Future Rate Expectations & Sources

by Steve Brown

Happy New Year to everyone and welcome to 2016! Our focus today is on the federal funds (FF) rate, expectations and sources for your bank to track this year. We know you will all recall that on Dec 16 the FOMC raised the target range for FF by 25bp to 0.25% to 0.50% and raised the interest rate paid on required and excess reserve balances (EBA) to 0.50%. The FOMC also increased the discount rate by 25bp to 1.00%. All of this action pushed banks to increase the prime rate to 3.50%. We bring this up because many banks we know are trying to figure out what to expect from rates in 2016, so we thought we would help by consolidating a bunch of information here to assist you.

Calendar: At this juncture, the FOMC is scheduled to meet Jan 26-27; Mar 15-16; Apr 26-27; Jun 14-15; Jul 26-27; Sep 20-21; Nov 1-2 and Dec 13-14. This is important because analysts now project 4 more rate hikes this year that are expected to occur at every other meeting (underlined above). So, assuming 25bp rate increases at each meeting, the FF rate should rise from a range of 0.25% to 0.50% now to 1.25% to 1.50% by the end of 2016 or about +100bp.

FOMC: To be sure we are thinking straight, we next review the updated dot chart (the FOMC participant assessment of the midpoint of the target range for the FF rate). As of the Dec FOMC meeting, the updated chart shows participants expect the FF rate will be: 115bp to 140bp (2016); 230bp to 255bp (2017) and 285bp to 310bp (2018). Roughly, that means FOMC participants are projecting about +90bp (2016); +115bp (2017) and +55 (2018). Since the FOMC doesn't move the FF rate in odd amounts, we can round the projections and end up with +100bp; +100bp and +50bp, respectively.

Economists: Next we review the FF rate projections from major Wall Street economists to see what they think. Looking to the Wall Street Journal survey of more than 60 economists, the ranges are: 0.38% to 0.88% for 2016 (0.73% avg.) and 0.38% to 3.63% for 2017 (2.26% avg.). Here again, we round the odd amounts and end up with an average of about +50bp (2016) and +175bp (2017). The good news here is that studies show economists are so poor at projecting rates that they are worse than weather people predicting weather on TV.

Futures: The math here gets a bit tricky and only the biggest banks make markets, so this metric has issues. That said, we figured you would still like to know so 30-day FF futures prices (also have a probability assigned) as of a recent point in time are: FF rate will be at 0.50% (with a 90% probability) or 0.75% (10%) in Jan; it is projected to be either at 0.50% (41%), 0.75% (53%) or 1.00% (5%) in Mar; Apr is 0.50% (34%), 0.75% (51%), 1.00% (14%) or 1.25% (1%); and Jun is at 0.50% (20%), 0.75% (44%), 1.00% (29%), 1.25% (6%) or 1.50% (0.4%). Note that for FF futures, this is thinly traded so the further out you go the fewer the contracts and the more 1 big bank can move things around. As such we stop at midyear.

LIBOR: The LIBOR curve is yet another way to see where rates might be heading. The idea is that this is the AA rated funding cost basis upon which the largest banks in the world benchmark their deposit products. For example, a core checking account might be pegged at 1% of the LIBOR rate for a given maturity (say overnight LIBOR), while a CD might be 5% (say for 90 day LIBOR) or something like that. So the checking account rate would be the O/N LIBOR rate of 0.37% x 1% or about 0.04% perhaps (while the 90D CD would be the 90D LIBOR rate of 0.61% x 5% or 0.03%). The big banks do this each day when they set rates for their branches and then as LIBOR moves around the funding/deposit pricing moves around as well. This is actually how they do it and their loans are pegged at a spread above the LIBOR curve for each given maturity. As things stand currently, it looks like LIBOR will move from about 0.37% to an average of 0.43% in Jan, 0.52% in Feb, 0.61% in Mar, 0.84% in Jun and 1.17% in Dec. Here the curve is basically telling us that market investors believe the Fed will raise the FF rate by about +75bp in 2016.

History: This is yet another way to look at things. Here we see that the last time the Fed raised rates prior to Dec the FF rate climbed +425bp. Given FOMC comments, this likely is too high, but it too serves as a baseline for bankers to pivot from.

As can be seen above, there are plenty of ways to look at things as you project into the future. Each one has its pluses and minuses, so perhaps a basket or baseline/stress approach might be the best for you this coming year until things settle down more. In the meantime, our advice is to remain aware as you tinker with things along the way. We will be back later to help you with more on this subject as things move around.

BANK NEWS

Economic Growth

The head of the IMF said rising interest rates in the US and a slowdown in China will lead to disappointing and uneven global economic growth in 2016. She also warned that low productivity, aging populations and ongoing effects of the global financial crisis were continuing to weigh on growth.

ATM Requirement

Banks are reminded that as of Oct 1, 2016 (for MasterCard) and Oct 1, 2017 (for Visa), banks that have not enabled ATMs to process chip transactions will be liable for fraud costs from any transactions.

Tenure

Did you know that more than 2,500 community banks have been around for 100Ys or more?

Multi-family lending

Bloomberg reports that between 2011 and 2015 loans for multi-family developments at insured depository institutions increased 45% and made up 17% of all commercial real estate loans held by financial institutions. Regulators have indicated this will be one area they will be closely reviewing when they exam banks in the coming year.