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# TWIN RATE RISES IN THE US, FORECASTS BNY MELLON BOUTIQUE

**By Kira Nickerson, BNY Mellon Investment Management**

*Robust jobs data in July underscored the strengthening US economy, according to BNY Mellon boutique Standish[1], and it could lead to two interest rate rises before the year-end.*

Expectations of a September rate hike have risen, with the futures market pricing in a 50% probability, Standish's chief economist Thomas Higgins says. The BNY Mellon US-based fixed income boutique goes one further and predicts a 25 basis point increase in September followed by another before the end of the year. This would see 2015 close out with US interest rates sitting at 0.5%.

The bullish attitude of the market, and more so Standish, comes after July US jobs data revealed non-farm payrolls expanded by 215,000 and the three-month moving average rose to 235,000, higher than the six-month moving average of 213,000.[2] US unemployment was unchanged at 5.3%, according to the US Bureau of Labor Statistics. Higgins comments: "The job gains were broad based with more than 64% of the 263 industries surveyed hiring during the month (July)."

Higgins goes on to note that the increase in aggregate weekly hours, which rose by 0.5% in July, suggests real GDP growth in the US was running above 3% at the beginning of the third quarter. "All of this seems to meet the criteria for 'some further improvement' in the labour market that the

Federal Reserve outlined in its July policy statement as a pre-condition for raising short-term interest rates."

Bolstering Standish's view of a quarter rate hike were other figures released in July: readings on inflation and GDP growth. The US economy grew at an annual rate of 2.3% in the second quarter, which was slightly below expectations of 2.5% but still advancement over the opening three months of the year, Standish reports. Meanwhile, the Fed's so-called 'preferred measure of inflation', core personal consumption expenditure (PCE), rose from 1% in the first quarter to 1.8% in the second.[3] This, Higgins says, represents a year-on-year growth rate of 1.3% and although this is well below the Fed's 2% target, he believes the central bank will welcome the pick-up.

Standish's CIO David Leduc says when the Fed finally does begin to hike rates, he anticipates another period of global market volatility. "However, we expect it to be relatively short-lived and much less violent than when the Fed first announced it was tapering QE. Back then, the Merrill Lynch Options Volatility Estimate (MOVE), which measures implied volatility in the US Treasury market, increased from a low of less than 50 to nearly 120 as the market brought forward the timing of eventual Fed tightening and Treasury yields spiked from 1.66% in May to nearly 3% by early September."

However, Leduc says this time around Treasuries are much closer to fair value and the Fed has repeatedly said interest rate hikes are likely to proceed at a "gradual pace," which suggests the increase in volatility should be less dramatic.

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[1] BNY Mellon Investment Management EMEA Limited is the distributor of the capabilities of its investment managers in Europe, Middle East, Africa and Latin America. Investment managers are appointed by BNY Mellon Investment Management EMEA Limited or affiliated fund operating companies to undertake portfolio management services in respect of the products and services provided by BNY Mellon Investment Management EMEA Limited or the fund operating companies. These products and services are governed by bilateral contracts entered into by BNY Mellon Investment Management EMEA Limited and its clients or by the Prospectus and associated documents related to the funds.

[2] US Labor Statistics

[3] US Bureau of Economic Analysis

On the back of these expectations, Standish is underweight duration in the short-end of the US Treasury curve. The team believes the market will continue to re-price at this end of the curve the closer it gets to the anticipated September move by the Fed. “This will likely result in a flatter US Treasury curve implying short-term rates will rise faster than long-term rates. We also expect US rates to underperform Australian and German rates as central banks in both countries remain more dovish than the Fed.”