



Close to Fed Liftoff, Despite Mixed Signals

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Fed Determined to “Normalize”

- Deflation is a global threat
- 20 central banks have eased this year
- Short rates negative in 5 of 20 countries on *Bloomberg* World Bond page.
- Fed prepping market for rate hikes

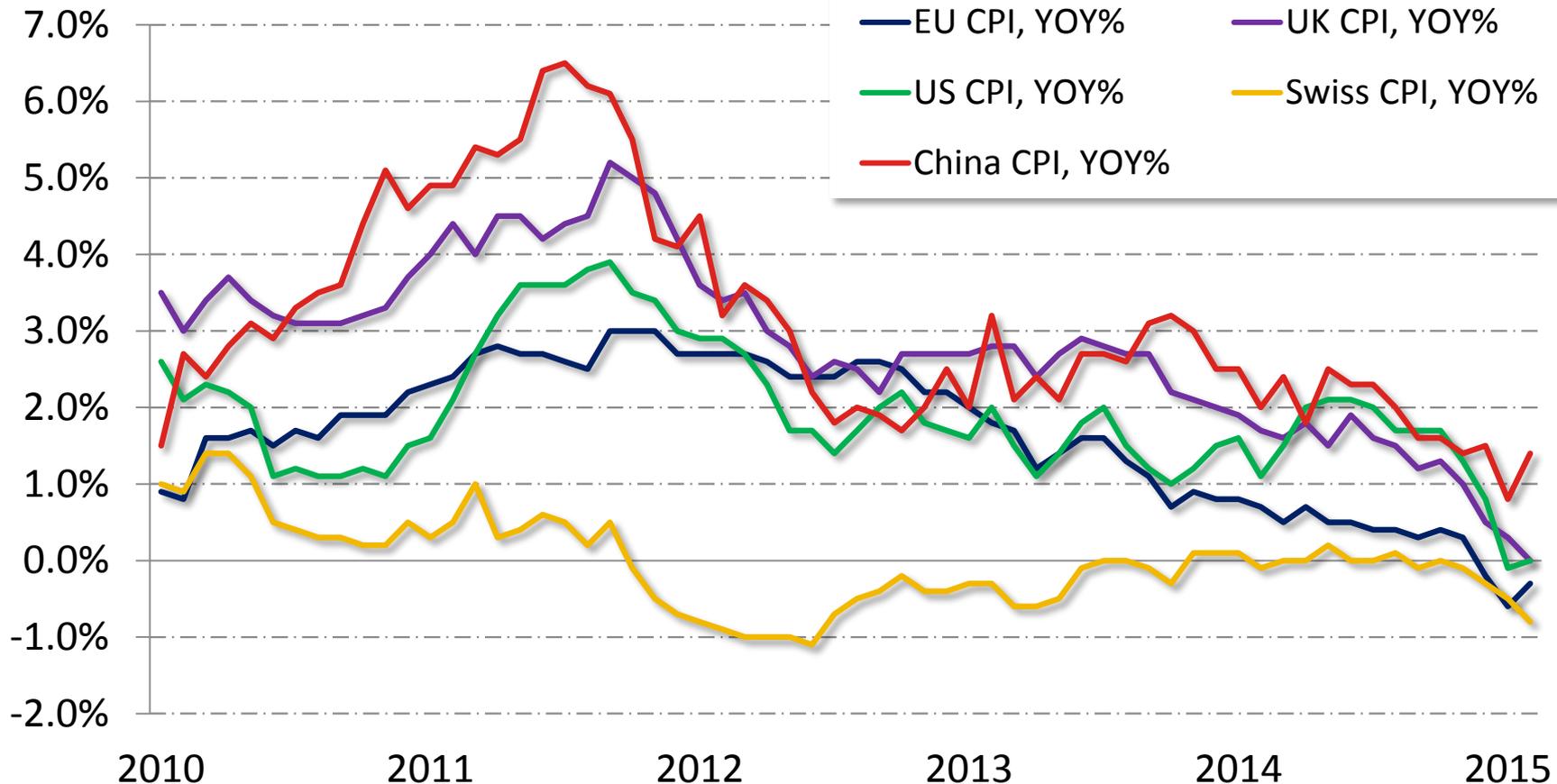
A Low Rate, Low Inflation World



Houston, TX, 2014

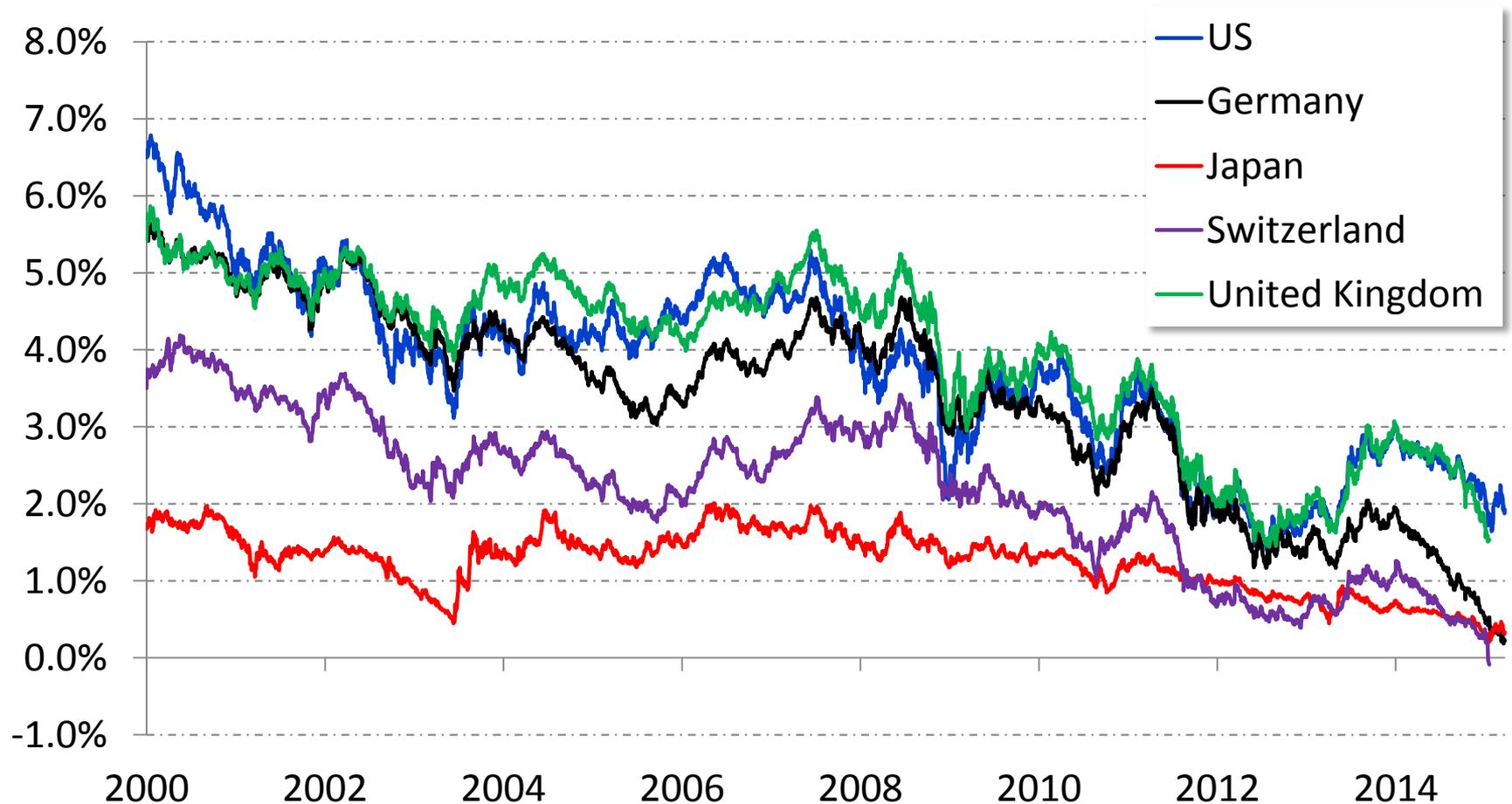


Growing Global Deflationary Pressure



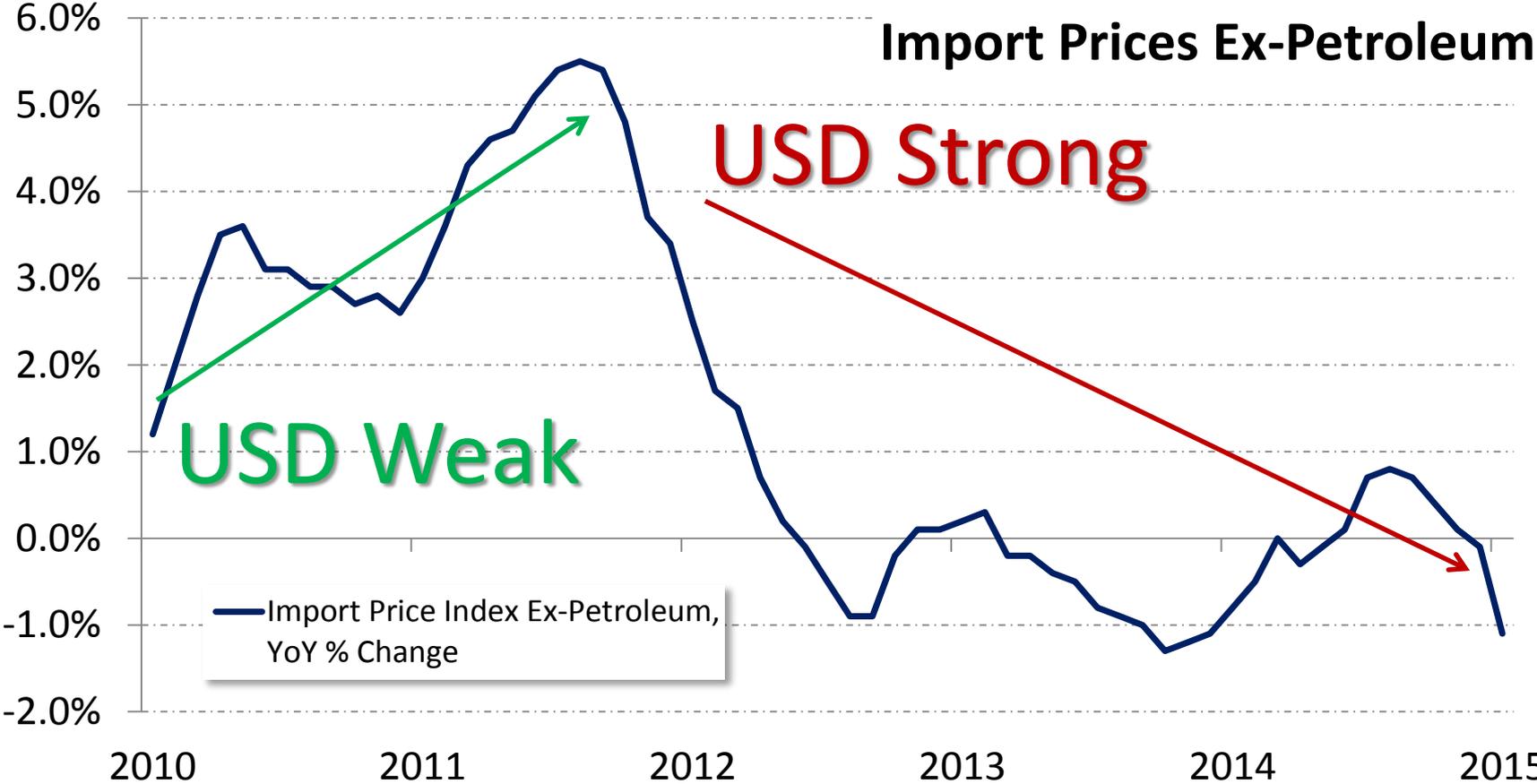
Source: Federal Statistics Office of Switzerland, National Bureau of Statistics of China, UK Office for National Statistics, Bureau of Labor Statistics, and Eurostat

Global Yields Pulling US Yield Down



Source: Bloomberg

Non-Energy Import Prices Falling



Source: Bureau of Labor Statistics

Economy Will Strengthen Despite Trouble in the Oil Patch



Regular	183.9
Plus	193.9
V-Power ^o	203.9
ATM	

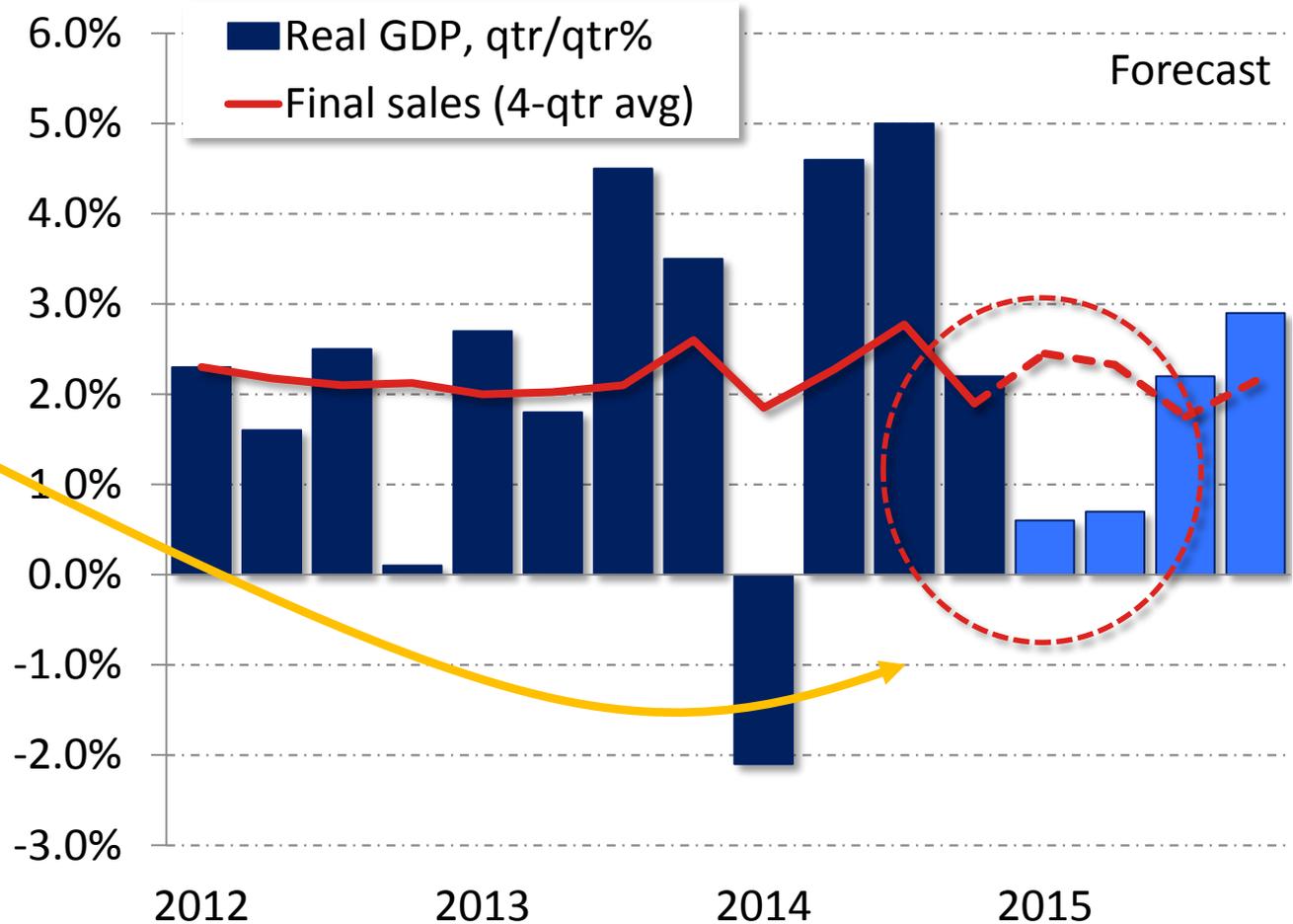


GDP Dips, then Rebounds

**Oil price drop
primary GDP
influence until
liftoff.**

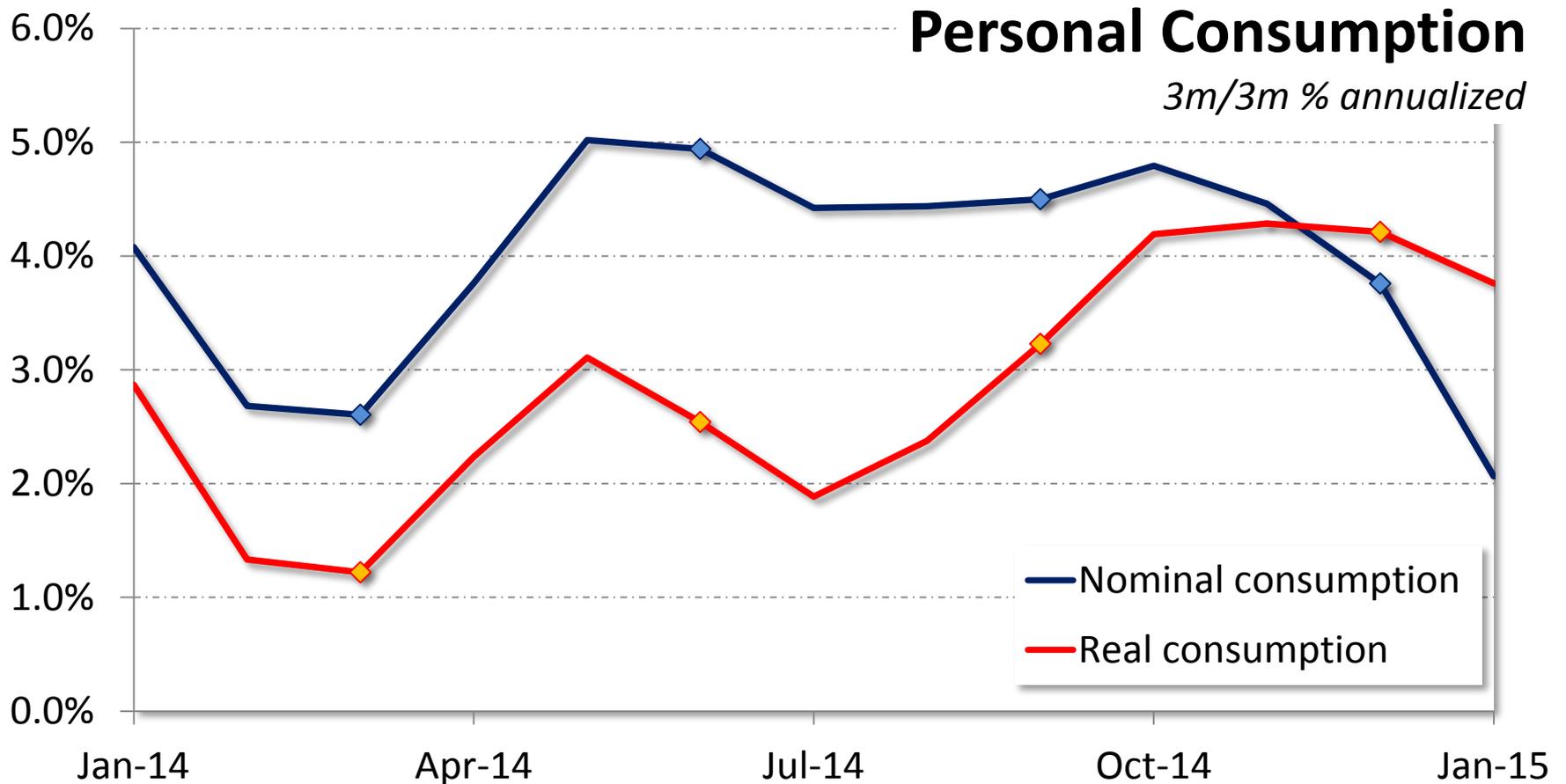
**Investment minus
plays out in
Q4-14 - Q2-15.**

**Consumer plus
bigger than
investment
minus, slow to
manifest.**



Source: Bureau of Economic Analysis

Oil Price Drop Already Lifting Spending



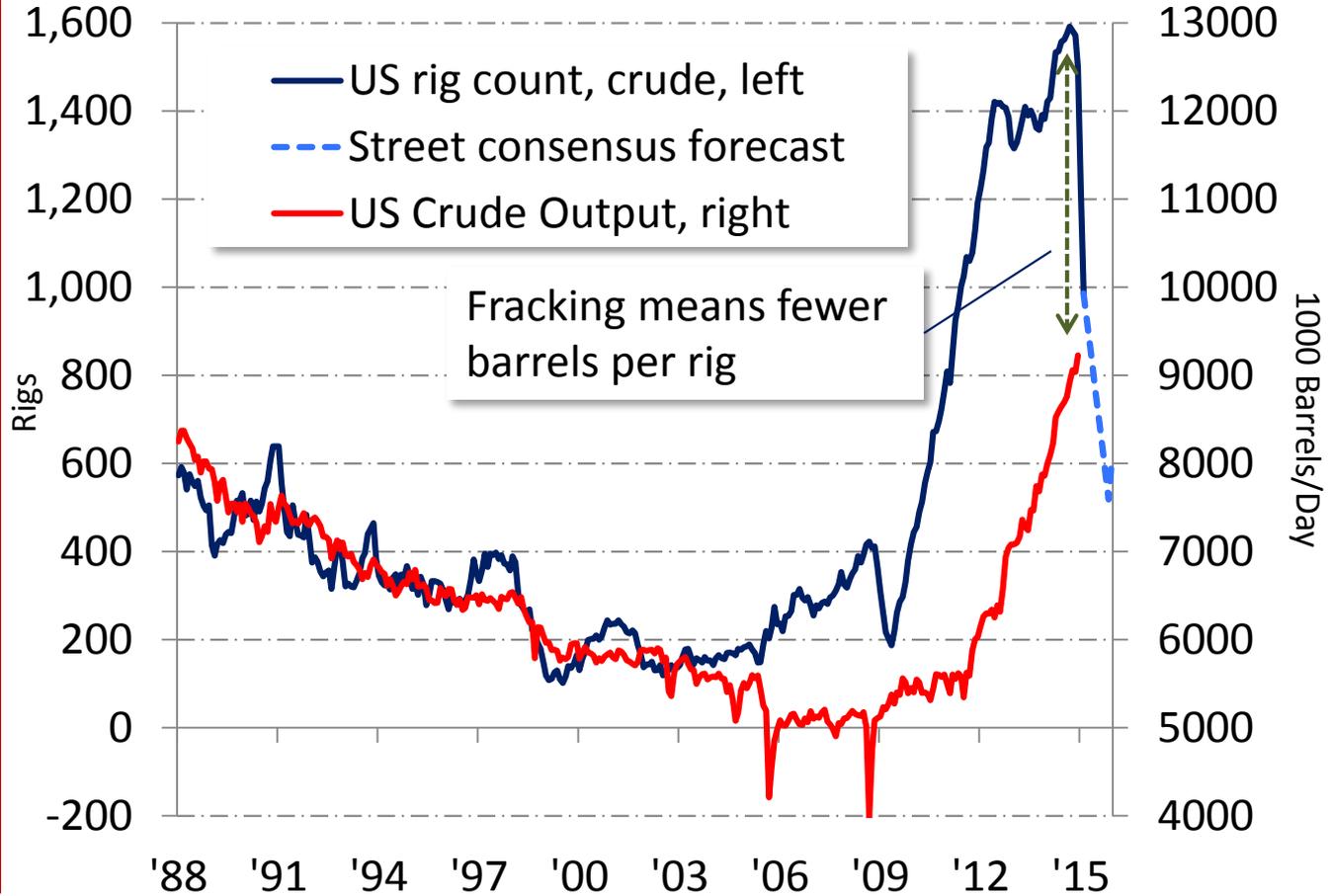
Source: Bureau of Economic Analysis

Rig Count and Oil Output

Rig count plunging. Likely to drop more than 50%

\$20bn drop in capex cuts 1.2%-1.5% in Q1-15.

Output rising despite rig count drop, keeping price under pressure.



Source: Baker Hughes Inc. & U.S. DOE

Oil Inventories Breaking Records



Source: U.S. Department of Energy

Inflation Expectations Near 2011 Low



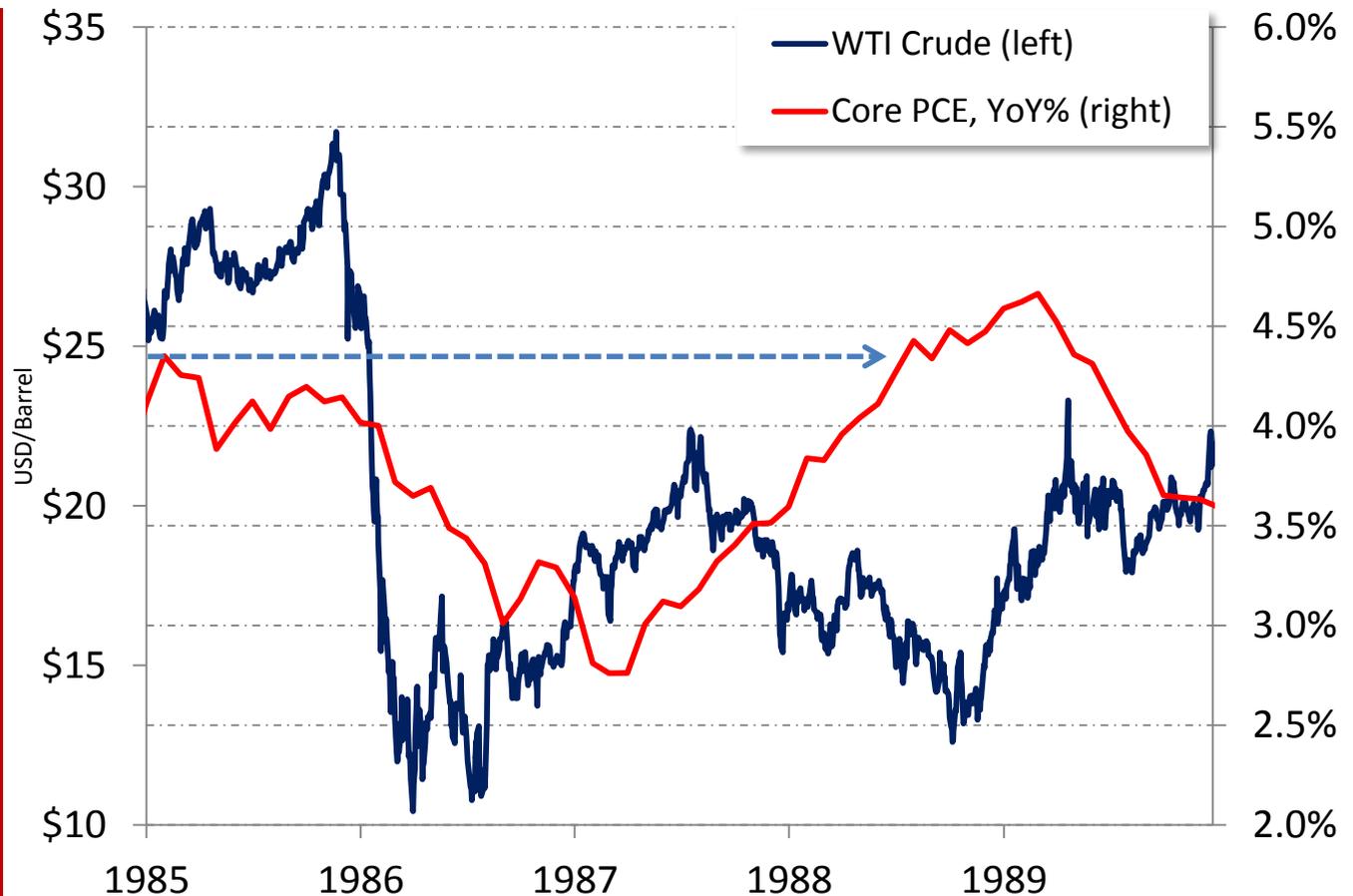
Source: Bloomberg

Oil Price Drop = 3-Yrs of Low Core Inflation

Substantial core inflation impact in every big, sustained oil price decline.

BOTH headline and core effect lasts years.

Inflation likely to rebound in late 2017.



Source: Bloomberg & Bureau of Economic Analysis

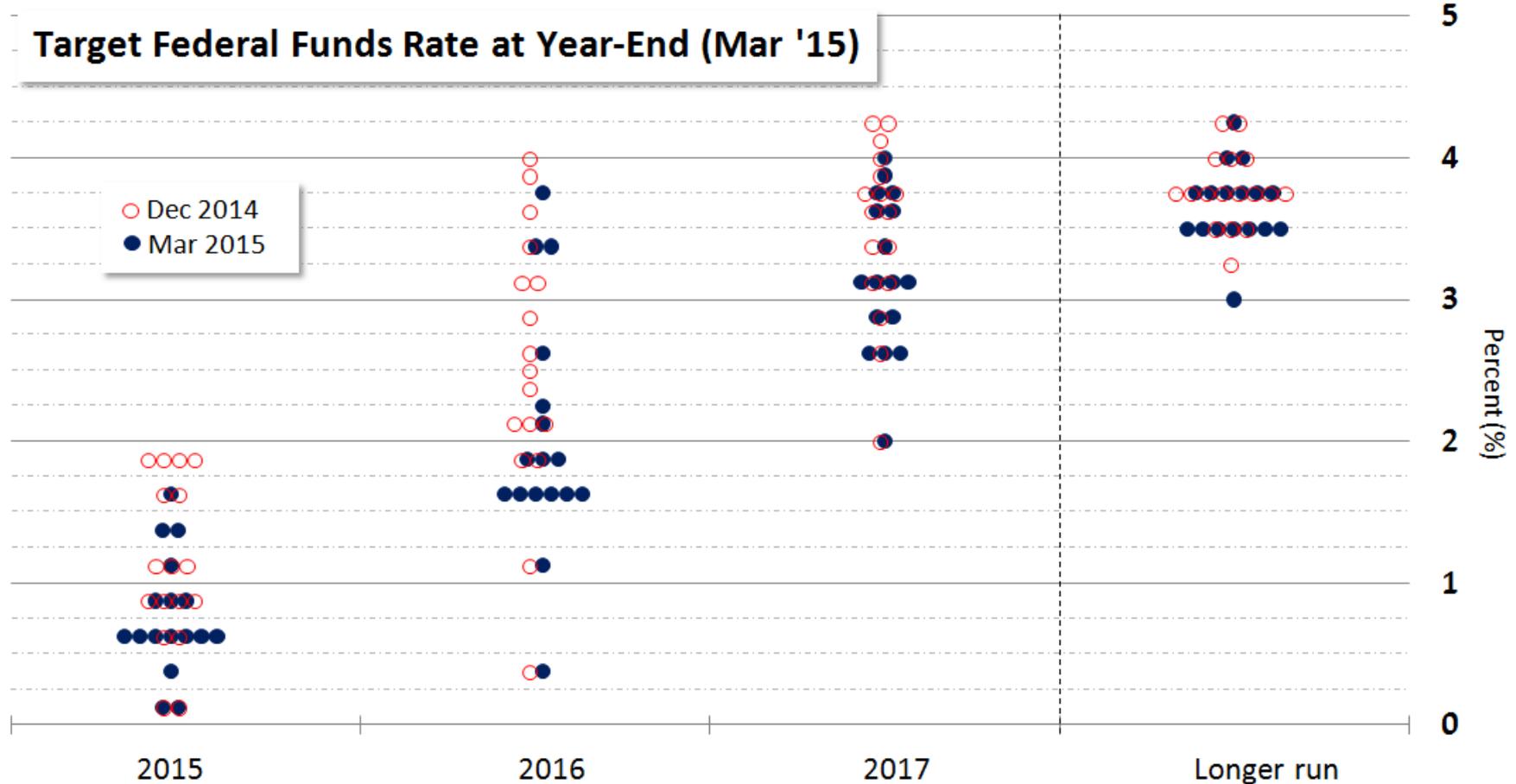
Fed focused on domestic recovery



~~UNEMPLOYED~~



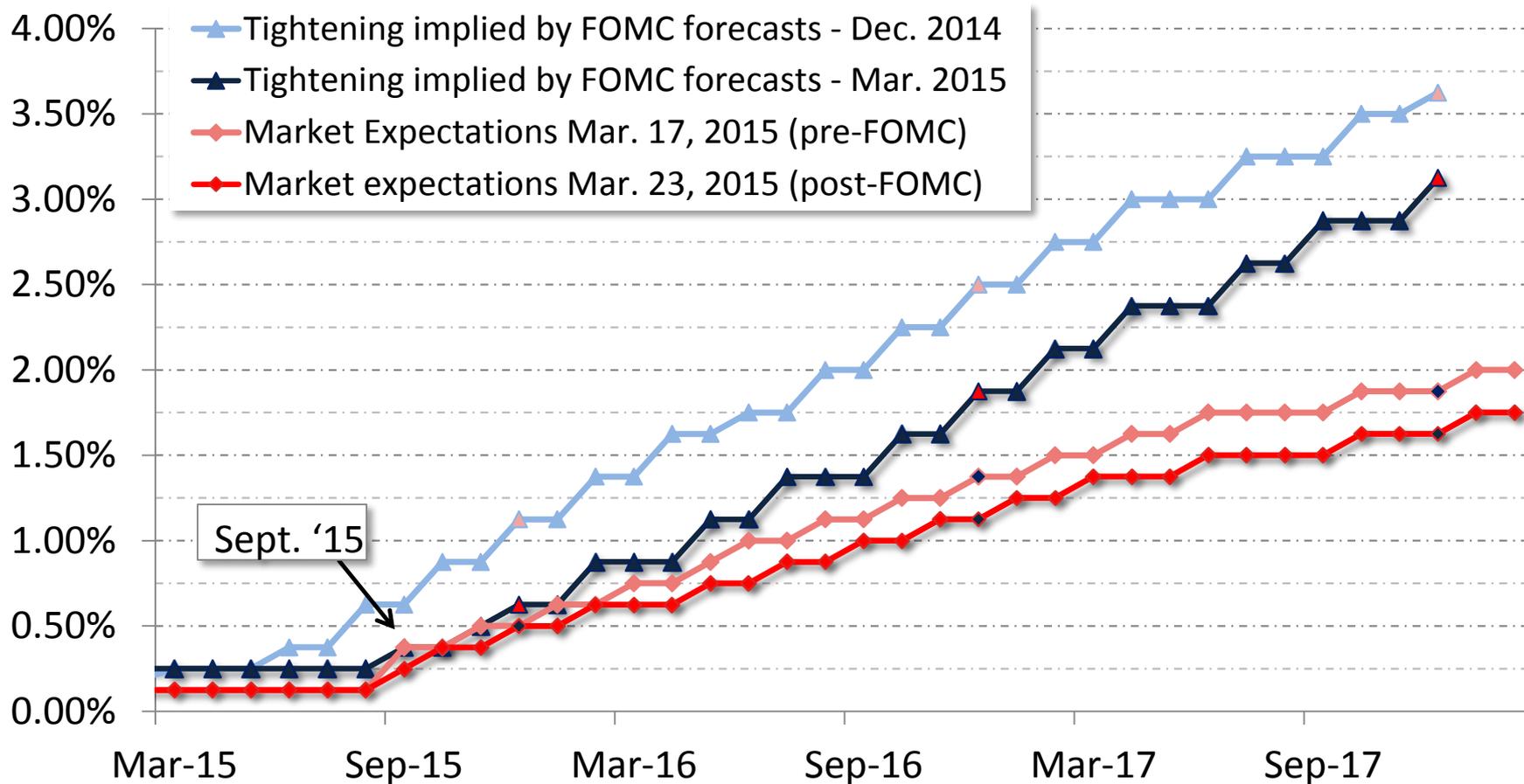
Dots Tumbled in March



Source: Federal Reserve, March 2015

Note: Each blue dot represent the expectations of one FOMC member. The median in 2015 is now 0.625% . In 2016, it is 1.875%. In 2017, it is 3.125%

Fed's Rate Call Moves Closer to Market's



Source: Federal Reserve, Bloomberg

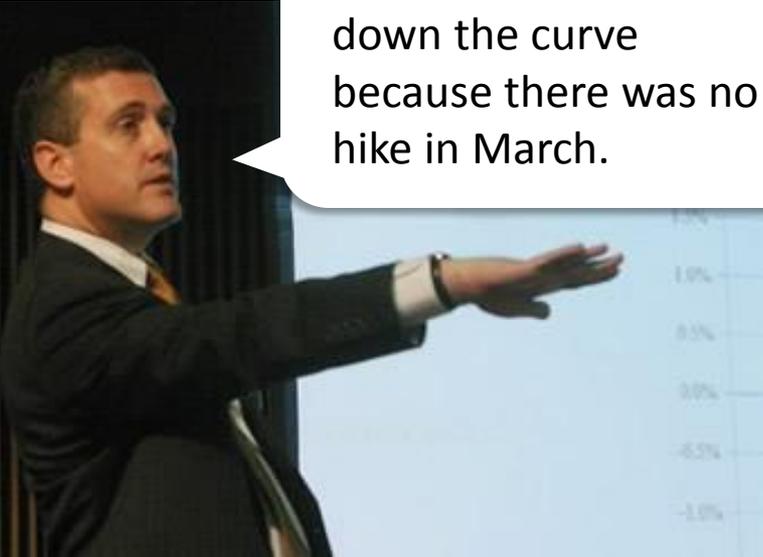
Communication, or Confusion?



A smooth path upward in the federal funds rate will almost certainly not be realized.



June is a viable option for rate increases.

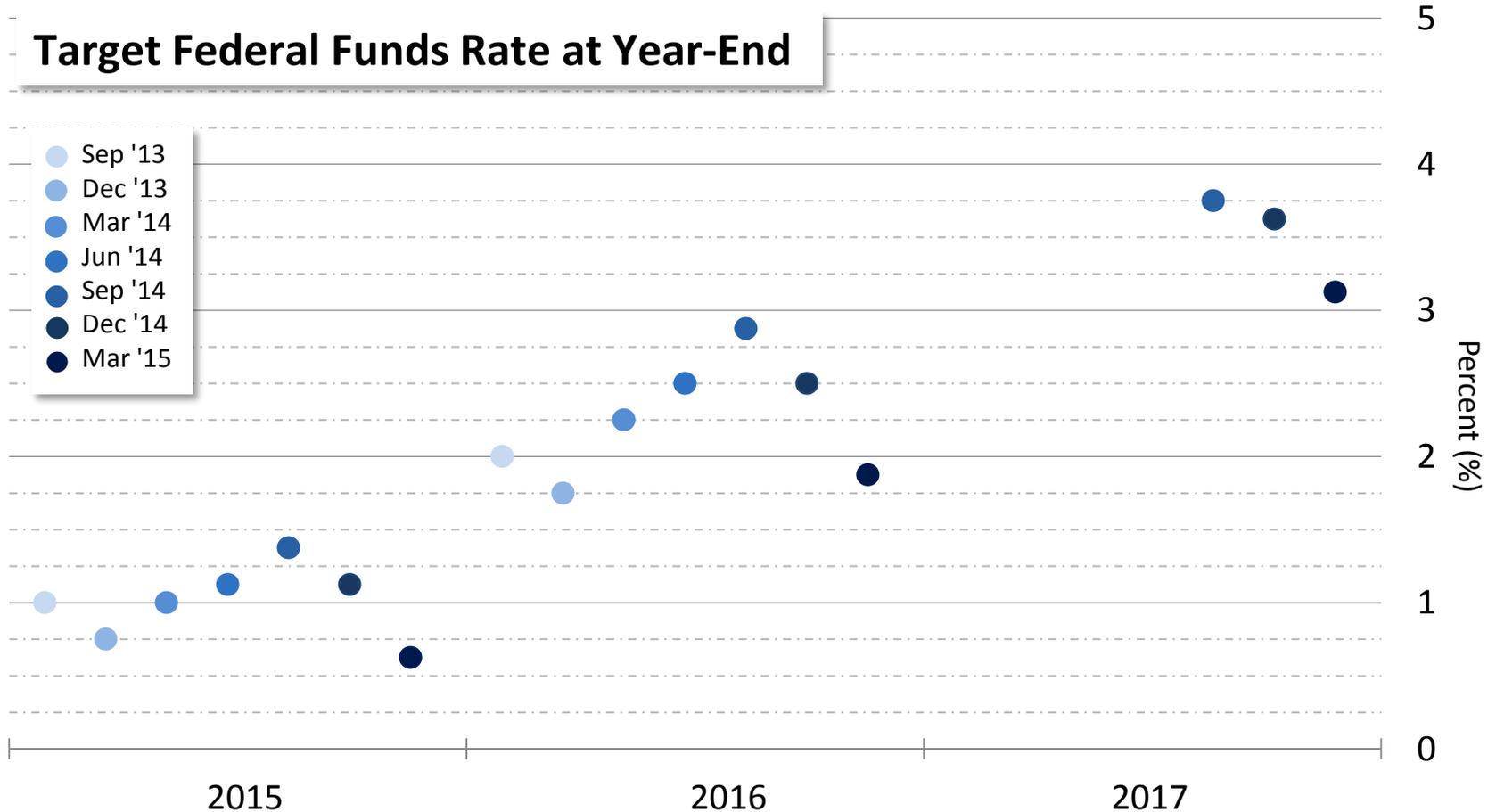


The dots moved further down the curve because there was no hike in March.



There is no single thing ... we must see ... in order to achieve that level of confidence. [That inflation will reach 2%.]

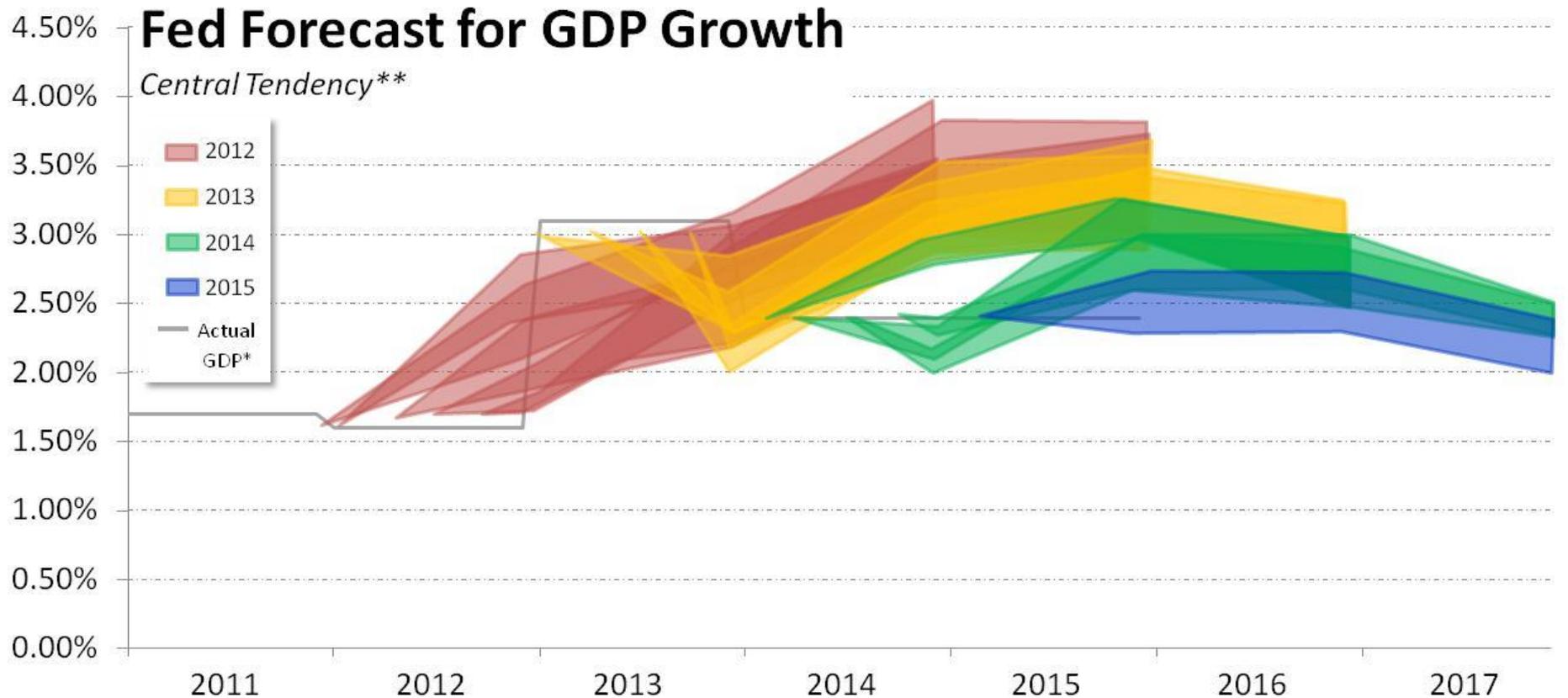
Fed Was Bold Until Tightening Drew Close



Source: Federal Reserve, March 2015

*Each dot represents the median fed fund target for the year from the corresponding meetings SEP.

Fed Capitulates to New Normal

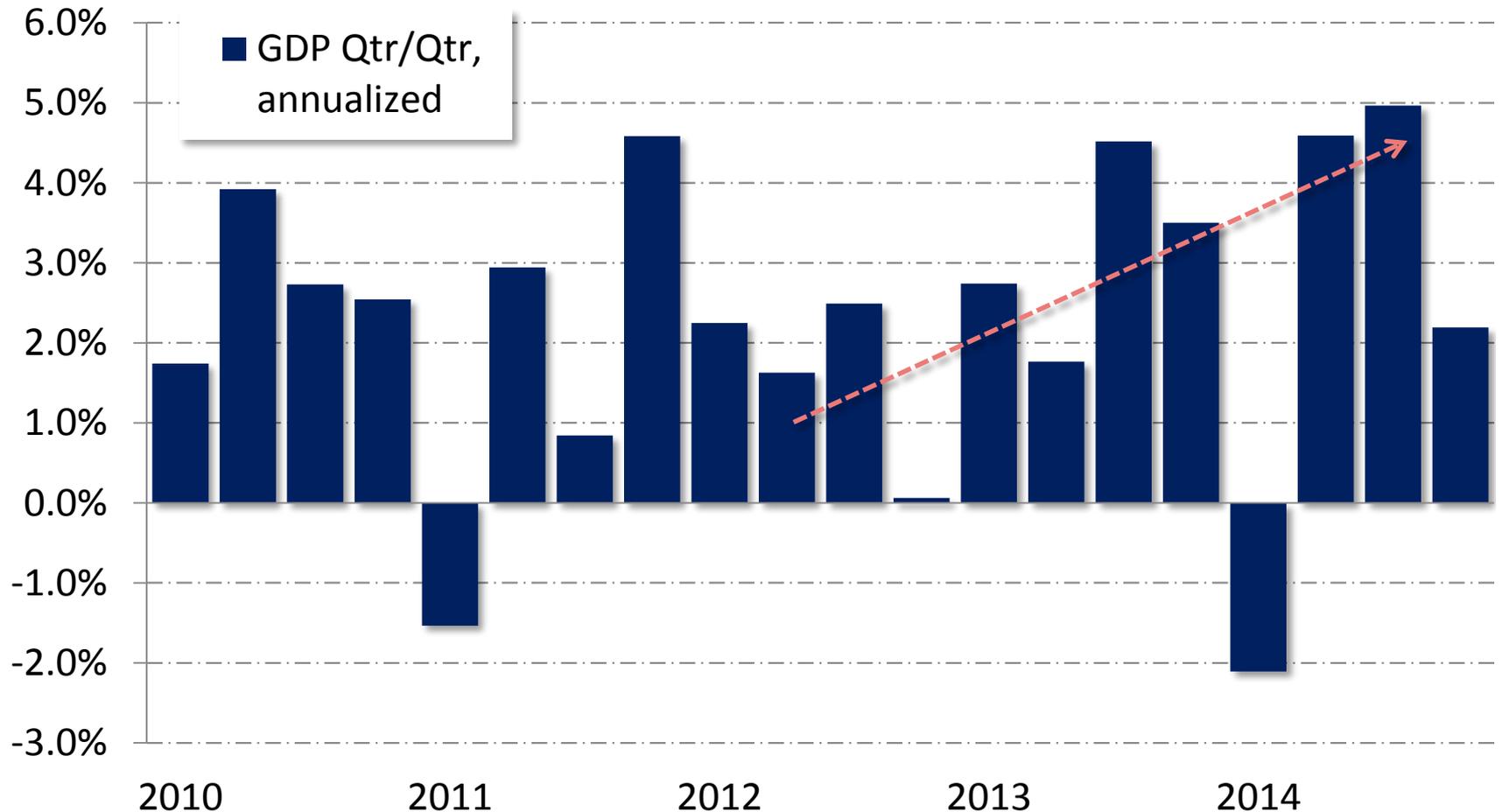


*Projections are plotted from actual Q4/Q4 GDP growth data (i.e. all 2012 projections start at 1.6%, the actual YoY GDP for Q4 2012). For 2015, the most recent data is used (Q4 2014).

**The central tendency excludes the three highest and three lowest projections of the range in each year.

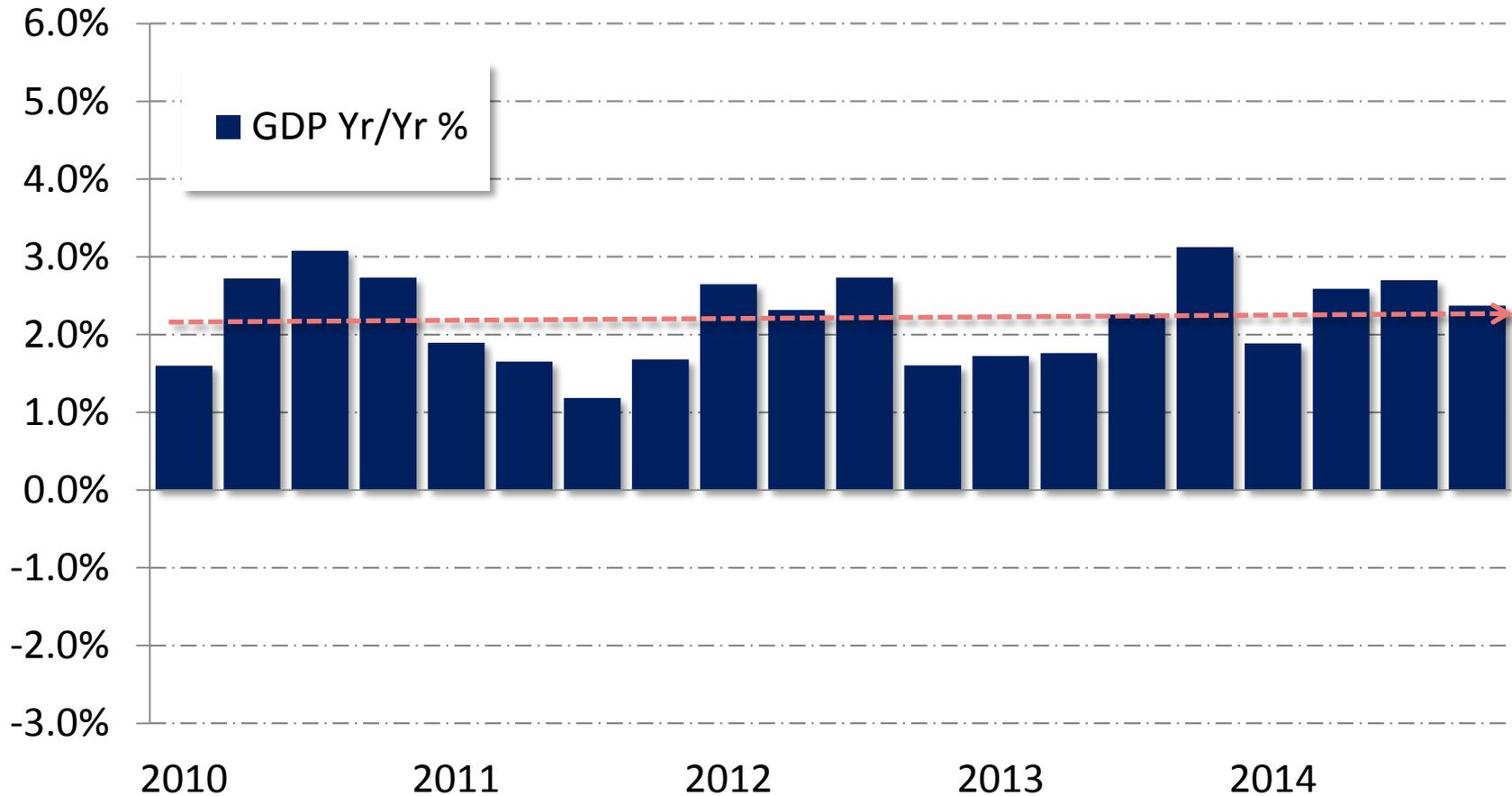
Source: WSJ, Federal Reserve FOMC, March 2015

Real GDP Growth (Dangerous Seasonals)



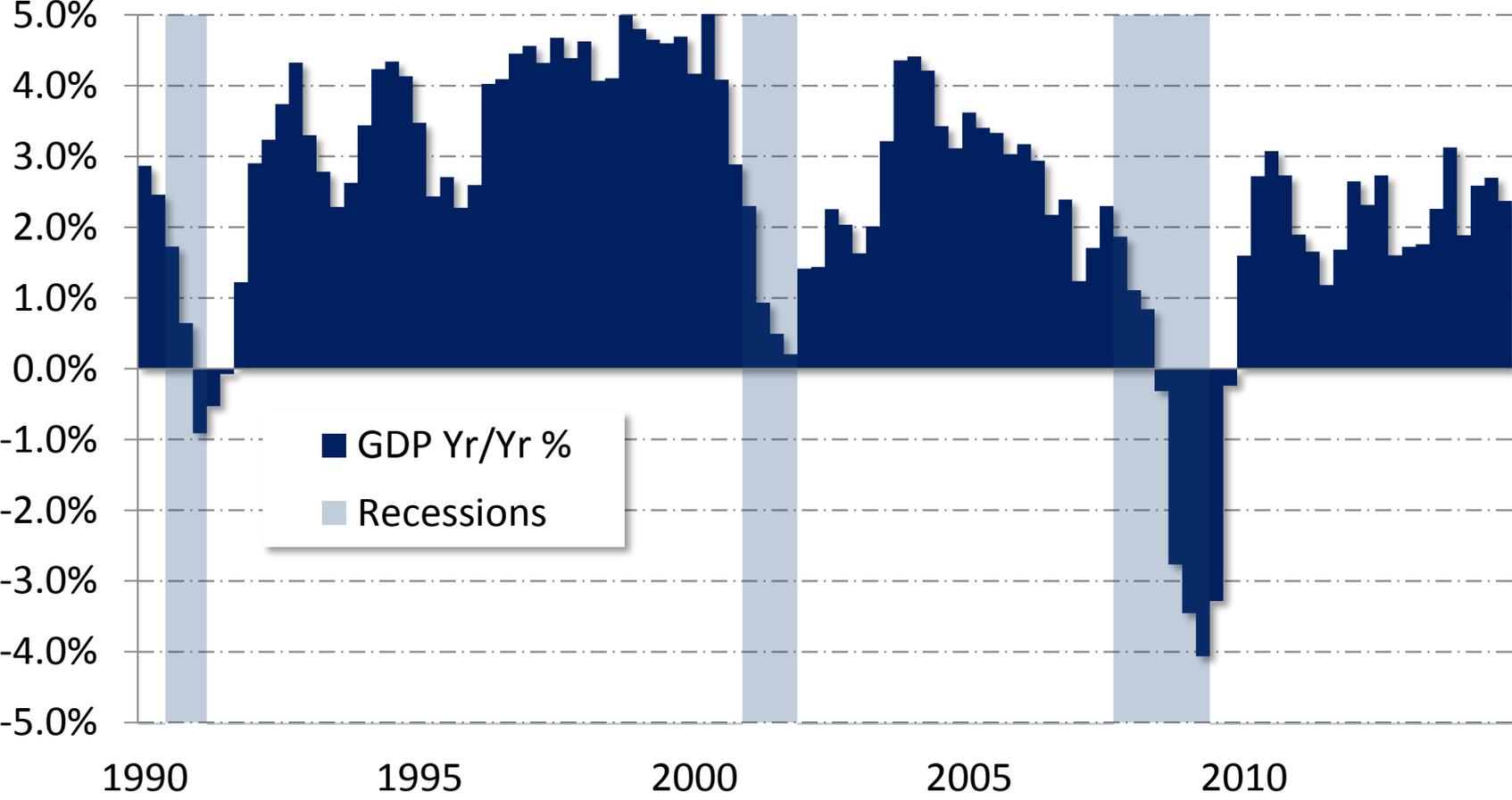
Source: Bureau of Economic Analysis

Real GDP Growth (Dangerous Seasonals)



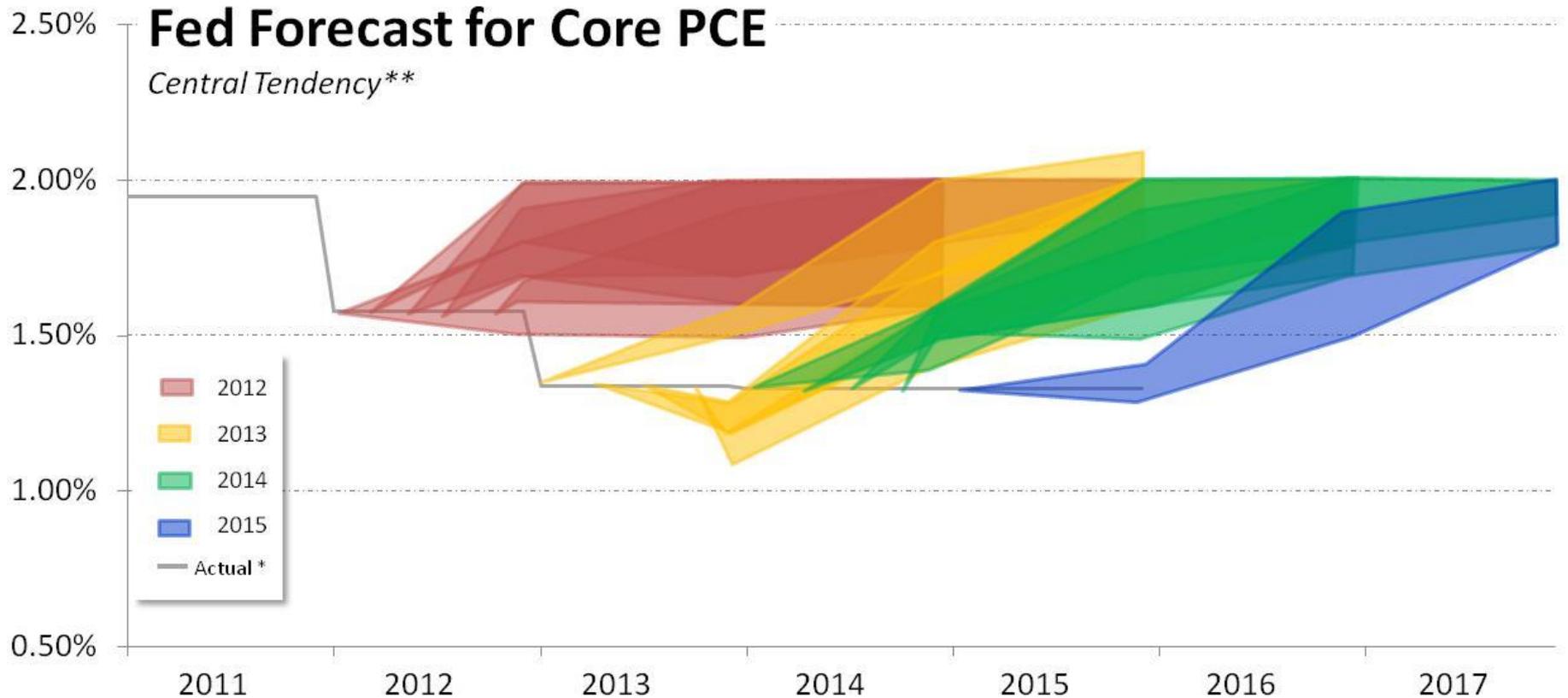
Source: Bureau of Economic Analysis

Real GDP Growth in Perspective



Source: Bureau of Economic Analysis

Fed's Inflation Forecast Always Goes to 2%

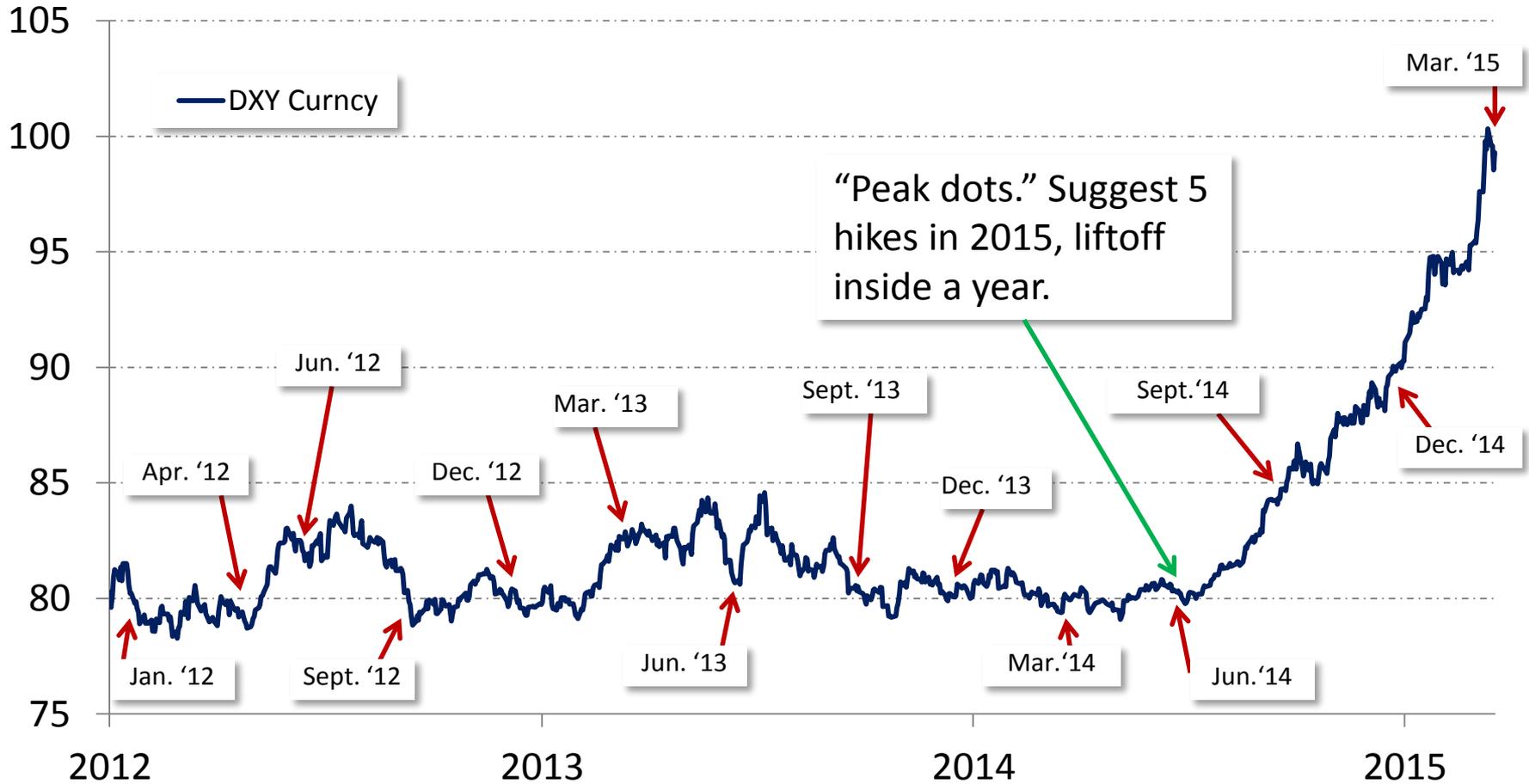


*Projections are plotted from actual core PCE YoY % for Q4 (i.e. all 2012 projections start at 1.58%, the actual YoY core PCE for Q4 2012). For 2015, the most recent data is used (Q4 2014).

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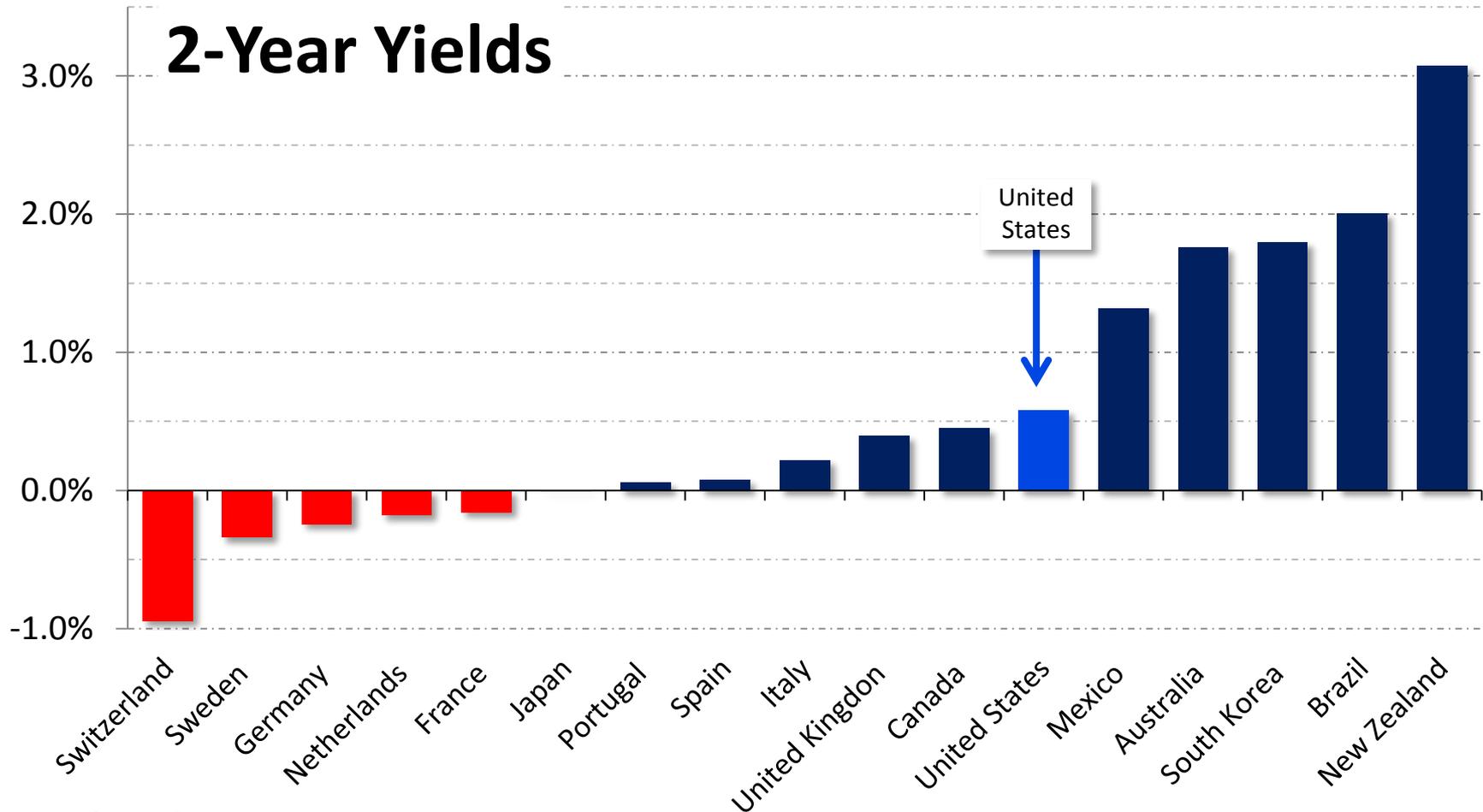
Source: WSJ, Federal Reserve FOMC, March 2015

USD Spot Index with FOMC Meetings



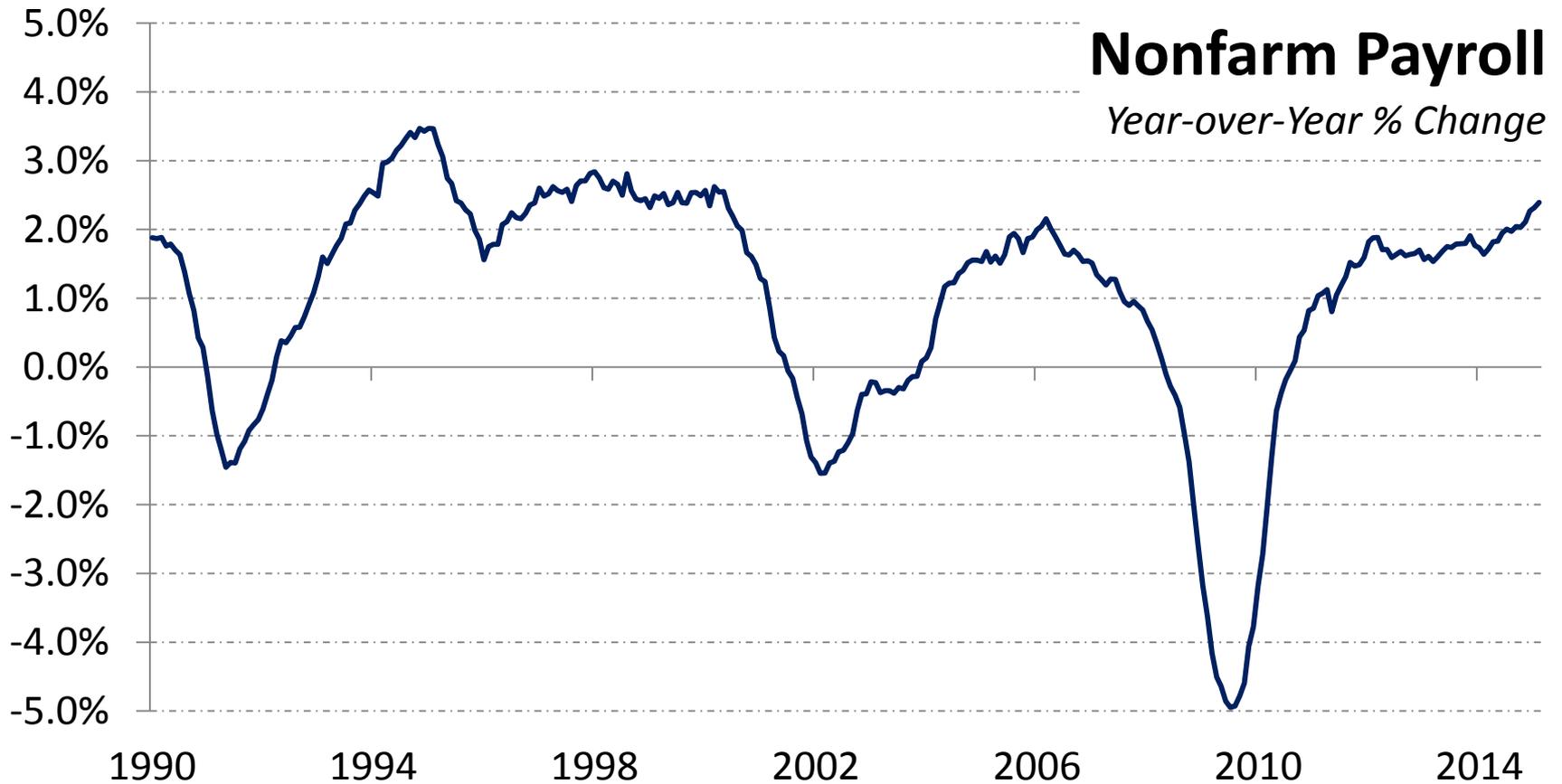
Source: Bloomberg

US Rates Are Among the Highest Already



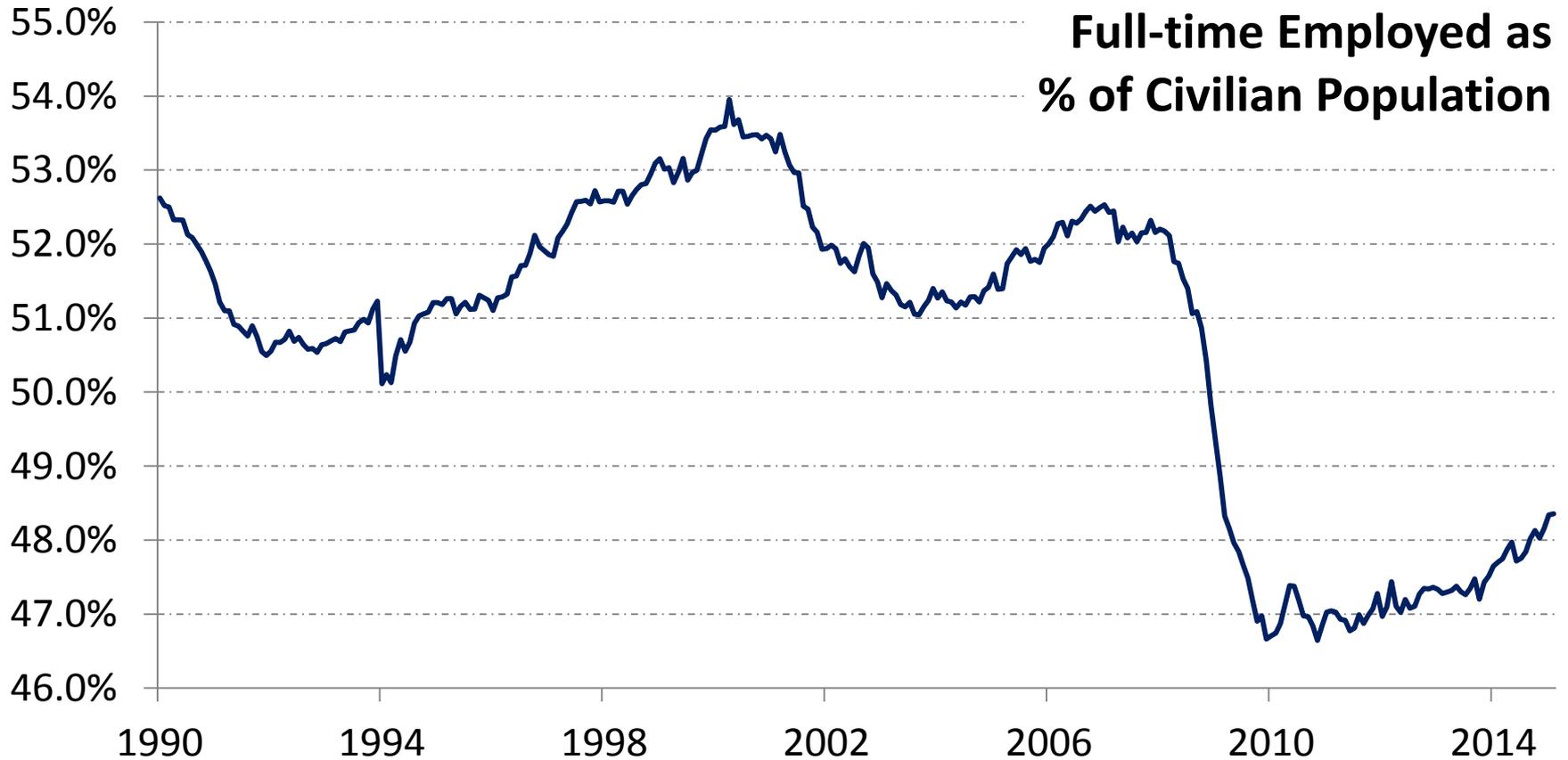
Source: Bloomberg

Job Growth Strong



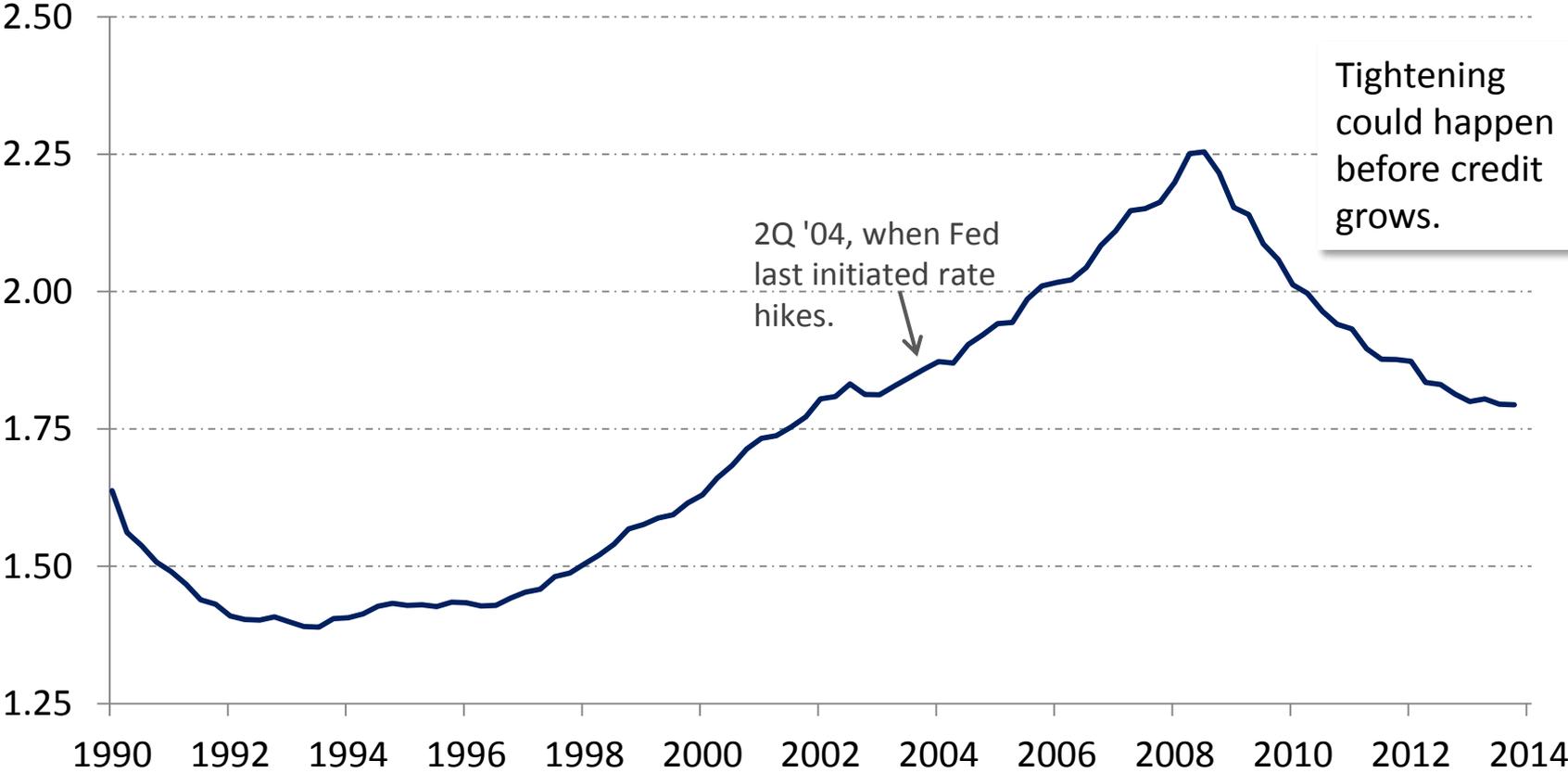
Source: Bureau of Labor Statistics

Job Quality Lousy



Source: Bureau of Labor Statistics

Ratio of Private Debt to Private GDP



Source: Federal Reserve & FTN Financial

Conclusions

- ❑ Global growth is sluggish.
- ❑ Global surprises abound.
- ❑ US starting to import deflation.
- ❑ Discipline and model dependence keeps Fed on course.
- ❑ **Q3 liftoff for fed funds rate likely.**
- ❑ **Tightening will contribute to global strains.**
- ❑ **Could pause/stop at 1%. Market thinks 2% peak ff rate.**
- ❑ **If they push to 2% in '16, rate cuts likely in 2017.**

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