FOMC Meeting This Week. What To Expect. The Fed Wants To Raise Rates.

Since the last FOMC meeting in April, economic data have improved. Most recently US payrolls and average hourly earnings have picked up and retail sales have rebounded. Only inflationary pressures have been conspicuously missing. Yet inflation is but one consideration for the Fed. As rescuer of last resort to the economy and the financial system the Fed is now about 7 years into a recovery with all its emergency bail out policies fully deployed. It needs to reset some of these tools in case of another financial or economic crisis. Granted, it also has to do this without precipitating a financial or economic crisis.

The bottom line is that the Fed wants to raise rates. It may not be able to. It has already signalled that it wants to raise rates and it that the path of rate hikes will be gradual. We can see why, the incremental interest expense to each 25 basis point hike (assuming it flows through the rest of the term structure uniformly) will be of the order of tens of billions of USD per annum, not large but not insignificant either.

The Fed has prepared the market for a rate hike for some time and the focus and attention on the next rate hike suggests that the market is prepared for it. What the market may not be prepared for is further delays which could signal a weaker economy than previously thought.