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ECONOMIC TALKING POINTS

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FLASH NOTE:

Fed Remains on Hold For One Reason – Greece. End of Story!

The only reason the Fed chose not to raise interest rates by a miniscule quarter point at today's FOMC meeting was because of Greece.

This speck of an economy --- China churns out an economy the size of Greece every week and a half! --- is now holding world financial markets hostage as the country edges closer to default and an inglorious exit from the Eurozone.

Simply put, the Fed couldn't comfortably pull the interest rate trigger until it got past the "potential" global financial fallout of a Greek default.

Yet true to form, not a word about Greece was mentioned in the FOMC statement. Instead, we were given some upbeat comments on the US recovery:

"…economic activity has been expanding moderately.."

"…underutilization of labor resources diminished…"

"…housing sector has shown some improvement…"

"…Committee expects inflation to rise gradually toward 2 percent over the medium term as the labor market improves."

Make no mistake, had it not been for Greece, the Fed would have raised rates 25 basis points at this meeting and the US economy would easily have been able to withstand it.

While the FOMC's latest projection of real GDP growth for this year was reduced to a range of 1.8% to 2% (from 2.3% to 2.7% last March), that change could not have been the justification to stay pat on monetary policy. This downward revision in growth was due to the GDP contraction in Q1, and virtually every member of the Committee attributed that decline to transitory factors. And they were proven right. The economy has since gathered more momentum, so much so that we revised up our expectations for 2Q growth to 3.1%, from 2.9%. Secondly, the Fed's own projections show inflation moving closer to their 2% target this year and next. In other words, if Janet Yellen and her colleagues at the central bank were truly "data dependant" in determining monetary policy (as they say in every one of their speeches), this was the month they should have begun to normalize rates.

But it appears the public urging by IMF chief Christine Lagarde asking the Fed to delay any rate increase (as well as similar if more discreet pleadings by the ECB) have had a significant impact on the Fed decision at this meeting.

So here's the concern now. By choosing to keep fed funds rate near zero for several more months despite evidence the US economy has firmly bounced back from the 1Q contraction, and with inflation pressures awakening, the risk of a price bubble in bonds grows exponentially. Should that bubble burst in the coming weeks and cause US bond yields to shoot up, economic growth would grind to a halt fairly quickly.

It appears Fed is prepared to take that chance for the rest of the summer. We view this decision based less on economic science and more on the throw of a dice.

Key Economic Forecasts

- Actual
- Forecast

United States

	I 2014	II 2014	III 2014	IV 2014	I 2015	II 2015	III 2015	IV 2015	I 2016	II 2016	III 2016	IV 2016
Real Gross Domestic Product (GDP):												
%	-2.1	4.6	5.0	2.2	-0.7	3.1	4.2	3.2	2.3	3.5	3.2	2.8
Personal Consumption Expenditures:												
PCE	1.2	2.5	3.2	4.4	1.8	3.2	3.4	2.8	2.7	3.6	3.2	3.3
Inflation, end of period, year-over-year:												
CPI %	1.5	2.1	1.7	0.8	-0.1	0.6	1.0	1.3	2.0	2.3	2.3	2.5
Unemployment Rate (end of period):												
%	6.7	6.1	5.9	5.6	5.5	5.3	5.3	5.1	5.0	4.9	4.8	4.7
Non-farm Payrolls, monthly avg. thousand:												
	189	267	237	324	195	255	270	275	235	245	250	250
Treasury 10-yr Note Yield % (end of period)												
	2.72	2.52	2.51	2.17	1.93	2.60	2.72	2.80	3.05	3.25	3.75	4.00
Federal funds rate % (end of period)												
	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.25	1.75	2.00

GDP Growth - Global Economy

Country	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
US	1.8	-0.3	-2.8	2.5	1.6	2.3	2.2	2.4	2.7	3.1
Eurozone	2.6	0.6	-4.1	1.7	1.4	-0.6	-0.4	0.9	1.7	1.9
United Kingdom	3.1	0.6	-5.2	1.7	0.7	0.3	1.8	2.6	2.8	3.0
Japan	2.1	-0.7	-5.4	4.6	-0.4	1.6	1.5	0.0	1.2	1.9
Canada	2.7	0.7	-2.8	3.2	2.5	1.7	2.0	2.5	2.3	2.9
India	9.1	8.8	6.3	8.4	8.6	6.7	4.9	7.5	6.5	7.0
China	14.2	9.6	9.2	10.5	9.3	7.8	7.7	7.4	6.7	6.4
Brazil	5.7	5.1	-0.3	7.5	2.7	0.9	2.3	-0.1	0.5	2.2
Mexico	3.3	1.4	-4.7	5.2	4.0	3.9	1.4	1.9	3.4	4.0
Australia	4.0	2.3	1.2	2.8	2.6	3.6	2.4	2.5	2.7	3.0
Russia	8.1	5.6	-7.9	4.0	4.3	3.4	1.3	0.6	-3.9	1.0
World	5.4	1.6	-1.9	4.2	3.0	2.6	2.9	3.2	3.9	5.4

Key Currency Values

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014	End 2015	End 2016
USD/Yen	91	93	81	77	87	105	119	125	110
Euro/USD	1.40	1.43	1.34	1.29	1.32	1.37	1.21	1.18	1.26

Oil (Brent spot) & Gasoline (Average retail unleaded, $)

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014	End 2015	End 2016
Crude oil per barrel	46	78	95	107	111	111	58	73	84
Gasoline	1.61	2.57	3.00	3.27	3.30	3.32	2.26	2.45	2.70

Major Stock Indexes

	End 2012	End 2013	End 2014	% Change '14	End 2015	% Change '15
DJIA	13,104	16,577	17,823	7.5	19,300	8.3
S&P 500	1,426	1,848	2,059	11.4	2,199	6.8
NASDAQ	3,019	4,177	4,736	13.4	5,157	9.1
RUSSELL 2000	849	1,164	1,205	3.5	1,277	6.0