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Wallace's Daily Policy Debrief

Today:

1) **Weekly Central Bank Report – Tom Gallagher**
2) **Policy Calendar – Kim Wallace**

Refining the Tapering Message

Last week was predictably filled with FOMC speakers repeating the message from the last FOMC meeting, a message many at the Fed feel is dovish on QE (data-dependent, and with a robust forecast QE is phased out from September through June) and on rates (with that robust forecast, 50-75bp of tightening by year-end 2015, and possibly a lower unemployment threshold before rate hikes would be considered). **Markets may be getting used to the more explicit framework offered by the Fed, but markets aren't buying the dovish talk and seem very unlikely to revert to pre-tapering levels of yields.**

One speech that stood out to us last week was delivered by Gov. Stein. The Board usually has a solid macroeconomics academic, and that's Stein's role now. His speech on Friday was a very analytical presentation of the Fed's current stance and the market reaction to last week's speech, but one that won't necessarily be readily absorbed by retail investors.

Specifically, he said, "it is appropriate to give relatively heavy weight to the accumulated stock of progress toward our labor market objective and to not be excessively sensitive to the sort of near-term momentum captured by, for example, the last payroll number that comes in just before the meeting." **In other words, a weak-ish payroll number on September 6 won't necessarily deter the Fed from announcing tapering on September 18 if data prior to that have been consistent with the Fed's forecast.** The emphasis on "the accumulated stock of progress toward our labor market objective" should be incorporated into the framework for predicting what the Fed will do this fall.

Here is one reasonable way of approaching the September decision. A few Fed speakers have referred to the six-month moving average of payroll gains. The pickup in this moving average has been offered as the reason the Fed could say in its last statement that downside risks have diminished since it launched open-ended QE. There are three monthly payroll reports before the September FOMC meeting.

- If they average 200k, then the six-month moving average would hold at its current level even after dropping the strong February gain (332k). That could lead to a more ambitious tapering of say $20-25B per month, down from the current $85B to $60-65B.

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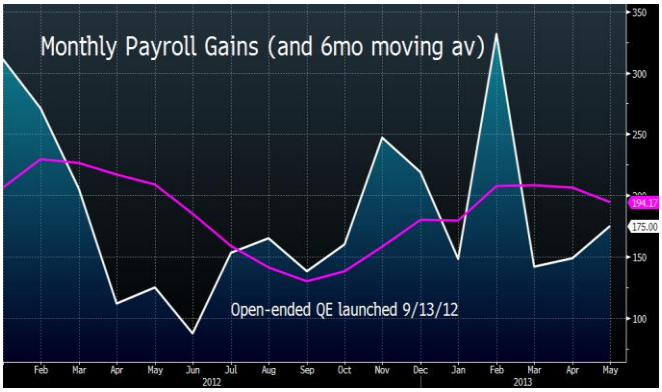
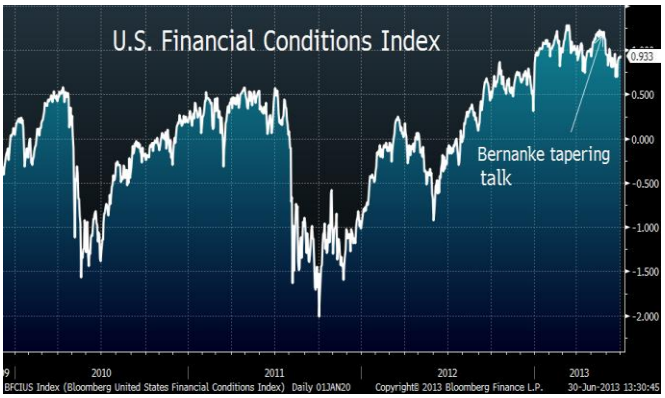
- If they average 175k, that represents progress from the September 2012 perspective and some stabilization. That could produce a tapering of a smaller magnitude, possibly $10-15B per month, especially if the unemployment rate falls with a constant or rising participation rate.



- If they average 150k, that would represent no progress from the September 2012 perspective, and could well lead to putting off the decision to taper. The three-month moving average is now just 155k, so this is very much in the realm of the possible.

How much has the Fed-induced rise in yields made September tapering less likely, due to the feedback effect of the higher yields? Perhaps not much. True, mortgage yields have risen considerably, **but an economy-wide measure, Bloomberg's financial conditions index, shows a fairly modest tightening of financial conditions.**



Markets settled down last week but didn't reverse much of the run-up in yields. The convulsions related to the updated tapering outlook may not have ended yet, but the scope for further reductions may be limited. The 2015 rate hikes priced into the market still look a little aggressive, but they have come down some from the highs last week. The main part of the rise in yields seems to have come from a higher term premium (the compensation for expected volatility in yields). To some extent that rise reflects current volatility (chart), so there should be further reductions if markets become less volatile. **But if the higher term premium also reflects the higher level of uncertainty inherent in the Fed's move to exit its unorthodox policy, the scope for bigger reductions will be limited.**

Across the Atlantic

Both the ECB and BOE meet on Thursday. There was a German press report that the ECB was considering its own version of QE, a proportionate purchase of all euro members' government bond markets. Such a move would be opposed by many German officials. That hasn't stopped ECB initiatives in the last few years, but it probably is enough to stop any action before the German election in September. On Bloomberg, 61 of 61 economists surveyed expected no change in rates this week.

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Today is new BOE Governor Carney's first day on the job. He is widely expected to push for a form of forward rate guidance, and quite possibly more QE. **Policy changes are perhaps more likely in August, which would give Carney a bit more time on the job and would coincide with the quarterly economic forecasting exercise by the BOE.**

- Tom Gallagher

Policy Calendar

Highlights for the Week

Central banks attract attention this week in rate policy and Basel III capital meetings. Abe and Kuroda continue efforts to explain and defend economic growth policies. ***– Kim Wallace***

Monday

- U.S. imposition of additional Iran sanctions, including cessation of transacting in rials by financial institutions and embargo of the sale or transfer of gold or other precious metals
- The Gas Exporting Countries Forum, Moscow

Tuesday

- 5am EDT, BOE officials present to Parliament their June Financial Stability Report, London
- 9:30, Federal Reserve Board of Governors meet to consider Basel III final rules, Washington, D.C.
- EU officials host Tunisian Prime Minister Ali Larayedh, Brussels

Central Bank Meetings This Week

Monday, July 1

Romania

- Key Policy Rate: 5.25% (-0.07% real rate)
- Last policy change: 3/29/2012 (-25bps)

Russia

- Refinancing Rate: 8.25% (0.85% real rate)
- Last policy change: 9/13/2012 (25bps)

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Tuesday, July 2

Australia

- Cash Target Rate: 2.75% (0.25% real rate)
- Last policy change: 5/7/2013 (-25bps)

Uganda

- Benchmark Rate: 11.00% (1.80% real rate)
- Last policy change: 6/6/2013 (-100bps)

Wednesday, July 3

Poland

- Repo Rate: 2.75% (2.25% real rate)
- Last policy change: 6/5/2013 (-25bps)

Sweden

- Repo Rate: 1.00% (1.20% real rate)
- Last policy change: 12/18/2012 (-25bps)

Thursday, July 4

United Kingdom

- Base Rate: 0.50% (-2.20% real rate)
- Last policy change: 3/5/2009 (-50bps)

ECB

- Refinance Rate: 0.50% (-0.90 real rate)
- Last policy change: 5/2/2013 (-25bps)

Summary of Last Week's Meetings

Country/Region	Key Rate	Other Actions
Israel	Unchanged at 1.25%	
Zambia	+25bps to 9.75%	
Hungary	-25bps to 4.25%	
Guatemala	Unchanged at 5.25%	
Czech Republic	Unchanged at 0.05%	

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Country/Region	Key Rate	Other Actions
Taiwan	Unchanged at 1.875%	
Bulgaria	+1bps to 0.02%	
Angola	Unchanged at 10.00%	
Colombia	Unchanged at 3.25%	
Trinidad & Tobago	Unchanged at 2.75%	

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