
October rally shows markets' addiction to low rates: OFR

By Editorial Staff Thu, Oct 29, 2015

"The market-implied probability of a Federal Reserve rate hike in 2015 is now down to approximately 25% to 35%," according to the Office of Financial Research. The estimate came prior to the Fed's meeting this week.

Prices of global risk assets rebounded in October after the Federal Reserve decided not to raise the Federal Funds rate by even a quarter of a point, raising questions about the dependency of asset prices on Fed policy, according to a new report from the Department of Treasury's Office of Financial Research.

"Extraordinarily accommodative monetary policy has supported risk asset prices since the global financial crisis and this month's market reaction suggests that these prices may still be contingent on accommodative policy," said the OFR report, entitled "Shift in Monetary Policy Expectations Supports Risk Assets."

"It remains to be seen whether current U.S. asset price ranges can be sustained once the Federal Reserve begins to raise interest rates, broadly expected to occur between December and June," the authors added. The report was released just ahead of the Fed's meeting this week, when the Fed again declined to raise rates.

Low rates seem to be the primary support for prices of the S&P500 and of emerging market equities, because the economic signals haven't been good, the report said:

"The rebound has occurred in the face of weaker U.S. equity fundamentals, such as the slowdown in global growth, negative effects of a stronger U.S. dollar on earnings, and continued weakness in the energy sector. For the third quarter, analysts continue to expect negative revenues and earnings for energy stocks, with modestly positive growth for non-energy S&P 500 stocks."

The likelihood of an increase in rates before the end of the year has been slipping, the OFR report said. "The market-implied probability of a Federal Reserve rate hike in 2015 is now down to approximately 25% to 35%, with an implied probability of a rate hike at the October 27-28 FOMC meeting of less than 10%."

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