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Interest Rate Monitor

The strongest-in-this-decade wage growth in January added to the bearish speculation on US treasuries as increase in inflation expectations cemented the belief that the Federal Reserve will stay on course for raising interest rates at least three times in 2018, if not more. Yields on 10-year USTs rose to 2.84%, its highest in four years. Yields on 2yr, 5yr and 30yr also closed the week higher at 2.14% (+3bps), 2.59% (+10bps) and 3.09% (+15bps) respectively, though the 2yr yields declined 2bps on Friday after the US employment report.

It may take hawkish comments from incoming Fed Chair, Jerome Powell to allude to more / faster tightening before the market gets excited about pricing more Fed hikes in the near-term than what is currently implied by the dot plot. The FOMC statement earlier this week didn't flash any warning signs of a shift in FOMC mentality. In this regard, Powell's first Semi-Annual Testimony, likely in mid February, will be a critical event. No firm date has been announced for the testimony.



Source: Bloomberg, Emirates NBD Research

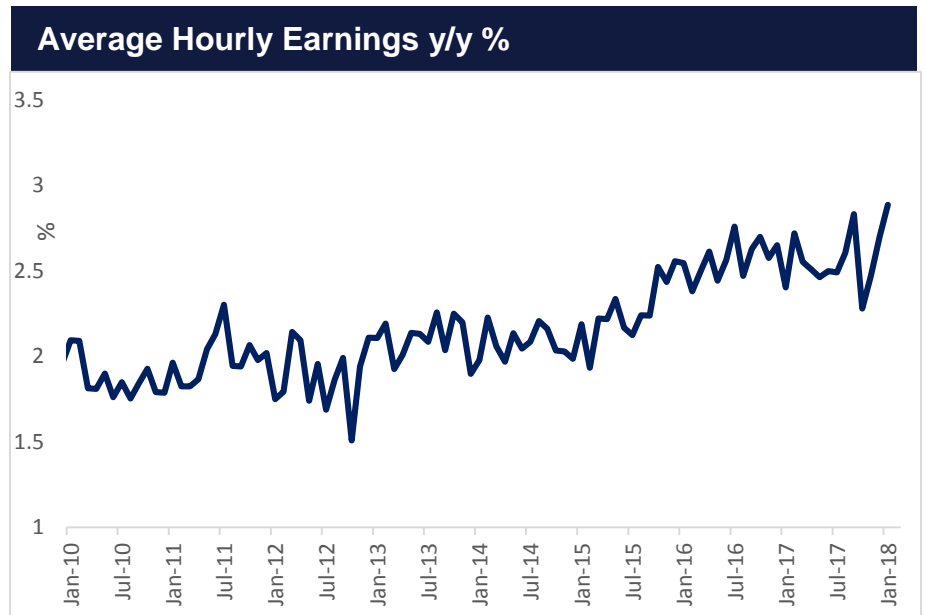
The outlook for annual consumer price growth over the next 10 years as measured by Treasury Inflation Protected Securities climbed to 2.14% last week, touching the highest since September 2014.

Strong Economic Data

Nonfarm payrolls rose 200,000 in January, exceeding the expectations of a 180,000 increase. The unemployment rate held steady at a near 17-year low of 4.1%. But the big story came on the wage front. Average hourly earnings growth was stronger than expected in January (+0.3% vs. expected +0.2%) and the December reading was revised up by 0.1% to +0.4%. In annual terms, average hourly earnings growth was 2.9% y/y vs. expected 2.6%, highest since June 2009 though there was a decline in the workweek from 34.5 hours to 34.3 hours.

US factory orders were 1.7% m/m in December vs. expected 1.5%. The final durable goods reading was revised down from +2.9% m/m to +2.8% m/m.

US January final University of Michigan index was also revised up to 95.7 vs. expected 95.



Source: Bloomberg, Emirates NBD Research

Federal Reserve

Fed Chair, Janet Yellen, finished her term on Saturday, 03 Feb 2018. Jerome Powell will be sworn in as the new Fed chair on Monday, 05 Feb 2018. Ms Yellen will become a distinguished fellow at the Brookings Institution on Monday, joining her Fed predecessor Ben Bernanke at the Washington-based think tank.

We expect minimal changes in Fed's monetary policy bias in the near term as a result of the change in its leadership. Despite recent strong data releases, most Fed officials are keen to see a more established economic trend before changing opinions.

- San Francisco Fed President John Williams (voter) said he didn't want to focus too much on one month's data and felt no need to change the Fed's gradual path of future hikes.
- Federal Reserve Bank of Dallas President Robert Kaplan (non-voter) said he has more conviction in his baseline view of 3 hikes in 2018 vs. 6 months ago and flagged he may be wrong and that more hikes could be needed. There is a possibility that the unemployment rate could dip below 3% this year.
- Federal Reserve Bank of Minneapolis President Neel Kashkari, who no longer votes on the FOMC but had been a consistent dovish dissenter in 2017, said that the most important thing he saw in the January US employment report was the pickup in the wage growth. He thought that if wage growth continued, it could have an effect on the path of interest rates.

Other events

- The government funding issue will resumes this week as the current deadline expires on 08 February. A failure to pass another funding bill by Friday night will result in a government shutdown.

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