

The Fed Cannot Not Raise Interest Rates This Year. It Has Backed Itself Into A Corner.

The fact that the Fed Funds effective rate is 15 bps and not 25 bps is reason enough not to raise rates. Central banks should refrain from moving rates about as they see fit. For one, their understanding of the economy is no better than anyone else's. How can one make interest rate policy amid this much ignorance? For another, they tinker with the most important price of all, the price of money, which anchors all other relative prices.

Market interest rates, are telling us something already. Let them be our guide. The market is being distorted by Fed OMO and rate prognostications. The market doesn't need to watch a Fed that is watching the economy. If the market focuses on the economy, the Fed can be absolved from that responsibility and go where all central banks should go absent crisis. The scrapheap.

On a more topical and practical note, the Fed has backed itself into a corner. If it raises rates, it does so into a US economy that isn't exactly firing on all 8 cylinders. You don't raise rates when inflation is this conspicuously absent, when you clutch at straws to find strength in labour markets. It is clear that the Fed wants to raise rates, is looking for an excuse to raise rates, because it telegraphed its intentions too soon, based on data that is now stale. If the Fed doesn't raise rates, given current sentiment, the market will take it as a sign of weakness and asset values will tumble further. Since the Fed has been revealed to be supporting asset markets, it won't do that. If it does raise rates, it will allay the market's fears but it will slow the real economy. It will have to go very slowly indeed into the next rate hike. And it will have to provide more liquidity support to the market. It couldn't possibly do a QE4, so a backdoor QE like the ECB's LTRO may be one idea. But if it did do that, then the effective rate would not rise substantially to the target rate and the Fed risks losing the little credibility it has left.

So we have this situation where the Fed is damned if it does and damned if it doesn't. In

other words, the Fed is simply damned.