

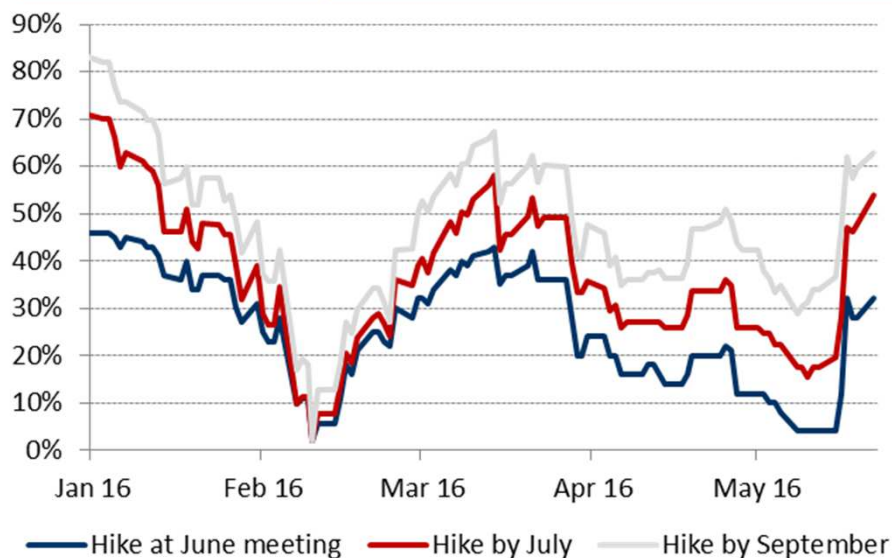
Current Rate Environment

Short Term Rates	Friday	Prior Week	Change
1-Month LIBOR	0.44%	0.43%	0.01% ↑
3-Month LIBOR	0.66%	0.63%	0.03% ↑
Fed Funds	0.50%	0.50%	0.00% ○
Fed Discount	0.75%	0.75%	0.00% ○
Prime	3.50%	3.50%	0.00% ○
US Treasury Yields			
2-year Treasury	0.88%	0.75%	0.13% ↑
5-year Treasury	1.36%	1.21%	0.15% ↑
10-year Treasury	1.84%	1.70%	0.14% ↑
Swaps vs. 3M LIBOR			
2-year	1.07%	0.93%	0.14% ↑
5-year	1.37%	1.22%	0.15% ↑
10-year	1.75%	1.62%	0.13% ↑

Fedspeak & Economic News:

- US Treasury yields moved higher by as many as 15 basis points in the belly of the curve in response to the hawkish April FOMC minutes released on Wednesday. The minutes included several references to a possible June rate hike (the Fed will conclude its two-day meeting June 15). The phrase that likely drove the selloff was: "Most participants judged that if incoming data were consistent with economic growth picking up in the second quarter, labor market conditions continuing to strengthen, and inflation making progress toward the Committee's two percent objective, then it likely would be appropriate for the Committee to increase the target range for the federal funds rate in June."
- The strong language suggests the Fed's goal is to keep market participants on their toes by suggesting the June meeting is "live". This aligns with the rhetoric provided by FOMC officials in recent weeks, including the Fed's Williams and Lockhart, both doves, who mentioned that the market was overly pessimistic. Both said that wages have been rising, which is one of the key criteria that needs to be satisfied in order for the Fed to introduce more tightening. In addition, the NY Fed's Dudley, dove, believes a hike in June or July is reasonable if the data justify it and noted that June is "definitely" a live meeting. In contrast, the moderately-dovish Fed governor Brainard mentioned she is concerned with the stability risks abroad and warned that policy divergence could provoke strong market reactions.
- The federal funds market was implying ~5 percent chance of a June rate hike before the release of the April FOMC minutes; however, after, the implied likelihood moved higher to ~30 percent. The market seems convinced that there is a small likelihood of a hike despite the fact the Fed has come out and said June is a "live" meeting. This probably reflects the market's concern surrounding the geopolitical wildcard, the June 23 UK referendum on EU standing, which will likely play an important role in the Fed's policy decision. According to Bloomberg's composite survey, the "leave" votes are even with the "remain" votes. An abrupt exit by the United Kingdom would be disastrous for the region and its unusually high likelihood probably has the Fed considering adopting a wait-and-see approach as a risk-management tool since the referendum will conclude after the June FOMC meeting.

Probability of a Rate Hike at One of the Next Three Fed Meetings



The likelihood of a rate hike at one of the next three FOMC meetings has recovered sharply since the release of the April Fed minutes this past Wednesday. The minutes suggest that the hurdle for the next hike has been lowered, which is the major reason underpinning the sharp rise. Per the notes, one of the conditions for hiking was: "if incoming data were consistent with economic growth picking up in the second quarter..." This language relaxes the hurdle compared to the March FOMC statement.

The Week Ahead

- Euro-area finance ministers** will discuss Greece's bailout review, including debt-relief measures and contingency plans in case budget targets are missed.
- The **G-7 leaders summit** will be held in Isejima, Japan, on Thursday, with the global economy, climate change and foreign policy on the agenda.
- Fedspeak:** St. Louis Fed President Bullard and Fed governor Jerome Powell will give speeches on Thursday.
- Top tier economic data** : Durable goods will be released on Thursday, and we will see another reading of first quarter US GDP on Friday.

Date	Indicator	For	Forecast	Last
23-May	Markit US Manufacturing PMI	May P	51.0	50.8
24-May	New Home Sales	Apr	522k	511k
26-May	Durable Goods Orders	Apr P	0.5%	1.3%
27-May	GDP Annualized QoQ	1Q S	0.9%	0.5%
27-May	U. of Mich. Sentiment	May F	95.4	95.8

Source: Bloomberg



Cleveland, OH

David Bowen 216-689-3925 Mary Coe 216-689-4606 Srđjan Demonjic 216-689-3922 Dusko Djukic 216-689-4224 Sam Donzelli 216-689-3635 Frank Kuriakuz 216-689-4071

Seattle, WA

Greg Dawli 206-689-2971 Wil Spink 206-689-2972

Documentation

Ramona Berce 413-567-6758 Linda Maraldo 216-689-0516 Marybeth Simon 216-689-0897

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David Bowen	Mary Coe	Srdjan Demonjic	Dusko Djukic	Sam Donzelli	Frank Kuriakuz
216-689-3925	216-689-4606	216-689-3922	216-689-4224	216-689-3635	216-689-4071

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