



The Bulletin

September 2015

Fed stays on hold

Overview After much prior speculation, the Fed decided to keep interest rates unchanged at its September 16/17 meeting. The Chair of the Fed, Janet Yellen, noted the economic recovery had ‘advanced sufficiently’ that an ‘argument could be made to raise interest rates at this time’ (and indeed one member voted for an immediate 25bps hike in rates). However, ‘heightened uncertainties abroad’ and a ‘slightly softer’ outlook for inflation (owing mainly to a renewed decline in oil prices) stayed the Fed’s hand for now. A majority of Fed officials (13/17), though, still believe it will be appropriate to raise rates before the end of this year, so a hike at the October or (more likely) December meeting is possible. At the same time, the Governing Council of the ECB has said that it is prepared to adjust the pace and duration of its asset purchase programme (QE) if downside risks to the growth and inflation outlook materialise. All in all, then, it seems that monetary policy in the two blocs is still set to diverge in the period ahead. This ultimately should support the dollar, though the US currency has weakened to around \$1.14 against the euro post the Fed’s ‘no change’ decision.

Euro area growth revised
UK activity eases a little in Q3
US economy very strong in Q2

Diary	Euro Area	UK	US
Central Bank Meetings	Oct 8	Oct 22	Oct 27/28
GDP	Nov 13	Oct 27	Oct 29
Inflation	Sep 30	Oct 13	Oct 15
Labour Market	Sep 30	Oct 14	Oct 2

Forecasts	End Sep 2015	End Dec 2015	End Mar 2016	End Jun 2016
Exchange Rates				
€/\$	1.14	1.10	1.08	1.05
€/£	0.73	0.71	0.70	0.70
£/\$	1.56	1.55	1.54	1.50
Swap Rates (5 year)				
Euro Area	0.40	0.50	0.70	0.90
UK	1.60	1.80	2.10	2.30
US	1.60	1.90	2.20	2.50

Euro Area growth revised

GDP growth in Q2 was revised up to 0.4% q-o-q (from 0.3%), with the first quarter also stronger than initially estimated at 0.5% (from 0.4%). On an annual basis, the economy grew by 1.5% in Q2, the fastest pace of increase since the second quarter of 2011. The latest Purchasing Managers data suggest the economy has expanded again in Q3 with the consensus expecting another 0.4% increase in GDP. The ECB, though, has slightly lowered its forecast for growth over the period 2015-2017, largely reflecting a weaker outlook for the global economy, and now expects GDP to increase by 1.4% this year and 1.7% and 1.8% in 2016 and 2017 respectively. It has also revised down its forecasts for inflation, which is expected to average just 0.1% in 2015, rising to 1.1% and 1.7% respectively over the following two years. The ECB left policy on hold at this month's meeting but said that, in light of 'renewed downside risks that have emerged to the outlook for growth and inflation', it is willing and able 'to act, if warranted', in particular by 'adjusting the size, composition and duration' of its QE programme.

UK activity eases a little in Q3

The expenditure breakdown of Q2 GDP shows consumer spending, investment and exports all contributed to the 0.7% growth (q-o-q). Consumer spending posted a 16th successive quarterly increase, and business investment rose for a 2nd consecutive quarter having flatlined in H2 2014. Exports rose by almost 4% q-o-q, after remaining largely unchanged in Q1. GDP growth appears to have eased a little in Q3 judging by the PMI data. The composite index averaged 55.8 in July-August, down from over 57 in Q2 and so consistent with solid but more moderate growth than in Q2. The unemployment rate averaged 5.5% over the 3 months to July, down slightly on February-April, and regular earnings growth rose by 2.9% y-o-y, the strongest increase since February 2009. Annual CPI inflation fell back to 0% in August with the core rate running at 1%. The MPC left interest rates unchanged this month, though one member again voted for an immediate 25bps increase. It noted that increased risks to the UK from recent global developments 'must be weighed against the prospects for a continued healthy domestic expansion'. Sterling weakened to around 73p against the euro over the past month.

Exchange Rates



US economy very strong in Q2

The pace of growth in Q2 was revised up substantially to 0.9% q-o-q from 0.6% initially, with investment increasing more strongly than first estimated. On an annual basis, the economy grew by 2.7% in Q2 and by 2.8% over the first half of 2015, ahead of last year's full year increase in GDP of 2.4%. The available indicator data point to another quarter of solid growth in Q3 but at a more moderate pace than in the previous quarter (the consensus forecast is for an increase in GDP of 0.7%). Employment rose again in August (173,000) albeit by less than over the previous three previous months (job gains averaged 250,000 a month in May-July), though the unemployment rate fell further to 5.1%, its lowest level since April 2008. Earnings growth still remains relatively subdued, however, at a little over 2% year-on-year. Annual PCE inflation also remains subdued, at just 0.3% at the headline level and 1.2% excluding food and energy prices. Amid much speculation in advance, the Fed decided to keep interest rates unchanged at near zero percent at its September 16/17 meeting, though it indicated that a first hike is still possible before the end of this year.

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