

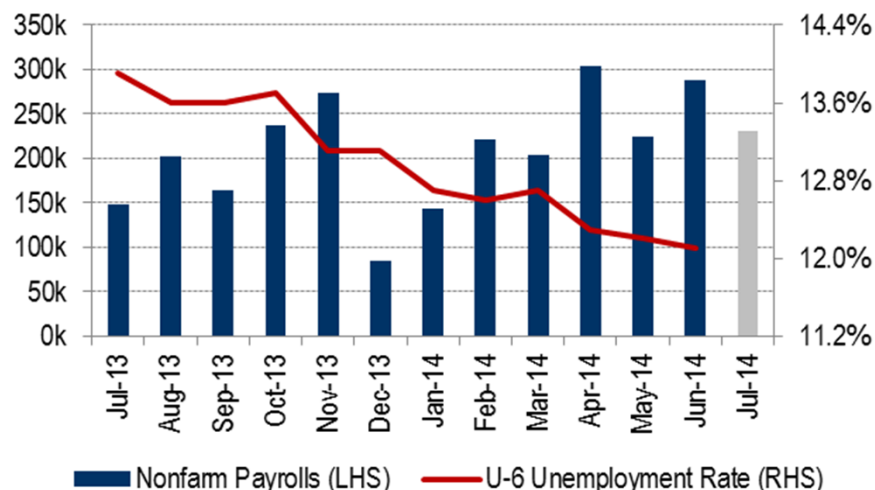
## Current Rate Environment

Short Term Rates	Friday	Prior Week	Change
1-Month LIBOR	0.16%	0.15%	0.01% ↑
3-Month LIBOR	0.23%	0.23%	0.00% ○
Fed Funds	0.25%	0.25%	0.00% ○
Fed Discount	0.75%	0.75%	0.00% ○
Prime	3.25%	3.25%	0.00% ○
<b>US Treasury Yields</b>			
2-year Treasury	0.49%	0.45%	0.04% ↑
5-year Treasury	1.67%	1.64%	0.03% ↑
10-year Treasury	2.47%	2.52%	(0.05%) ↓
<b>Swaps vs. 3M LIBOR</b>			
2-year	0.74%	0.67%	0.07% ↑
5-year	1.85%	1.79%	0.06% ↑
10-year	2.64%	2.68%	(0.04%) ↓

## Fed Speak &amp; Economic News:

- How vigorous has the US economy been? That is the question the Fed will need to answer at its upcoming gathering on Tuesday and Wednesday. It will have plenty of data to consider: second quarter GDP growth, consumer confidence, ADP employment, home sales, US PMI, and core PCE, among other data. To put things in perspective, the labor market has improved remarkably since the Fed's last meeting, and not just by one or two measures, but by a handful. The three-month moving average of job gains has risen to 272k per month (including the June jobs report), the unemployment rate has ticked down 0.6 percent with an unchanged participation rate during the past six months, and the four-week moving average of jobless claims is close to the level that we saw before the crisis. Despite the foregoing, we are still missing one cardinal piece to the puzzle: wage growth.
- Wage growth has become the axis of the Fed's argument for forecasting a gradual return to normalized rate levels. That being said, the Fed's forecasts for interest rates are lower than those of market participants'. What exactly does the Fed see that market participants do not? Remember, rates currently sit near the zero bound; in layman's terms: rates cannot go any lower. The Fed has to be absolutely sure that the economy is ready for an environment of higher interest rates. When you throw in the fact that various wage pressure indicators are hovering at or below two percent the result is a Fed reluctant to raise rates. However, the central bank will probably acknowledge the improvement in the labor market in its next statement because it is hard to deny. Keep in mind that declining slack in the labor market should *eventually* lead to higher wage inflation, which implies there is lag between the two. The Fed probably knows this better than most, ergo the reason for its forecasts being later than market participants'.
- It is unlikely that we will see any curve balls at the Fed's meeting this week. It is expected that the Fed will announce another \$10 billion reduction in monthly purchases with no discernible changes to forward guidance. On Friday, the July jobs report will be released; it is expected to be bullish given the recent momentum in the labor market (e.g., jobless claims have declined). That being said, Treasury yields have risk to the upside, with the Treasury's \$93bn supply (i.e., two-, five-, and 7-year auctions) coming to market along with a plethora of economic data releases (including the July jobs report).

## The Labor Market Has Shown Improvement



Source: Bloomberg

The jobs report for June was very bullish, printing at 288k, well above consensus. The July jobs figure is expected to print at 231k, shown by the grey bar in the chart to the left. Even if you expand your view and look at the U-6 unemployment rate, a broader measure that includes discouraged workers, the number does not convey anything different than other measures. In short, the majority of indicators suggest labor market slack has reduced.

## U.S. Economic Data

- CPI MoM printed at 0.3% vs 0.3% expected
- Durable goods orders surprised to the upside at 0.7% vs. 0.5% expected
- New home sales disappointed at 406k vs 475k expected

Date	Indicator	For	Forecast	Last
28-Jul	Markit US Composite PMI	Jul P	60.9 A	61.0
29-Jul	Consumer Confidence Index	Jul	85.5	85.2
30-Jul	GDP Annualized QoQ	2Q A	3.1%	(2.9%)
30-Jul	Fed QE3 Pace	Jul	\$25B	\$35B
30-Jul	ADP Employment Change	Jul	230K	281K
31-Jul	FOMC Rate Decision	30-Jul	0.25%	0.25%
1-Aug	Change in Nonfarm Payrolls	Jul	231K	288K
1-Aug	ISM Manufacturing	Jul	56.0	55.3
1-Aug	Univ. of Michigan Confidence	Jul F	81.5	81.3
1-Aug	Markit US Manufacturing PMI	Jul F	56.4	56.3
1-Aug	Unemployment Rate	Jul	6.1%	6.1%

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