking policy action during the summer would also allow the markets to absorb any possible blowback that could occur well before the November elections. Many connected the first interest rate hike to the stock market's worst-ever start early in this new year. However, the markets both here and overseas have rallied strongly in March and April.

So this week might be the pause that refreshes, but don't automatically think we are done with rate increases for the year. Concerns about the global economy and uneven GDP growth in the United States continue with the balance of risks still tilted a bit to the negative. The Fed's charter is guided more by long-term financial stability that promotes full employment and low inflation.

As such, we believe conditions should warrant at least one rate hike before the elections, perhaps as early as midyear if financial conditions continue to progress as they have recently.

Takeaways:

- We certainly will not get the four quarter-point rate hikes implied by the Federal Open Market Committee projections last December, but the Fed won't be reticent to hike if financial conditions are right.
- The markets are implying the next rate hike is closer to the end of this year, but we believe that is an underestimation of the likely rate hike path.
- Keep an eye on both domestic job growth and wage improvements as well as overseas markets, whose continued improvement will be an indicator for a nearer-term rate.

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