

Economic Analysis

Weekly Focus: FOMC Rate Hike

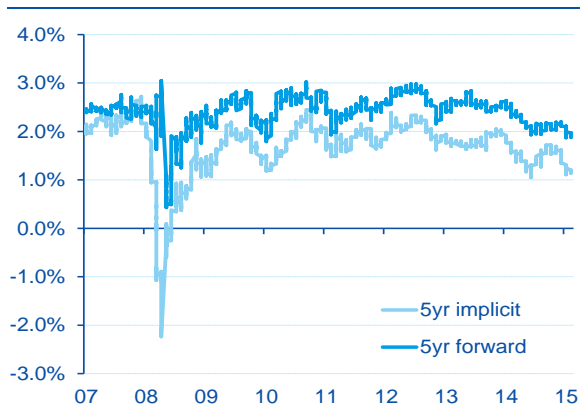
Kim Chase

FOMC Weighing All Data Before Rate Hike Decision, Including August's CPI

The Fed only has a few working days left to decide whether a rate hike is appropriate now, or whether it is best left for a later date. In line with our baseline scenario, we expect that the **FOMC statement (Thursday)** will reveal the Committee's willingness to raise rates. While it seems that the Fed *should* increase rates at this meeting, there are a variety of factors that could stand in their way. Labor market conditions have improved, and the unemployment rate has dropped to the Fed's long-term projection at 5.1%; therefore, this will be the most supportive argument in favor of a rate hike on Thursday. On the other hand, global financial market volatility and the threat of an imminent slowdown in China are forcing the FOMC to reconsider whether the economy is ready for higher interest rates. Last but not least, the Fed is concerned that low levels of inflation pose a risk to the success of their policy normalization strategy. **August's CPI report (Wednesday)** will be released on September 16th, the first day of the FOMC meeting, and as long as core inflation does not shift downwards, we should see increasing support for a rate hike announcement on the 17th. Oil prices, import prices, and inflation expectations declined in August, yet most FOMC members have acknowledged that these trends are only temporary. It is important for them not to be distracted by movements in headline inflation and rather to focus on the gradual upward pace of core prices.

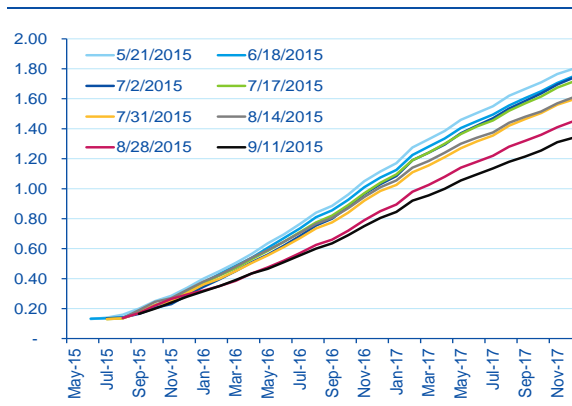
For this reason, we maintain our view that the Fed *should* increase rates next week, but there is a real possibility that some FOMC members may be spooked by the ongoing weakness in the global economy. Most participants seem comfortable as long as a rate hike occurs sometime this year, whether that is September or December. However, the risk of delaying (even to December) is that it allows for the possibility that economic data do not improve in the intermeeting period, and in keeping with their data-dependent strategy, the FOMC would be forced to delay liftoff until 2016. The benefit of increasing in September is that it sends a signal to the world that the Fed is confident in the direction the U.S. economy is heading – and this will likely fuel increased confidence in the real economy.

Graph 1
Market Inflation Expectations (%)



Source: FRB & BBVA Research

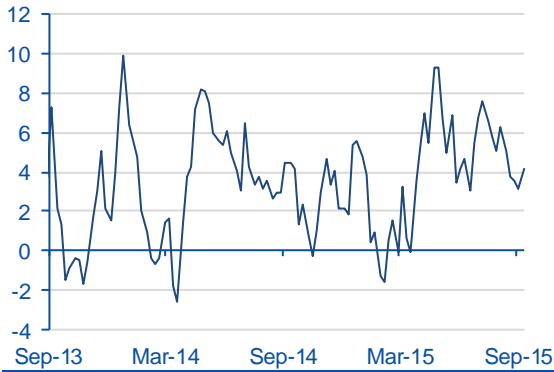
Graph 2
Federal Funds Rate Futures (%)



Source: Bloomberg & BBVA Research

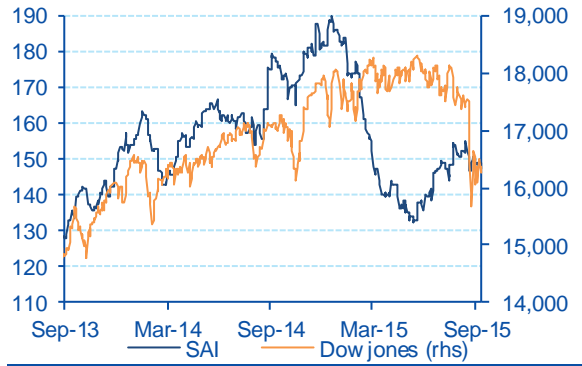
Economic Trends

Graph 3
BBVA USA Weekly Activity Index (3 month % change)



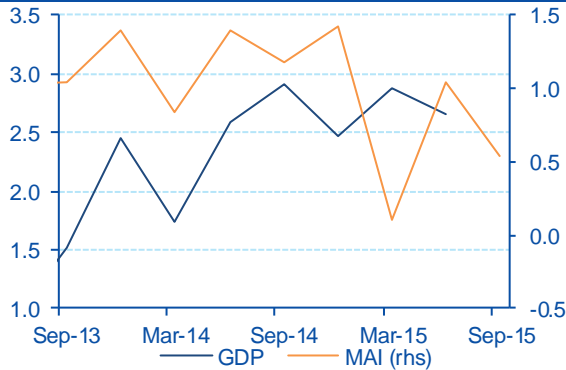
Source: BBVA Research

Graph 4
BBVA USA Surprise Activity Index & Dow Jones (Index 2009=100 & eop)



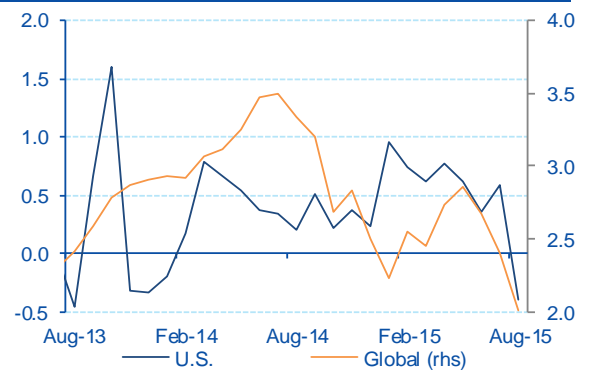
Source: Bloomberg & BBVA Research

Graph 5
BBVA USA Monthly Activity Index & Real GDP (4Q % change)



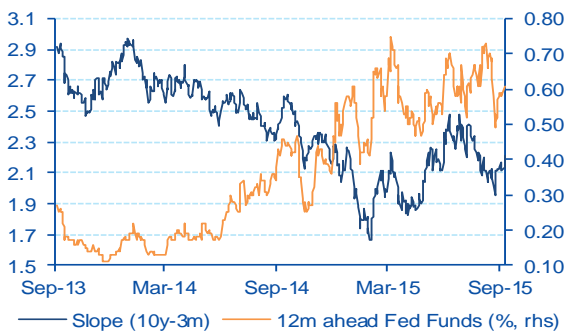
Source: BBVA Research & BEA

Graph 6
BBVA USA Risk Index (> 0 = increasing risk)



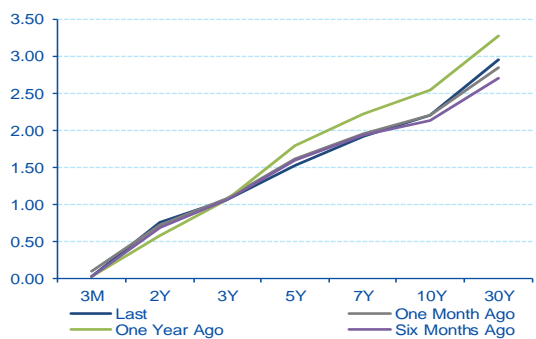
Source: BBVA Research

Graph 7
Fed Futures & Yield Curve Slope (% & 10year-3month)



Source: Haver Analytics & BBVA Research

Graph 8
U.S. Treasury Yield Curve (% p.a.)



Source: Haver Analytics & BBVA Research

Week Ahead Economic Calendar

Date	Event	Period	BBVA	Consensus	Previous
15-Sep	US Empire State Manufacturing Survey General Business Conditions SA	SEP	-6.70	0.00	-14.92
15-Sep	Adjusted Retail & Food Services Sales SA Total Monthly % Change	AUG	0.50	0.30	0.60
15-Sep	Adjusted Retail Sales Less Autos and Gas Stations SA MoM Percent Change	AUG	0.40	0.40	0.40
15-Sep	US Industrial Production MOM SA	AUG	0.40	-0.20	0.56
15-Sep	US Capacity Utilization % of Total Capacity SA	AUG	78.20	77.80	78.00
15-Sep	US Industrial Production Industry Groups Manufacturing MoM SA	AUG	0.10	-0.30	0.80
15-Sep	US Manufacturing & Trade Inventories Total MoM SA	JUL	0.10	0.10	0.80
16-Sep	US CPI Urban Consumers MoM SA	AUG	-0.10	-0.10	0.10
16-Sep	US CPI Urban Consumers Less Food & Energy MoM SA	AUG	0.10	0.10	0.10
16-Sep	National Association of Home Builders Market Index SA	SEP	61.00	61.00	61.00
17-Sep	US Initial Jobless Claims SA	SEP 12	270.00	276.00	275.00
17-Sep	US Continuing Jobless Claims SA	SEP 5	2253.00	2260.00	2260.00
17-Sep	US New Privately Owned Housing Units Started by Structure Total SAAR	AUG	1185.00	1170.00	1206.00
17-Sep	Private Housing Units Started by Structure Total Monthly % Change SA	AUG	-1.74	-2.99	0.20
17-Sep	Private Housing Authorized by Bldg Permits by Type Total SAAR	AUG	1215.00	1158.50	1130.00
17-Sep	Private Total Housing Authorized by Building Permits MoM SA	AUG	7.52	2.53	-15.50
17-Sep	Philadelphia Fed Business Outlook Survey Diffusion Index General Conditions	SEP	7.50	6.00	8.30
17-Sep	Federal Funds Target Rate - Upper Bound	SEP 17	0.50	0.50	0.25
18-Sep	Conference Board US Leading Index MoM	AUG	0.20	0.20	-0.20

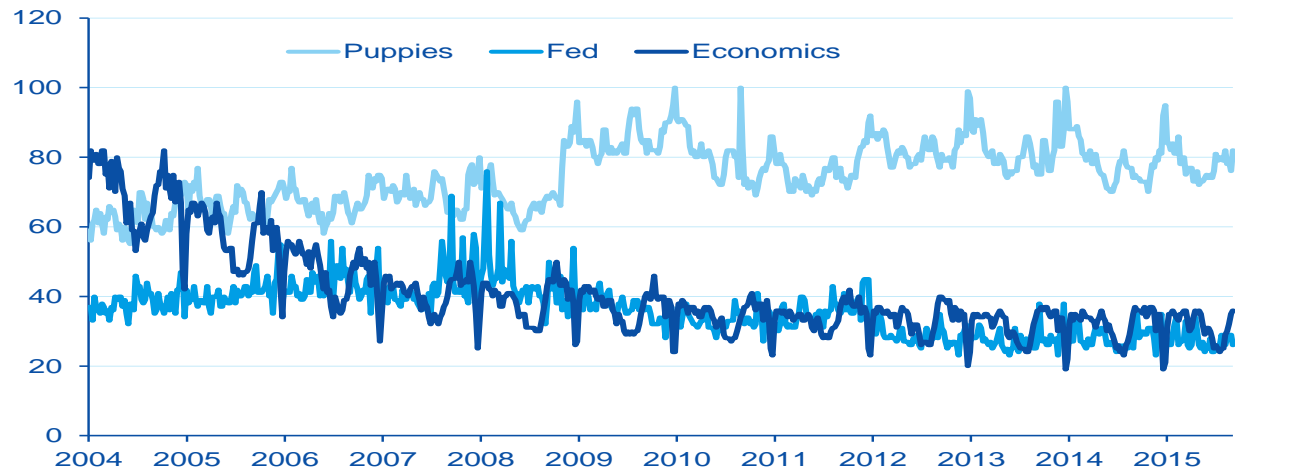
Economic Outlook

	2015				2014	2015	2016	2017
	1Q	2Q	3Q	4Q				
Real GDP (% SAAR)	0.6	3.7	2.4	3.0	2.4	2.5	2.8	2.8
CPI (YoY %)	-0.1	0.0	0.3	1.2	1.6	0.3	1.8	2.1
CPI Core (YoY %)	1.7	1.8	1.8	1.7	1.7	1.7	1.8	2.0
Unemployment Rate (%)	5.6	5.4	5.2	5.1	6.2	5.3	4.9	4.6
Fed Target Rate (eop, %)	0.25	0.25	0.50	0.50	0.25	0.50	1.50	2.50
10Yr Treasury (eop, % Yield)	2.04	2.36	2.33	2.53	2.21	2.53	2.72	3.64
US Dollar/ Euro (eop)	1.08	1.12	1.05	1.07	1.23	1.07	1.13	1.20
Core Logic Home Prices (YoY %)	4.96	5.80	6.05	5.85	7.55	5.76	4.40	2.45

Fun Fact

According to Google Trends, Web Search interest for puppies has exceeded that of economics since the crisis.

Worldwide Web Search Interest, 2004-Present



Source: Google Trends & BBVA Research

Recent Publications

[U.S. Economic Outlook: Monthly Update](#) (September 11, 2015)

[The Changing Landscape of Small Business Lending](#) (September 10, 2015)

[Heightened Bond Liquidity Risk is the New Normal](#) (September 10, 2015)

[FOMC Preview: September 16-17th Meeting](#) (September 9, 2015)

[August Employment Report Supports a September Rate Hike, but There's No Guarantee](#) (September 4, 2015)

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[Heightened Bond Liquidity Risk is the New Normal](#) (September 3, 2015)

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