

Daily Insight

Fed hike approaching

Group Economics
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- **The Minutes of July's FOMC meeting indicated that conditions for a rate hike are approaching.**
- **Rate rise depends on sustained economic growth and "some" improvement in employment.**
- **Strong US economic data after FOMC meeting suggest rate hike in September still on the cards.**

Conditions approaching, but not yet there

The minutes of July's FOMC meeting suggested that most members thought that conditions for a rate hike had not yet been achieved, but they were approaching that point. Participants were optimistic about the improvement in the labour market, but many saw scope for some further improvement. Many participants said that "sustained economic growth and further improvement in the labour market was key in supporting their expectation that inflation would move up to the Committee's 2% objective.

Fed's preparation for the rate hike

The Fed has been preparing markets for a rate hike this year. A delay could have counterproductive effects for the economy. Participants noted that "a prompt start to normalization would likely convey the Committee's confidence in prospects for the economy". Some nuances were discussed around the Fed's data dependency. Some participants advised that data be viewed in light of the cumulative gains made to date, without overemphasising month-to-month data. Regarding the communication, it was noted that emphasis should be made of the path for policy and not the initial increase. In their discussion of the appropriate path, a gradual path was the preferred option to ensure that the economy can absorb higher rates.

Strong US economic data after July's FOMC meeting

Economic data are taking outsized importance in shaping investors views on the timing of the upcoming Fed rate hike. Since the last meeting the economy has been showing signs of strong fundamentals. The last labour market report was strong. Nonfarm employment increased by 215K in July. Job gains above 200K are a sign of a strong labour market, while the unemployment rate is now at 5.3%. As a result slack is diminishing. The impact of the labour market is slowly filtering through to the economy. Retail sales rebounded strongly in July, with upward revisions to June's sales. Demand for housing is increasing and as a result the US housing market is picking up momentum. This all adds to the picture of an economy growing at above trend rates.

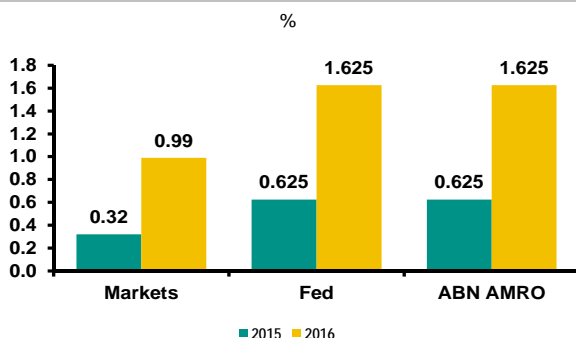
US inflation to rise to 2% target in the medium term

July's inflation report, released yesterday showed that core consumer prices increased 0.1% down from 0.2% the previous month. This left them up by 1.8% yoy. A sharp fall in air fares depress core inflation in July, while the effects of the strong dollar were visible in weak core goods prices. Meanwhile, shelter (rental prices), which comprise a relatively large share of core inflation (around 42%) are pushing up inflation. A higher demand for rental properties is exerting pressure on rental prices. This is likely to continue and we expect core inflation to gradually firm during the year as diminishing slack also puts upward pressure on inflation. This would support the Fed's view that inflation will rise gradually to 2% over the medium term as the transitory effects of declines in energy and import prices gradually dissipate.

Rate hike in September

We expect "some" further improvement ahead as the gains in the job market continue to support the economy. This is what the Fed wants to see before a rate hike. Consequently, a rate hike in September remains very likely in our view. Tighter financial conditions will, however, lead the Fed to opt for a significantly slower pace of rate hikes compared to past cycles.

Rate forecasts some divergence still



Source: Bloomberg, ABN AMRO

Financial markets	Close	Change 1 day	Change 5 days	Change YTD
Currency markets				
EUR/USD	1.1144	0.2158	-0.0538	-7.8856
USD/JPY	123.83	0.0242	-0.4822	3.3812
AUD/USD	0.7366	0.2450	0.0815	-9.8960
USD/CHF	0.9641	-0.1553	-1.2597	-3.0373
NZD/USD	0.6606	0.0757	0.5326	-15.2751
GBP/USD	1.5699	0.1212	0.5637	0.7832
USD/SGD	1.3989	-0.3064	0.1288	5.5375
USD/CAD	1.3106	-0.1752	0.3522	12.7786
Bond markets				
2-year German Govt Bond yield	-0.2570	-0.0030	0.0270	-0.1590
10-year German Govt Bond yield	0.6190	-0.0230	0.0140	0.0780
Yield curve Germany	0.8760	-0.0200	-0.0130	0.2370
2-year US Treasury Bond yield	0.6574	0.0000	-0.0499	-0.0071
10-year US Treasury Bond yield	2.1274	0.0018	-0.0580	-0.0438
Yield curve US	1.4700	0.0018	-0.0081	-0.0367
US 2-year sw ap rates	0.9020	-0.0288	-0.0435	0.0077
US 10-year sw ap rates	2.2070	-0.0292	-0.0552	-0.0791
US sw ap curve	1.3050	-0.0004	-0.0117	-0.0868
EU 2-year sw ap rates	0.0845	0.0020	0.0025	-0.0905
EU 10-year sw ap rates	0.9473	-0.0017	-0.0317	0.1353
EU sw ap curve	0.8628	-0.0037	-0.0342	0.2258
Euribor 3 Month ACT/360	-0.0290	-0.0010	-0.0050	-0.1070
ICE LIBOR USD 3 Month	0.3329	0.0000	0.0185	0.0773
JPMorgan EMBI Plus Sovereign S	433.4800	12.0500	14.0500	46.0400
Equity markets				
Nikkei 225	20,223	-1.61	-1.81	15.88
Hang Seng Index	23,168	-1.31	-3.13	-1.85
Hang Seng China Enterprises Index	10,642	-1.19	-3.63	-11.20
Australian Stock Exchange S&P/ASX 200 Index	5,339	-0.77	-0.92	-1.34
Singapore Straits Times Index	3,041	-0.28	-0.66	-9.63
Euro Stoxx 50 Index	3,430	-1.88	-1.57	9.01
S&P 500 Index	2,080	-0.83	-0.31	1.01
MSCI World Daily Total Return Gross USD	778	-1.03	-1.00	1.29
AEX Index	469	-2.04	-1.71	10.55
Chicago Board Options Exchange Volatility Index	15	10.59	12.05	-20.57
Commodity markets				
Reuters/Jefferies CRB Total Return	194	-1.53	-2.58	-15.73
Gold spot USD/Oz	1,134	0.01	1.68	-4.30
Generic first NYMEX Crude Light future	41	-0.12	-3.50	-23.50
Generic first Brent Crude Oil future	47	-0.02	-4.21	-17.76
LME Copper 3 Months Rolling Forward	4,995	-0.79	-3.75	-20.71
Generic first Wheat future Chicago Board of Trade	497	0.05	-1.34	-15.81

Day	Date	Time	Country	Key Economic Indicators and Events	Period	Latest outcome	Consensus	ABN AMRO
Monday	17/08/2015	01:50:00	JP	GDP - % qoq	2Q P	-0.4	-0.6	
Monday	17/08/2015	14:30:00	US	Empire State PMI - Manuf. general business conditions - index	Aug	-14.9	4.7	
Monday	17/08/2015	16:00:00	US	NAHB home builders' confidence index	Aug	61.0	61.0	62.0
Monday	17/08/2015	15:45:00	EC	ECB announces weekly QE details				
Tuesday	18/08/2015	10:30:00	GB	CPI - % yoy	Jul	0.1	0.0	0.0
Tuesday	18/08/2015	13:00:00	TR	Repo rate - %	Aug 18	7.5	7.7	
Tuesday	18/08/2015	14:30:00	US	Housing starts - % mom	Jul	0.2	0.4	
Wednesday	19/08/2015	01:50:00	JP	Merchandise trade exports - % yoy	Jul	7.6	5.7	
Wednesday	19/08/2015	14:30:00	US	Inflation excl food and energy - % mom	Jul	0.1	0.2	0.2
Wednesday	19/08/2015	14:30:00	US	Inflation excl food and energy - % yoy	Jul	1.8	1.8	1.8
Wednesday	19/08/2015	14:30:00	US	Inflation (CPI) - % mom	Jul	0.1	0.1	0.1
Wednesday	19/08/2015	14:30:00	US	Inflation (CPI) - % yoy	Jul	0.2	0.2	0.2
Thursday	20/08/2015	09:30:00	NL	Consumer confidence - index	Aug	4		5
Thursday	20/08/2015	09:30:00	NL	Unemployment rate	Jul	6.9		6.9
Thursday	20/08/2015	10:30:00	GB	Retail sales - % mom	Jul	-0.2	0.6	
Thursday	20/08/2015	16:00:00	US	Existing home sales - % mom	Jul	3.2	-1.4	
Thursday	20/08/2015	16:00:00	US	Philadelphia Fed - business confidence - index	Aug	5.7	6.5	
Friday	21/08/2015	15:45:00	US	Markit Manufacturing PMI	Aug P	53.8		55.0
Friday	21/08/2016	10:00:00	EC	Manufacturing PMI	Aug P	52.4		53.0
Friday	21/08/2017	10:00:00	EC	Services PMI	Aug P	54.0		54.5
Friday	21/08/2017	10:00:00	EC	Composite PMI	Aug P	53.9		54.5

Source: Bloomberg, Reuters, ABN AMRO Group Economics (we provide own forecasts only for selected key variables and events)

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