Economic and Market Insights

Sept. 19, 2016

By Scott Colbert, CFA
Chief Economist, Director of Fixed Income
The Commerce Trust Company

Not Enough Economic Mojo -- Federal Reserve Will Likely Hold Off on Potential Interest Rate Hike This Week

The Federal Reserve (Fed) meets this week to discuss a plethora of economic issues, but when the shouting is over, raising interest rates another quarter point is not likely to happen just yet.

This decision is not rocket science. The potential negative effects of prematurely raising interest rates in a period while we are still deleveraging mountains of debt from the Great Recession likely still outweigh any harm lurking from future inflation and the fear that the reasonable job growth will compound into a rapidly overheating economy.

With no real danger of the economy imminently overheating, the Fed can afford to wait. If the U.S. economy manages to get out of its slow-growth rut, it can easily play catch-up with a series of interest hikes if needed.

There have been other historical times like these, both here in the United States after the Great Depression, and more recently, in Europe and Japan, where central banks have had to reverse any tightening measures after an initial preemptive rate hike. That would be operating procedure for a credit-driven expansion, but an anathema during recoveries with little or no credit growth.

So far, it appears the one interest rate hike of last December has been all this economy can handle. Some economists have said the first quarter-point interest rate hike in almost a decade last December actually carried the impact of a 2% jump relative to the rest of the world economies as they lower rates and use quantitative easing monetary policies. In other words, our one-and-done rate hike, which seems absurdly small, is actually much bigger when viewed in the context of what other countries are up to with their monetary policies.

When you add in the fact that September is the bumpiest market month of the year and the last rate hike caused worldwide market disruptions, support for a rate increase ought to be a tough sell. With surprisingly downbeat purchasing manager reports in August and U.S. retail sales falling more than expected amid weak purchases of automobiles and a range of other goods, the expectations of a Fed interest rate increase should logically be diminished even more.

However, don't count out a rate bump before the end of the year, even with the raucous national election approaching in November. The Fed has stated they will be "data-dependent" in rolling out a very gradual progression of interest rate hikes. We believe they should stick to their course. And hopefully the data will continue to improve and afford the Fed enough economic forward momentum to allow them to gradually take their foot off their monetary accommodation once again.

<u>Takeaways:</u>

• No short-term interest rate bump by the Fed this month
• U.S. economy is fundamentally sound, but stuck in a slow-growth mode.
• Next Federal Open Market Committee meeting likely to see an interest rate hike is Dec. 13-14.