



Economic Update:

Fed Takes on Growth

June 6, 2018

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Chief Economist

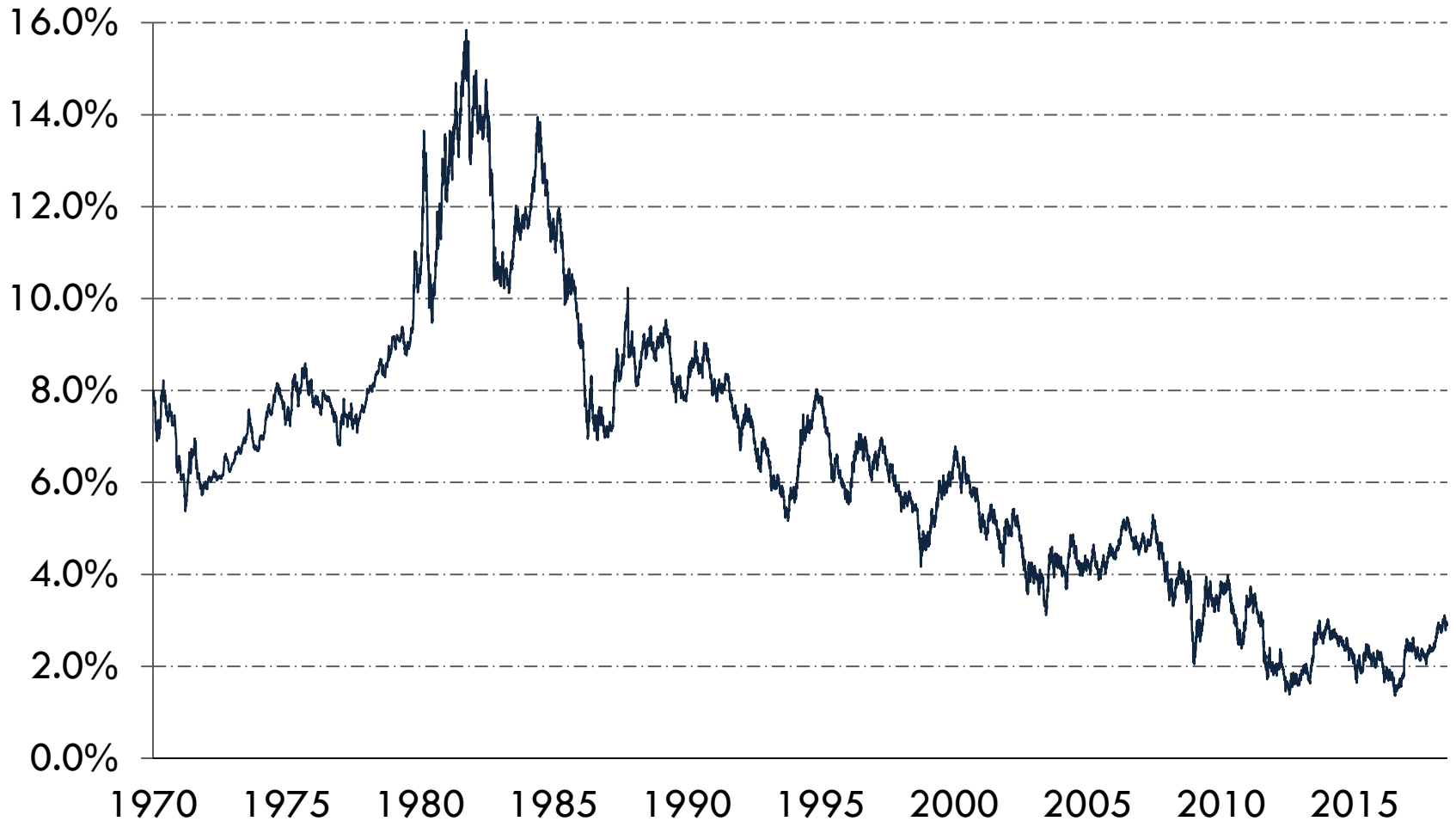


Rising yields reflect changing Fed goals

- ❑ Fear of deflation & zero lower bound dominated Bernanke/Yellen Fed
- ❑ Powell says will respect PhDs on the committee
- ❑ Old-school Phillips curve thinking reemerging

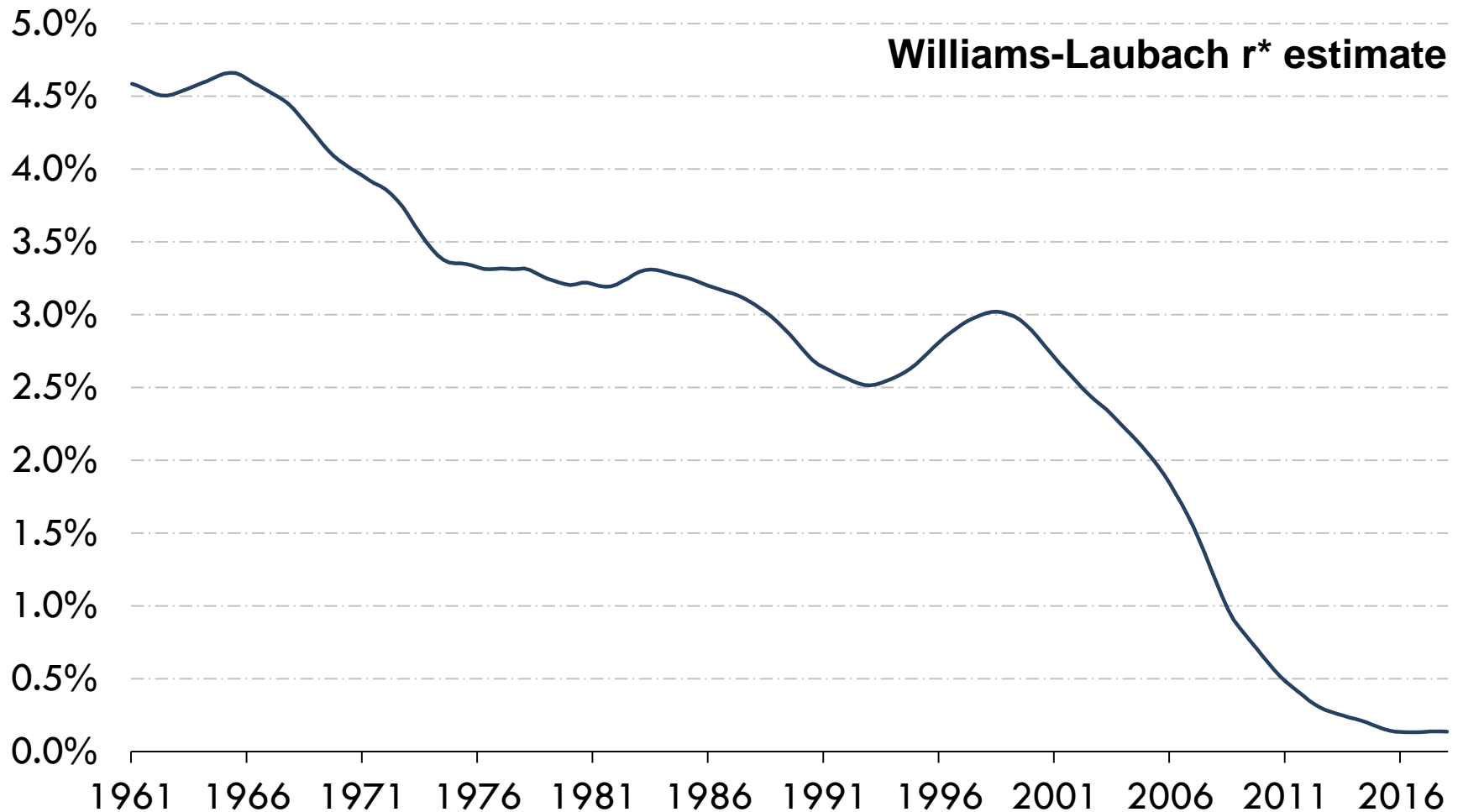
10-yr US Treasury yield

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The long decline in the natural rate

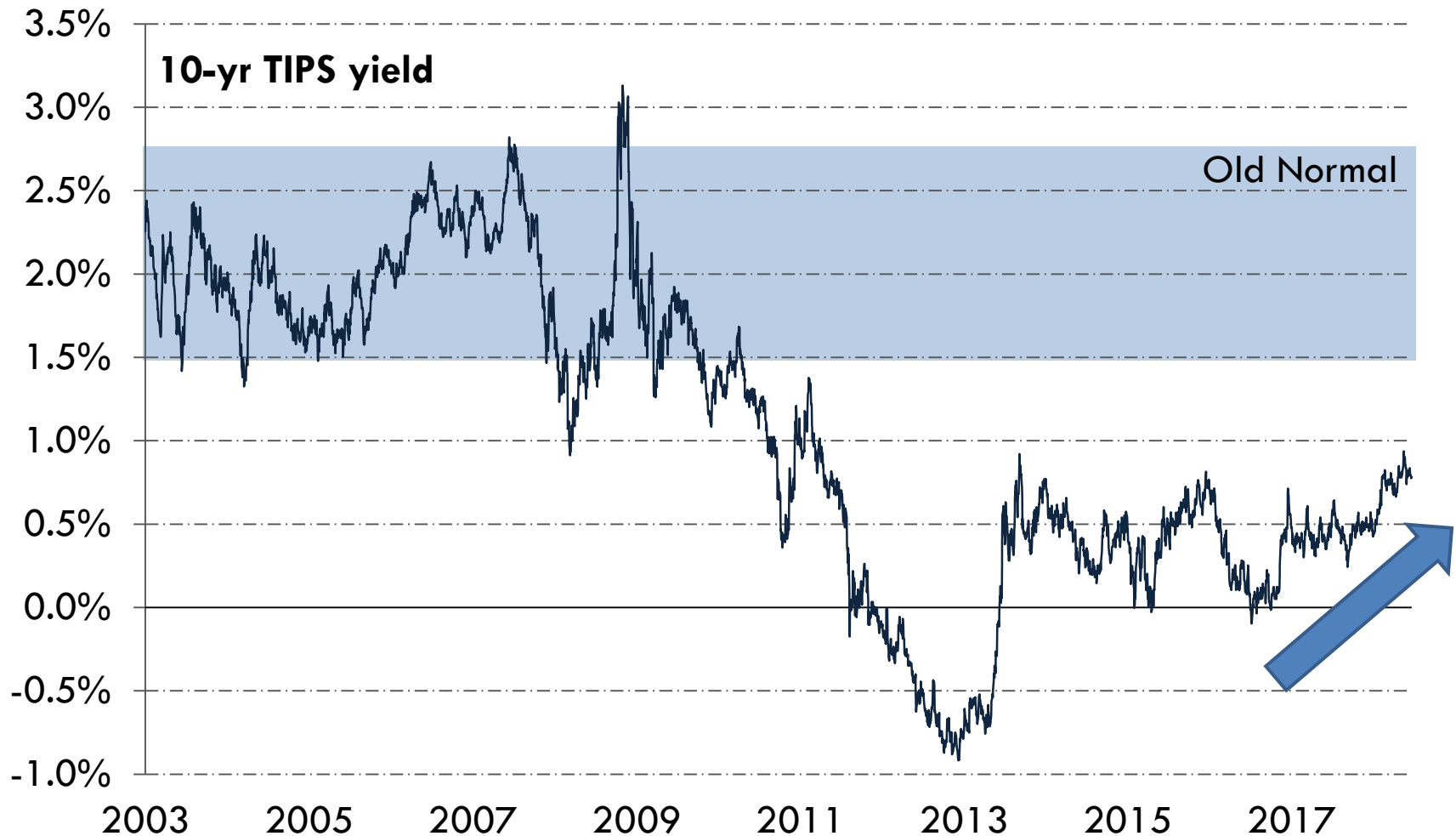
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Real 10-yr yield

Reflects supply of/demand for credit

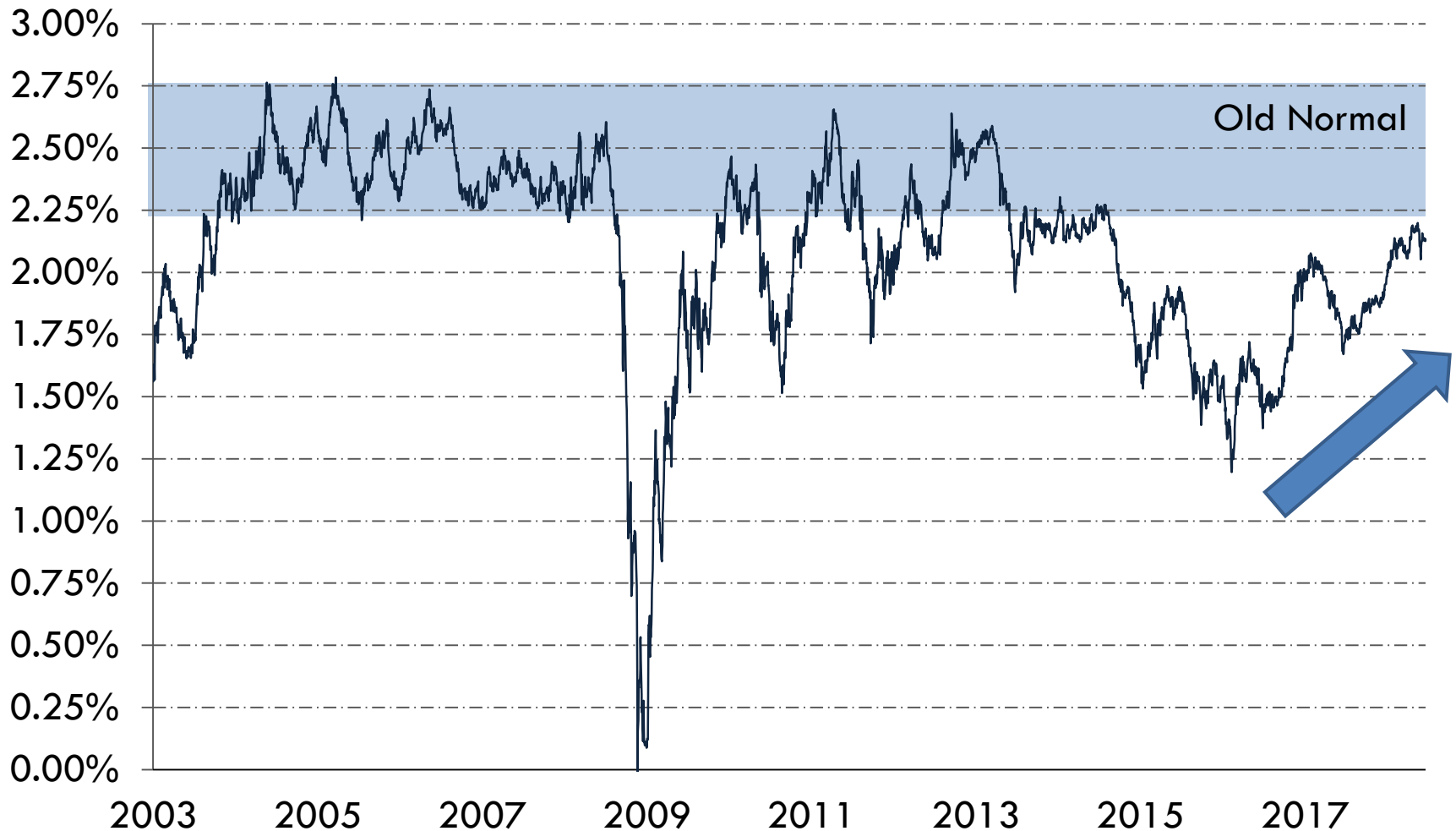
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10-yr breakeven inflation expectations

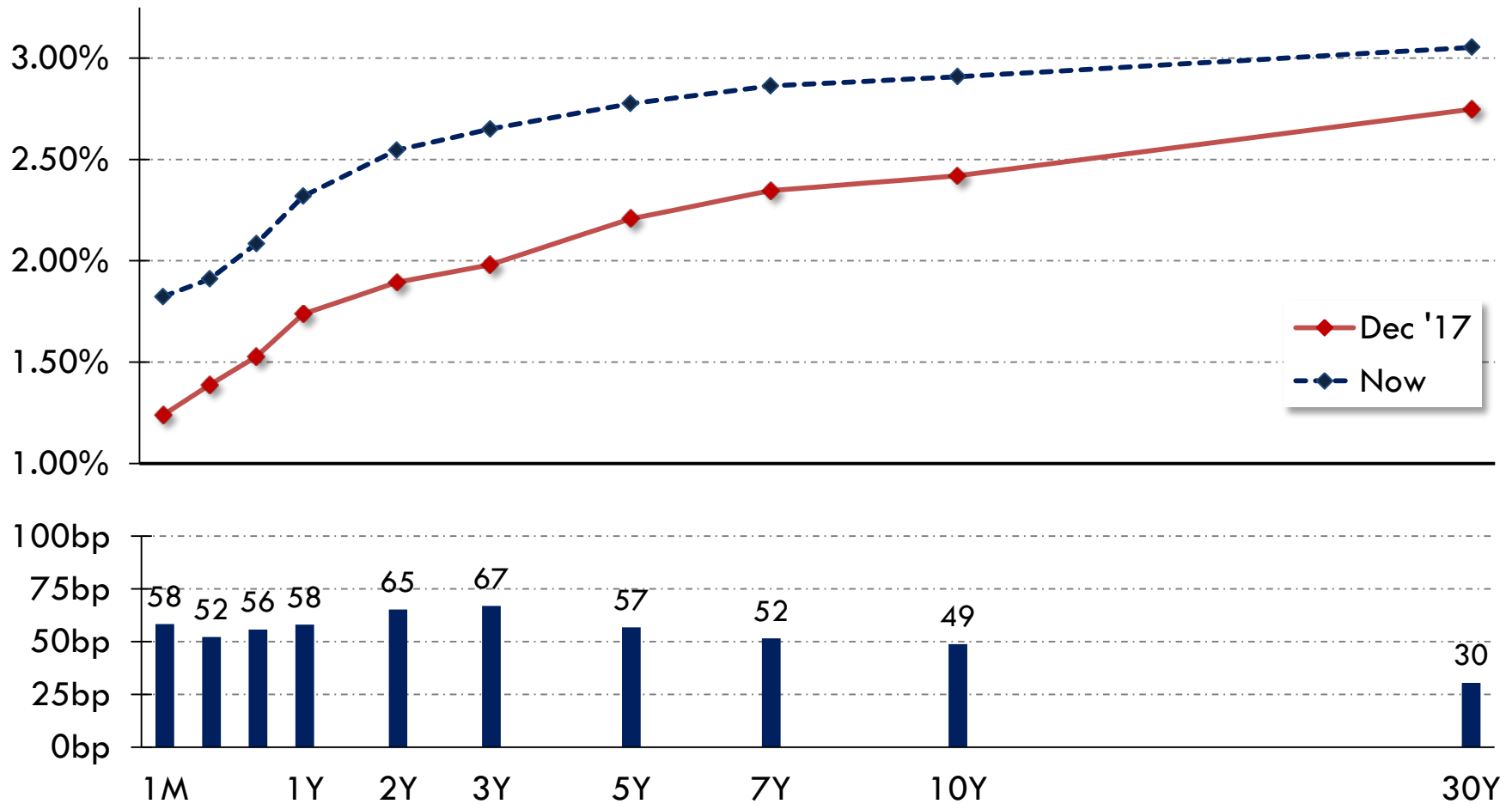
Average inflation expected over next 10 years

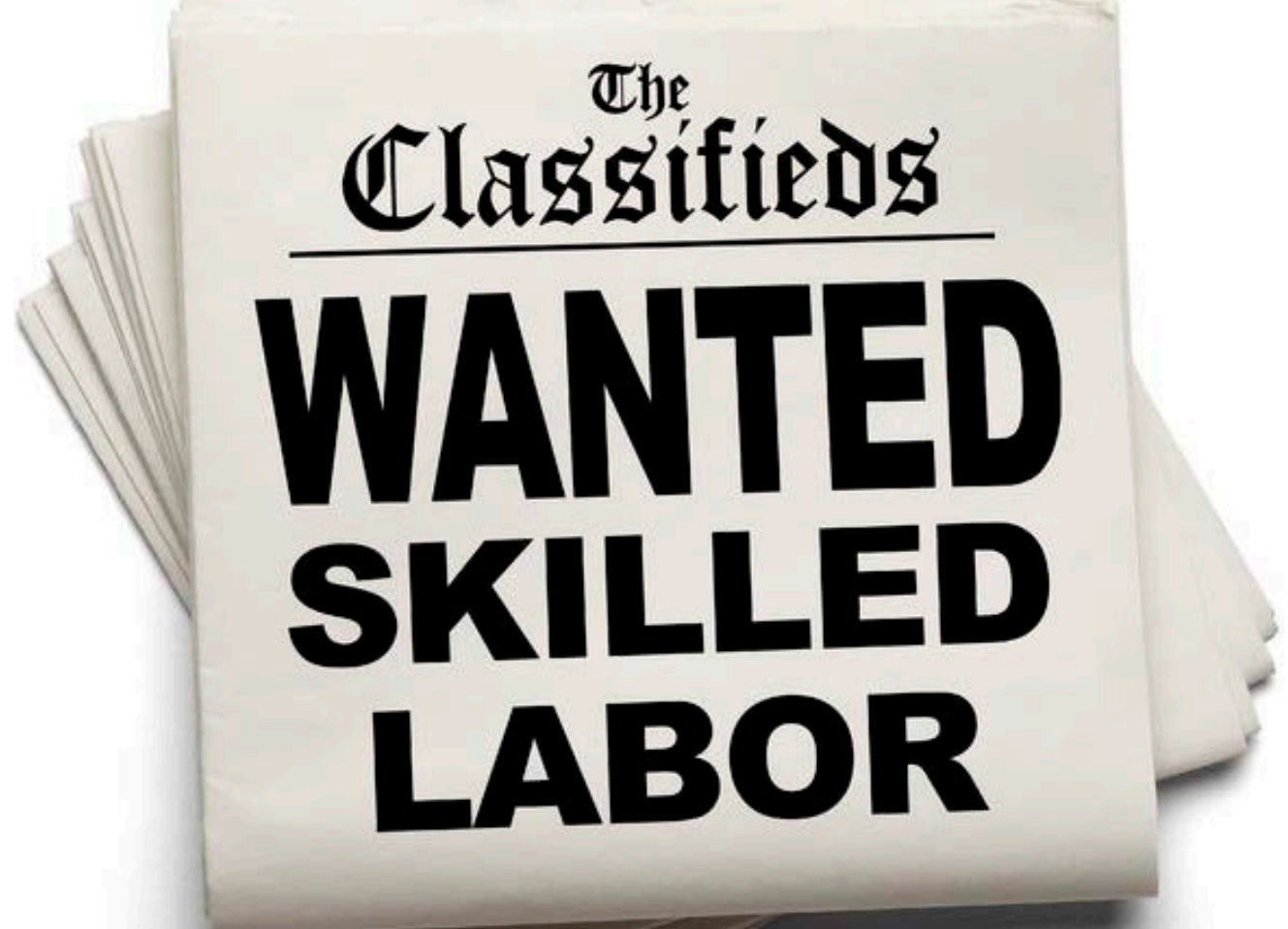
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Treasury yield curve year-end 2017 & now

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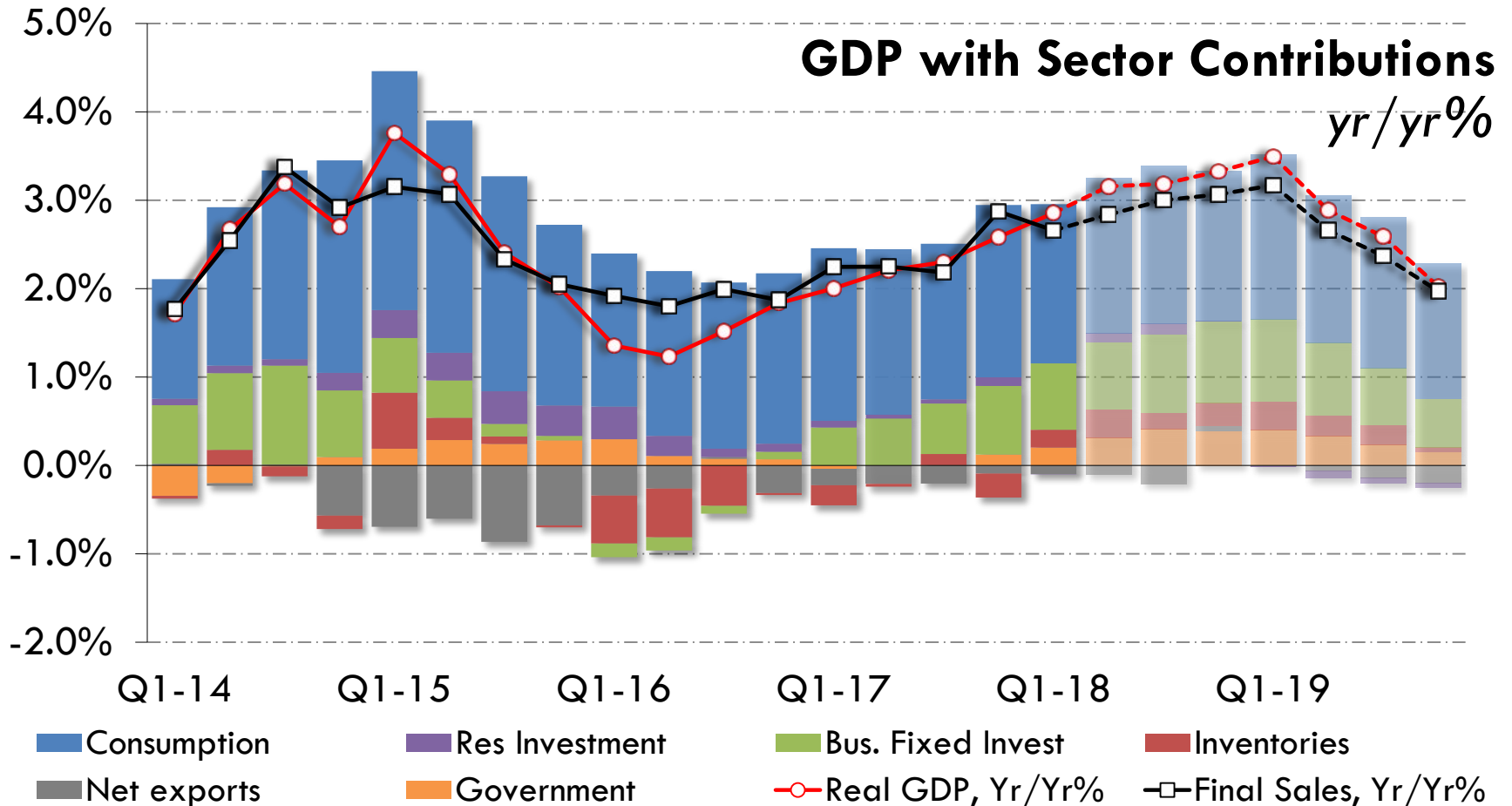


Economy humming, labor is tight

- ❑ Stronger economy can handle higher rates
- ❑ Confidence points to increased spending
- ❑ Higher rates could limit the consumption bounce

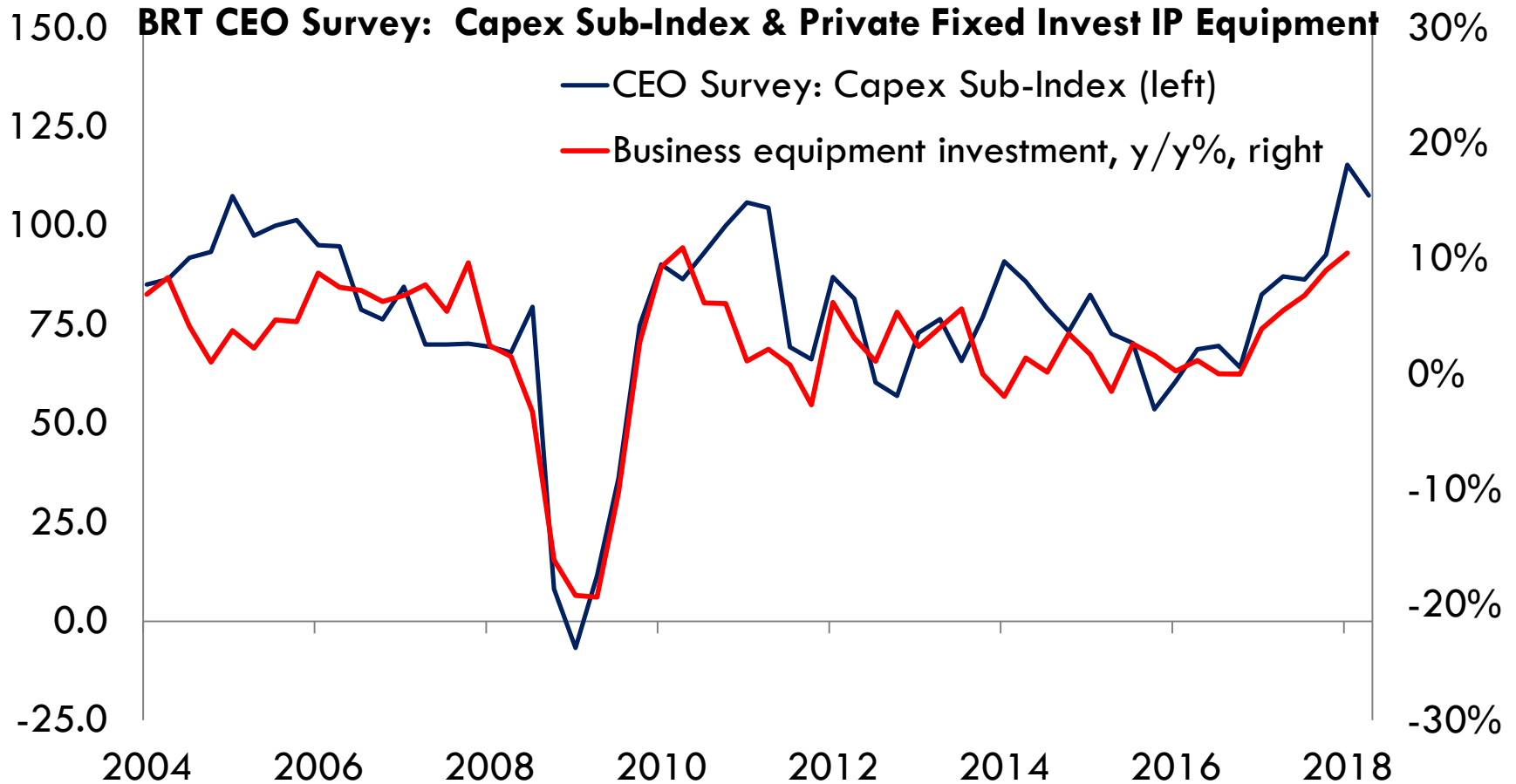
GDP to accelerate past 3.0% in 2018

Problematic for Fed as unemployment falls below 4.0%



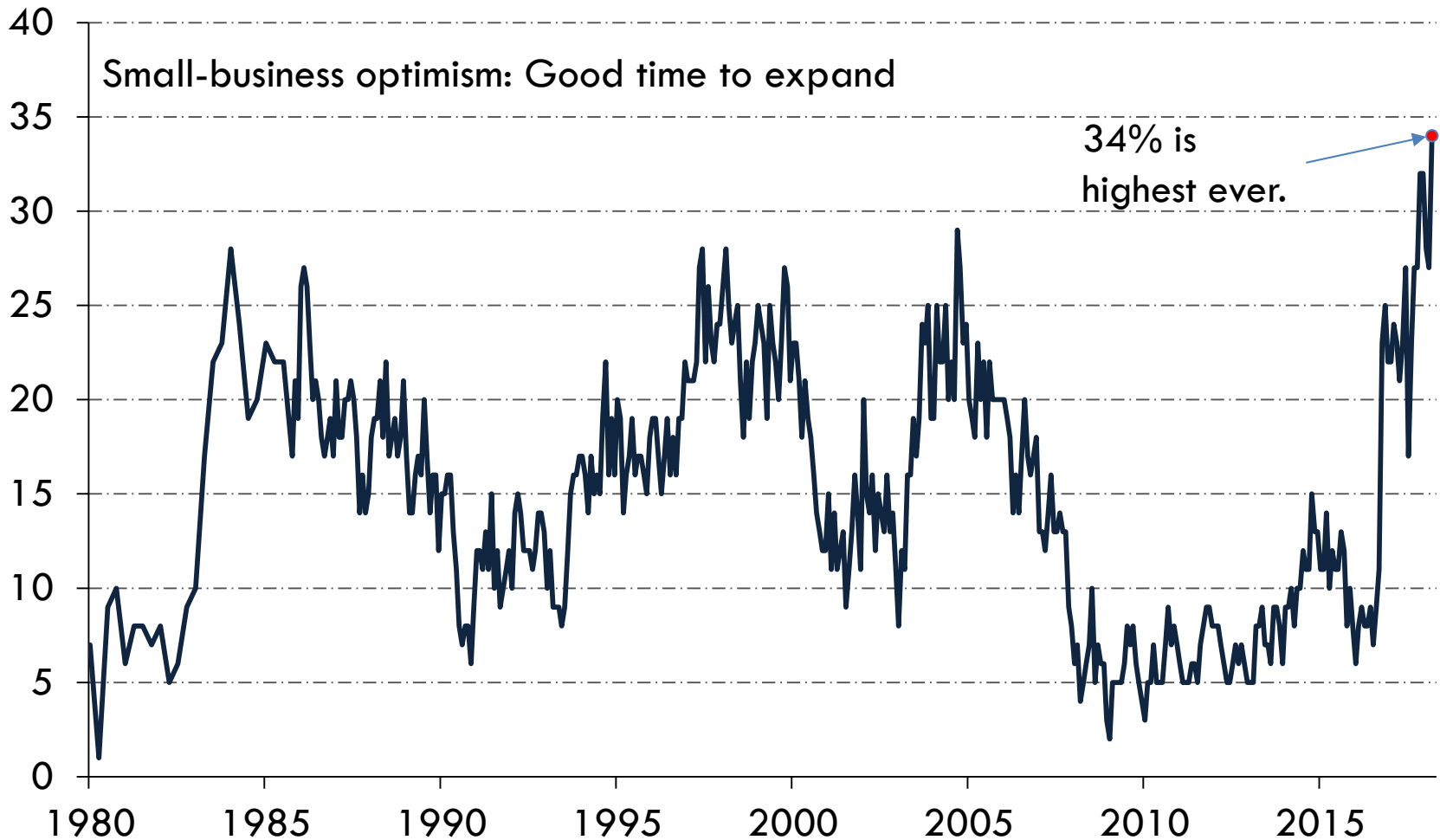
Cap spending plans rose before tax cut

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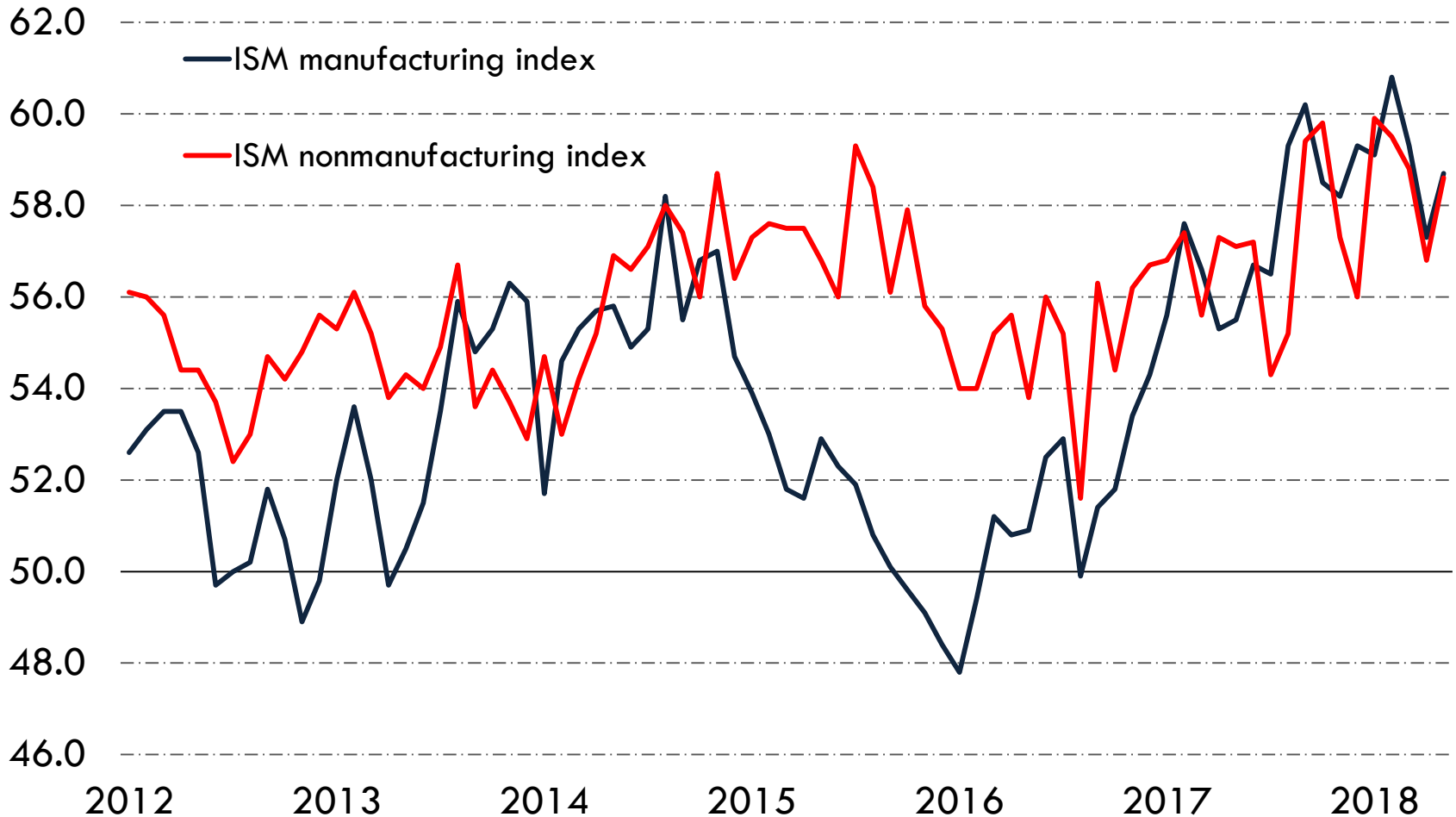
NFIB small business good time to expand

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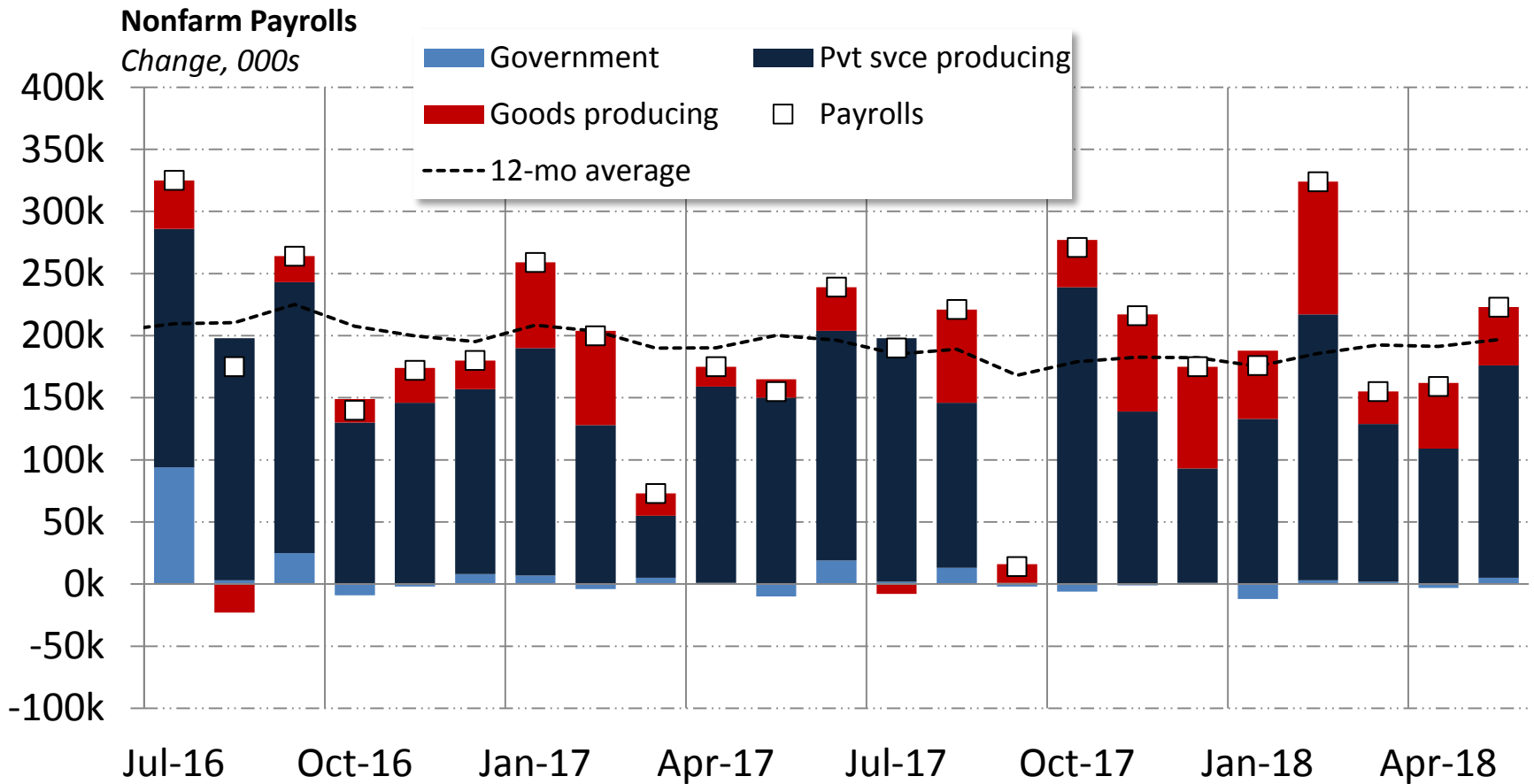


ISMs point to strong growth

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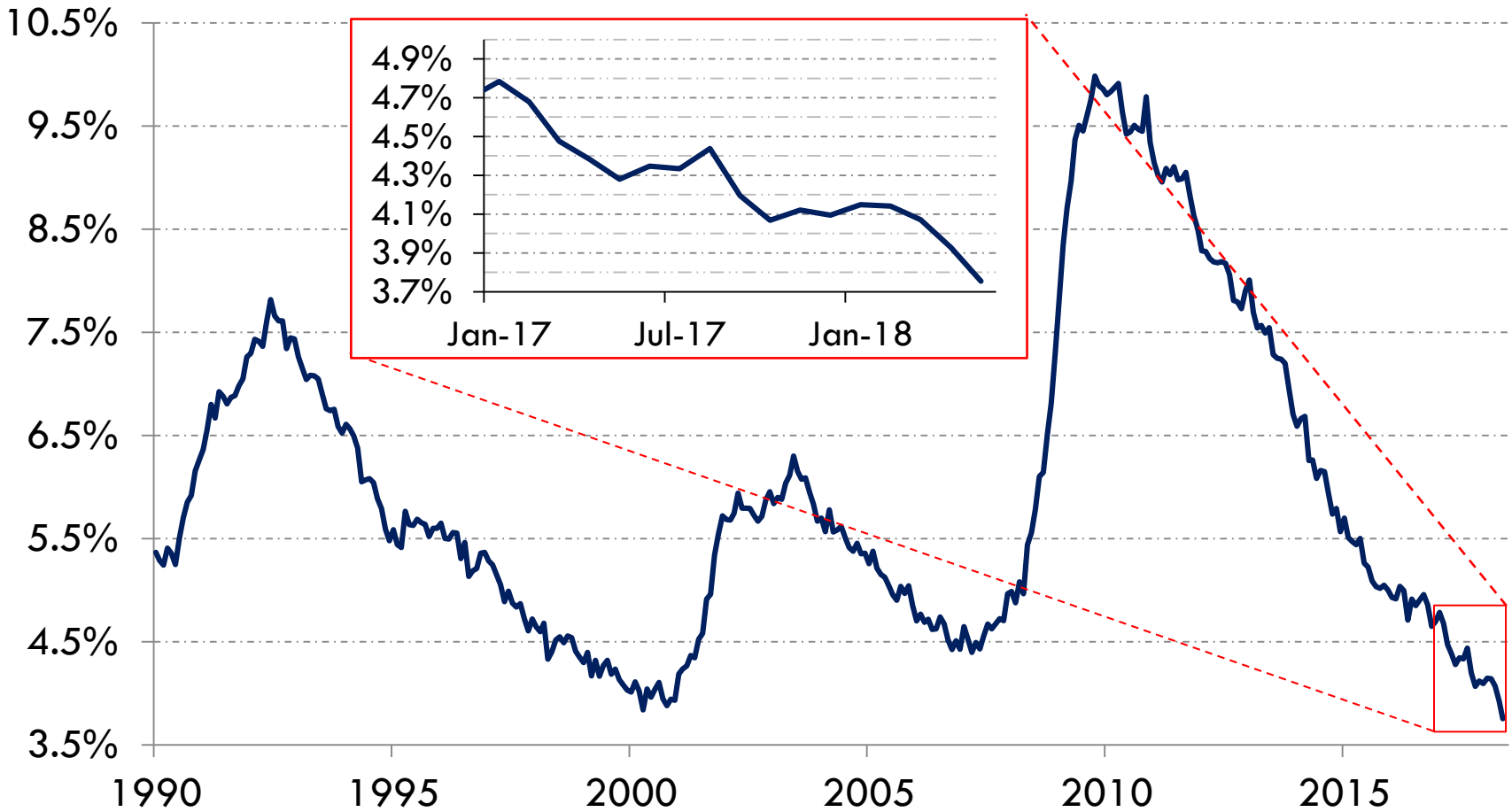


Solid employment growth



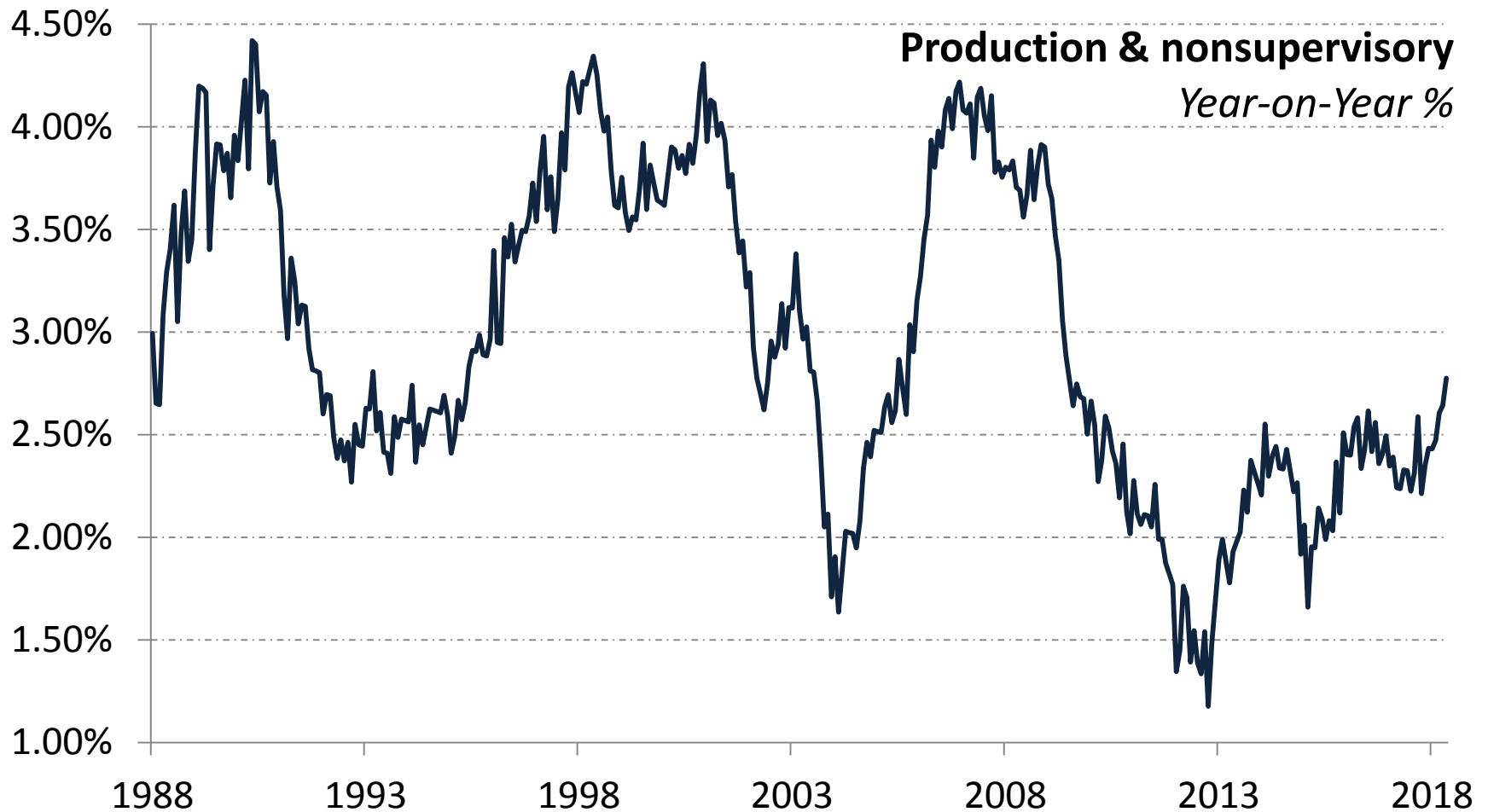
Unemployment rate under 4%

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Average hourly earnings weak, but rising

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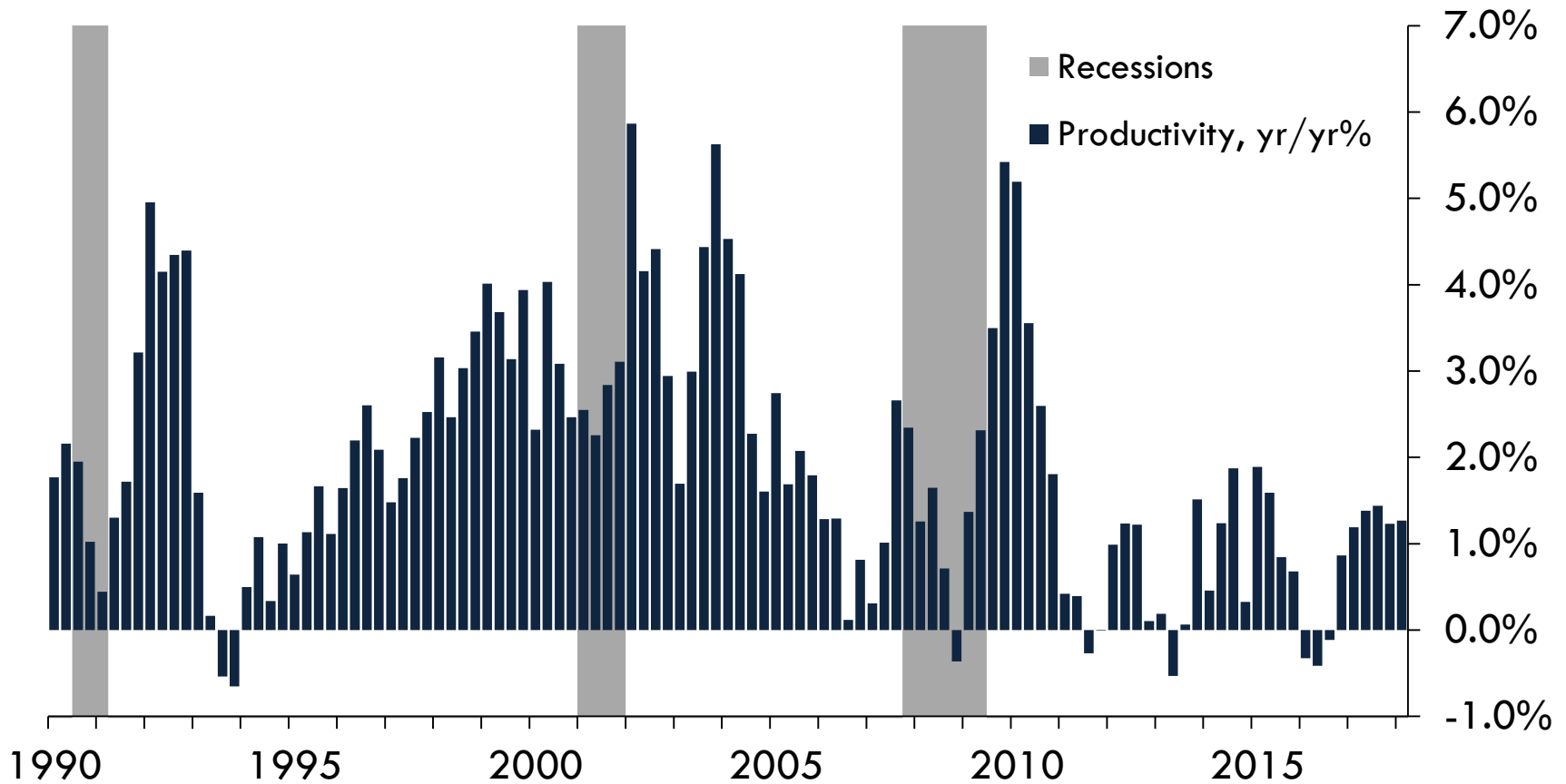


Faster productivity = higher living standard

“To get wages to go up sustainably in the long term we need higher productivity.” - Jay Powell, March 1, 2018

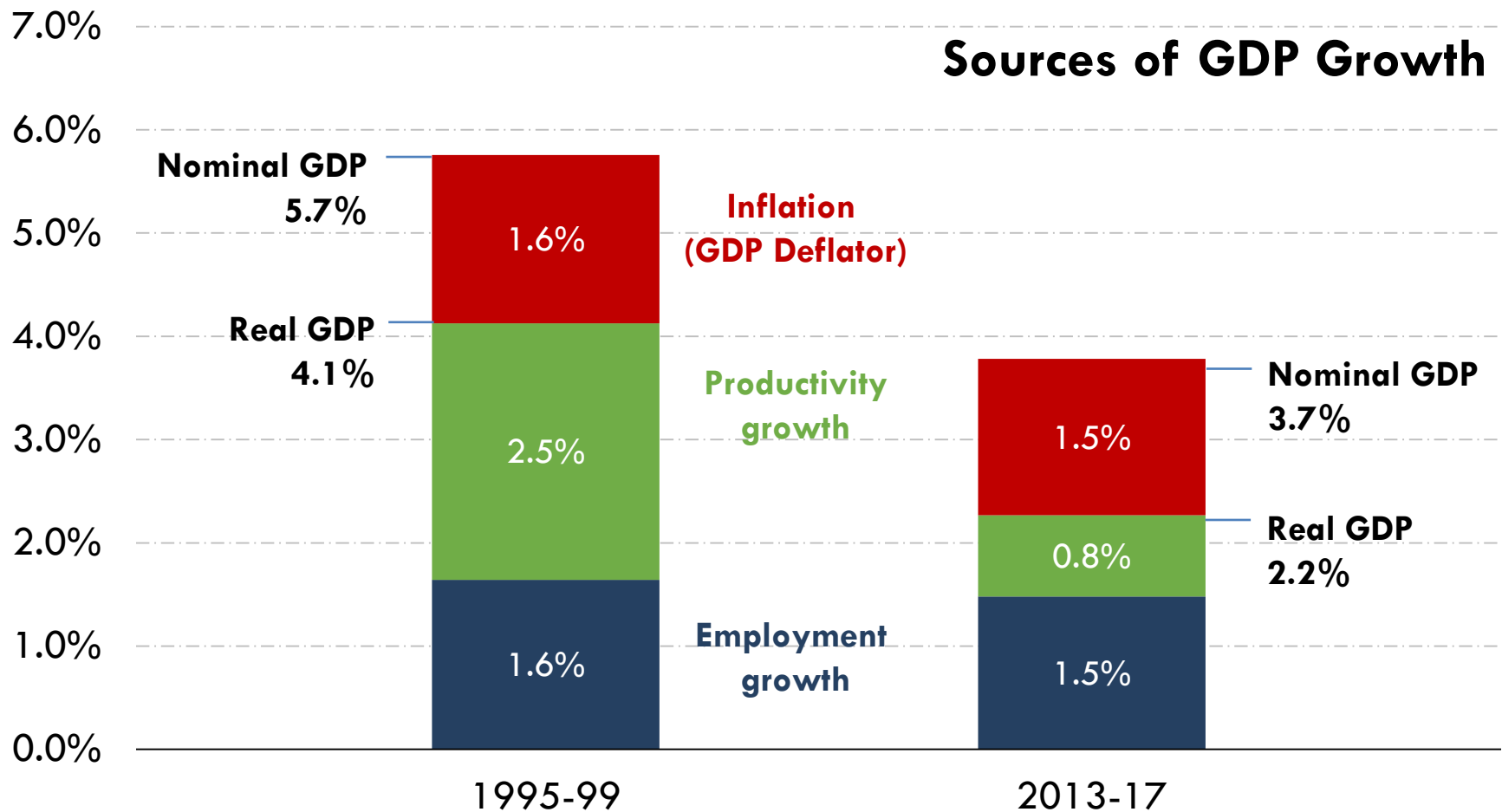
Late-cycle productivity key to happiness

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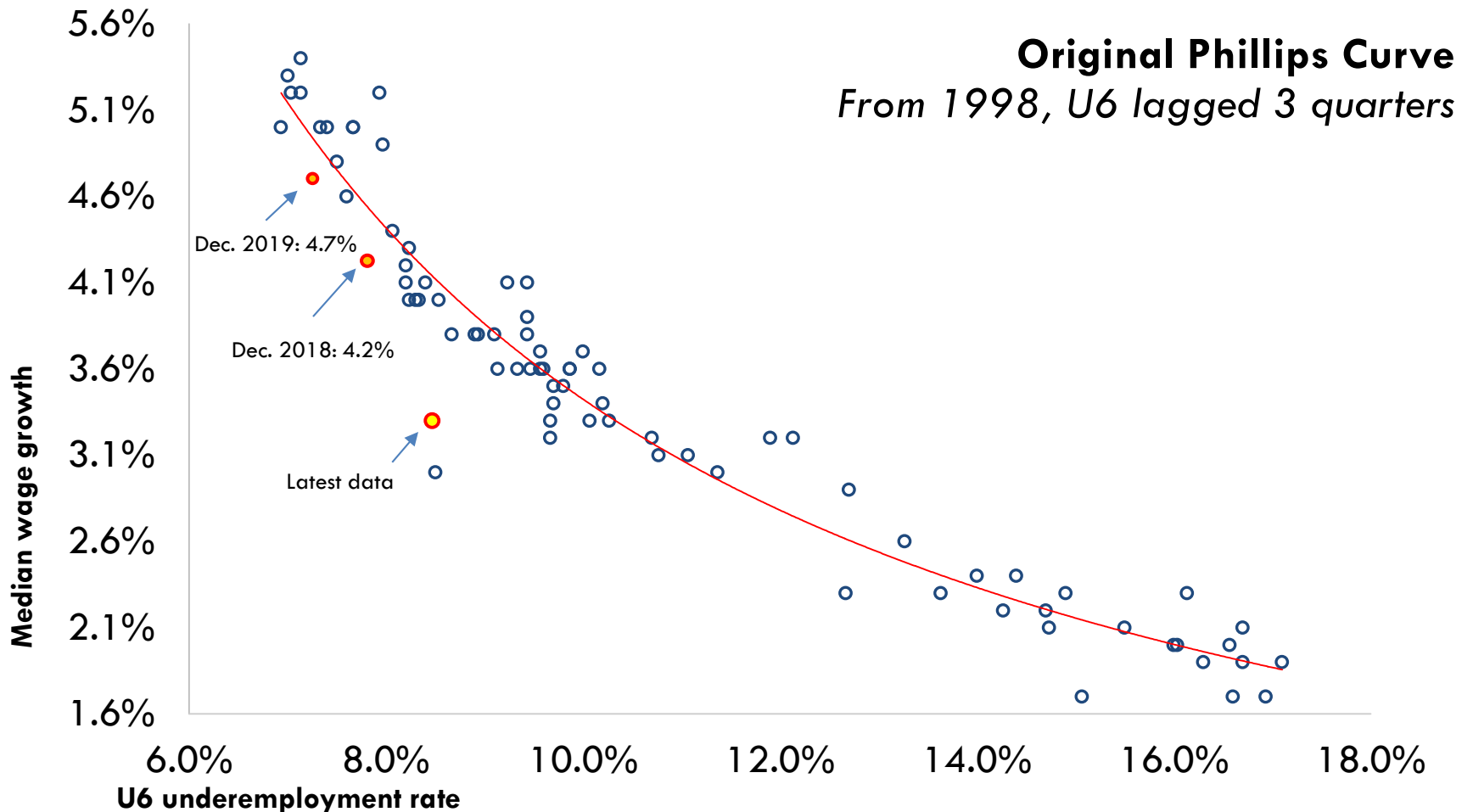
Why productivity is important

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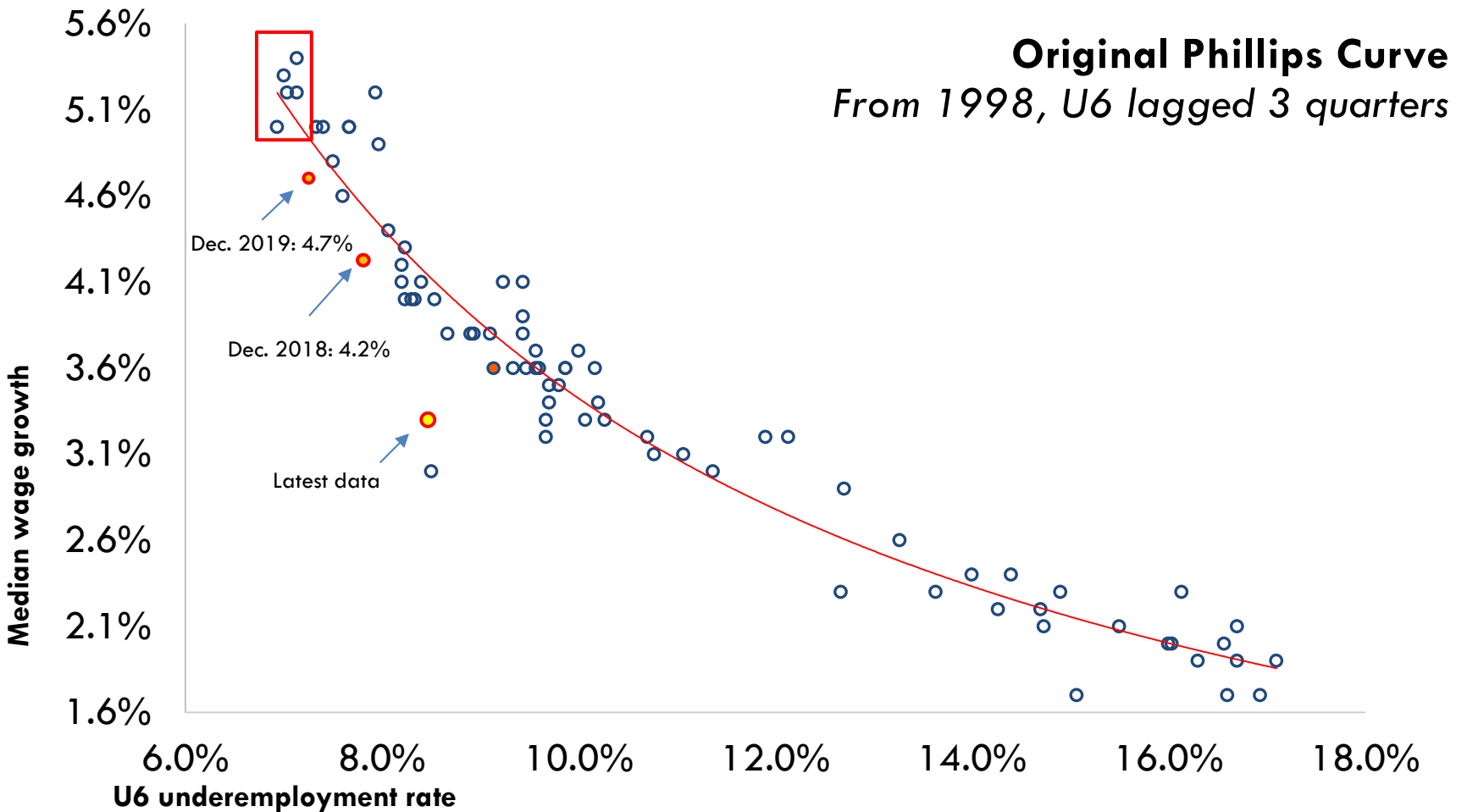


Wages should rise faster

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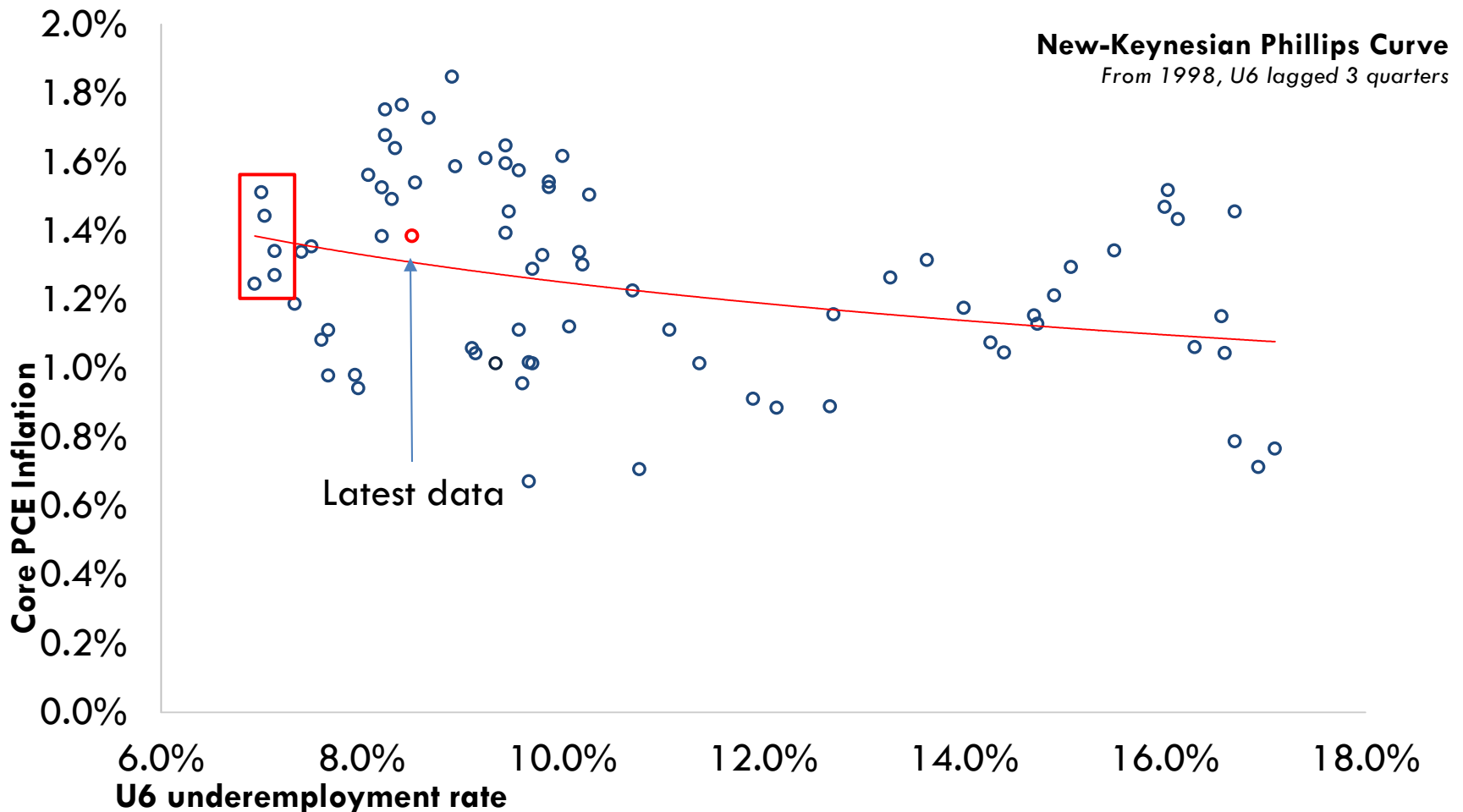


But wage inflation...

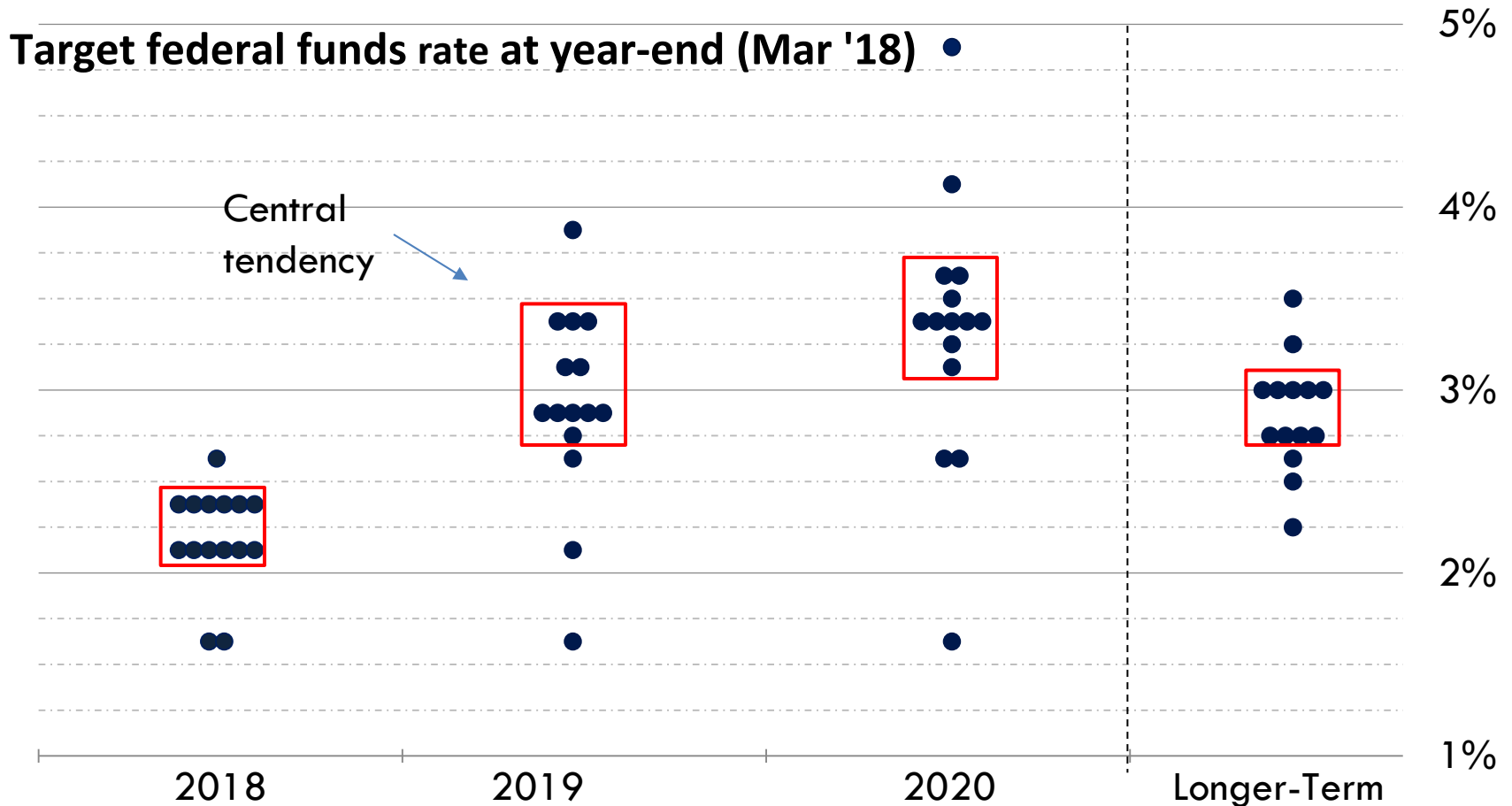


...does not always trigger price inflation

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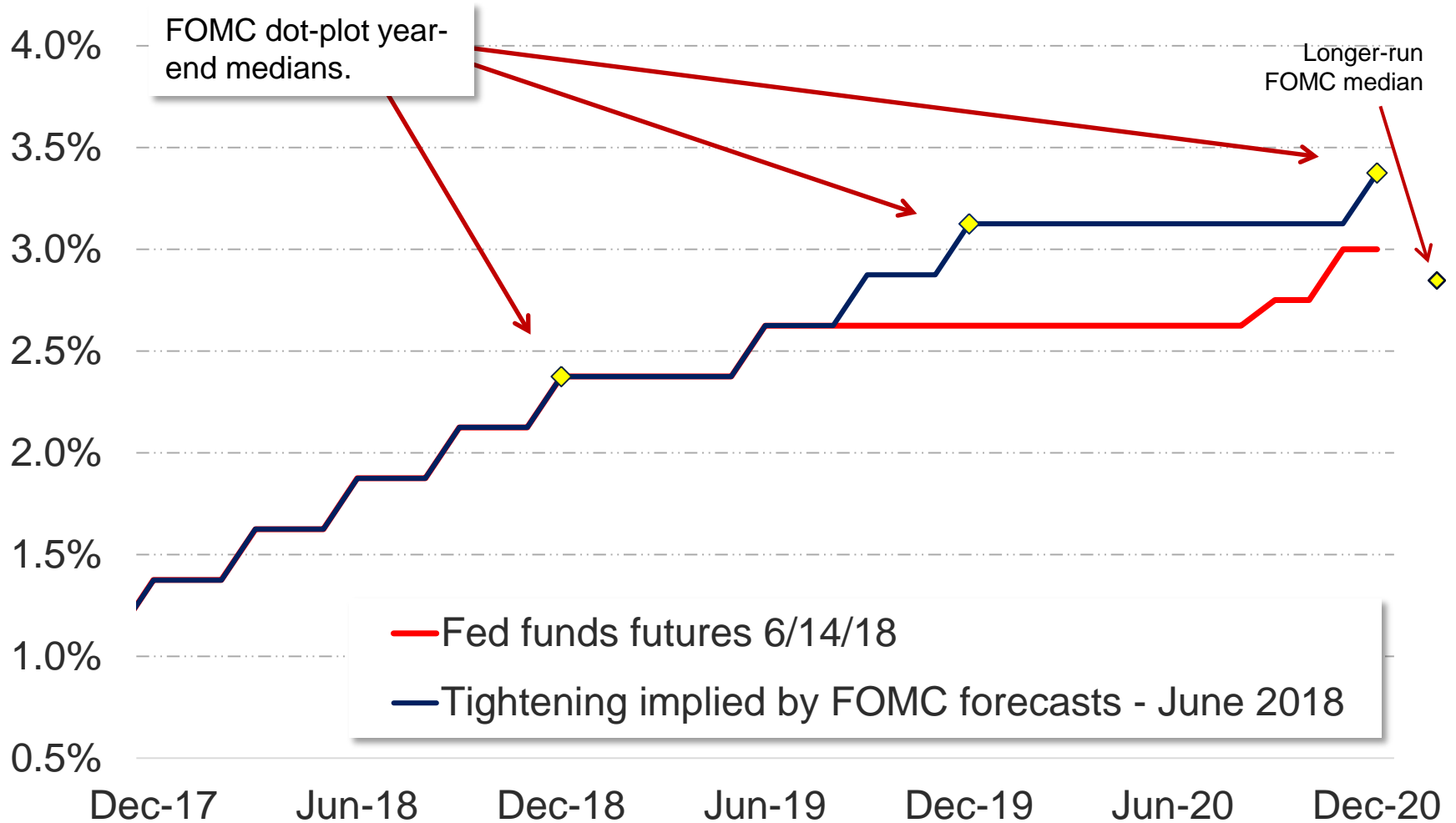


The dot plot and central tendency



Note: Each blue dot represent the expectations of one FOMC member. The median target range for 2018 is 2.125, for 2019, it is 2.875%, for 2020 3.375%, and for the Longer-Term is 2.875%.

Median dots and FF futures





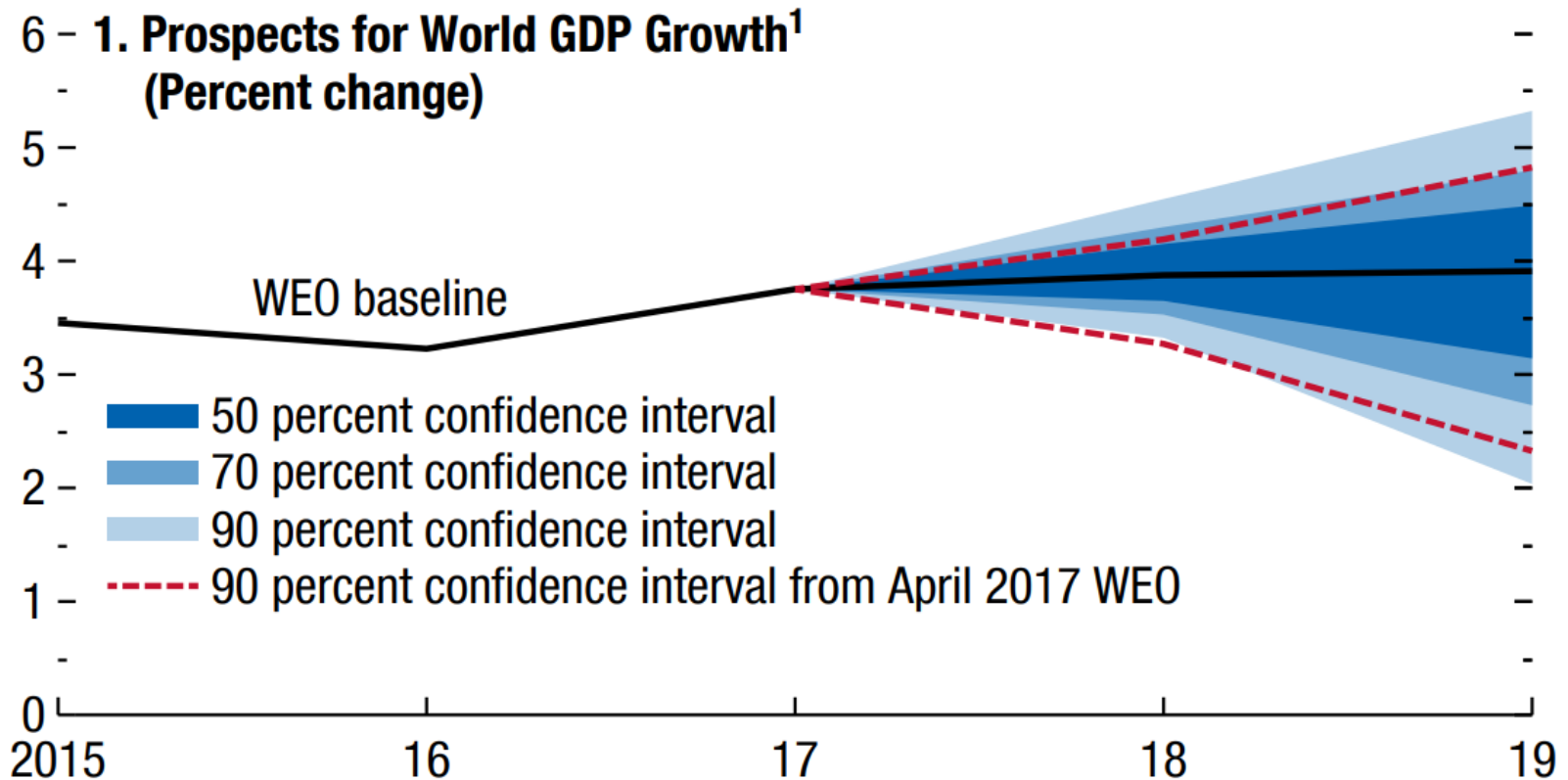
What could stop the Fed

- ❑ Emerging market unrest
- ❑ Higher oil prices
- ❑ Stock market

IMF Risks to Global Outlook tilted down

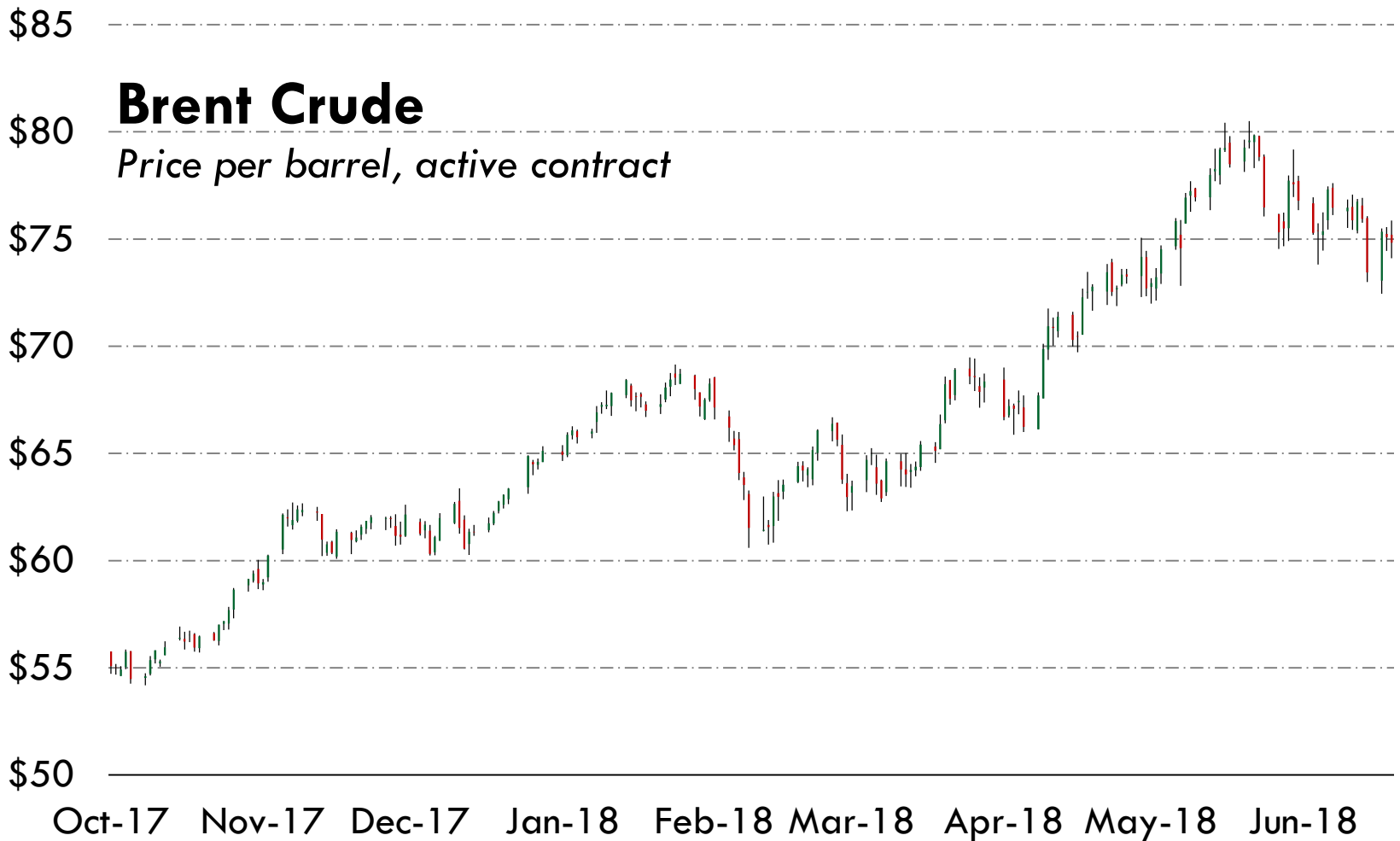
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The risks around the central growth forecast are two-sided and broadly even over 2018–19.



Oil price rising

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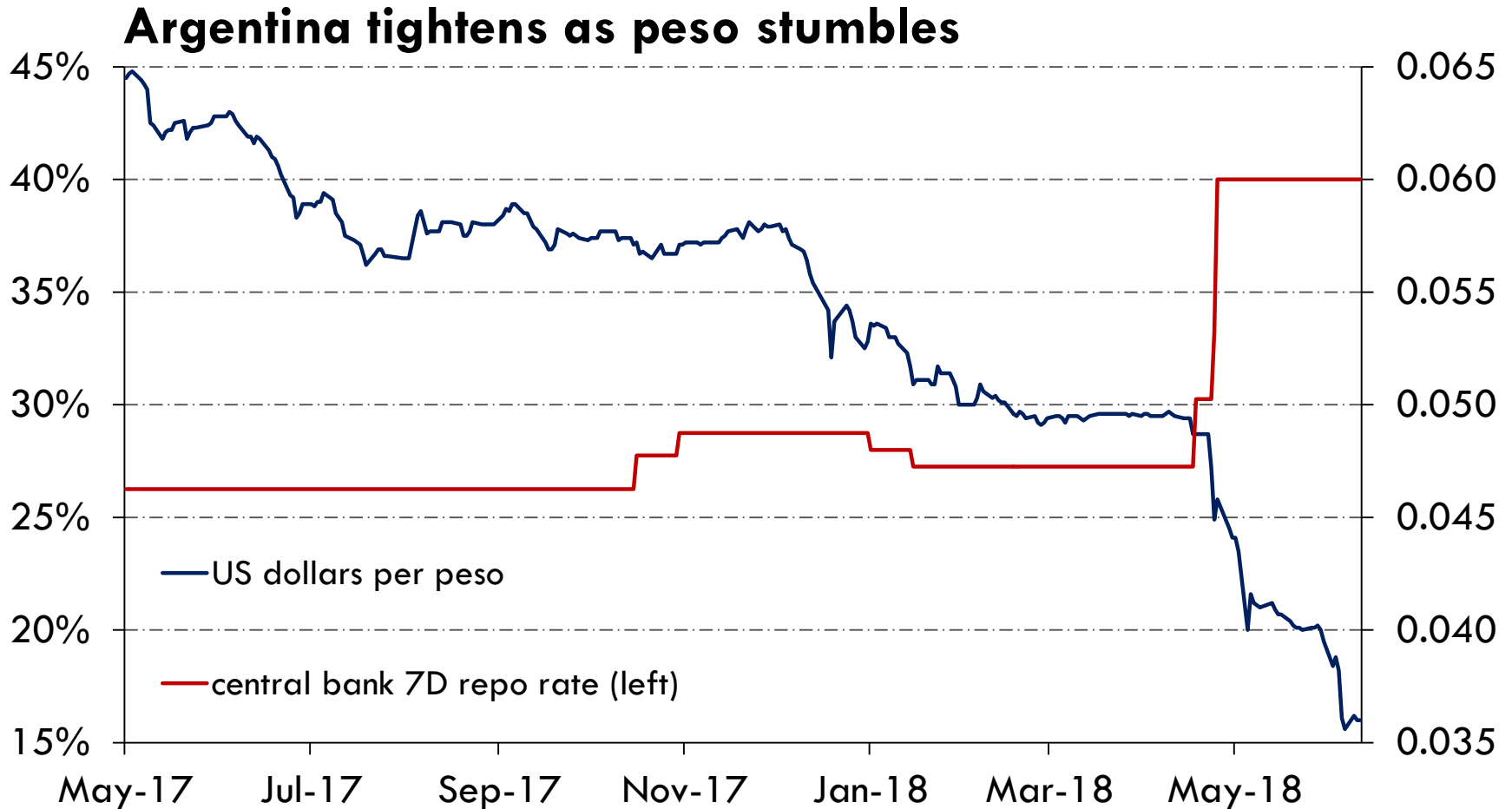
Brent crude in Turkish Lira

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Emerging market capital flight

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Stocks volatile

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Bottom line: Late-cycle dynamics

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- ❑ 3.5% growth; cools next year
- ❑ Wage growth rising, inflation low
- ❑ Fed controls expansion's length
- ❑ Productivity necessary to sustain expansion
- ❑ 1-2 more rate hikes this year
- ❑ Bonds rally as long as Fed is disciplined
- ❑ Watch for tighter credit in subprime, leveraged loans and foreign bank USD funding

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