Don't You Dare Touch That Punchbowl.

Raising interest rates is difficult when everyone is watching you. Its much easier to take the punchbowl away when people are not watching. Walking in on the party when it is in full swing and expropriating the punch bowl is likely to trigger all kinds of protest. And the withdrawal can be painful when you don’t know what kind of additives have gone into the mix when you weren’t watching.

The Fed had telegraphed its intentions to raise rates much too early and as a result got itself into a bind. The thinking then, 2 years ago, was that a rate hike would be less disruptive if telegraphed to the market early enough. Come September 2015, and conditions had changed so that a rate hike was not entirely feasible. Reasons put forward included the slowing Chinese economy, stock market volatility, falling emerging market currencies, and the risk of deflation. What was not explicitly put forward was the risk of a slowing US economy. Rising LIBOR, widening credit spreads, some 50 basis points in IG this year, some 200 basis points in HY, and a strong USD, have achieved some de facto tightening of financial conditions. Mortgage rates remain stable and have not reacted, but on average, across the economy, for consumers, retailers and producers, **the impact is easily more than a 25 basis points Fed rate hike**. With the starting point of such low interest rates, the percentage impact on debt service is significant and **will likely slow the economy**.

Another problem which can be illustrated by the punchbowl analogy is that you have a hundred guests, three drunks and everyone else is teetotal and on a diet and all you have to offer is punch and steak. Low interest rates and serial QE have not revived the economy much. The marginal returns to policy have been less than a roaring success. Asset prices are up but output and wage growth have been weak. The credit creation has not spurred growth because **demand is simply deficient**. Unfortunately, **the antidote is fiscal stimulus, which is difficult to justify politically and ideologically**. There are also risks to financing further spending after the first round went into expensive bailouts of expensive private investors.