

<http://blog.en.erste-am.com/2017/06/28/interest-rate-hike-interest-rate-hike/>

After the interest rate hike is before the interest rate hike?

Gerold Permoser



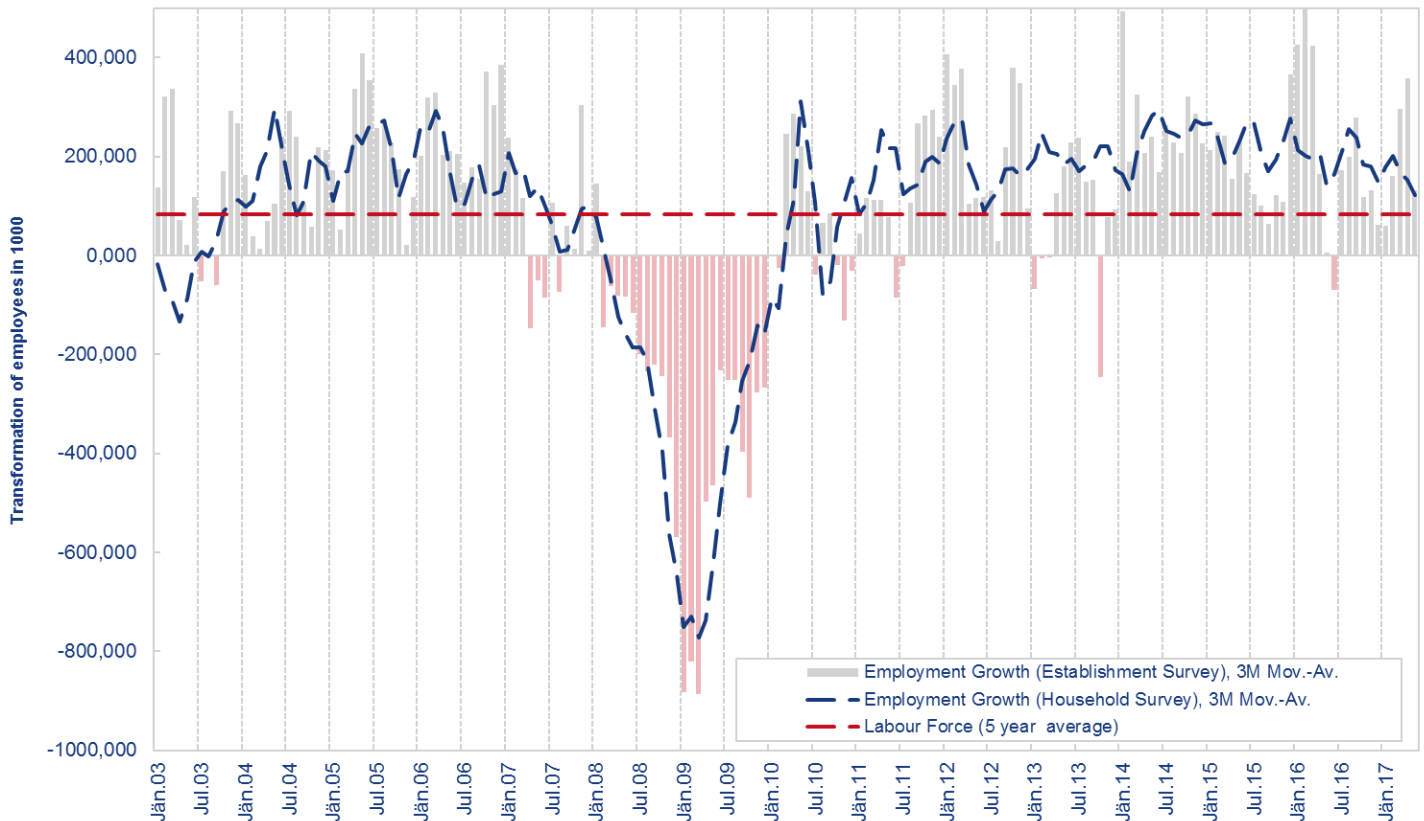
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Imagine a fairy that grants you three wishes. What would you wish for? The answer would be very easy for me. I would just like to know if the economy is caught up in a recession or has embarked on an expansionary phase a year from now. And whether the central bank will be pursuing an expansive or restrictive policy. If I got these two wishes granted, I would even forego the third one. Or, as a good fund manager, I might engage in risk management and save up for bad times. Growth and monetary policy are of significant relevance to the return of almost all asset classes.

US central bank increases Fed funds rate: was that it, or is there more to come?

The World's most important central bank, the US Federal Reserve, increased its most important key-lending rate, the Fed Funds rate, by 25bps to a target band of 1% to 1.25% on 14 June. This prompts the question of whether this was it, or if there is more to come. I personally am convinced that the US central bank will tighten its monetary policy further in the coming months. There are several reasons for this. I would like to discuss one of them in the following.

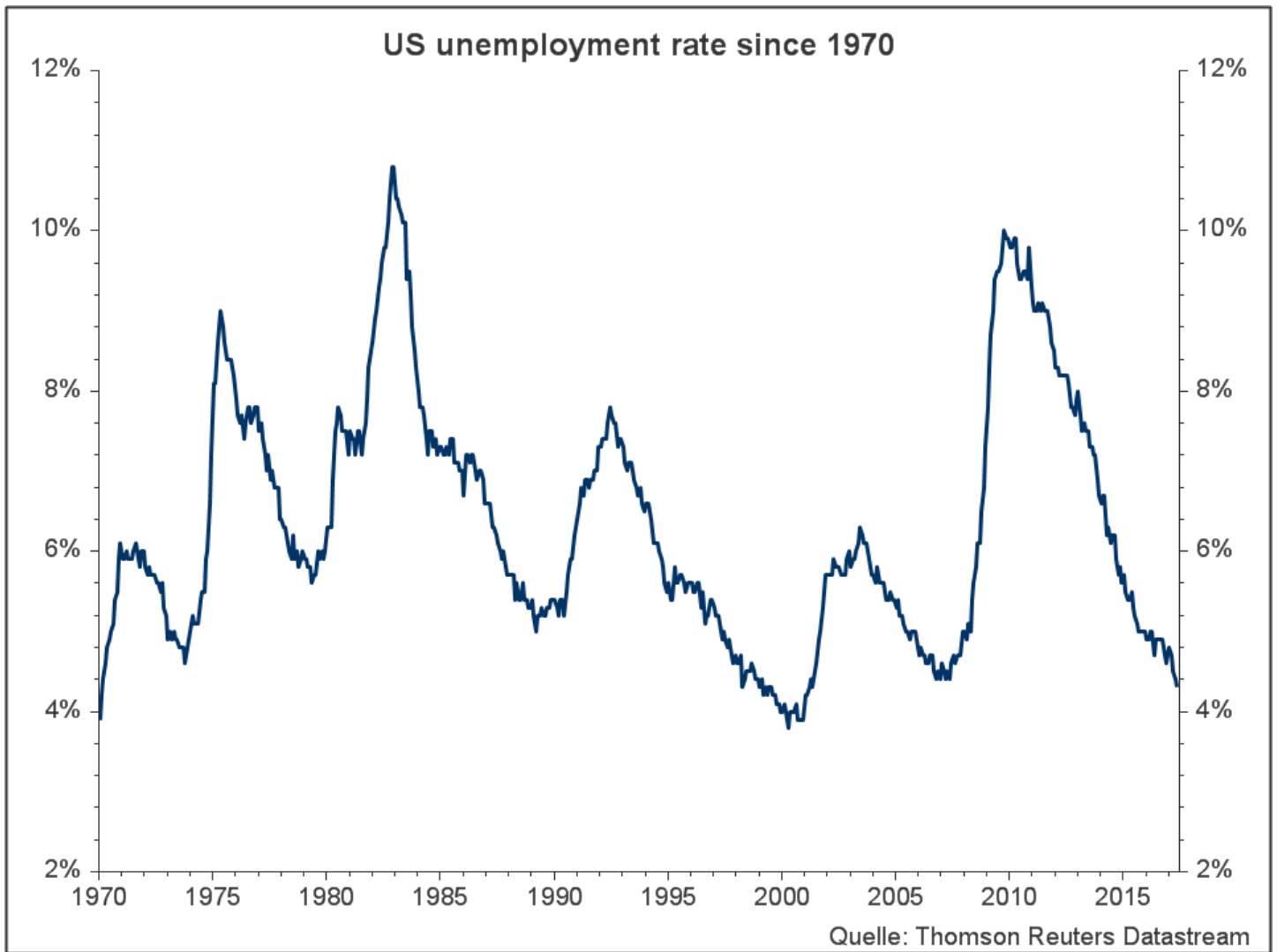
Employment vs. labour force



The chart above juxtaposes supply and demand in the US job market. The supply of labour force hinges on two factors: the change in the number of people at an employable age and the percentage of people thereof who are looking for work (participation rate). In the chart, the red line illustrates how many people on average have entered the labour force in the past five years. At the moment, the number averages 80,000. This means that every month an average of 80,000 have entered the job market.

Job growth in the USA

The fact that there is also a blue line and bars in the chart that represent the newly created jobs per month is based on the statistical approach taken in the USA. Here, two statistical models are used to establish these numbers. On the one hand, a so-called household survey is made among private households. On the other hand, a survey establishes what employment status companies report (establishment survey). Both numbers may differ significantly from month to month, which is why for a short-term market assessment it is important to look at both. In the long run (as also manifests in the chart above), they paint the same picture: on a 3M average, the US economy has created 120,000 (Household Survey) or 130,000 (Establishment Survey) jobs, respectively, per month. The chart also illustrates the fact that the US economy has constantly created more jobs than would have been necessary to accommodate the additional labour force. This, in turn, results in a decline of the unemployment rate, which at this point is already extremely low, also from a historic perspective.



Given that about 80,000 people enter the job market per month and about 125,000 jobs are created per month, the demand for labour force exceeds supply. As a result, the unemployment rate is falling and is currently at a very low 4.3%.

In view of this situation, I have no doubt that the US central bank will continue to tighten its monetary policy. How it will be doing this (interest rate hikes, reduction of the government bond holdings, change in forward guidance (i.e. guidance of market expectations through statements made by the central bank)) I do not want to discuss at this point. Generally, the idea holds: "After the interest rate hike is before the (next) interest rate hike".

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He began his career as a fixed-income analyst at the Creditanstalt in Vienna. He moved to asset management at Innovest KAG in 2000. He made significant contributions in the investment field there and advanced to CIO (director of asset allocation and research). Gerold Permoser studied at the University of Innsbruck and is a CFA charter holder. He offers training at the University of Vienna and at various post-graduate institutions for analysts and portfolio managers (i.e., at VÖIG, the Association of Austrian Investment Fund Companies).