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ECONOMIC TALKING POINTS

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The Time Has *Really* Come To Raise Rates!

We'll get right to the point. If the Federal Reserve is to maintain a shred of credibility, they should resume raising rates at the September meeting. The 151,000 increase in payrolls last month exceeds the minimum 100,000 needed to prevent a rise in the unemployment rate. It also means payrolls have now risen an average of 232,000 the last three months, with the private sector contributing 196,000 to the total. Both represent a significant acceleration from previous three-month averages. Moreover, the unemployment rate has been at or below 5% since September 2015! Given these numbers -- and so many more that we haven't even touched on – it's fair to say the Fed has achieved its mandate to secure full employment.

Inflation, the Fed's other mandate, is also moving higher, though admittedly at an agonizingly slow crawl. Nevertheless the main price indices are edging closer to the 2% target set by the central bank. The latest (July) core PCE index was up 1.6% over the year, compared with 1.3% rate in July 2015. And core CPI is even higher, running at a 2.2% annual rate now, versus 1.8% a year ago.

What about international shocks, like Brexit, which the Fed has used the last few months to delay a rate increase? It can't be used as an excuse this month. Whatever concerns the Fed had that Brexit could destabilize capital markets or possibly trigger a global recession are now much less of an issue in terms of US monetary policy. World financial markets have calmed down remarkably fast after the initial shock of UK voters choosing to leave the EU. Brexit is much more a regional political problem than a global economic one.

Another relevant factor that should motivate the Fed to act this month is simply the broader health of the US economy.

• Both personal income and spending numbers have been on a sustained upward trend.
• New home sales are being purchased at the fastest pace since 2007.
• Existing home sales this year will be the strongest in a decade.
• Auto sales continue at a strong 17 million unit annual rate.
• Consumer confidence last month shot up to 101.1, highest in a year.
• Claims for jobless benefits are still at historically low levels.
• While we did get some disappointing news from the Institute for Supply Management on August manufacturing activity, offsetting that slight weakness was today's report by the government on total factory orders, which jumped 1.9%, the largest amount in nine months. When you strip out the volatile numbers on defense and aircraft to get a purer figure on business orders for capital goods, it rose 1.5%, its biggest increase since January.

What of the dollar? Clearly Fed policymakers should monitor closely how an extra notch up in rates will affect the US currency. A strengthening of the greenback is to be expected as global investors take advantage of the relatively higher returns from U.S. financial assets. A more muscular dollar could be deleterious to US exporters.

The problem with this last point is that foreign demand for US goods and services has been getting stronger even though the dollar's value remains firm. This morning's report on our trade balance shows US exports in July leaped to its the highest level since last September, both in nominal and real dollar terms.

So if we focus on the economic fundamentals, the benchmarks have been reached for Fed to finger flick short-term rates another 25 basis.

Not doing so, however, raises the risk of a bubble forming in the bond market. The lofty levels in Treasury bond prices and historic low yields has the feel of a wobbly drunk at the top of a steep hill; he's certain to fall, only you don't know when or how hard that fall will be. Should the Fed stand pat in September, that step-sloppy drunk only gets more unstable and the inevitable fall could be much more painful.

Bottom line:
We believe the moment has arrived for another rate increase. The Fed takes great pride in proclaiming its immunity to political pressure when it comes to the conduct of monetary policy. Well, it's time to demonstrate that. Should the Fed choose to skip September, it would make meaningless their claim to be "data dependent." Instead, the curtain has been raised to reveal that they are increasingly "politically dependent."

Key Economic Forecasts

- Actual
- Forecast

United States

	I 2015	II 2015	III 2015	IV 2015	I 2016	II 2016	III 2016	IV 2016	I 2017	II 2017	III 2017	IV 2017
Real Gross Domestic Product (GDP):												
%	2.0	2.6	2.0	0.9	0.8	1.1	2.7	2.5	2.4	3.3	2.8	2.4
Personal Consumption Expenditures:												
PCE	2.4	2.9	2.7	2.3	1.6	4.4	3.0	2.7	2.4	3.0	2.7	2.8
Inflation, end of period, year-over-year:												
CPI %	-0.1	0.1	0.0	0.7	0.9	1.0	1.3	1.4	1.8	1.9	2.2	2.3
Unemployment Rate (end of period):												
%	5.5	5.3	5.1	5.0	5.0	4.9	4.7	4.5	4.5	4.5	4.5	4.9
Non-farm Payrolls, monthly avg. thousand:												
	195	231	174	282	196	153	210	175	210	220	220	210
Treasury 10-yr Note Yield % (end of period)												
	1.93	2.38	2.06	2.27	1.78	1.49	1.58	1.78	2.10	2.30	2.55	2.90
Federal funds rate % (end of period)												
	0.13	0.13	0.13	0.38	0.38	0.38	0.38	0.63	0.88	1.13	1.38	1.63

GDP Growth - Global Economy

Country	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
US	1.8	-0.3	-2.8	2.5	1.6	2.2	1.7	2.4	2.6	1.8	2.7
Eurozone	2.6	0.6	-4.1	1.7	1.4	-0.6	-0.4	0.9	1.5	1.3	1.4
United Kingdom	3.1	0.6	-5.2	1.7	0.7	0.3	1.8	2.9	2.2	1.4	0.8
Japan	2.1	-0.7	-5.4	4.6	-0.4	1.6	1.5	-0.1	0.5	0.6	0.8
Canada	2.7	0.7	-2.8	3.1	3.1	1.7	2.2	2.5	1.2	1.6	2.5
India	9.1	8.8	6.3	8.4	8.6	6.7	4.9	7.4	7.8	7.5	7.8
China	14.2	9.6	9.2	10.5	9.5	7.8	7.7	7.3	6.9	6.2	6.0
Brazil	5.7	5.1	-0.3	7.5	2.7	0.9	2.3	0.1	-3.8	-4.1	-0.8
Mexico	3.3	1.4	-4.7	5.2	4.0	3.9	1.4	2.3	2.5	2.2	2.6
Australia	4.0	2.3	1.2	2.8	2.6	3.6	2.4	2.6	2.5	2.5	3.0
Russia	8.1	5.6	-7.9	4.0	4.3	3.4	1.3	0.6	-3.7	-2.0	0.3
World	5.4	1.6	-1.9	4.2	3.0	2.6	2.9	3.0	2.6	2.4	2.9

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