Fixed Income Perspectives

The Fed Raises Rates

December 16, 2015

Federal Reserve Open Market Committee (FOMC) announced an increase in the target range for the federal funds rate to 1/4% to 1/2%. The fed funds rate has held a target range of 0% to 1/4% since 2008. This is the first increase in the fed funds target rate since June 2006.

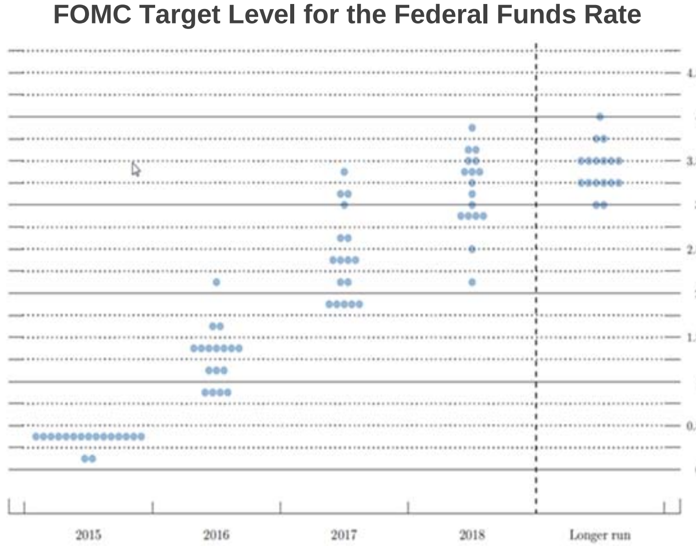
Federal Funds Target Rate (lower bound)

Source: Federal Reserve Bank of New York

On its own, this move seems a bit hollow. Not only was this the most highly anticipated and expected announcement from the Fed in recent memory, the target range of 0.25%-0.50% remains highly accommodative. The Fed still maintains the economy is "expanding at a moderate pace"; a view it has held for the past few years. This is not quite the robust economy one would hope to accompany a rate increase. It is not clear that the zero rate policy maintained over the past several years actually lead to any significant increase in lending or overall economic activity.

Going forward, the focus for the markets will be the pace of additional rate hikes. Arguably, the pace of rate increases is more important than the actual "liftoff" itself. According to the Fed's Summary of Economic Projections, the median expected target rate for 2016 is 1 3/8%. This implies four rate increases of 1/4 point each over the coming 12 months. The Fed remains committed to a data dependent approach stating "the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data." It remains to be seen if the "moderate pace" of the economy will generate the data needed to support those moves.

FOMC Target Level for the Federal Funds Rate



Source: Federal Open Market Committee - Summary of Economic Projections