

After the Rate Increase, What Then?

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What the FOMC Did At Dec Meeting

- The Fed made the first step towards normalization of policy by moving the target federal funds range up to 25-50 bp
- The question now is where do we go from here and how fast.
- But before we get to that question let us briefly review what the Fed said and what the “incoming data” showed in terms of three key components of the economy-
 - GDP growth
 - Employment and
 - Inflation

What the Fed Said

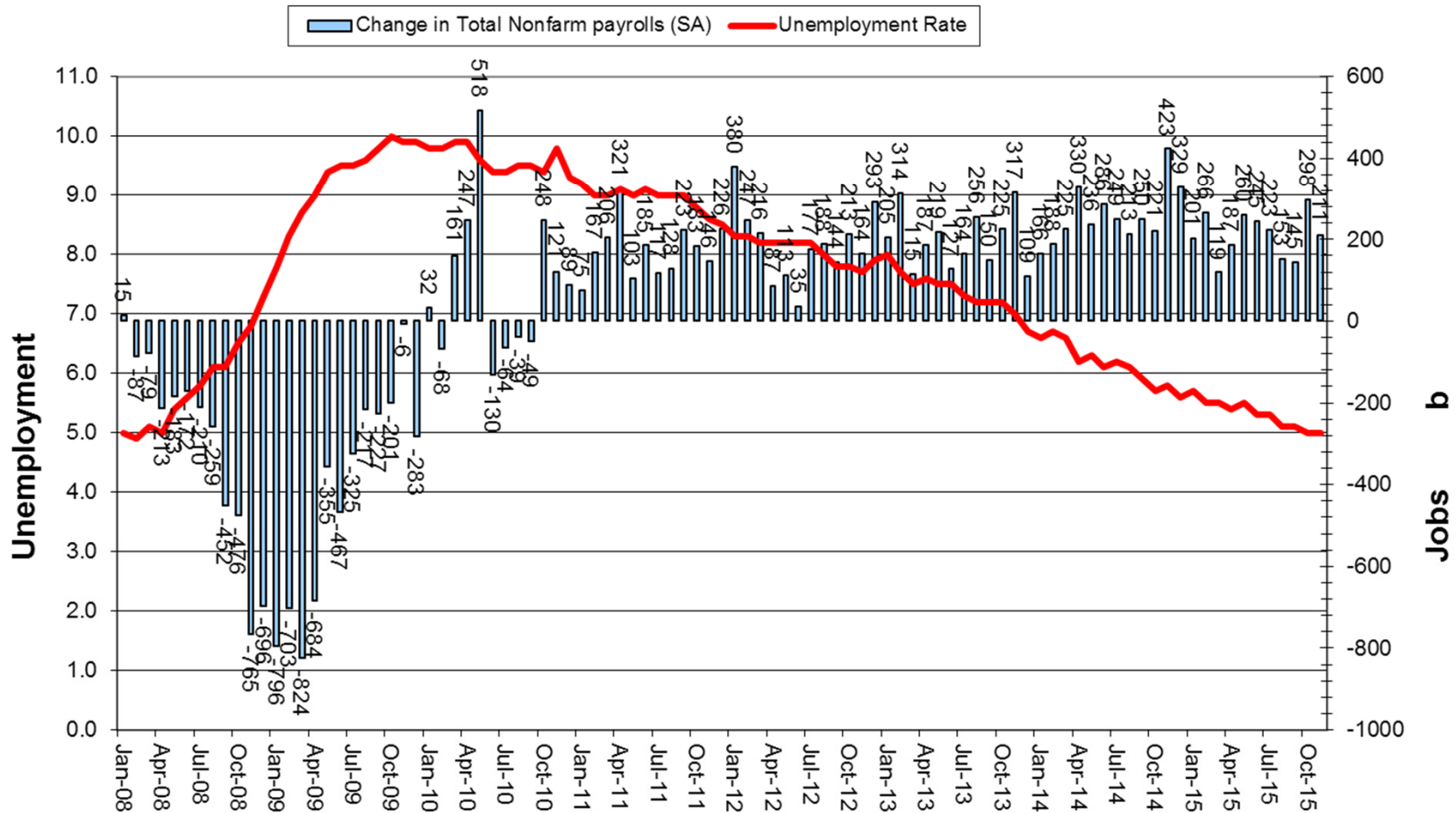
- Economy is expanding at moderate pace
- Considerable improvement in labor markets
- Committee is reasonably confident that inflation will move to its 2% objective over medium term
- Policy remains accommodative
- In terms of timing and size of future moves
 - Will assess **REALIZED** and expected economic conditions including labor markets, inflation and financial and international developments
 - Expects that conditions will evolve to warrant only **GRADUAL** increases and will remain low for some time

What Did the FOMC See in Terms of Employment, Inflation & GDP?

- Unemployment fell more rapidly than expected and now is at 5.0% in Nov- clearly below the FOMC's initial trigger point of 6.5%
 - During the first 11 months of 2015, the economy created an average of 210 K jobs per month and 2.3 million as compared with 253K on average for 2014 and 2.8 million jobs
 - That is about the average for an economy growing at a bit less than 4% per year or slightly more
- Inflation is running considerably below target (.2% v 2%) and it is questionable how stable inflation expectations are.
- GDP growth has been erratic this year
 - .6 Q1, 3.9 Q2 and 2.1 Q3
 - Economy can be almost flat and still show about 2.6% growth for 2015.

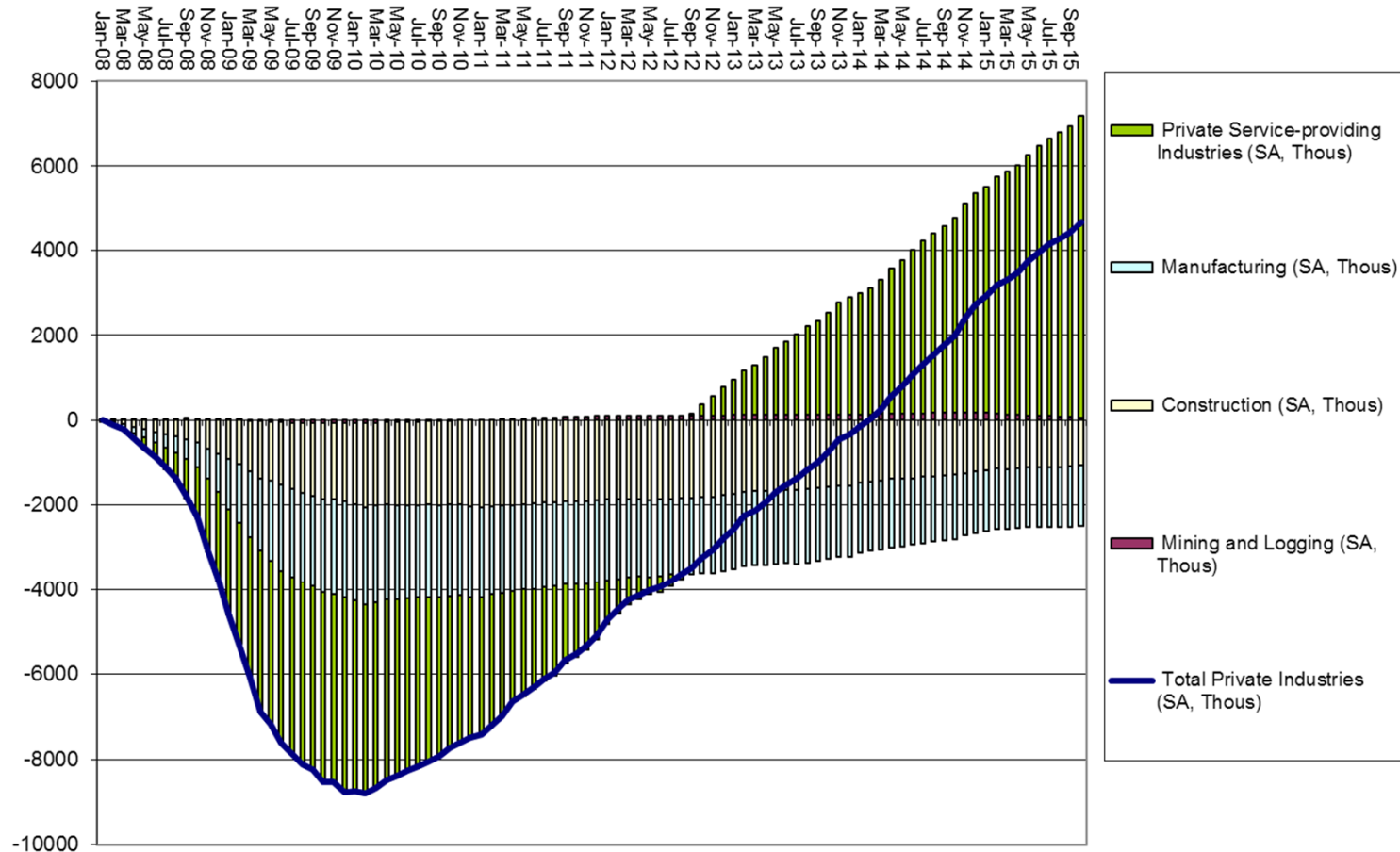
298K Jobs Were Created in Oct and 211K in Nov.
 Average 210K per month Over First 11 Months Compared to 253K
 in 2014

Total Monthly Job Change (Thousands) and Unemployment Rate 2008-2015



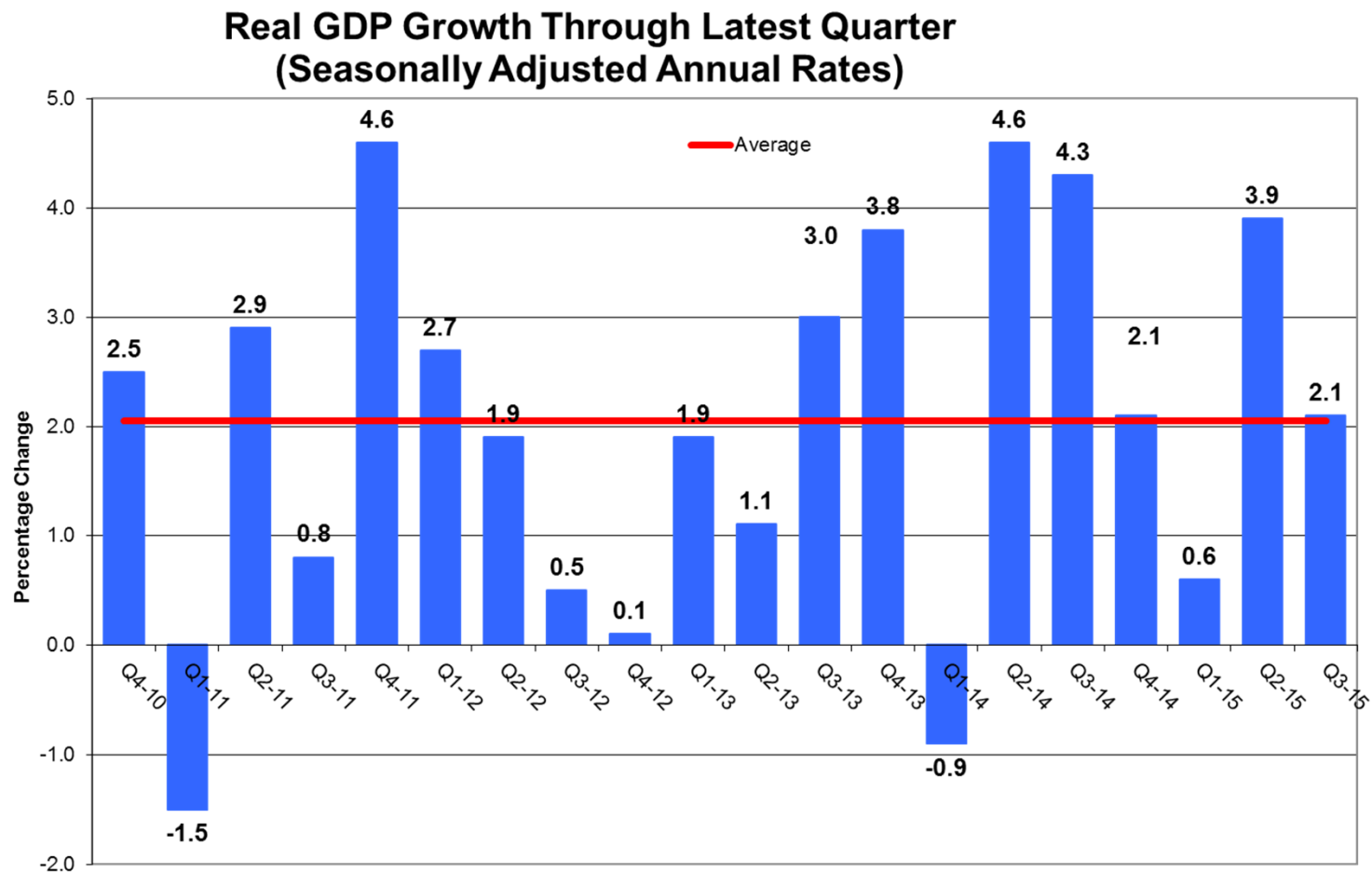
Most of the Jobs Created Were in Services

Cumulative Change in Private Sector Employment and Contributions to Change

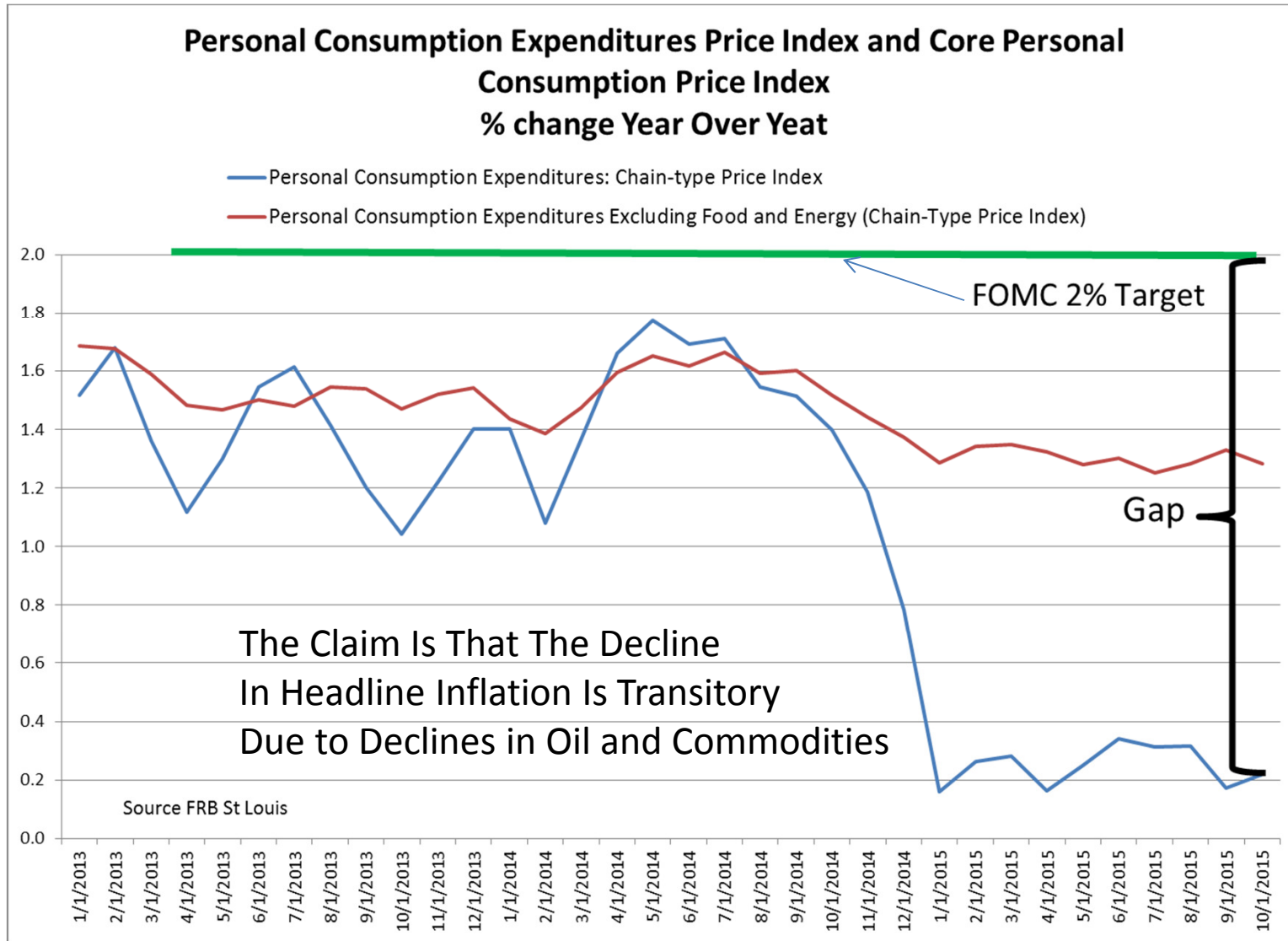


Labor Markets, Inflation, and GDP Are the Key

- Q3 GDP Was Also Supportive



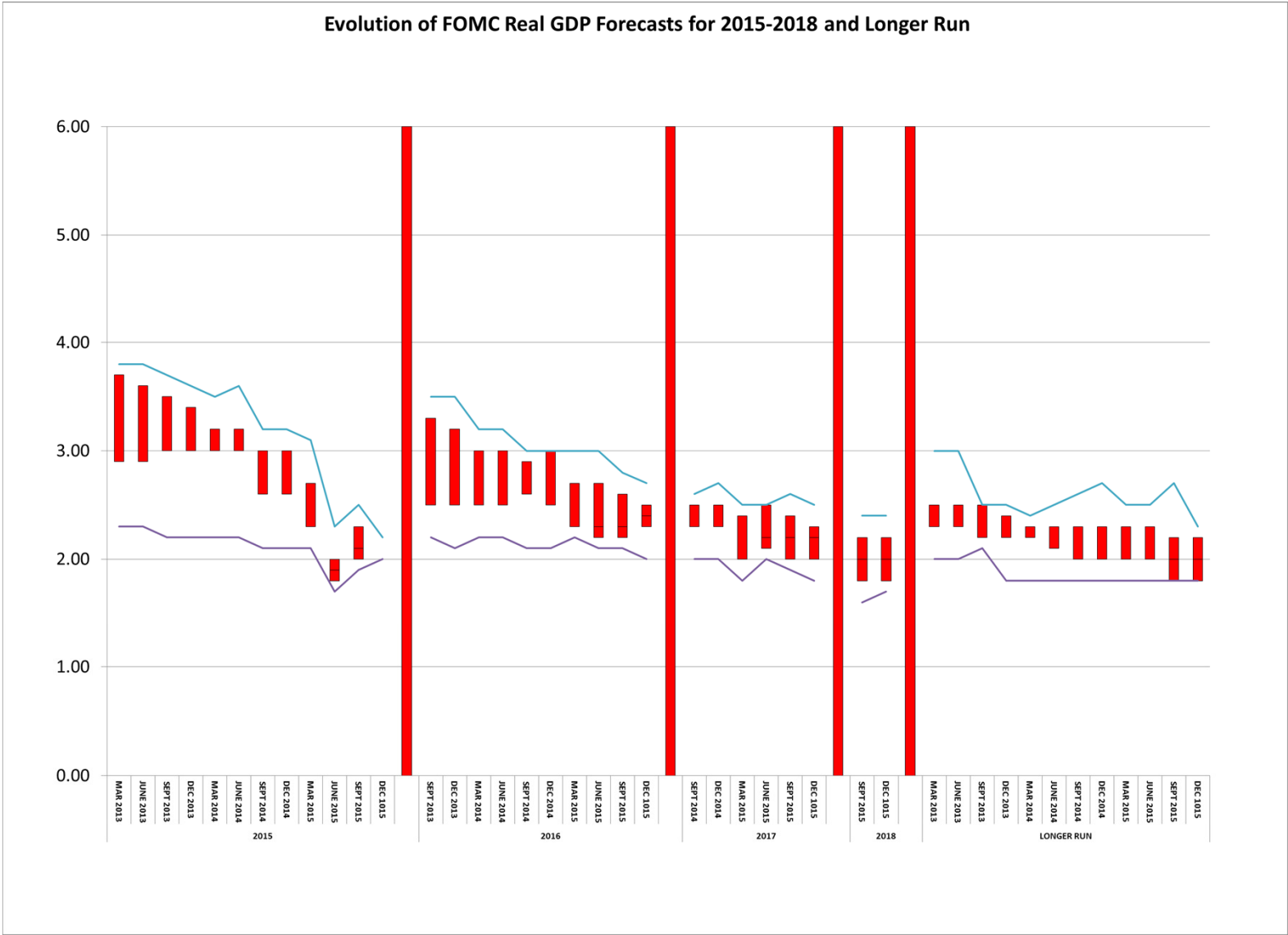
Inflation? Where Is It?



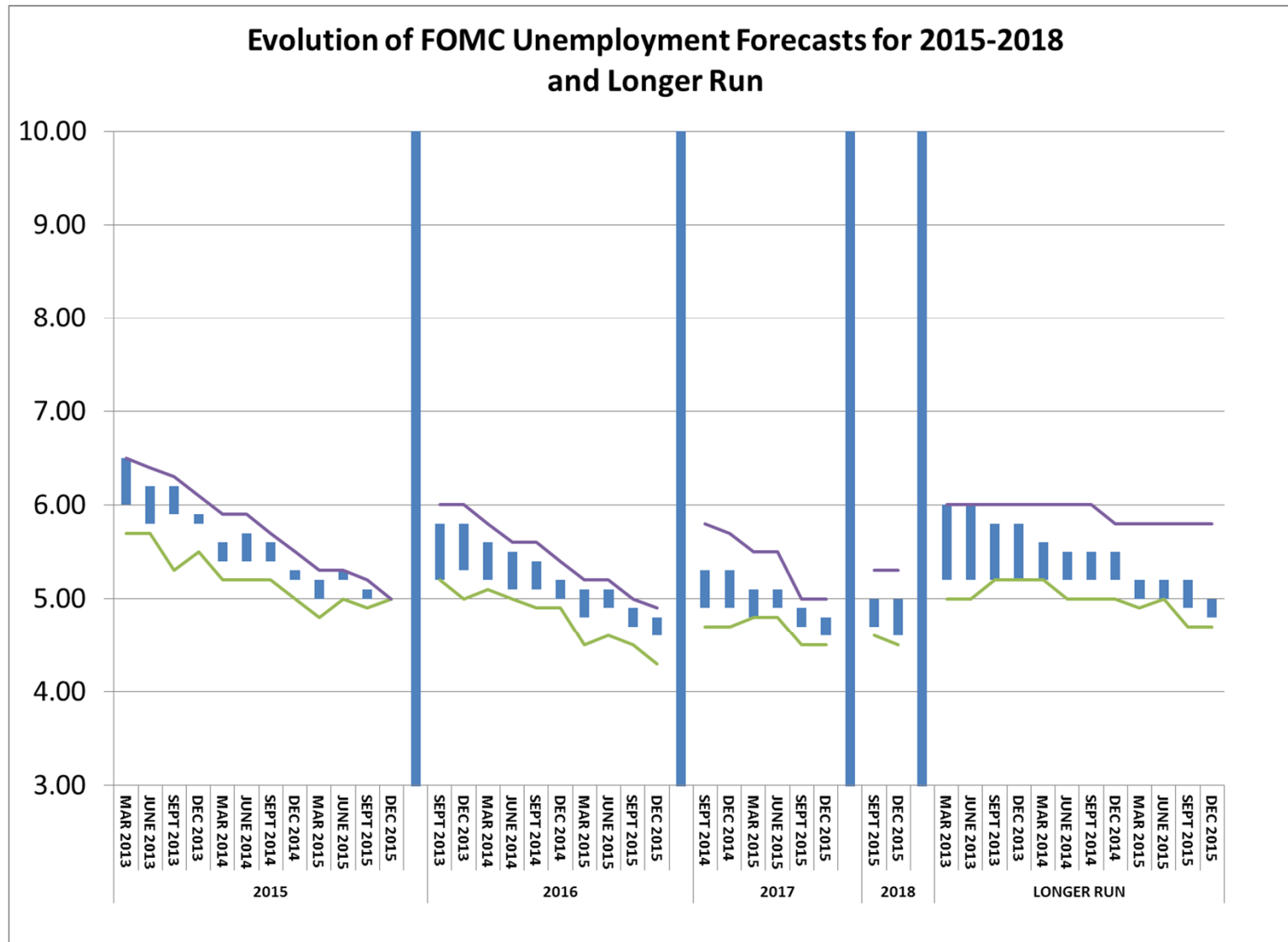
What Does The FOMC See?

- The next few slides will review the FOMC's forecasts released at the meeting showing the path forward.
- I would propose to look carefully at the dot charts to try to show what the likely path might be.

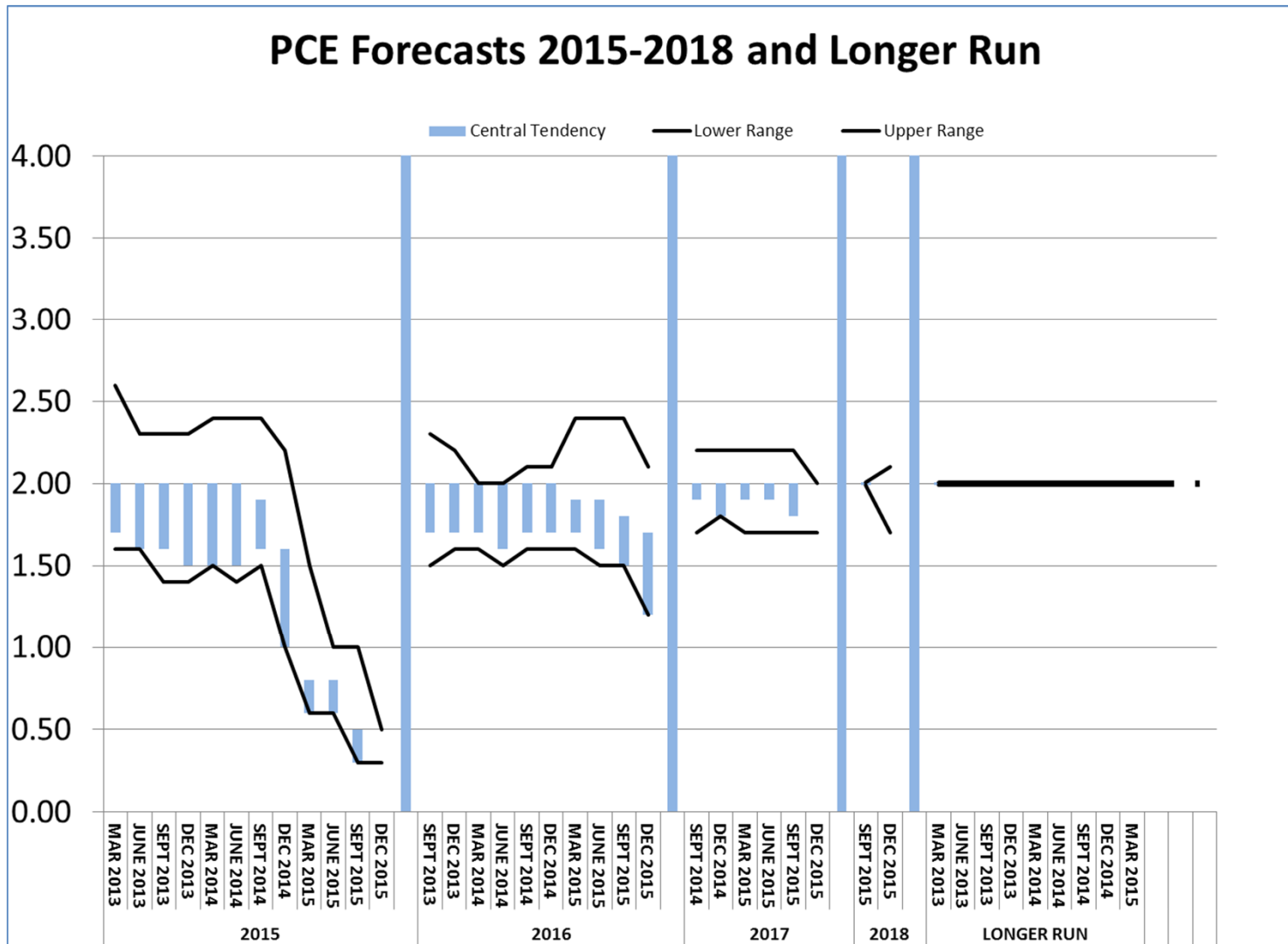
Current Growth Path is Greater Than FOMC Forecast for 2015 in September



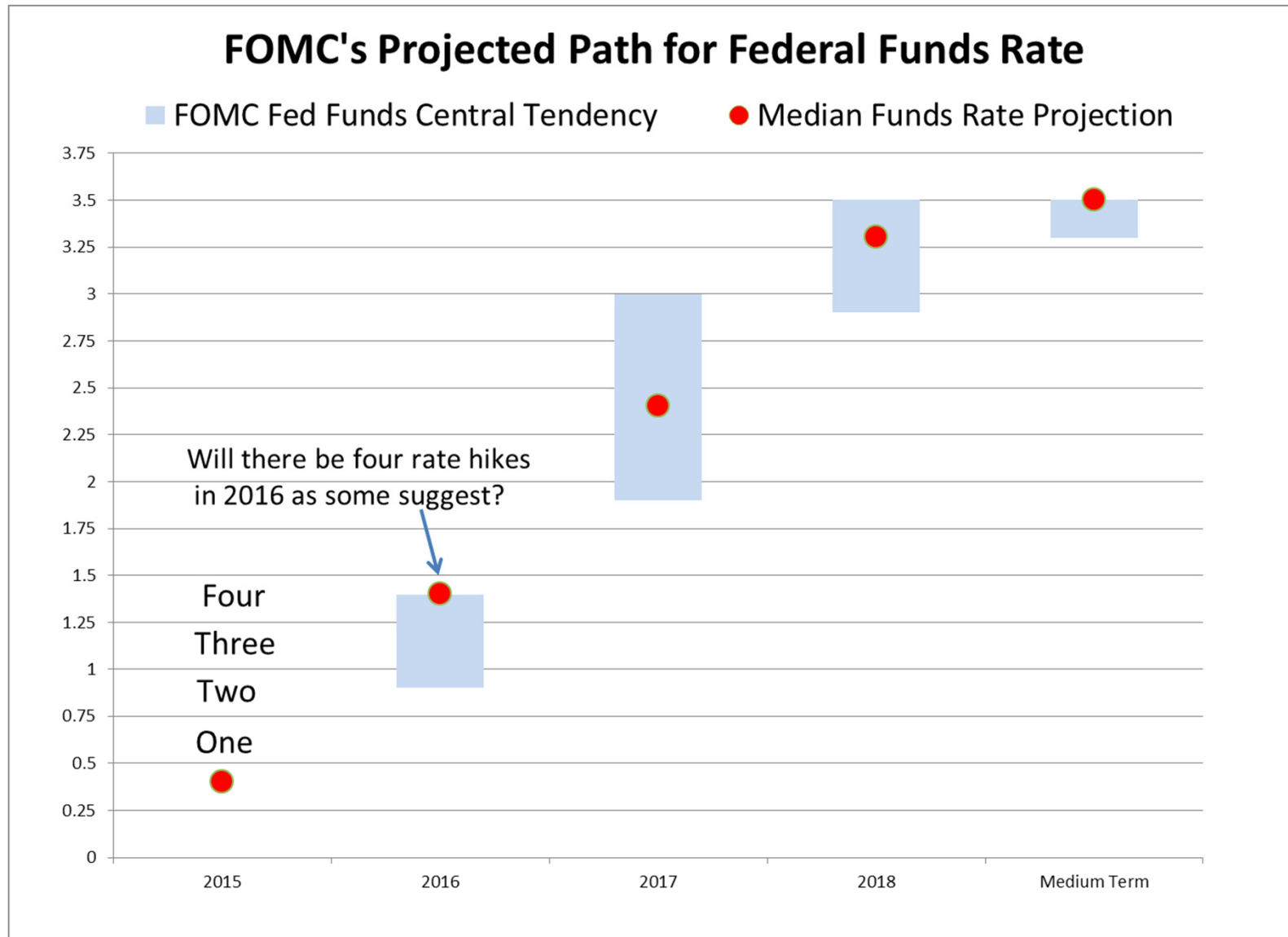
Committee Expects Continued Labor Market Improvement



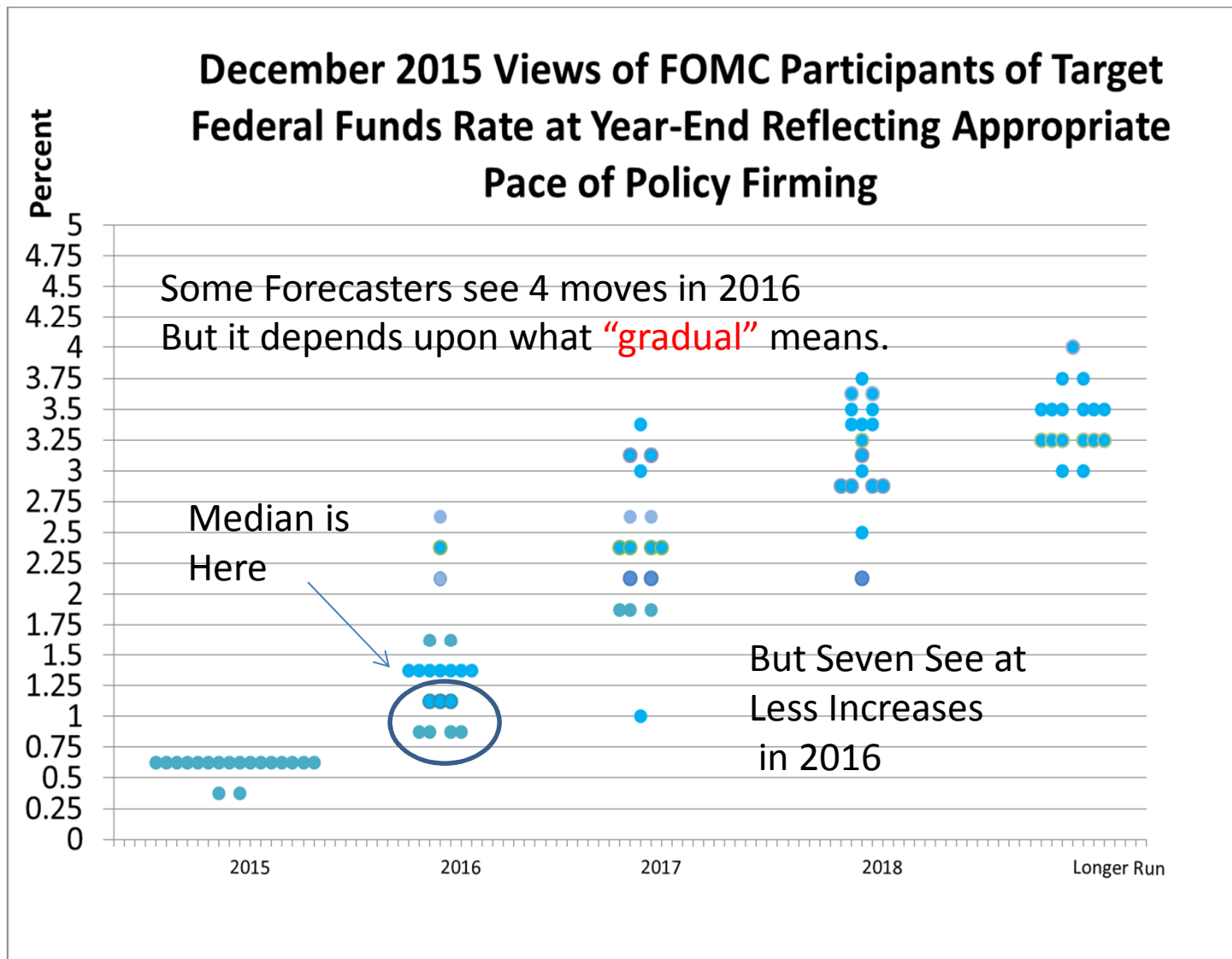
PCE Is Expected to Be Below Target Through 2017



Will The FOMC Move 4 Times in 2016?



FOMC Participant Views of Target Funds Rate Path – The Key is 2016



Why Not Four Moves?

- The Key Lies in What Important Data Will Be Available at What FOMC Meeting
- Monitoring GDP Is Important Because It Tells the Committee Something About Downside Risks
 - Remember the Committee Views Itself as Engage in Risk Management
 - Did the rate move weaken growth or not?
- Information on GDP Occurs With a Lag So This Combined with the FOMC's Promise to Move Gradually May Tell US When and How Many Rate Moves Will Occur in 2016, Given the Dots

When Will the FOMC Have New Info on GDP?

For the Jan FOMC Committee will have no new info on GDP from that available in Dec.

In March, the FOMC will have Q4 GDP, but those data will have been generated before policy was changed so if weak then the committee will be faced with the problem of reversing course or.....

No new GDP info for April meeting

By June, the FOMC will have two looks at Q1 and how the economy and markets are responding. This is the first meeting where a second rate hike could occur

No new GDP info will be available in July so no possibility of a further rate hike then, even if none in June.

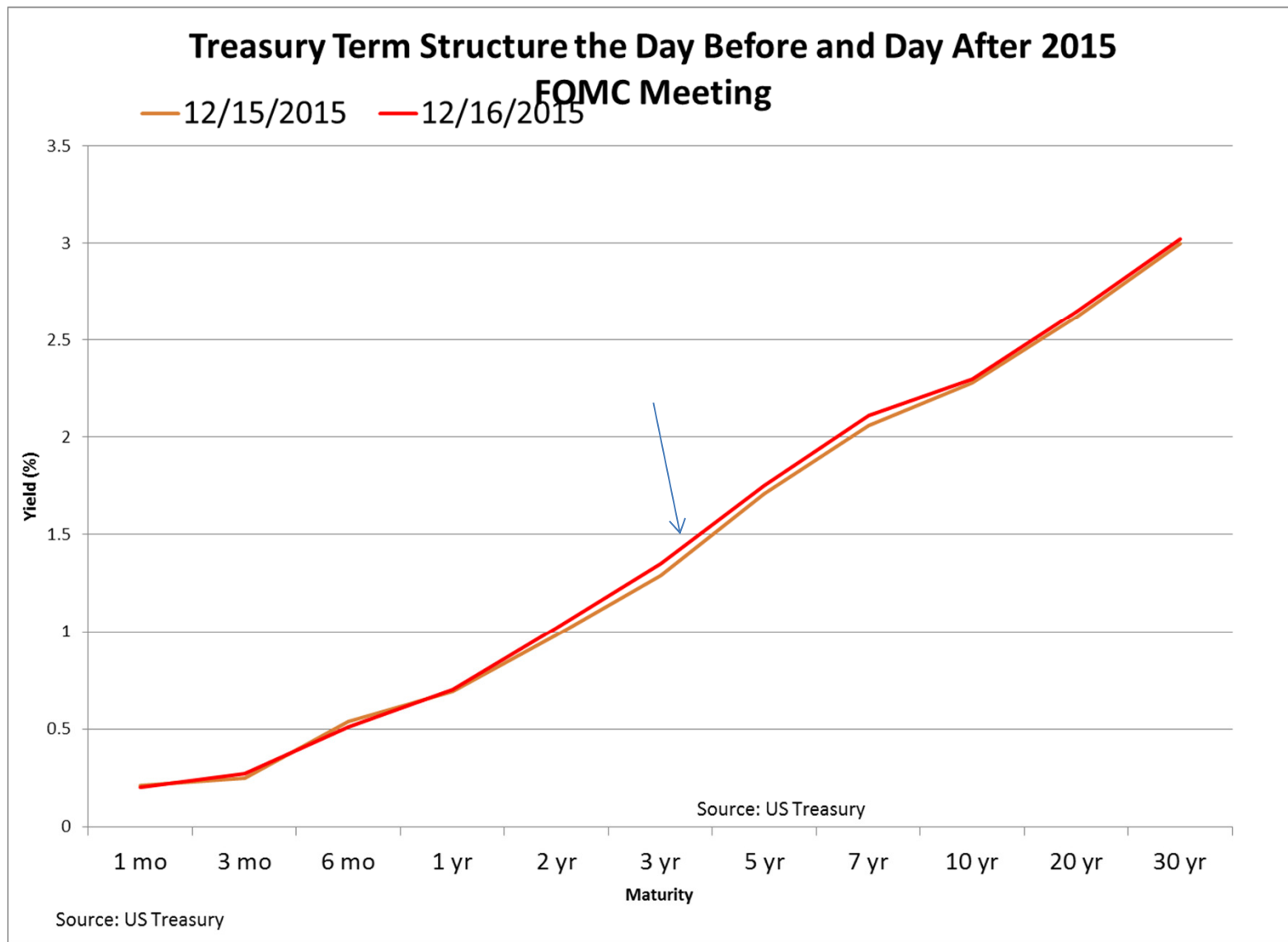
In Sept two releases of Q2 GDP will be available. If no move in June and good numbers for Q2 then the first move could happen in Sept.

Nov is the next likely candidate for a move since the final Q2 GDP will be available and first look at Q3

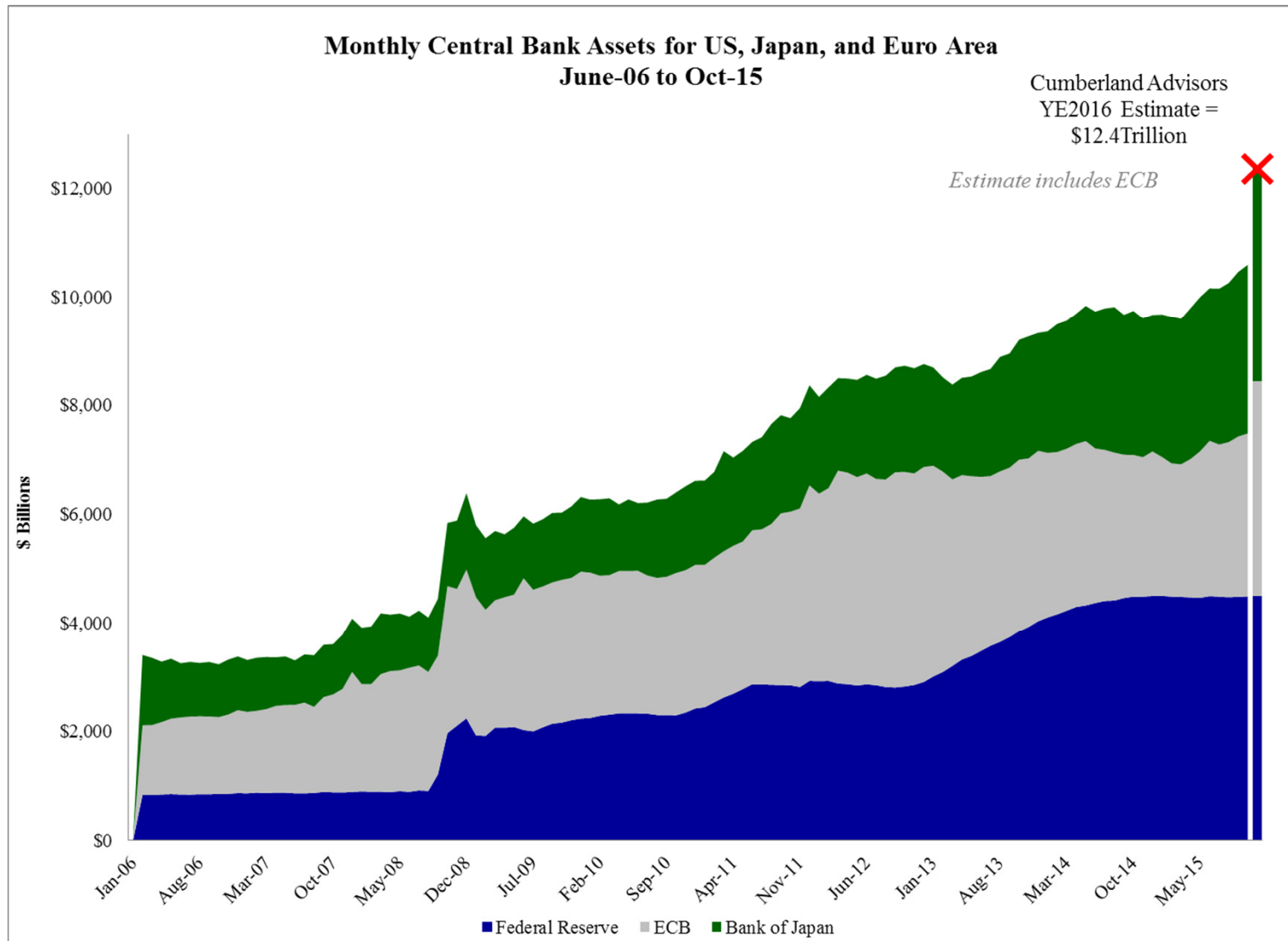
Little or no chance for a Dec move since no really new info on GDP will be available

| GDP Information Available to FOMC at Meeting Time | | | |
|----------------------------------------------------------|--|----------------------|---------------------------|
| FOMC 2016 Meeting Dates | | Release Dates | GDP Estimate |
| | | 21-Jan | 3rd Q 2015 |
| Jan 26-27 | | | |
| | | 29-Jan | 4th Q 2015 1st est |
| | | 26-Feb | 4th Q 2015 2nd est |
| March 15-16 | | | |
| | | 25-Mar | 4th Q 2015 3rd est |
| April 26-27 | | | |
| | | 28-Apr | Q1 2016 1st est |
| | | 22-May | Q1 2016 2nd est |
| June 14-15 | | | |
| | | 28-Jun | Q1 2016 3rd est |
| July 26-27 | | | |
| | | 29-Jul | Q2 2016 1st est |
| | | 26-Aug | Q2 2016 2nd est |
| Sept 20-21 | | | |
| | | 29-Sep | Q2 2016 3rd est |
| | | 28-Oct | Q3 2016 1st est |
| Nov 1-2 | | | |
| | | 29-Nov | Q3 2016 2nd est |
| Dec 13-14 | | | |
| | | 22-Dec | Q3 2016 3rd est |

Where are Interest Rates Today by Comparison? Term Structure Was Largely Unaffected Except for a Slight Movement in the Belly of the Curve



Markets Are Flooded With Liquidity



Will Funds Flood Into the U. S.?

G7 Government Bond Yields

| Country | 2-year Yields | 10-year Yields |
|-------------------------|---------------|----------------|
| As of November 20, 2015 | | |
| USA | 0.905 | 2.259 |
| Canada | 0.611 | 1.617 |
| UK | 0.606 | 1.872 |
| France | -0.317 | 0.815 |
| Germany | -0.396 | 0.478 |
| Italy | -0.009 | 1.493 |
| Japan | -0.030 | 0.314 |
| Swiss | -1.148 | -0.363 |

Source: Bloomberg

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Bottom Line

- There is a case for a more gradual set of rate hikes than some suggest
 - Speeches will help
- Interest rates are likely to move up on the short end but flatten and perhaps decline on the long end
 - There is a flood of liquidity world wide
 - Interest rates are unattractive outside the U.S.
 - Negative rates in key countries will create profitable carry trade
 - Exchange rate moves will accelerate that trend

Disclosure

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