Daily Insight

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Fed official plays down inflation concerns

US Macro: Concern over inflation is misplaced, suggests Bullard – St Louis Fed President Bullard (non-voter in 2018, voter in 2019) discussed his macro outlook today in prepared remarks. As a cheerleader of the dovish camp, Bullard expressed his scepticism over the validity of the Phillips Curve in the modern era, pointing to empirical work from the BIS that showed the relationship between labour market tightness and inflation 'may be close to zero'. He also said that the Fed's current policy stance is already close to neutral, assuming the real neutral fed funds rate is around zero. While we think labour market tightness will ultimately (likely in 2019) lead to inflationary pressure, we believe market concerns – as suggested by the rout in equity markets in recent days - that we are on the verge of a significant heating up in inflationary pressures are misplaced. Wage growth does indeed look like it is picking up, but US corporates have significant room to raise wages in the near term, and the recent rebound in productivity means that unit labour cost growth is still around zero. We would need to see unit labour costs growth back above 2% on a sustained basis for core inflation to meaningfully pickup. Meanwhile, one of the key arguments for rate hikes of late – overly easy financial conditions – has arguably taken a knock given the equity market correction. While it remains to be seen how far the correction will run, the Fed would likely pause if markets become disorderly. (Bill Diviney)

Euro Macro: Positive news for Germany's industrial sector – Positive news reports about Germany's industrial sector were published today. To begin with, factory orders soared in December. New orders increased by 3.8% mom, following a modest 0.1% decline in November. Monthly orders data tend to be very volatile and quarterly data better reflect the underlying trends. During 2017Q4 as a whole, orders increased by 4.1% qoq, somewhat higher than the 3.7% recorded in Q3. This bodes well for production growth moving into 2018. Indeed, we expect Germany's economy to have gathered momentum in 2017Q4-2018Q1, with GDP growth expected to pick up somewhat compared to 2017Q3 (0.8% qoq). On top of that, the details of Germany's orders report show that the strength in Q4 was concentrated in machinery orders from other eurozone countries, which jumped by 14% qoq in Q4. Although machinery orders can be influenced by one-off big-ticket items, we nonetheless think this underlines that fixed investment growth in the eurozone is accelerating.

Meanwhile, IG Metall's 6% wage demand resulted in a less stellar wage deal of 4.3% over 27 months and some one-off payments. The overall package limits the annual pay rise to somewhat below 4%. The deal also opens the possibility for some workers to temporarily take extra-time off (work 28 hours instead of the standard 35 per week). In exchange, companies have been given the ability to hire more people that are willing to work 40 hours instead of 35, which gives them some more flexibility to raise production when necessary. As we wrote in our Short Insights of 1 February (here) we think that Germany's wage deal does not reflect a broader trend within the eurozone as a whole, as the majority of the other big eurozone countries still face significant slack in their labour markets, which depresses wage growth. (Aline Schuiling)

(https://insights.abnamro.nl/en/2018/02/short-insight-german-6-wage-demand-an-isolated-case/)