# Suppose the US Fed Decides To Delay The Rate Hike.

Yet another FOMC meeting has passed and the market continues to scrutinize the language of the FOMC statement for clues of what the Fed intends to do, heavily assuming that the Fed in fact knows what to do. The details will have been circulated ad nauseum by the financial press so we won’t delve into them here. Instead let us consider possibilities.

The market has been expecting the US Fed to raise interest rates, the timing is fluid but sometime this year seems to be the expectation. The Fed has to raise interest rates eventually if nothing else to reset an important policy tool. The strength of the US economy where employment is finally catching up to headline GDP growth is another factor. The current growth the US is experiencing is reminiscent of the mid 1990s Goldilocks (not too hot, not too cold, just right) economy, helped by depressed oil, energy and commodity prices. The weakness in the global economy is also helping the US grow without a pickup in inflation. China’s growth is decelerating, Japan is in recession and the Eurozone while recovering is barely clinging on to positive growth.

The consensus is therefore that the US has done with monetary accommodation and low rates while the rest of the world, stagflationary economies excepting, are in monetary loosening mode. What if the Fed was to postpone its rate hike? What would be the consequence? What is the likelihood? The USD could weaken. The consensus is for a strong USD and this is a very strong consensus. In the absence of a rate hike, the market could be quite unpleasantly surprised. The 10 year US treasury yield could move towards 1% and the 30 year to 2%. This could happen anyway while we wait for the rate hike. Fixed coupon issuance is likely to slow as tax receipts improve and debt is issued in FRN format. The demand and supply dynamics could flatten the curve.

Why might the Fed delay a rate hike? Low inflation might be one reason. 5 year 5 year forward breakeven which traded between between 2.4% to 2.6% has fallen steadily to 1.94% in Jan 2015. Deflation risk might stay the hand of the Fed. Slowing international growth is another possibility. The US is currently the main engine of growth. Of course people forget that the 7% growth rate that China puts out is a big number for a big economy, but even that number is shrinking. Latin America is flirting with stagflation. Brazil’s rising rates since March 2013 have not stopped the Real from steadily losing ground against USD. Europe has only just begun its money printing and debt monetization activities. If the European QE takes time to bite and Europe slows further, the US may not be able to raise rates for a while. In these scenarios, however, a weak USD is not likely since other currencies would be debased aggressively. Then there is the little question of the US treasury’s interest expense, currently 416 billion USD a year. A 0.25% hike in rates could, depending on debt maturities, issuance and impact on the term structure, result in interest expense rising some 50 billion USD, a 12% increase. Gently does it Janet.