Why a June Fed hike is a 50:50 call

Markets think a June hike is almost certain. But a mixed economic picture means its not a done deal

Source: Shutterstock

Inflation: Focus on sluggish core PCE

Over the past few months, we've seen headline CPI push well above 2%. But the Fed has started to place renewed emphasis on core PCE, which has struggled to break-out of a 1.6-1.8% range over the past 6 months.

This seems to go hand-in-hand with what we're seeing on wages. Unless we see core PCE actively pushing above 2%, we're unlikely to see the Fed hiking faster.

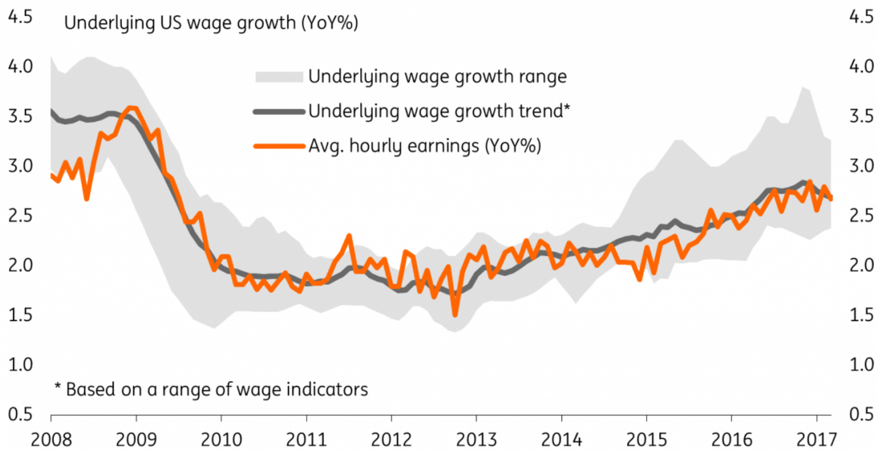
1.6 Core PCE inflation

March 2017 (YoY%)

Wage growth: 3%.. so close, yet so far

There's little doubt that tight conditions in the jobs market have been driving up pay. Fed contacts report higher staff turnover and prevalent skills shortages. But recent progress in the data has been steady. Headline wage growth has been range-bound around 2.6-2.8%, and is unlikely to push above 3% until much later in the year. In short, it's certainly not screaming: "hike faster!"

Wage growth struggling to move above 3%



Source: Macrobond, ING

Business investment: Looking up

The Fed has itself pointed to improving investment. Part of that is an oil rig story, but there does seem to have been a broader pickup. The prospect of an easier tax and regulatory environment have buoyed business surveys.

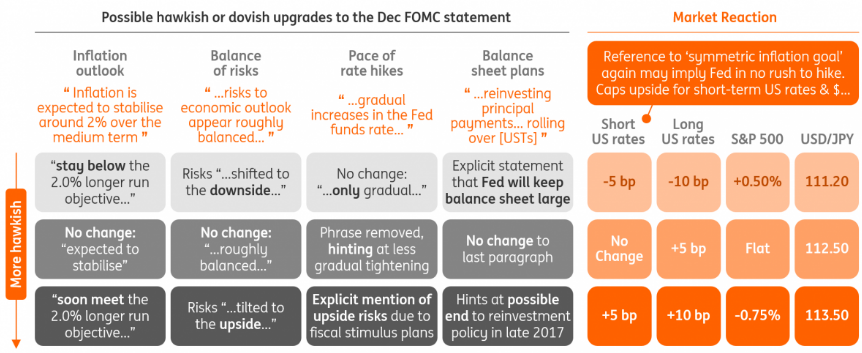
But we wonder whether lack of progress on the finer details of Trump's plans will dampen some of this optimism.

Fiscal policy: Big question marks

The direction of travel seems clear, but the details are still sketchy. Whilst Trump is still pushing for 15% corporate tax and a simpler tax code for households, Congress wants to see a fiscally neutral package. As it stands, Trump's latest announcements may struggle to pass.

Until we know the finer points, the Fed is unlikely to drastically alter it's current rate hike plans.

Scenarios: How markets could react to May's Fed statement



Source: ING

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