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Wall Street Likes the Odds of a June Rate Hike After Fed Foregoes March Move

By **James Langford**|03/16/16 - 03:20 PM EDT

Long odds are long for a reason, after all. They rarely pay off, and the 4% chance that the **Federal Reserve** would raise interest rates Wednesday is just one more example.

The wisdom of the crowd, illustrated in the interest-rate futures trading that showed a 96% chance the central bank would do nothing, proved correct. Based on that gauge, along with some optimistic notes in a statement from the central bank's monetary policy committee, rates won't increase again until June, probably by 25 basis points.

That would take the bank's benchmark short-term rate to a range of 0.5% to 0.75%, building on a December hike of 25 basis points that was the first since rates were cut to nearly zero to bolster the economy during the 2008 financial crisis.

The Fed's statement appeared particularly "dovish" on interest rates," Michelle Meyer, U.S. economist with **Bank of America's Merrill Lynch,** said in a phone interview afterward. The most obvious of the cautionary notes was "expecting only two hikes this year, down from four in December," she said. "They've really shifted expectations about the pace of the hiking cycle."

The Fed's latest projections, which indicate rates of as much as 0.75% to 1% by the end of the year, mirror Bank of America's forecast, which calls for increases in June and December. If that comes true, summer would, in essence, be delivering for banks "the unfulfilled promise of spring," to quote one of Amory Blaine's girlfriends in F. Scott Fitzgerald's *This Side of Paradise*.

In leaving rates unchanged on Wednesday, the Fed's monetary policy committee cited softness in exports and business investments that are countering improved hiring and a pickup in inflation.

Economic conditions in the near term will probably only warrant gradual increases, leaving rates lower than normal for some time, the committee said in its statement.

The path of interest rates "is necessarily uncertain," Fed Chair Janet Yellen said in a press conference afterward, "because the economy will surely evolve in unexpected ways."

Raising rates, which would bolster interest income for banks like **JPMorgan Chase(JPM - Get Report)** and Jim Cramer's Action Alerts PLUS holdings **Wells Fargo** (WFC - Get Report) and **Bank of America** (BAC - Get Report) , has become more difficult for policymakers amid global market volatility prompted by a slowing economy in China and plummeting oil prices.

A number of emerging markets are "suffering under the weight of declines in oil prices," which are also affecting Canada and Mexico and have curbed inflation's progress toward the Fed's 2% goal, Yellen noted.

Additionally, the European Central Bank has adopted negative interest rates, weakening one of the world's most widely used currencies against the dollar and hurting U.S. exporters.

Should the Federal Reserve increase rates against that backdrop, the dollar would strengthen even further. As a result, **Morgan Stanley** economist Ellen Zentner predicts only one increase this year, in December.

"While the domestic U.S. economy has indeed held up well, the global economy has not," she said in a note to clients on Sunday. The central bank's monetary policy committee will likely maintain a bias toward tightening, Zentner said, but "we expect the Fed to fight an uphill battle in trying to convince financial markets that further rate hikes are warranted. In what may feel like a repeat of 2015, a tug of war with markets ultimately holds the Fed to delivering just one hike."

Jerry Braakman, who oversees assets of $1.1 billion as chief investment officer for **First American Trust** in Santa Ana, Calif., also expects no more than a single hike.

"It's a difficult world," he said in a telephone interview before the Fed's two-day meeting began. "Our expectation is that the Federal Reserve will sit patiently until they really see us moving through that."

While unemployment has improved, falling to 4.9% this year from a high of 10% in 2009, "there are still a lot of risks external to the U.S." Braakman said. "If China becomes a more serious issue, that can have impacts for the U.S. and U.S. multinationals as well." Braakman said the Federal Reserve probably won't raise rates more than 25 basis points for the full year, and "that might even be challenged."

A single increase would be a disappointment for large U.S. banks, whose net interest margin -- which gauges interest income from loans against interest paid to depositors -- dropped from a median of 3.67% in 2006 to 2.93% at the end of last year, depressed by seven years of nearly zero rates.

That would create more pressure on finance stocks, which have already fallen 11% this year amid tighter regulation and concerns that sliding oil prices, which reached a low of about $26 a barrel in February, would lead to widespread defaults on loans. The drop is almost nine times the decrease in the broader **Standard & Poor's 500** and the **Dow Jones Industrial Average.**

"We went into the year expecting two rate increases," **Citigroup** (C - Get Report)CFO John Gerspach said at a conference last week. "At this point in time, I think there's still hope that we could end up with the two rate increases, but it's probably more likely that we'll end up with one."