

Date	Indicator	For	Estimate	Consensus*	Previous Period
23-March -2015	Chicago National Activity Index	FEB	NA	NA	0.13
23-March -2015	Existing Home Sales	FEB	4.92M	4.94M	4.82M
24-March -2015	Consumer Price Index- CPI	FEB	0.2%	0.2%	-0.7%
24-March-2015	CPI Ex. Food & Energy	FEB	0.1%	0.1%	0.2%
24-March-2015	FHFA Home Price Index MoM	JAN	0.6%	0.5%	0.8%
24-March -2015	New Home Sales	FEB	472K	475K	481K
24-March-2015	Richmond Fed Manufacturing Index	MAR	NA	2	0
25-March -2015	Durable Goods Orders	FEB	0.3%	0.5%	2.8%
25-March -2015	Durable Goods Orders Ex. Transportation	FEB	0.4%	0.5%	0.0%
26-March -2015	Initial Jobless Claims	03/21	297K	295K	291K
26-March -2015	Kansas City Fed Manufacturing Index	MAR	NA	NA	1
27-March-2015	GDP Annualized QoQ	Q4 T	2.4%	2.4%	2.2%
27-March -2015	GDP Price Index	Q4 T	0.1%	0.1%	0.1%
27-March -2015	U of Michigan Sentiment- Final	MAR	92.0	91.8	91.2

\*Consensus from Bloomberg

## FOMC Scales Back Rate Hike Expectations

The large gap between the Federal Open Market Committee's Fed funds target rate expectations and the market's own projections about the future path of the Fed's rate policy closed rapidly this week and it wasn't the market adjusting to the Fed, it was the Fed bringing its views more in-line with the market.

The gapping difference between the FOMC's December 'dot-plot' of where each of 17 FOMC market participants saw the Fed funds rate at the end of 2015, 2016, and 2017 and the market's view was never resolved. As recently as February, the FOMC median dot-plot for the end of 2015 was at 1.125%, while the Fed funds futures market's expected value for December 2015 was only 0.45%, a huge difference of 0.675 percentage points for a period that at the time was only 10 months away. By the end of 2017, the difference from the Fed's view on rates and the market's ballooned to over 2.0 percentage points. Such a wide and persistent difference in FOMC and market guidance on policy rates has never been seen before.

Clearly, something had to give. Either market rates needed to move much higher in a very short-period of

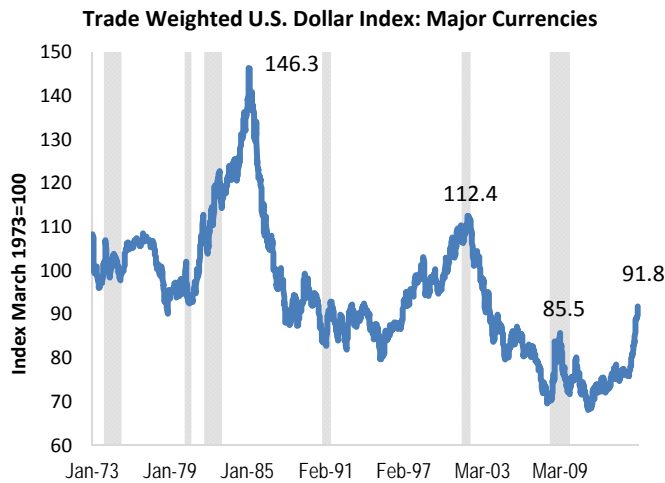
time, potentially upsetting a relatively sanguine economic outlook, or the FOMC would need to rethink the December 'dot-plot'. And re-think they did. While I expected some downward adjustment in the "dot-plot" projections, the extent of the downward revision was more than anticipated. I foresaw a 25-basis-point downward adjustment over the next three years, but what we received was a 50-basis-point-plus downward adjustment.

Today, there is much more agreement between the FOMC "dot-plot" and the futures market expectations on the Fed funds interest rates over the next three years – but not total alignment. The FOMC median expectation of the target rate at year-end is 0.625%, while the Fed funds futures market is still at 0.43% in December, a difference of 0.195%. By the end of 2017, the FOMC median sees the Fed funds rate at 3.125%, while the futures market expectation is still 1.4 percentage points below that level at 1.73%.

Implications: The FOMC blinked a bit, giving in to the market guidance on interest rates. Increasing concern about the rising dollar was evident in the March FOMC statement with the mention of weak export growth. The major trade weighted dollar index is now well above the levels seen during the height of the global financial crisis, and is now approaching 12 year highs. The trade

weighted dollar has risen another 8.0% since December when the FOMC laid out their ambitious rate hike expectations.

**The Rising Dollar's a Drag**

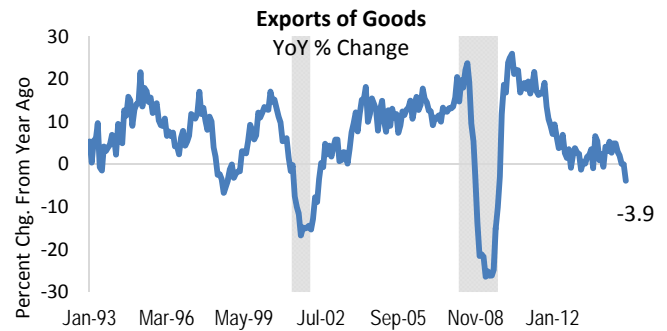


Source: Federal Reserve System

Already, U.S. goods exports are almost 4% lower than a year ago, and the drag on the U.S. trade balance is likely to be greater than the Fed envisioned back in December. A strong U.S. consumer only adds to the pressure on the trade balance as imports accelerate. The Q4 current account deficit widened to -\$113.5 billion from -\$98.9 billion in Q3 in part due to deterioration in the balance on goods.

With the lead-up to the March FOMC meeting, as currency traders became more concerned about imminent Fed rate hikes, the U.S. dollar soared. In less than a month, the dollar has gain nearly 8.0% against the euro. From a year ago, the dollar has appreciated about 25% against the euro. Now might be a good time to book a European vacation, but if I was a U.S. manufacturer trying to sell into the Eurozone right now, I would be sweating bullets.

**U.S. Goods Exports Take a Dive**

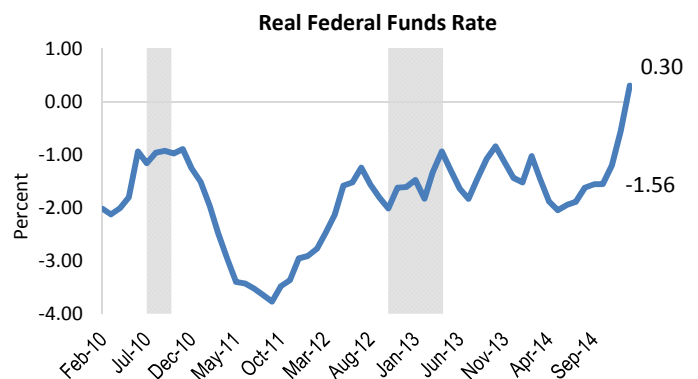


Source: Bureau of Economic Analysis, Census Bureau

It is harder for the Fed to raise interest rates in a world where the other major central banks are going in the other direction. According to Bloomberg, 24 global central banks have eased monetary policy in the first quarter of 2015. The global rate and currency divergence has only intensified with the launch of the ECB's QE program in March. German 10-year Bund yields slipped to just 0.185% yesterday with U.S. 10-year Treasury rates holding at 1.96%.

The FOMC statement noted that "inflation is anticipated to remain near its recent low level in the near-term...". With global oil prices yet to find a bottom, low inflation could remain longer than currently appreciated. Just in the last five days alone, WTI crude oil prices fell more than 6%. In fact, low inflation in the U.S. is already raising real interest rates in the United States without the Federal Reserve having to lift a finger. The real Fed funds rate has risen nearly 2.0 percentage points since October.

**Real Fed Funds Rates Already On The Rise**



Source: Federal Reserve System

While the first rate hike from the Fed could theoretically come in June, September is looking more likely now given the revised "dot-plot" guidance from the Fed. Beyond liftoff, rate hikes are expected to continue at a gradual pace- about half the pace seen in recent tightening cycles.

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## Major Economic Indicators

Economic Data	History				Forecast								Yr/Yr % chg or Annual Avg.			
	2014.1	2014.2	2014.3	2014.4	2015.1	2015.2	2015.3	2015.4	2016.1	2016.2	2016.3	2016.4	2013	2014	2015	2016
Real GDP*	-2.1	4.6	5.0	2.2	2.0	2.9	2.9	3.0	2.7	2.8	2.7	2.8	2.2	2.4	2.9	2.8
Personal Consumption Expenditures*	1.2	2.5	3.2	4.2	2.8	3.5	3.5	3.4	3.1	3.1	2.9	2.8	2.4	2.5	3.4	3.2
Non-residential Fixed Investment*	1.6	9.7	8.9	4.8	3.5	5.0	5.0	5.0	4.7	4.6	4.6	4.2	3.0	6.3	5.4	4.8
Private Housing Starts (000s units)	925	985	1,030	1,075	1,010	1,070	1,101	1,133	1,145	1,170	1,230	1,250	930	1,004	1,079	1,199
Vehicle Sales (mill. Units, annualized)	15.6	16.5	16.7	16.8	16.6	17.1	17.2	17.2	17.2	17.2	17.3	17.3	15.5	16.4	17.0	17.2
Industrial Production*	3.9	5.7	4.1	4.3	0.0	3.3	3.3	3.2	3.4	3.4	3.4	3.4	2.9	4.2	2.9	3.4
Nonfarm Payroll Employment (mil.)	137.8	138.6	139.4	140.2	141.1	141.9	142.7	143.6	144.4	145.2	146.0	146.7	136.4	139.0	142.3	145.6
Unemployment rate	6.7	6.2	6.1	5.7	5.5	5.3	5.2	5.1	5.0	5.0	4.9	4.9	7.4	6.2	5.3	5.0
Consumer Price Index* (percent)	2.1	2.4	1.2	-0.9	-3.0	1.7	1.9	1.9	1.9	1.9	2.0	2.1	1.5	1.6	0.1	1.9
"Core" CPI* (percent)	1.8	2.2	1.4	1.5	1.9	1.8	1.8	1.9	1.9	1.9	2.0	2.0	1.8	1.7	1.8	1.9
PPI (finished goods)* (percent)	4.1	3.5	0.4	-5.1	-11.5	0.3	1.0	1.1	1.3	1.3	1.4	1.4	1.2	1.3	0.3	1.8
Trade Weighted Dollar (Fed BOG, major)	76.9	76.4	77.5	82.2	89.0	89.5	90.4	90.7	91.0	91.8	92.5	92.4	76.1	78.3	89.9	91.9
Crude Oil Prices -WTI (\$ per barrel)	99	103	98	76	49	50	52	54	62	63	64	65	98	94	51	64

\*Quarterly Data Percent Change At Annual Rate; Annual Data Year-on-Year % Chg, or Annual Average.

Financial Data	History				Forecast								Annual Average			
	2014.1	2014.2	2014.3	2014.4	2015.1	2015.2	2015.3	2015.4	2016.1	2016.2	2016.3	2016.4	2013	2014	2015	2016
S & P 500	1,835	1,900	1,976	2,009									1,644			
Dow Jones Industrial Average	16,177	16,604	16,954	17,345									15,010			
Federal Funds Rate (effective)	0.07	0.09	0.09	0.08	0.12	0.13	0.21	0.46	0.88	1.13	1.38	1.71	0.11	0.08	0.23	1.27
Treasury-3 Month Bills (yield)	0.05	0.03	0.03	0.02	0.04	0.05	0.11	0.36	0.78	1.03	1.28	1.61	0.06	0.03	0.14	1.18
Treasury-2 Year Notes (yield)	0.37	0.42	0.52	0.52	0.59	0.65	0.88	1.08	1.55	1.85	2.10	2.43	0.31	0.45	0.80	1.98
Treasury-5 Year Notes (yield)	1.60	1.66	1.70	1.57	1.46	1.53	1.72	2.00	2.44	2.64	2.89	3.02	1.17	1.63	1.68	2.75
Treasury-10 Year Notes (yield)	2.77	2.62	2.50	2.27	1.98	2.17	2.35	2.51	2.71	2.84	2.95	3.18	2.35	2.54	2.25	2.92
Treasury-30 Year Notes (yield)	3.68	3.44	3.27	2.97	2.55	2.75	2.90	3.05	3.16	3.27	3.40	3.53	3.44	3.34	2.81	3.34
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.33	3.58	4.00	4.25	4.50	4.83	3.25	3.25	3.35	4.40
Libor 3-Mo. U.S. Dollar	0.26	0.25	0.24	0.23	0.26	0.27	0.33	0.58	1.00	1.25	1.50	1.83	0.28	0.25	0.36	1.40
Mortgage-30 Year (yield)	4.36	4.23	4.14	4.03	3.71	3.92	4.16	4.30	4.52	4.65	4.76	4.99	3.98	4.19	4.02	4.73
BAA Corporate (yield)	5.12	4.82	4.74	4.74	4.52	4.62	4.70	4.87	5.05	5.20	5.32	5.55	5.10	4.86	4.68	5.28

Source: Bank of the West Economics, Bloomberg, Federal Reserve