First Trust
Monday Morning OUTLOOK
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Fed Not Going Away

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Close your eyes (well, not literally). Imagine a huge manufacturing economy, in Asia, growing very rapidly. It became the second largest economy in the world, from ruin, in just a few short decades and produced 14% of global output. Now imagine it collapses.

If you had your eyes closed, you would think – China! But, you would be wrong. We are describing Japan. It collapsed in 1990 and hasn't risen since, but the global economy did just fine, while the US roared ahead. It's true that the US had a short 9-month recession starting in July 1990. But Japan had little to do with that. The Fed hiked the federal funds rate to 9¾% in 1989, when inflation was 5¼%. Iraq invaded Kuwait and oil prices shot up.

If anything, the economic problems in Japan that started back in 1990 should have hit the US harder than today's problems in China. Back in 1990, the US goods exports to Japan were 0.8% of US GDP; today, goods exports to China are 0.7% of GDP. And, China is about the same size as Japan in relative terms to the global economy, especially if it continues to devalue its currency.

What's interesting is that Japan is still trying to induce growth, announcing last week its central bank will use negative short-term interest rates for banks as an incentive for them to lend. Japan's 10-year Treasury security now yields 0.05% (to be clear, that zero to the right of the decimal point is not a typo). But, Japan started quantitative easing in 2001 without success. If it really wants to grow again, it needs to roll back tax hikes, cut government spending, and reduce regulations.

Regardless, when Japan announced negative rates, US markets responded. Odds of Federal Reserve rate hikes in 2016 fell, bond yields fell, and equities soared. Federal funds futures markets now put the odds of a March rate hike at only 18% and are indicating only one quarter-point rate hike in 2016.

We think this is overdoing it. Between today and the next Fed meeting in mid-March the US gets two more jobs reports and two more inflation reports. If those reports show what we expect – continued solid job growth, core inflation running near 2%, and the overall inflation rate heading back toward 2% – don't be surprised to see Fed officials use speeches and press comments to put a March rate hike back on the radar.

Don't view this as a negative. Fears about China's impact on the US are already overblown in markets and a Fed rate hike will signal the US economy is still growing, while entrepreneurial profits head higher.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
2-1 / 7:30 am	Personal Income – Dec	+0.2%	**+0.2%**	+0.3%	+0.3%
7:30 am	Personal Spending – Dec	+0.1%	**0.0%**	0.0%	+0.5%
9:00 am	ISM Index – Jan	48.4	**49.3**	48.2	48.0
9:00 am	Construction Spending – Dec	+0.6%	**+1.0%**	+0.1%	-0.6%
2-2 / *afternoon*	Total Car/Truck Sales – Jan	17.3 Mil	**17.3 Mil**		17.2 Mil
afternoon	Domestic Car/Truck Sales – Jan	13.7 Mil	**13.6 Mil**		13.5 Mil
2-3 / 9:00 am	ISM Non Mfg Index – Jan	55.2	**54.9**		55.8
2-4 / 7:30 am	Initial Claims – Jan 30	279K	**281K**		278K
7:30 am	Q4 Non-Farm Productivity	-2.0%	**-2.6%**		+2.2%
7:30 am	Q4 Unit Labor Costs	+4.0%	**+1.9%**		+1.8%
2-5 / 7:30 am	Non-Farm Payrolls - Jan	190K	**189K**		292K
7:30 am	Private Payrolls – Jan	180K	**183K**		275K
7:30 am	Manufacturing Payrolls – Jan	-2K	**-5K**		8K
7:30 am	Unemployment Rate – Jan	5.0%	**5.0%**		5.0%
7:30 am	Average Hourly Earnings – Jan	+0.3%	**+0.3%**		0.0%
7:30 am	Average Weekly Hours - Jan	34.5	**34.5**		34.5
7:30 am	Int'l Trade Balance – Dec	-$43.2 Bil	**-$43.2 Bil**		-$42.4 Bil
2:00 pm	Consumer Credit– Dec	$16.0 Bil	**$18.3 Bil**		$14.0 Bil