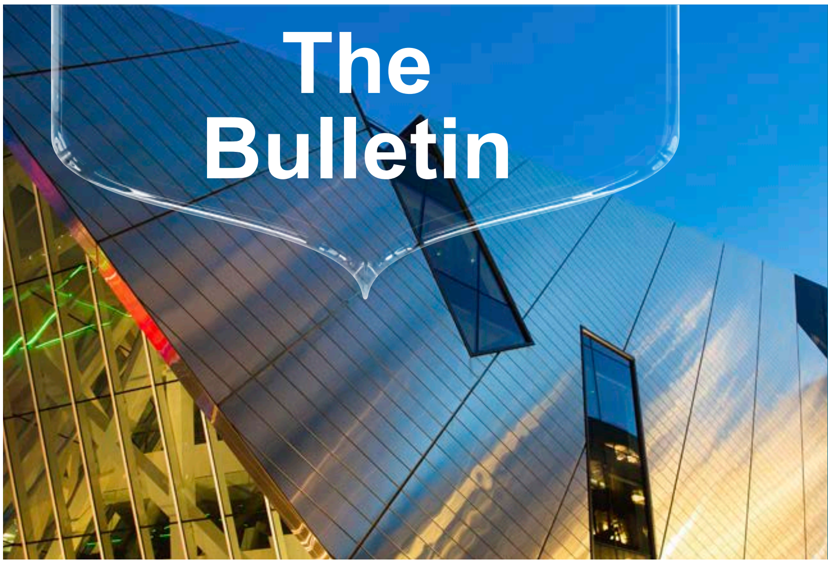
Bank of Ireland

Economic Research Unit



August 2015

Fed approaching lift-off

Overview The Fed is moving closer to commencing the first interest rate-hiking cycle in the US in more than a decade (the last one began in June 2004).The minutes of its end-July meeting noted that while the economic conditions for raising rates 'had not yet been achieved', they 'were approaching that point'. In particular, members wanted to see some further improvement in the labour market, with 'many' believing that any remaining slack would be eliminated 'in the near-term'. Most members also continued to believe that the downward pressure on inflation from falls in energy prices would abate and inflation would move up to its 2% target over the medium-term. There has been a further decline in oil prices since the Fed met in July related largely to concerns about the growth outlook in China, concerns that prompted the Chinese central bank to devalue the yuan earlier this month. This will dampen headline inflation for a while longer, but the impact should still prove transitory. The market currently sees just a 1 in 3 chance of the Fed raising rates at its mid-September meeting, and is not pricing in a full 25bps increase until early next year. This may yet prove too sanguine. In any case, the data flow (particularly relating to the labour market) between now and the September meeting, together with any Fed commentary, will be important in gauging whether the hiking cycle is likely to commence next month.

Euro area GDP rises again in Q2

UK growth reaccelerates

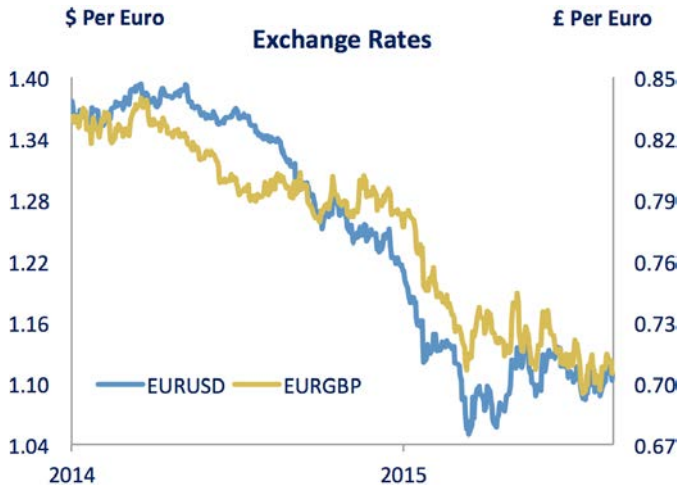
US economy picks up

Diary	Euro Area	UK	US
Central Bank Meetings	Sep 3	Sep 10	Sep 17
GDP	Sep 4	Aug 28	Aug 27
Inflation	Aug 31	Sep 15	Sep 19
Labour Market	Sep 1	Sep 16	Sep 16

Forecasts	End Sep 2015	End Dec 2015	End Mar 2016	End Jun 2016
Exchange Rates				
€/$	1.08	1.06	1.05	1.05
€/£	0.71	0.70	0.70	0.70
£/$	1.52	1.51	1.50	1.50
Swap Rates (5 year)				
Euro Area	0.50	0.60	0.80	1.00
UK	1.80	2.00	2.30	2.50
US	1.90	2.20	2.50	2.80

Euro area GDP rises again in Q2

GDP rose by 0.3% q-o-q in the second quarter. This was down a touch from the 0.4% increase in Q1 but still marked a ninth consecutive quarter of expansion. Amongst the largest economies, Germany led the way, with GDP increasing by 0.4%; the Italian economy expanded for a second consecutive quarter; whereas activity in France stagnated, albeit after very robust growth in the first quarter. The composite PMI dipped in July but at 53.9 was in line with its average level in Q2 and so points to another quarter of modest growth in Q3. The labour market is gradually improving with the unemployment rate falling to 11.1% in the three months to June, about a half a percentage point lower than in the corresponding period in 2014. Annual inflation was unchanged at 0.2% in July though the core rate rose to 1%, its highest level since April last year. The ECB kept policy on hold in July and reiterated that it intends to implement QE in full. A third financial assistance programme has been granted to Greece amounting to €86bn euro over the next three years.



UK growth reaccelerates

The pace of economic activity reaccelerated in the second quarter with GDP increasing by 0.7% q-o-q after rising by 0.4% in Q1. The services sector was the main driver of growth in Q2, contributing 0.5% points to the increase in GDP, while construction output was flat and manufacturing activity posted a small decline. The composite PMI dipped in July, though at 56.6 it is still consistent with growth running at a similar pace as in Q2 (the consensus forecast is for an increase in GDP of 0.7% in Q3). Surprisingly, employment fell slightly in Q2 and the unemployment rate nudged up to 5.6%, though this may prove to be an aberration. Headline inflation rose to 0.1% in July and the core rate jumped to 1.2% from 0.8% in June. The Bank of England expects headline inflation to pick up towards the end of this year rising to 1.5% by the close of 2016, and has indicated that this would be consistent with the need to begin gradually raising interest rates from early next year.

US economy picks up

Growth picked up in Q2 as GDP rose by 0.6% q-o-q following an increase of 0.2% in the first quarter. Consumer spending reaccelerated, and exports and government spending rebounded after falling in Q1, which more than offset a slowdown in investment. The available indicator data suggest growth is being maintained at a reasonably strong pace in Q3, with both manufacturing output and retail sales posting sizeable m-o-m increases in July and the ISM non-manufacturing index rising to a decade high (of over 60) in the same month. July also saw another 200k+ increase in employment while the unemployment rate remained at a 7-year low of 5.3%. The Fed left interest rates unchanged in July but said it 'anticipates that it will be appropriate to raise' rates when 'it has seen some further improvement' in the labour market. The market is not pricing in a first full 25bps increase in rates until early 2016, though a hike this year cannot be ruled out.

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