

US Weekly Economic Update

16th August 2010

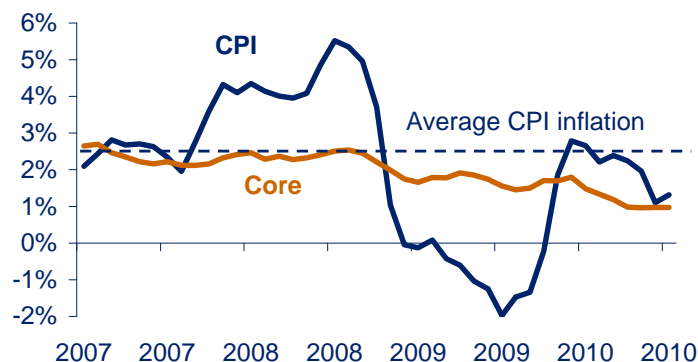
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- **The Federal Open Market Committee extended the stimulus measures supporting the economy.** The Fed Funds rate was left unchanged at 0% to 0.25%, but the Fed announced it would reinvest the proceeds of maturing mortgage bonds that it purchased as part of its asset purchase scheme. The funds will be used to purchase long dated Treasury securities which should help keep down longer-term interest rates, providing a modest on-going stimulus to the economy.
- **It's not hard to see why policymakers are getting a little jittery about growth prospects.** The economy probably grew by less than 2% (annualized) in Q2, and employment figures have been disappointing in recent months – a real worry given the high rate of unemployment and the central importance of the domestic consumer to the wider US economy. Retail sales were up 5.5% y/y in June, which on the surface sounds impressive, but is really a reflection of the depressed state of the economy in mid-2009. Retail spending is still almost 5% below the high water mark recorded in late 2007 (and more than 7.5% below the level of spending after taking account of inflation over the period). So in truth, the consumer spending data for July did little to alter the picture of a lacklustre recovery that is losing, rather than gaining, momentum.
- **Inflation ticked up to 1.3% in July from 1.1% in June, driven by higher energy prices. But core inflation, a better gauge of underlying price pressures, remained close to all time lows of 0.9%.** With growth so weak, concerns about deflation (falling prices) are growing, but shouldn't be overdone. Shelter costs, which account for over 40% of the basket of goods and services used to calculate inflation, is a key reason for the decline, reflecting the extreme weakness in the housing market. Clothing prices (4% of the CPI basket) are also falling in y/y terms. But most other elements continue to see price increases. Transport (17% of the CPI basket), increased by 5.5% y/y in July, medical costs (6% of CPI basket) were up 3.2% y/y, education (6%) by 2% y/y and other goods and services (10%) were up 2.8% y/y. This doesn't mean that the Fed can afford to be complacent about deflation risks, just that we shouldn't exaggerate them either.

Chart of the week: Year on year CPI and core inflation

Source: Thomson Datastream



MARKET RATES MONITOR	13 th August 2010	6 th August 2010	Year ago
Fed Funds Rate Target	0.25%	0.25%	0.25%
10-yr US Treasury yield	2.68%	2.86%	3.89%
30-yr Mortgage (Freddie Mac)	4.44%	4.49%	5.22%
US dollar/Japanese Yen	86.35	85.12	97.44
Euro/US Dollars	1.28	1.33	1.42
British Pound/US dollars	1.56	1.60	1.67