

Current Rate Environment

Short Term Rates	Friday	Prior Week	Change
1-Month LIBOR	0.19%	0.19%	0.00% ○
3-Month LIBOR	0.28%	0.28%	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% ○
US Treasury Yields			
2-year Treasury	0.27%	0.30%	(0.03%) ↓
5-year Treasury	1.03%	1.10%	(0.07%) ↓
10-year Treasury	2.13%	2.17%	(0.04%) ↓
Swaps vs. 3M LIBOR			
2-year	0.48%	0.55%	(0.07%) ↓
5-year	1.27%	1.36%	(0.09%) ↓
10-year	2.36%	2.42%	(0.06%) ↓

Fed Speak & Economic News:

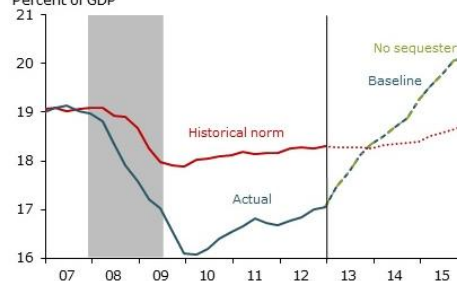
- The lack of clear communication from Federal Reserve officials has amplified uncertainty surrounding the debate of a reduction in quantitative easing leading into this week's two-day FOMC meeting. With the Fed in the spotlight, markets continue to sing the same tune as in the prior weeks: erratic investor behavior and increasing long-term interest rates. As an indicator of the broader rates market, the 10-year Treasury yield surged to a 52-week high last week, hitting 2.28%. Understandably, mortgage refinancing demand dropped by 36% for June versus May. This reaction is a response to the quick spike in rates as investors consider the impact of tighter monetary policy. Although Chairman Bernanke insists that scaling back asset purchases would be neither policy tightening nor irreversible, investors have begun to question the Fed's commitment to keep rates low, consequentially pushing interest rates higher across the board. While St. Louis Fed President James Bullard (centrist) pushed to continue stimulus measures during his speech last week, the past few weeks demonstrate what could happen once the Fed begins to reverse course. The threat to remove liquidity haunts market participants and fuels speculation, in turn sparking turbulence among various asset classes as we await results of Wednesday's FOMC meeting.
- Although the Fed's unprecedented asset purchases have stirred controversy, it has won the unwavering approval of the IMF. What hasn't, though, is the accompanying fiscal policy. "Ill-designed" components of the Obama administration's belt-tightening strategy like sequestration and tax hikes have failed to win favor in the international community, leaving U.S. growth stunted by these budget-conscious initiatives. While Fed support has outweighed potentially crippling policies, the U.S. economy is anticipated to grow at an underwhelming 1.9%. A recent IMF report outlines revisions the government must make to reduce deficits over the long-term and also to enable a smooth exit strategy for the Fed. As current monetary policy is not sustainable on an ongoing basis, the IMF urges fiscal restructuring through the following measures: repealing the sequester and replacing it with gradual deficit-reduction strategies; immediately raising the debt ceiling; and, employing "back-loaded" initiatives to achieve financial sustainability over the long-term. Failure to do so could warrant future credit downgrades or, worse, more economic unrest.

Dual Cases Show Tax Hikes, Not Cuts, as Fiscal Drain

A. Federal government spending
Percent of GDP



B. Federal government tax revenue
Percent of GDP



While sequester cuts have widely been accepted as the primary drag of economic growth, a study by the Federal Reserve Bank of San Francisco purports otherwise. Over the past two years, fiscal policy has been contractionary instead of expansionary, deviating from "historical norms," or what policy would be if it followed historical relationship between fiscal policy and the business cycle. Analysis of present conditions and projections based on the "actual" and "historical norm" cases highlight the detrimental impacts of current policy, specifically, the relative drag that taxes have on growth. Bank economists suggest that 90% of the 1% loss in GDP resulting from current budget policy comes from taxes and not cuts.

Source of Chart Data: Federal Reserve Bank of San Francisco Source of Financial Data: Bloomberg

U.S. Economic Data

- The Treasury's budget in May remained consistent with forecasts as the U.S. government posted a budget deficit of \$138.7 billion.
- Retail sales rose more than forecasted as purchases climbed 0.6% in May. This gain was the largest in three months, following a 0.1% increase in April.
- The Producer Price Index grew 0.5% after falling 0.7% in April. Likewise, U.S. factory output climbed 0.1% - its first gain in three months. After falling in April and March, the gain paints a more optimistic outlook for the summer.
- The preliminary reading for U.S. Consumer sentiment declined in June from its six-year high, falling from 84.5 to 82.7.

Date	Indicator	For	Forecast	Last
17-Jun	Empire Manufacturing	May	7.8 A	(1.4)
18-Jun	Consumer Price Index (MoM)	May	0.2%	(0.4%)
18-Jun	Housing Starts (MoM %)	May	11.4%	(16.5%)
19-Jun	FOMC Rate Decision	Jun 19	0.25%	0.25%
20-Jun	Philadelphia Fed Business Outlook	Jun	(2.0)	(5.2)

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