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Weekly Commentary

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Will the futures market be correct about a Fed hike?

When we talk about Federal Reserve hikes, we are referring to the federal funds rate. That is what many global central banks call the base rate, i.e., the figure upon which others, such as credit cards and mortgages, are based. The singular here is deceiving. It used to be a point, but for more than two decades, the Fed has instead identified a "target range," in other words a plurality of potential points. Currently, that is 3.50-3.75%.

While the range is crucial today if you are closing on a house or paying down a credit card, its future level is more important to the markets — So much in finance is based on expectations. Through trades and bets, the fed funds futures market "predicts" the next policy move, which in turn impacts other trades.

With this in mind, we turn to this week's Federal Open Market Committee (FOMC) meeting. Chair Warsh has talked tough about curbing inflation but has not guided the committee to a hike in his short tenure. Last week, the Bureau of Labor Statistics reported that the Consumer Price Index (CPI) ran hotter in August than it had in July. Headline CPI increased 0.4% month-over-month (m/m) in August, higher than July's 0.1% growth; Core CPI increased 0.3% m/m, higher than July's 0.2% growth. (The Core reading does not include volatile components such as energy and food prices.)

The shifts caused the fed funds futures market to vastly increase the forecast for a quarter-point rate hike — more than a 90% of a chance versus around 65% in the days before. The FOMC will do what it feels right, regardless of what the market thinks. We will all know at 2 p.m. Wednesday, when the meeting ends and the announcement is made.

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