

Fed Watch Spring Forward

Published 16 March 2017

WisdomTree

Contributor

The Federal Reserve (Fed) has decided to “spring forward” its monetary policy decisions. In what had become only recently a highly telegraphed move, the voting members implemented another 25 basis points (bps) increase in the target range for the Federal Funds Rate at their March policy convocation. However, prior to this action, the markets had been operating under the assumption that the first rate hike for 2017 would happen in June, not three months earlier. So, the natural questions are: what was the reasoning behind this latest rate hike, and where does that leave potential policy decisions going forward?

As recently as Chair Janet Yellen’s Semiannual Monetary Policy report to Congress in mid-February, the Fed did not seem to be expressing any urgency or guidance that a rate increase could be imminent at its March meeting. It was only over the last two weeks that a change in the policymakers’ tenor became apparent. From an economic perspective, what apparently tilted the vote in favour of another tightening move was the fact that data had become available suggesting the Fed was very close to achieving its dual mandate: maximum employment and price stability. More than likely, the inflation part of this mandate helped to tilt the scales, as the latest reading for the Fed’s preferred gauge, the personal consumption expenditures price index, had risen to +1.9%, or just shy of the Fed’s 2% stated threshold. In addition, financial conditions, another apparent “Fed fan favourite,” and global economic activity moved in a direction the policymakers felt more comfortable with.

Thus, to prepare the markets for a move at its March meeting, the Fed needed to provide guidance, specifically from what we like to refer to as “the Big 3”: Yellen, Vice Chair Stanley Fischer and NY Fed President William C. Dudley. The latter got the ball rolling on 28 February in an unscheduled interview in which he said that the case for a rate hike had become “a lot more compelling” and that it should happen “fairly soon.” Fischer followed suit a few days later, and Yellen seemed to put her final stamp on the matter at her 3 March speech in Chicago.

Given the financial markets somewhat placid response to these appearances, the Fed used this green light and, no doubt, continued on its quest to move the Federal Funds target range as far away from zero as it possibly can. In our opinion, the Fed wishes to have as much cushion as possible to use traditional easing methods in the future and potentially lower interest rates when the next economic landscape calls for such a move.

In addition, the Fed also appears to have a different mindset compared to last year. In other words, the “economic data bar” has been lowered so that upcoming reports do not necessarily need to justify a rate hike, but they just don’t need to be weak enough to prevent such a move. The policymakers also seem to have a different Eurozone election outlook as well, as last year’s Brexit vote affected their decision-making

process, but apparently this year, the Dutch and French elections did not prevent a March rate hike. It is also interesting to note that while inflation and employment data may have argued for a rate hike, there is a disconnect with other economic data, namely GDP. To be sure, fourth-quarter growth was pegged at a subpar rate of +1.9% while forecasts for first-quarter real GDP seem to be lining up for a potential reading of +1%, if not lower.

Conclusion

With the rate hike timetable being moved up by three months, at least from the markets' perspective, one must wonder: is the Fed going to be more aggressive going forward, and will the policymakers' prior forecast for three rate hikes in 2017 turn into four actual increases?

Also, could the timetable to begin addressing the Fed's balance sheet get pushed up as well? Certainly, these are all good questions, but we have a lot of uncertainties (for example, US fiscal policy and European elections) and future economic data to contend with first. However, what seems to be clear is that the Fed wishes to continue on its path of removing accommodation. Against this backdrop, investors should consider solutions for a rising rate environment.

Important Risks Related to this Article

Important Information

Marketing communications issued in the European Economic Area (“EEA”): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. The information contained in this document is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

The application of regulations and tax laws can often lead to a number of different interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.