LARRY'S MORNING COMMENTARY

Rate Hike

From Saxo Bank... (what would Janet do?)

The case for a US hike

The FOMC meeting on September 20-21 will be the key event this month for investors. There is clearly a case for higher interest rates. **Here are six factors that could push the central bank to further normalise monetary policy:**

- The slowdown in the job market seen last spring appears to be temporary. Indeed, the latest economic indicators are quite good, with almost 255,000 new jobs created in July, well above the consensus of 180,000. If the next NFP report confirms this trend, it will give more weight to the arguments of the FOMC members who consider the economy to essentially be at maximum employment. In those circumstances, the Fed will have no excuse for not hiking rates.
- The official unemployment rate, established at 4.9%, is close to the NAIRU threshold at which the economy is in balance and inflation pressures are neither rising nor falling. Although the importance of the NAIRU has declined regarding monetary policy assessment, several FOMC members still continue to pay attention to this theoretical indicator that currently indicates it is about time to hike rates.
- The increase in average hourly earnings, which is closely monitored by the Fed, has accelerated more than expected to a monthly path of 0.3% in July, and stands at its highest rate since the Great Recession;
- Financial stress indices are going down. The St. Louis Fed Financial Stress Index is close to its lowest level on record, which goes back to December 1993.
- Economic forecasts, which are always a tricky exercise, indicate the momentum is strengthening, particularly through sustained private consumption and durable good orders. The Atlanta Fed GDPNow forecast is currently at 3.5% for the third quarter;
- **Last but not least, investors need to keep in mind the Fed is in a complicated position.** The central bank needs to increase rates

before it is too late and that the US enters an economic slowdown. Its strategic mistake is that it has waited too long. The economic situation was good enough in summer 2015 to tighten monetary policy, and the Fed has probably lost a few precious months which could complicate its task. It won't be able to act through changes in interest rates because they are already too low, so it will be forced to start a new program of bond buying that has many disadvantages, notably popping up the prices of financial assets.