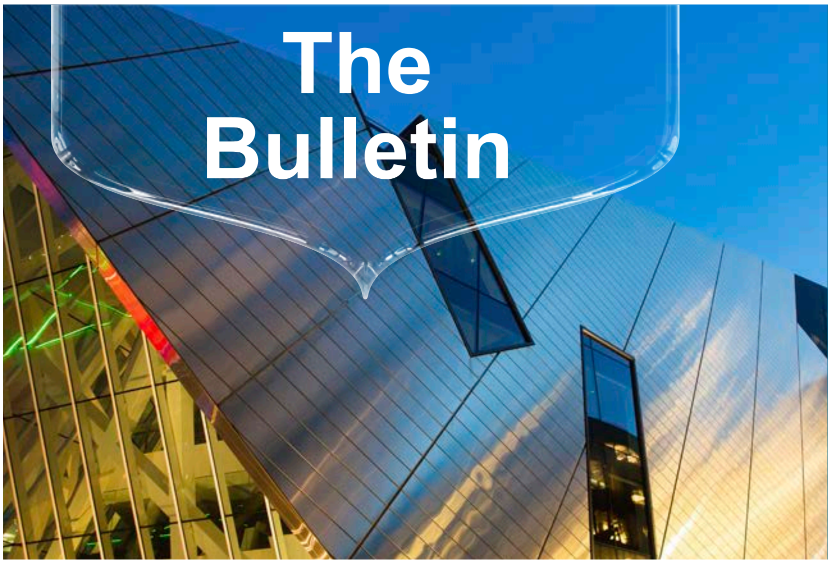
Bank of Ireland

Economic Research Unit



October 2015

To hike or not to hike

Overview Concerns about the global economy remain to the fore notwithstanding some recovery in equity markets since late September. Softer than expected employment growth in August-September in the US has added to these concerns and the market has pushed out the expected timing of a first Fed interest rate increase to the middle of next year. This in turn has contributed to a fall in the dollar, which in trade-weighted terms is down around 2% over the past month. However, both the Fed Chair and Vice Chair have said that a hike in rates is certainly still possible before the end of this year, though some (albeit a minority) of their colleagues are urging a delay. A rate increase at this month's meeting is unlikely, so whether the Fed moves at the following meeting in December may well depend on the labour market data that is released between now and then. In particular, a continuing fall in the unemployment rate from its already low level of 5.1% may be enough to prompt the Fed to (finally) begin the process of 'normalising' interest rates.

Euro area recovery continuing

Easing in UK survey data

US jobs growth softer

Diary

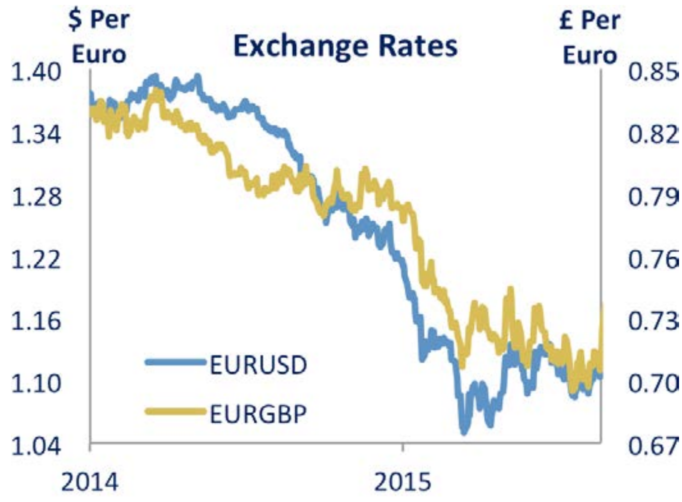
	Euro Area	UK	US
Central Bank Meetings	Oct 22	Nov 5	Oct 27/28
GDP	Nov 13	Oct 27	Oct 29
Inflation	Oct 30	Nov 17	Nov 17
Labour Market	Oct 30	Nov 11	Nov 6

Forecasts

Forecasts	End Dec 2015	End Mar 2016	End Jun 2016	End Sep 2016
Exchange Rates				
€/$	1.10	1.08	1.05	1.05
€/£	0.71	0.70	0.70	0.70
£/$	1.55	1.54	1.50	1.50
Swap Rates (5 year)				
Euro Area	0.40	0.50	0.70	0.90
UK	1.50	1.80	2.00	2.20
US	1.60	1.90	2.20	2.40

Euro Area recovery continuing

The economic recovery remains intact judging by the available survey data. The composite PMI averaged 53.9 in Q3, the same as in Q2 and so pointing to another increase in GDP of around 0.4% q-o-q. The IMF expects full year growth of 1.5% according to its latest World Economic Outlook, followed by 1.6% in 2016. The steady pace of growth over the past year has been accompanied by an increase in employment and a gradual decline in the unemployment rate. The latter has fallen by around 1% point from its 2013 peak though it remains very high at 11%. Annual inflation fell back into negative territory in September to -0.2%, driven by a decline in energy prices, but core inflation was unchanged at 0.9%. The ECB President, Mario Draghi, had previously warned of the possibilty of 'negative inflation numbers in the coming months..mostly due to oil price effects', so the Septmber reading will not have come as a surprise. Still, the ECB says it is closely monitoring the outlook for inflation and is prepared to take further policy action if necessary.



Easing in UK survey data

An easing in the survey data points to some moderation in the pace of economic growth. The composite PMI fell to 55.1 in Q3 (57.2 in Q2) and closed out the third quarter at 53.3. The services sector continues to be the main driver of growth though activty has softened a touch recently, while manufacturing has weakened. The IMF expects GDP to increase by 2.5% this year and 2.2% in 2016. The unemployment rate remains on a gradual downward trend. It fell to 5.4% in the 3 months to August, broadly in line with its average over the decade pre the financial crisis. Annual inflation dipped into negative territory in September (-0.1%) but the core rate was unchanged (1%). The Bank of England voted 8-1 to keep interest rates at 0.5% this month with the lone dissenter again voting for a 25bps increase. Market expectations regarding the timing of a first rate hike have been pushed out to Q1 2017, which may prove too sanquine. This has weighed on sterling, which has weakened to around 73.5p against the euro.

US jobs growth softer

Growth seems to have eased recently following a strong increase in GDP in Q2. Consumer spending looks to have increased at a solid pace in Q3 but exports are likely to have weighed on GDP. The IMF sees growth averaging 2.6% this year, rising to 2.8% in 2016. Job gains have also softened, to 167,000 per month in Q3 from 231,000 in Q2. Nonetheless, the unemployment rate has continued to fall, and stood at 5.1% in September. Having left interest rates unchanged in September, a number of Fed members, including Chair Yellen, have since said that a first hike is still likely 'later this year'. Some others, however, are urging a delay given uncertainty about the economic outlook related largely to international developments. The market sees a less than 35% chance of a rate increase by end year, down from c.65% before the September meeting. This shift in expectations has contributed to some modest weakening of the dollar recently.

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