A CLOSE CALL, BUT YELLEN WILL LIKELY ACT

Six Reasons the FOMC Will Hike Rates Tomorrow

It’s Time to Just Get On With It (Certainly FMI Thinks So)

As FOMC members head back to their homes and hotels after the first session of their two-day meeting, fed funds futures markets are still pricing in just a 30% chance that Yellen and Co. will raise the funds target rate tomorrow.

While it is a close call, FMI’s “gut feel” is that the FOMC will raise rates tomorrow. These are our reasons, in brief:

1. Yellen wants to change the subject. Endless speculation by analysts and others over “will she or won’t she raise rates” is arguably counter-productive and certainly tiresome. Yellen has said, repeatedly, that the market should focus on the projected, very gradual arc of rate hikes, not on the timing of the first move. The way to do that is to actually start the (slow) march to “normalcy.”

2. Yellen needs to make her mark as a leader. While she does not have the over-sized ego of a Volcker or a Greenspan, Yellen is no doubt conscious of the long shadows cast by her predecessors (even, perhaps, by Ben “Shock and Awe” Bernanke). She needs to take a stand. The chance to push-back against the IMF, World Bank and other bureaucrats trying to meddle in Fed policy is an added benefit.

3. Deflation, even disinflation, is not a thing. Even with recent moderation, key measures of core inflation are not that much below the official +2% target. When oil prices stabilize (as they must eventually), price pressures will be more evident. Besides, as every Fed official should know, inflation is always and everywhere a monetary phenomenon.

4. Labor markets are healthy. With the jobless rate at 5.1%, it meets the Fed’s definition of full employment. Even if the presumed “shadow inventory” of discouraged or marginally-attached would-be workers is larger than normal, every labor measure, from UI claims to payrolls to JOLTS, shows a vibrant, improving jobs market. Even wage trends appear to be picking up.

5. The downside of starting to raise rates is minimal. One rate hike, or a few, will have negligible impact on the macro economy. If, down the road, the economy gets into trouble, the Fed can always pause or even reverse course. Other central banks have had so-called false starts in recent years without damaging their economies or denting any policymaker’s career. In contrast, waiting too long to act would likely be disastrous.

6. It’s time. The funds target has been effectively zero for almost seven years. The recession ended more than six years ago. The crisis has long passed. There is simply no justification for keeping monetary policy on a crisis-footing.