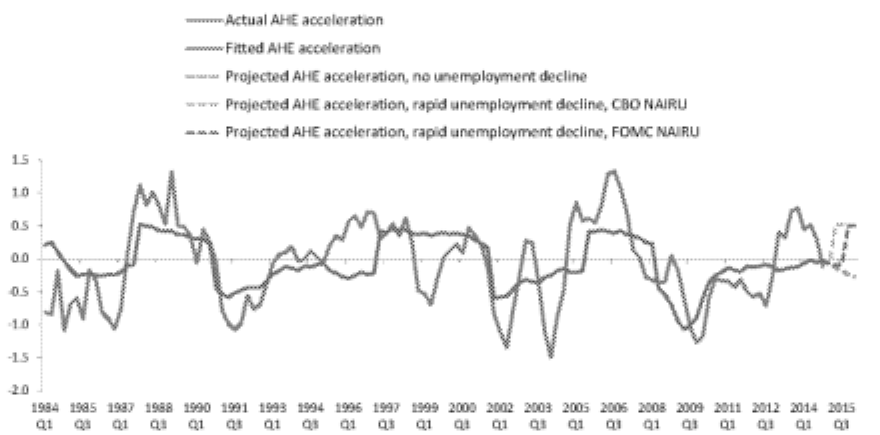
We then project our model to assess the prospects for wage acceleration in the near future. If the unemployment rate remains stagnant at its present level, 5.5%, the NAIRU will not get breached and our model implies that wage inflation will not increase. By contrast, suppose that the unemployment rate continues its rapid decline. In particular, we consider the case in which payrolls grow at a steady pace of 225k per month through the end of Q1 2016, and simulate the path of the unemployment rate using the Atlanta Fed's "Jobs Calculator", under the assumption of an unchanged labor force participation rate.[1] Then our model suggests that wage inflation will pick up because the NAIRU will be breached. The timing of this event, however, depends crucially on the estimate of the NAIRU. In our projection, the unemployment rate will fall below the CBO's estimate of the NAIRU, which is slightly below 5.4%, in Q2 2015. But it will only fall below the FOMC's most recent estimate, 5.0%-5.2%, in Q3 or Q4 2015.[2]

This highlights the importance of the FOMC's reduction of its NAIRU estimate at the March meeting from a range that was consistent with the CBO's estimate to the above-discussed range. All else being equal, the lower NAIRU estimate implies that the FOMC expects wage acceleration to be delayed by three-to-six months. The likely corollary is that the committee now expects to raise rates a quarter or two later.

Actual, fitted, and projected wage acceleration



Source: FRB Atlanta, Haver Analytics and Deutsche Bank

Japanese Potential Buyers?

Treasury demand ebbs and flows between different investor classes. In 2014h2 foreign FX reserves managers became important but as much as a diversification trade away from Euros. Given the decision by the GPIF to increase their allocation to overseas bonds and equities, there is naturally a lot of interest in the potential for Japanese buying of Treasuries going forward. Here we try and quantify the potential in terms of three specific sectors: pensions; insurance and deposit taking institutions including the banks and post office. Note that we only have data for outward investment so this is not exclusively Treasuries but we can presume that the bulk of any outward investment adjustments will be made via Treasuries, given low Euro yields.

[1] We also assume that the average monthly population growth rate and the average monthly CES/CPS employment ratio remain at their current levels.

[2] For illustrative purposes, the chart uses the lower bound of the FOMC's estimate, 5.0%, which gets breached in Q4 2015 in our projection.