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Economic Research Unit

Bank of Ireland

April 2015

Fed still on track to hike

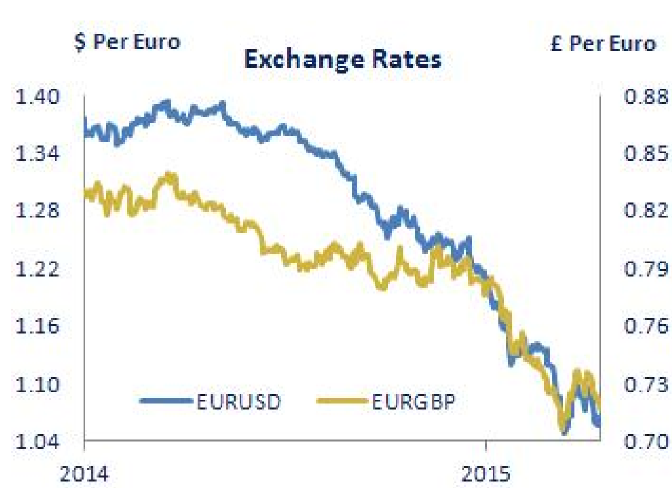
Overview The pace of economic activity in the US moderated in the final quarter of 2014 and has slowed further in the opening months of this year, although the latter may be at least partly attributable to poor weather conditions. Employment growth has also stepped down a gear recently but has nonetheless been sufficient to lower the unemployment rate further to 5.5%. The Fed has said that it will be 'appropriate' to raise interest rates if it sees a continuing improvement in the labour market and a first hike is still likely this year, albeit perhaps later now (e.g. September) than sooner (e.g. June). The recent appreciation of the dollar has begun to feature a little more prominently in the Fed's deliberations as it is dampening both exports - the March policy statement noted that export growth had weakened - and inflation, which suggests the central bank will proceed cautiously and gradually when raising interest rates. The dollar's ascent against the euro has stalled for the moment – the most recent low in EUR/$ was just under $1.05 in mid-March – though we still expect it to strengthen further. However, its gains may be more modest from here on it, particularly as there are increasing signs that the recovery in the Euro area economy is gaining momentum.

Forecasts	End Jun 2015	End Sep 2015	End Dec 2015	End Mar 2016
Exchange Rates				
€/$	1.06	1.05	1.05	1.03
€/£	0.72	0.71	0.70	0.70
£/$	1.47	1.48	1.50	1.47
Swap Rates (5 year)				
Euro Area	0.30	0.50	0.70	0.90
UK	1.40	1.70	2.00	2.30
US	1.70	2.00	2.30	2.60

Diary	Euro Area	UK	US
Central Bank Meetings	Jun 3	May 11	Apr 29
GDP	May 13	Apr 28	Apr 29
Inflation	Apr 30	May 19	Apr 30
Labour Market	Apr 30	Apr 17	May 8

Euro area activity gathers pace

The economy gained momentum in Q1 based on survey and hard data. The composite PMI rose for a fourth consecutive month in March to an 11-month high of 54, while both industrial output and retail sales growth accelerated over the first two months of the year. Employment rose again in Q4 and the unemployment rate fell further in February to 11.3%. Inflation rose in March but remained in negative territory at -0.1%. The ECB commenced QE on March 9 and as of early April had purchased 64bn euro in assets, of which almost 53bn euro was public assets (mainly sovereign bonds) and the remainder (privately issued) covered bonds and ABS. Sovereign bond yields generally remain close to record lows and well below the levels prevailing at the time of the announcement of QE in late January. There has been limited contagion to date from the situation in Greece, despite the lack of an agreement between the new government and its European creditors that would see the release of the final tranche of funds under the current 'bailout' programme.



UK inflation remains at 0%

GDP rose by 0.6% in Q4 2014 and it seems that growth has been maintained at around this pace in the opening months of 2015. The composite PMI rose further in March and averaged 57.4 in Q1, slightly ahead of Q4. The unemployment rate nudged down to 5.7% over the three months to January and average earnings growth picked up a little. Annual inflation was unchanged at 0% in March while the core rate fell to 1%, its lowest level since August 2006. The Bank of England's Chief Economist noted recently that a cut in interest rates *may* be warranted given the subdued inflation outlook. The market is attaching a small probability (c10%) to such a move over the next few months, though by the same token it does not expect a first rate hike until the second half of 2016. Sterling rose to a high of c70.5p against the euro in mid-March before easing back to around 72p, which is still well ahead of where it started the year (c78p) the impending general election notwithstanding.

US employment growth slows

The economy grew by 0.5% in Q4 2014 according to the final GDP reading, having expanded by 1%+ in both Q2 and Q3. Growth slowed further in the first quarter of 2015 judging by a range of indicators, including retail sales and industrial output, but this may be partly attributable to poor weather in January/February. Employment rose by just under 200k a month in Q1, down from almost 325k p/m in Q4, though the former was still sufficient to produce a decline in the unemployment rate which ended Q1 at 5.5%. The Fed kept policy on hold in March and said it will be 'appropriate to raise' interest rates when 'it has seen further improvement in the labour market and is reasonably confident that inflation will move back to 2%...over the medium term', adding that while a hike was unlikely in April, one could be 'warranted at subsequent meetings'. This keeps the door open to a June move though indications from Fed members since point to 'lift-off' later in 2015.

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