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Despite Fischer, Fed Sets up for December, not a September Hike

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There's what Janet said, and there's what everyone else thought Janet Yellen said. From 10 a.m. to almost noon, the market thought Yellen said that the economy is approaching the levels where another Fed rate hike is appropriate, but there appeared to be no urgency to raise rates. This implied a lower probability of a September hike but kept a December hike very much on the table. Then Stan Fischer, Fed vice-chair appears on Bloomberg saying that nothing Yellen said was inconsistent with either a September or December increase, or even both! Ouch! That sent the market down a couple hundred points after being up strongly in the late morning. The ten-year Treasury yield reacted instantly and has now reached 1.62%, the highest in 2 months. Goldman Sachs says that Yellen's and Fischer's talk has increased the probability of a September increase to 40%.

I don't think so. I rate a 20% probability of an increase in September and a 60% to 70% chance in December (An increase in the November meeting is almost zero as it occurs less than a week before the presidential election.) The market is over-reacting to Fischer's comments. Recall he was the one who said in February that "4" rate increases were on the table. To be sure, there is still almost a month of data before the September 25 FOMC meeting, particularly the employment report next Friday. GDP growth in Q3 in running north of 3%, a welcome gain from the awful first half which saw GDP grow at only 1%. GDP will have to grow at 3% in the second half of 2016 to average 2% for the year. This is still well short of the 2.4% growth for all of 2016 that the FOMC forecast last December, and reflects (once again), the horrible productivity numbers the economy has been experiencing.

Despite the fireworks today, equities have been moving in an extremely narrow path. Everyone feared a sell-off this month, like last August and the year before. Historically, September has been the worst month of the year for the stock market. In recent years traders decided to sell in August ahead of the expected downturn in September. However, this year so many big guns were either short or sharply underweight equities, there were too few left to sell in the absence of bad news. Stock investors don't want a September hike, but will be willing to put up with one in December, especially if the economy strengthens. The earnings recession appears to be over, but guidance in the second half of the year has not strengthened significantly. If it does, expect nice stock gain by year end.
