US Fed faces new challenge: a world without labour 'slack'

REUTERS, *Washington*

BUSINESS is coming in so fast and workers are in such high demand at AOW Associates Inc, an Albany, New York-based construction firm, that its chief financial officer hired a guy six weeks ago for a job that didn't exist.

"We keep our project management ads continuous, even if we are not looking to fill a particular role, and if someone does come along, we make a job for them," AOW CFO Nicki Armsby said in a recent interview.

The company is not alone in looking for creative ways to deal with a US labour shortage that, according to recent economic data and documents from the US Federal Reserve, may be getting worse.

Policymakers at the Fed, which holds its latest policy meeting this week, must now decide what weight to give to signs that the economy is reaching a point where wages, inflation and other laggard indicators may turn higher.

Data on Friday showed US employment costs rose in the first quarter at an annualized rate of 4 percent, continuing what JP Morgan economists view as a steady march higher since the unemployment rate fell below 5 percent in 2015.

Investors appear to be betting on that scenario playing out. The yield on the benchmark 10-year US Treasury note breached the 3 percent level last week for the first time in more than four years.

And labour shortages have been cited by analysts as being responsible for the growing backlogs for manufactured goods in recent supply manager reports.

Add in the fiscal stimulus from the Trump administration's tax cuts and spending that is hitting the economy this year, and the higher prices for aluminium, steel and potentially other goods triggered by new import tariffs, and the tenor of upcoming Fed analysis could be poised to shift.

"Demand has stayed very strong," said Tim Fiore, who heads the Institute of Supply Management's manufacturing business survey committee. "There is plenty for a strong expansion ... Dig into the details and the employment side has clearly been constricting producers' ability to meet demand."

A police officer keeps watch in front of the US Federal Reserve building in Washington.

REUTERS/FILE

The Fed is not expected to raise interest rates at the end of its two-day policy meeting on Wednesday. It also is not releasing updated economic forecasts and Fed Chairman Jerome Powell is not scheduled to hold a press conference.

The policy statement alone could show how policymakers have accounted for a range of recent developments, and how their thinking may have evolved since the last meeting in March, when the US central bank raised rates.

According to documents released in the interim, the wages and inflation debate within the Fed appears to be shifting.

In the minutes from the March 20-21 meeting, released earlier this month, the word "slack" was jettisoned in the discussion of labour markets, a notable change in what has been a staple description of labour conditions during the current economic expansion.

The Fed then said in its "Beige Book" report, also released this month that entrepreneurs across broad sectors of the economy were struggling to fill both skilled and unskilled jobs.

"The labour market is tight and continuing to tighten," Erin Browne, head of asset allocation at UBS Asset Management, said on Friday after the Labour Department released the latest employment cost data.

"We are finally starting to see that translate into wage inflation."

Although inflation has remained below the Fed's 2 percent medium-term target for years, there appears to be growing confidence among policymakers that the pace of price increases will not collapse again and that the objective will be reached.

"They no longer see downside risk to inflation," said Ed Al-Hussainy, senior interest rate and currency analyst for Columbia Threadneedle Investments.

Data from CME Group and Eurodollar futures still point to just two more rate hikes this year, though many economists argue the Fed will ultimately raise rates on a quarterly basis from here on, leading to three more hikes by the end of 2018.

The direction of wage growth will be critical to the Fed's assessment, with Powell citing it as the missing piece in the discussion of whether "full employment" has truly been reached or exceeded. That, in turn, will shape the debate about whether the Fed may even need to move faster and further than expected with its monetary tightening.

If the choice is coming between raising compensation and leaving money on the table in the form of unfilled orders, then the weight may be shifting.

Banks push back Bank of England rate forecasts

REUTERS, *London*

Banks have pushed out their predictions for when the Bank of England will raise interest rates after data last week showed a sharp and unexpected slowdown in Britain's economic growth.

Expectations the British central bank would raise borrowing costs in May had already weakened after Governor Mark Carney highlighted "mixed" economic data and noted there were also "other meetings" this year in an April 19 interview.

Economists now forecast the BoE will not act until August and may even wait until 2019. Before Friday's GDP data most economists had expected the central bank to tighten monetary policy next month.

The changed expectations have hurt the pound, which has fallen sharply in value since the GDP release.

HSBC became the latest bank to erase its solitary rate hike call for 2018, saying on Monday that likely downward revisions to the BoE's growth forecasts in May would make it harder to justify a rate hike.

"Our view of no rate rises beyond May remains intact: we've gone from 'May and done' to just 'done'," Simon Wells and Elizabeth Martins, analysts at the bank, wrote in a note. The BoE raised interest rates for the first time in a decade last November, by 25 basis points to 0.5 percent.

Market expectations of a rate hike in May, as measured by swap markets, have fallen following the GDP data to less than 20 percent from around 50 percent. Friday's figures showed Britain's economy expanded by just 0.1 percent between January and March, the weakest quarter since 2012.

Earlier this month the market was pricing in as much as a 90 percent chance of a May rate rise.

The change in banks' forecasts signals a much weaker outlook for the pound, which has been among the best performing major currencies in 2018. For the year, it is now up less than 2 percent against the dollar after having been up more than 6 percent two weeks ago. Expectations of higher rates lifted sterling to its highest since the Brexit referendum in June 2016 at \$1.4377 (1.05 pounds) on April 17 but it has tanked nearly 5 percent since then, to \$1.3715 on Monday.

The likelihood that the BoE will not hike next month also means bond prices could rally further and presents a more volatile backdrop for the UK stock market. UBS scrapped its estimate of a single rate rise in 2018 after the weaker-than-expected growth figures while Nomura, which has long been hawkish on UK interest rates, now sees a first hike in August.

John Wraith, a UBS economist, said inflation could fall back to the central bank's target of 2 percent later this year and that concerns about talks between Britain and the European Union over the terms of their divorce could resurface.

Japan, UAE agree to expand cooperation during Abe's visit

REUTERS

Japan's Prime Minister Shinzo Abe shake hands with Sultan Bin Saeed Al Mansoori, United Arab Emirate's economy minister, during the Japan-United Arab Emirates business forum in Abu Dhabi yesterday.

AFP, *Abu Dhabi*

JAPAN and its top trade partner in the Middle East, the United Arab Emirates, agreed on Monday to expand economic, political and defence cooperation.

Tokyo and Abu Dhabi also signed an investment protection agreement, capping off a two-day visit by Japan's Prime Minister Shinzo Abe to the oil-rich Gulf state.

Abe arrived late Sunday on the first leg of a Middle East tour which will also take him to Jordan, Israel and the Palestinian territories.

In a joint statement, the two countries praised growing trade between them.

They "stressed the importance of further enhancing trade, investments, and business such as renewable energy, sustainable water desalination ... artificial intelligence, health care and medical equipment," the statement said.

They also reiterated their commitment to diversify joint business ventures in the non-energy sector, and stressed the need to boost defence cooperation.

The UAE is Japan's main trading partner in the Middle East, accounting for about a third of Tokyo's trade in the region.

It is also Japan's second-largest supplier of crude oil, accounting for almost a quarter of its needs and more than half the trade volume between them last year -- \$28 billion -- was energy-related.

Press secretary of the Japanese foreign ministry Norio Maruyama told reporters in Abu Dhabi the two countries are expected to sign a memorandum of defence cooperation next month.

He also said the agreement for the promotion and protection of investment will likely boost investments by both countries.

Abe held talks with the crown prince of Abu Dhabi and deputy supreme commander of UAE armed forces Sheikh Mohammed bin Zayed Al-Nahayan.

On Monday, Abe hailed cooperation with the UAE as a "strategic relationship" and welcomed Abu Dhabi's renewal of oil concessions with Japanese oil firms.

"Over the past five years since I last visited Abu Dhabi, our bilateral relations have made dramatic progress to a relationship that has been called a strategic relationship," he told a UAE-Japan business forum.

Top executives from Japan's leading business groups addressed the forum, highlighting projects underway in the UAE as well as future plans.

"On this visit, we are accompanied by 27 companies representing Japan with a delegation of top business leaders," Abe said.

In February, Abu Dhabi's state energy company ADNOC said it had awarded Japan's INPEX a 10 percent stake in Lower Zakum offshore oil concession, in a 40-year deal worth \$600 million.

ADNOC also said it had extended INPEX's 40 percent stakes in Abu Dhabi's Satah and Umm Al-Dalkh concessions for another 25 years.

In 2017, trade volume between the two countries increased 10.5 percent to \$28 billion, with Japan's exports accounting for \$7.2 billion -- a drop of 10 percent from the previous year, according to official figures released by the Japanese embassy in Abu Dhabi.

Meanwhile, representatives of Japan, Jordan, Israel and the Palestinians held a meeting on the Jordanian banks of the Dead Sea on Sunday night to discuss their "corridor for peace and prosperity" initiative.

Japan's Foreign Minister Taro Kono told reporters the initiative -- which aims to promote regional cooperation including through the creation of an agro-industrial park in the West Bank -- was making progress.

"Today, we are witnessing tangible results. Our efforts have finally started to bear fruits," Kono said.

Brussels begins big battle on post-Brexit budget

AFP, *Brussels*

THE EU will this week unveil its first formal plans for a larger, one-trillion-euro-plus long-term budget after Britain's departure, which threaten to further deepen divisions in the bloc.

From slashed farm funds that will anger French farmers, to development cash tied to respect for democracy, and demands for greater national contributions, the 2021-2027 budget promises to be an explosive mixture.

EU Budget Commissioner Guenther Oettinger, who will present the plans in Brussels on Wednesday, says that tough steps are needed to fill a 12 to 14 billion euro hole left by Brexit.

A race against time will follow, especially as the European Commission, the EU's executive arm, wants the budget agreed before the next European Parliament elections in May 2019, two months after Britain leaves.

EU states say it is "impossible" given the rifts between east, west, north and south, with countries anxious not to put their hands in their pockets at a time when populism on the march.

"They have to take responsibility for the ambitions that they have expressed" for the EU after Brexit, an official in Jean-Claude Juncker's commission said on condition of anonymity.

The loss of Britain deprives the EU of one of its biggest net contributor nations at a time when the bloc is trying to finance new areas such as defence and tackling migration.

Countries including Austria and the Netherlands are already gearing up to fight any demand for increased national contributions, although France and Germany have said they are ready to pay more.

The sums at stake in the budget debate are huge, even if on the face of it they only represent a tiny fraction of the overall wealth of the European Union -- the current 2014-2020 budget represented just 1 percent of the bloc's GDP.

Oettinger has called for countries to increase their contributions to "between 1.1 percent and 1.2 percent" of their national budgets for the next "multi-annual financial framework".

AFP/FILE

European Commissioner for Budget and Human Resources Guenther Oettinger delivers a speech during the Hannover Fair in Germany.

But along with the new resources "there will have to be cuts," the German commissioner has warned.

Sources said they would be "modest" amounting to less than 10 percent.

Most will target the two areas that together account for nearly three quarters of all EU spending.

The EU's infamous Common Agricultural Policy is first in the crosshairs, accounting for 37 percent of the bloc's spending. That will be difficult to swallow for France, whose farmers are the biggest beneficiaries of CAP funds.

Paris has said it is ready to defend "substantial reform" but the "indispensable security of aid for farmers cannot be affected", a diplomatic source said.

Also targeted will be so-called cohesion funds that are used to fund development in poorer European countries. They represent a further 35 percent of the EU's budget.

Most of that money currently goes to eastern former Soviet bloc countries which are still catching up economically.

But southern nations such as Spain and Italy have started demanding that some is redirected to tackle mass youth unemployment in their countries. The eastern countries are also alarmed by the commission's plans to link the funds to respect for the rule of law.

Poland and Hungary, both criticised by Brussels over democratic issues, have battened down the hatches and say they are being criticised for failing to take in refugees.

"We will not accept arbitrary mechanisms which will make the funds an instrument of political pressure, Poland's deputy European affairs minister Konrad Szymanski said.

Some of the money saved will be directed to guarding the EU's frontiers in the wake of the migration crisis, with the Commission planning to more than quintuple the size of the Frontex border agency to nearly 6,000, a European source said.