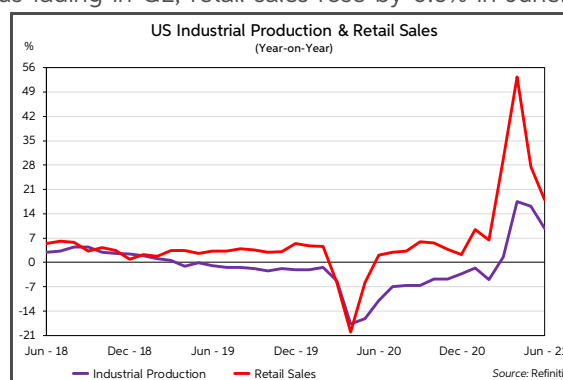


The Worm Turns

- **The US economy does not look like one where official interest rates should be pitched at virtually zero.** The labour market appears to be tightening rapidly, with close to one million jobs added in each of the last two months and the unemployment rate dropping to 5.4% in July from 5.8% in June. Strong jobs growth is expected to continue in the coming months also. Unfilled job openings rose by 590,000 to a seasonally adjusted 10.1 million in June, the highest level since record-keeping began in 2000. This is greater than the number of unemployed persons, which stood at 8.7m in July. Meantime, the economy is growing strongly, with real final GDP sales rising by 9.1% and 7.7% annualised in Q1 and Q2, respectively, restoring output to its pre-pandemic levels. Strong survey data for July point to continuing robust economic growth as we move into the second half of the year.
- **Meanwhile, inflationary pressures are building.** Average hourly earnings rose by 0.4% in both June and July, with the year-on-year rate standing at 4%. The core CPI rate, which excludes food and energy, stood at 4.3% in July, with the headline rate running above 5% in recent months. The Fed's preferred inflation measure, the core personal consumer expenditure deflator, has risen to 3.5% year-on-year. It is the strong view of the Fed that the upsurge in inflation this year is due to temporary factors that will abate. Thus, it expects inflation to drop back to around its 2% target by the end of next year. Fed officials have been saying for the past year that they would maintain the current very loose stance of monetary policy, comprising of near zero interest rates and bond purchases of \$120bn a month, until there is "substantial further progress" toward the central bank's goals for inflation and employment.
- **Over the past week, there have been soundings from several top Fed policymakers that the inflation goal has been achieved and that another couple of months of strong jobs growth could see its' employment goal accomplished.** This suggests that policy tightening could be coming before too long. We would not be surprised to see the Fed start tapering its asset purchases in the fourth quarter. Indeed, the Fed will likely provide clarity on its intentions in this regard by next month. This would pave the way for interest rate hikes somewhat further down the line. The market view, as evidenced in futures contracts, is that the first Fed rate increase will be in December 2022, with the funds rate being hiked from 0.125% to 0.25%. Rates are seen as rising by a further 50bps in 2023, taking them up to 0.75%.
- **We wonder if the Fed will be this patient, especially if the labour market continues to tighten rapidly and inflation proves anyway sticky in 2022 and remains comfortably above 2%.** It is a long time to December 2022 to wait for a meagre rate hike. US bond markets are turning a bit nervous, with ten year yields climbing to 1.35% from lows of around 1.15% earlier in the month. The dollar is also becoming a bit perkier, with the euro falling to its lowest levels of the year, close to \$1.17. A close eye needs to be kept on the Fed in the coming weeks as markets will need to come to terms with the likely shift in policy, which may come earlier than they had anticipated.
- **Thus, the latest Fed meeting minutes will garner close attention on Wednesday.** This week we will get an update on activity in the US economy in July also. Despite the fiscal stimulus fading in Q2, retail sales rose by 0.6% in June. However, the forecast is for retail sales to edge lower by 0.3% in July, although, this would still leave them circa 18% above their pre-Covid level. Meantime, industrial production is set to rise for the fourth month running. Output is projected to rise by 0.5% in July despite widespread reports of supply chains being stretched.
- **In terms of survey data,** regional manufacturing bellwethers such as the Philly Fed and the Empire State indices will shed some light on whether shortages of inputs have abated slightly in August. We also get a raft of housing market data, including housing starts (July) and homebuilder sentiment (August).
- **In the UK, retail sales will also feature.** Having increased by 0.5% in June, retail sales are projected to rise by a further 0.5% in July despite concerns activity may be impacted by the Delta variant and the associated "Pingdemic", which has resulted in over a million people having to self isolate. In terms of inflation, the consensus is for UK CPI to rise by 0.3% in July, meaning the year-on-year rate would ease slightly to 2.3%. However, the Bank of England now expects inflation to rise to 4% in Q4, largely due to one off factors such as temporary supply bottlenecks. Regarding the labour market, the unemployment rate is forecast to hold steady at 4.8% in June. **Meanwhile, there is a quiet data schedule in the Eurozone this week, while Q2 GDP data are due in Japan.**



	Interest Rate Forecasts			
	Current	End Q3	End Q4	End Q1
		2021	2021	2022
Fed Funds	0.125	0.125	0.125	0.125
ECB Deposit	-0.50	-0.50	-0.50	-0.50
BoE Repo	0.10	0.10	0.10	0.10
BoJ OCR	-0.10	-0.10	-0.10	-0.10
Current Rates Reuters, Forecasts AIB's ERU				

	Exchange Rate Forecasts (Mid-Point of Range)			
	Current	End Q3	End Q4	End Q1
		2021	2021	2022
EUR/USD	1.1767	1.18	1.18	1.17
EUR/GBP	0.8501	0.85	0.85	0.84
EUR/JPY	129.61	131	131	131
GBP/USD	1.3840	1.39	1.39	1.39
USD/JPY	110.13	111	111	112
Current Rates Reuters, Forecasts AIB's ERU				

Date	UK & Irish Time		Release	Previous	Forecast
This Week:	ECB Speakers:				
	BoE Speakers:				
	Fed Speakers:		Kashkari, Powell (Tue)		
Mon 16th	JPN:	00:50	GDP (Q2 Preliminary Reading)	-1.0%	+0.2%
	CHINA:	03:00	Industrial Output (July)	(+8.3%)	(+7.8%)
	CHINA:	03:00	Retail Sales (July)	(+12.1%)	(+11.5%)
	US:	13:30	NY Fed / Empire State Index (August)	43.0	30.0
Tue 17th	UK:	07:00	ILO Employment (June) - Unemployment Rate (June)	+25,000 4.8%	4.8%
	UK:	07:00	Average Weekly Earnings (3 months to May) - Ex-Bonus	(+7.3%) (+6.6%)	(+8.7%) (+7.4%)
	UK:	07:00	Claimant Count (July)	-114,800	
	EU-19:	10:00	Flash Employment (Q2)	-0.3% (-1.8%)	
	EU-19:	10:00	GDP (Q2: Second Reading)	+2.0% (+13.7%)	+2.0% (+13.7%)
	US:	13:30	Retail Sales (July) - Ex-Autos - Ex-Gas/Autos	+0.6% (+18.0%) +1.3% +1.1%	-0.3% +0.2%
	US:	14:15	Industrial Production (July) - Manufacturing Output - Capacity Utilisation	+0.4% (+9.8%) -0.1% 75.4%	+0.5% (+16.1%) +0.5%
	US:	15:00	NAHB Homebuilder Sentiment (August)	80	80
Wed 18th	JPN:	00:50	Machinery Orders (June)	+7.8% (+12.2%)	-2.8% (+15.8%)
	JPN:	00:50	Trade Balance (July) - Exports	+¥384.0Bn (+48.6%)	+¥202.3Bn (+39.0%)
	UK:	07:00	CPI (July) - Core	+0.5% (+2.5%) +0.5% (+2.3%)	+0.3% (+2.3%) +0.3% (+2.2%)
	UK:	07:00	PPI Output Prices (July) - Input Prices	+0.4% (+4.3%) -0.1% (+9.1%)	+0.4%
	EU-19:	10:00	Final HICP (July) - Ex-Food & Energy	+0.3% (+2.2%) +0.2% (+0.9%)	+0.3% (+2.2%) +0.2% (+0.9%)
	US:	13:30	Housing Starts (July) - Building Permits	+1.643m / +6.3% +1.594m / -5.3%	+1.610m / -2.0% +1.608m / +0.9%
	US:	19:00	FOMC Meeting Minutes (27-28th July 2021)		
Thu 19th	US:	13:30	Initial Jobless Claims (w/e 9th August)	+375,000	
	US:	13:30	Philly Fed Business Index (August)	21.9	
Fri 20th	UK:	00:01	Gfk Consumer Confidence (August)	-7	-7
	JPN:	00:30	CPI (July) - Ex-Food & Energy	(+0.2%) (+0.2%)	(-0.4%)
	GER:	07:00	Producer Prices (July)	+1.3% (+8.5%)	+0.8% (+9.2%)
	UK:	07:00	Retail Sales (July) - Ex-Fuel	+0.5% (+9.7%) +0.3% (+7.4%)	+0.5% (+6.4%) +0.3% (+5.3%)

♦ Month-on-month changes (year-on-year shown in brackets)

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