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Inching towards a Fed ‘credibility’ hike

A strong jobs report has likely sealed the chance of a Fed hike, but not the start of a hiking cycle. The Fed is most likely to hike next week, or risk its credibility, unless August inflation underwhelms.

Inching towards a Fed ‘credibility’ hike

A 25bps Fed rate hike next week now looks most likely after a stronger-than-expected non-farm payrolls report for August. The only caveat to this outlook would be an underwhelmingly soft inflation report for August this Friday. With Fed Chair Warsh already characterising the current US policy rate of 3.75% as not restrictive, any failure to hike, especially due to pressure from the administration, would hurt the Fed’s credibility, impacting equities and bonds.

Tactically adding semiconductor equities; using volatility to buy on dips

This week’s softness in equity markets underscores the near-term headwinds from: i) rising oil prices due to a re-escalation of Middle East tensions; ii) rising bond yields; and iii) unsupportive seasonality (September being historically a weak month for US equities). The US and Asia-ex-Japan corporate earnings outlook remains robust. A chips shortage means the earnings outlook remains robust, while valuations have turned more attractive after the latest weakness.

Tighter monetary policies to support EUR and JPY; GBP remains vulnerable

Possibly a 25bps ECB rate hike by year end, taking the policy rate to 2.75%. This follows upgrades to the central bank’s growth and inflation forecasts and hawkish comments from President Lagarde. Meanwhile, the BoE is likely to hold rates next week as domestic labour and housing markets soften. BoJ is likely to hike next week amid rising domestically generated inflation. Any signal of an acceleration in the pace of hikes would potentially make the JPY the strongest major currency in the coming weeks.

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