

PERSPECTIVES

FED LIFTOFF: MORE QUESTIONS THAN ANSWERS

December 10, 2015

Topics: [Market and Economics](#) / Contributors: [Jess B. Yawitz, Ph.D.](#)

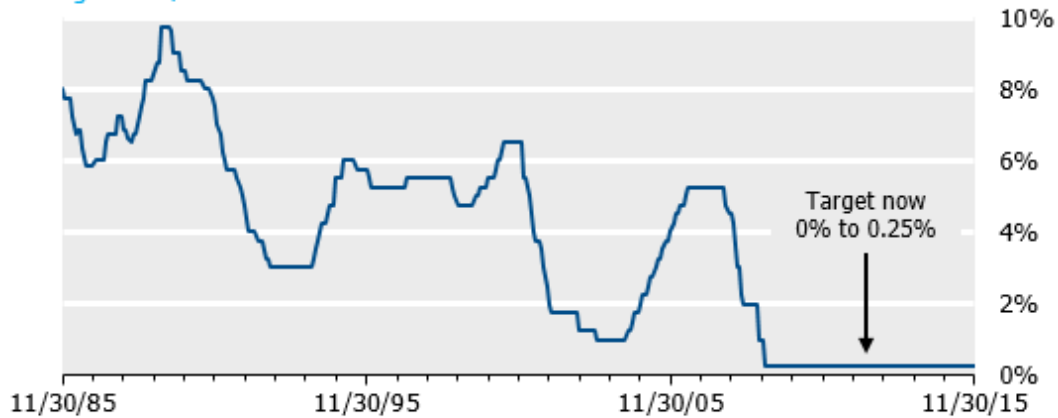


Markets are currently implying nearly an 80% probability that on December 16th the fed funds target range will be raised by 25 basis points. This expected increase will be the first rate hike since June 2006 – when a share of Lehman Brothers cost more than a share of Apple, and when a lot of today's Wall Street traders were working summer jobs between semesters in college.

If the overnight rate is raised, we will finally have an answer to a question market participants have been asking for quite some time: when will the Fed get off of zero? That may be the only answer provided on December 16, however, as the Fed has a delicate task ahead.

Exhibit I: Historical Fed Funds Rate

Target Rate, %



Source: Bloomberg

Historically, the Fed affected the overnight funds rate by managing the supply and demand of bank excess reserves, which before the 2008 financial crisis totaled in the low billions. Now that bank excess reserves are approximately \$2 trillion, however, the Fed will have to employ different tools to move the overnight rate, including paying interest on excess reserves and utilizing an overnight reverse repurchase facility. Furthermore, since the financial crisis, China's central bank, the European Central Bank, and perhaps a dozen other central banks around the world have lowered rates and then raised them, only to lower them again.

It's easy for us to say after the fact, but most market participants (including NISA) think the fed funds rate probably should have been raised already. Either way, this first Fed rate hike may raise more questions than it will provide answers. Here are a few.

- Now that they've started, how quickly will they go?
- What will be the terminal fed funds rate?
- How well will the different tools work?
- Against a backdrop of global monetary accommodation, will Fed rate hikes lead to a materially stronger US dollar, retarding economic growth and keeping inflation low?
- Will higher US rates harm already fragile emerging markets – potentially leading to a tipping point for some?
- How will an increase in short rates be transmitted across the yield curve?

Of course, the Fed has said on numerous occasions that the course of monetary policy is data dependent, and so the answer to at least some of these questions very well may be, "it depends."

Disclaimer: By accepting this material, you acknowledge, understand and accept the following:

This material has been prepared by NISA Investment Advisors, LLC ("NISA"). This material is subject to change without notice. This document is for information and illustrative purposes only. It is not, and should not be regarded as "investment advice" or as a "recommendation" regarding a course of action, including without limitation as those terms are used in any applicable law or regulation. This information is provided with the understanding that with respect to the material provided herein (i) NISA is not acting in a fiduciary or advisory capacity under any contract with you, or any applicable law or regulation, (ii) that you will make your own independent decision with respect to any course of action in connection herewith, as to whether such course of action is appropriate or proper based on your own judgment and your specific circumstances and objectives, (iii) that you are capable of understanding and assessing the merits of a course of action and evaluating investment risks independently, and (iv) to the extent you are acting with respect to an ERISA plan, you are deemed to represent to NISA that you qualify and shall be treated as an independent fiduciary for purposes of applicable regulation. NISA does not purport to and does not, in any fashion, provide tax, accounting, actuarial, recordkeeping, legal, broker/dealer or any related services. You should consult your advisors with respect to these areas and the material presented herein. You may not rely on the material contained herein. NISA shall not have any liability for any damages of any kind whatsoever relating to this material. No part of this document may be reproduced in any manner, in whole or in part, without the written permission of NISA except for your internal use. This material is being provided to you at no cost and any fees paid by you to NISA are solely for the provision of investment management services pursuant to a written agreement. All of the foregoing statements apply regardless of (i) whether you now currently or may in the future become a client of NISA and (ii) the terms contained in any applicable investment management agreement or similar contract between you and NISA.