US Stock response to Interest Rate Hike

Investors are waiting to hear what the United States Federal Reserve will do with interest rates at their meeting later this week. The Fed previously indicated that when the economy is strong enough they would phase out the quantitative easing bond buying program and then raise interest rates. Quantitative easing is now history and many expect the Fed to nudge up short term interest rates. We are wondering what will be the US stock response to an interest rate hike. There a several factors pushing on the markets at this time. Recession in Japan, the risk of recession in Europe and a distinct economic slowdown in China have driven stocks lower across the world. The US economy is doing better and we have seen a yearlong stock rally, until last week! Last week US stocks fell their worst in two years. *The Wall Street Journal* reports that starting the week stocks have **pared the worst of their losses** but are still down from their highs.

U.S. stocks pared the worst of their losses in afternoon trading, brushing off steep declines in emerging markets and European stocks. Investors in those regions were seeking safety ahead of a highly anticipated meeting from the Federal Reserve later this week, when officials could signal an increase in short-term interest rates. Currencies in Russia and Indonesia were hit Monday, along with markets in Malaysia and Thailand. Europe's Stoxx 600 fell 2.2%, extending a 5% slide last week.

Now add higher interest rates. What will the US stock response be to an interest rate hike?

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In general higher interest rates hurt stocks because higher interest rates add to the cost of doing business, unless you are a bank. Thus we might think that the US stock response to an interest rate hike will be to drive the market down. But, where else would you put your money? Markets are down in Europe, Asia and developing markets. And, higher interest rates will drive up the value of the dollar. This is partially because Forex traders can get a better interest rate in greenbacks so they will buy dollars and hold them as opposed to other currencies. Currencies from the Ruble to the Rupee are weakening **against the US dollar**. According to *BBC Business News*:

As of Monday afternoon, it takes more than 60 rubles to buy a single dollar. The 60 mark is considered a "psychological barrier" for Russia's national currency, says the BBC's Moscow correspondent, Steve Rosenberg. Since the start of the year, the ruble has lost more than 45% of its value against the dollar.

Russia may be a special case because of the sanctions and low price of oil but the slide of other currencies includes countries like Colombia, another oil exporter. According to the Bogota Post **Money, Money, Money** article:

The Colombian government approved the 2015 budget on December 2 amid a looming shortfall and a fiscal deficit.

The budget for the coming year was originally based on the assumption that the price of oil would hover around $98 USD per barrel. But crude oil has taken a tumble, and is now at $67.30 USD – more than 30 percent lower – and lawmakers did not adjust the budget accordingly.

The government is now staring down a $6.5 billion USD budget shortfall which they are hoping to make up through imposing controversial tax reform laws.

A financial analyst told The Bogota Post that the new tax reforms are expected to affect entrepreneurs most.

Several years ago it took 2,400 Colombian pesos to buy a US dollar and then the dollar slide while the peso rose to 1,600 to the dollar. It was a spectacular success story as the price of oil rose. While the oil fracking boom and high OPEC production have been good for the US economy the fall in prices has been a problem for nations like Colombia.

In the end the US stock response to an interest rate hike will likely be negligible as the shift of capital to the USA and lack of better prospects elsewhere keeps upward pressure on US markets.

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