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A Timely Warning Call

The unorthodox specificity found in the International Monetary Fund's latest forecasts for the US economy reintroduces a level of confusion and uncertainty for investors surrounding when the Federal Reserve will raise interest rates. News out of Washington last Thursday threw an absolute curveball at the Fed's escape plan from zero interest rate policy. As a topic that was previously over-discussed and framed by the financial media, the IMF as the de facto global monetary policy authority has entered the discussion. Previous statements from the US Fed and their Federal Open Market Committee (FOMC) ensured for investors that the data dependency of the US Fed would dictate when we would see higher interest rates. The plea from the IMF Thursday could reshape this debate.

Ultimately, the typical investor has to question whether the Fed raising rates in the second half of 2015 or the beginning of 2016 would really make any material difference. And the assumption is a very likely, no. But it is important to discuss the motivation behind the IMF speaking out in this nature and entering an arena they typically stay absent from, which is imposing their view on US monetary policy. Furthermore, what are the risks they are implying, which really centres on the uncertainties in the global economy at present time?

PIMCO founder Bill Gross made the strongest argument for why the IMF made this recommendation to Chair Yellen and the FOMC. Gross suggests that in a post gold standard world where the US dollar is the world's reserve currency, the global economy looks to it for stability. Thus, the IMF makes their case to the US Fed to remember to move slowly because as we see liquidity taken away from the global markets, US policy shocks have far reaching effects as witnessed over the last 8 years.

The problem this creates for the US Federal Reserve is their mandate to the US congress is to make policy decisions based on domestic employment and inflation. Global financial stability, which is arguably in their realm of interest, doesn't dictate when they should raise rates. And as many economists have argued this week, waiting until 2016 with the jobless rate trending lower and expected to be below 5 per cent, is waiting too long to raise rates. As St. Louis Fed President Jim Bullard discussed last week, the Fed will be proactive in raising rates, not reactionary.

One could argue in many instances the Fed's policy is aligned with the interests of the global economy, but this decoupling notion (of US and global growth) that was introduced in September of last year is once again exhibiting its challenges. If the Fed were to wait, they are giving credence to the IMF's implied concerns.

It circles back to the earlier question of does it really make a difference when the Fed raises rates? No, not when. It's clearer, however, a reputable institution doesn't so much see trouble with when the Fed acts, but the effects of raising rates. It's a liquidity issue for markets that risk the readjustments, like a 40 basis point swing in US treasuries in a moment's time which we saw in October, 2014, or the German 10 year bund yield moving from one twentieth of a per cent to eight tenths of a percent in less than week.

The IMF has warned. Now we wait and see.

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