



The US Macro Puzzle

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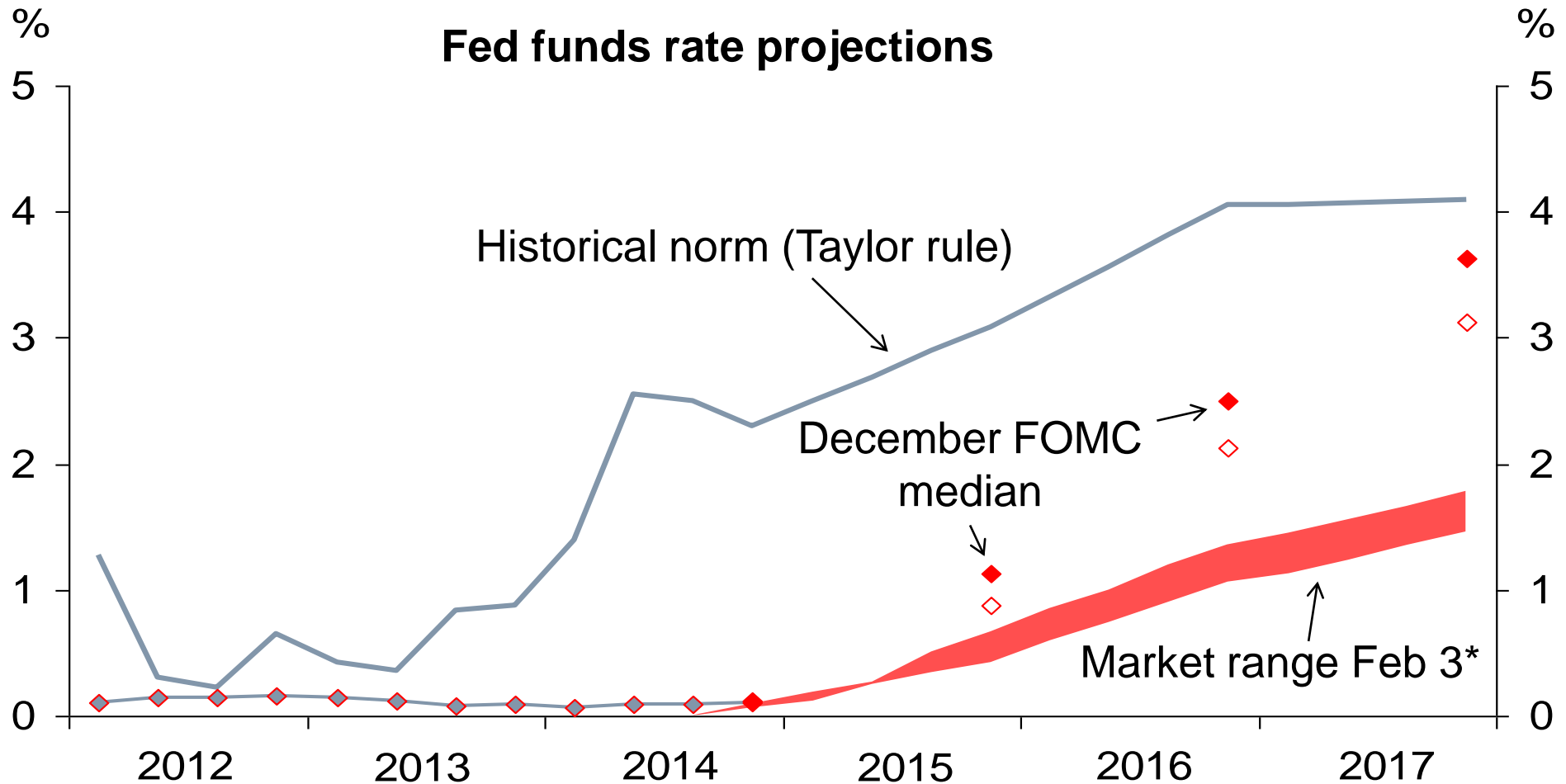
Outline



- Puzzle: Market-Fed disconnect on rates
- Difference of views on inflation prospects
- Phillips curve not dead
- Labor market tightening faster than expected
- Other measures of slack diminishing
- Euro risk

Source: DB Global Markets Research

Puzzle: Gap between Fed and Market rate expectations

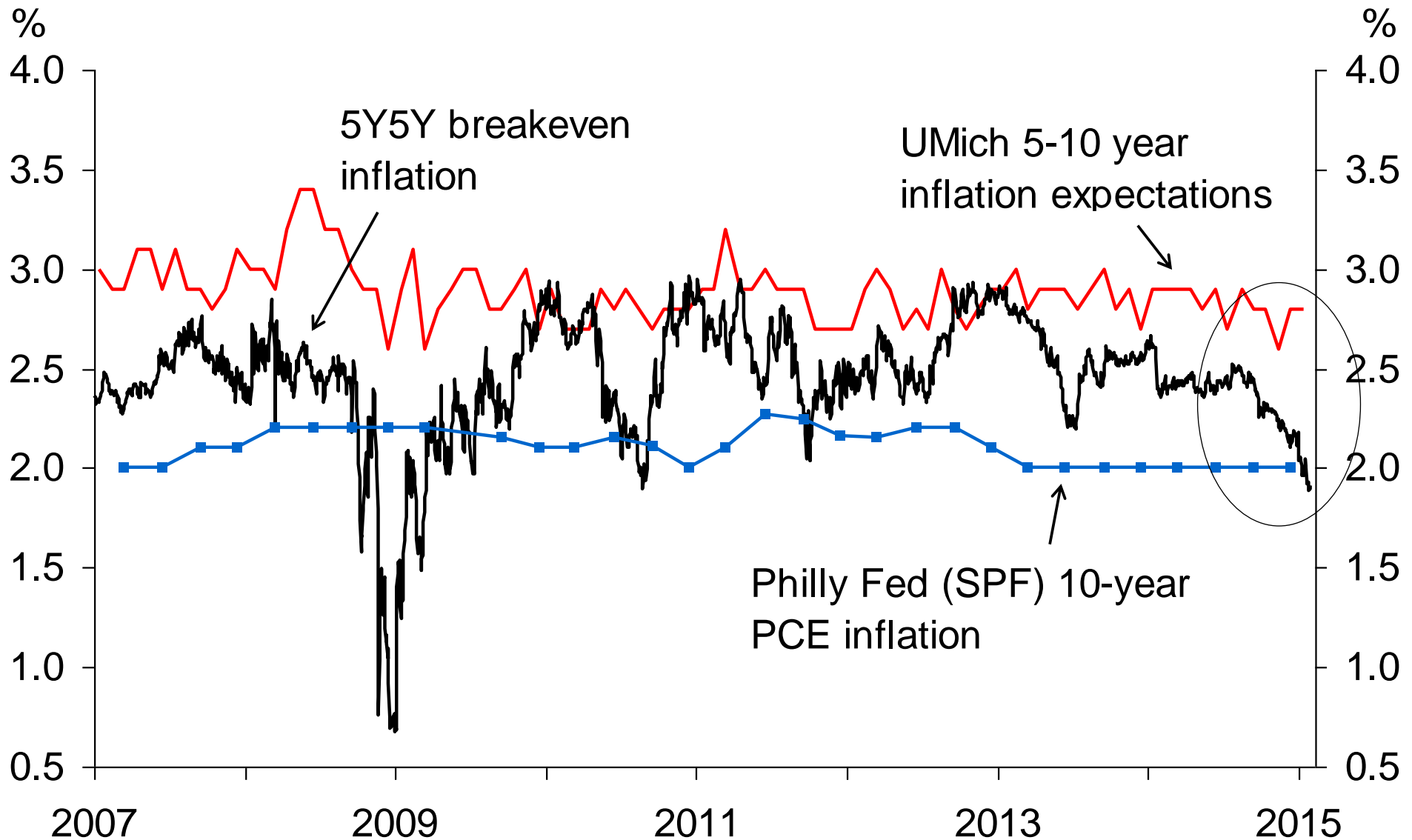


* Based on eurodollar futures, fed funds futures, and OIS curve

Sources: Bloomberg Finance LP, FOMC, Haver Analytics, Deutsche Bank Research

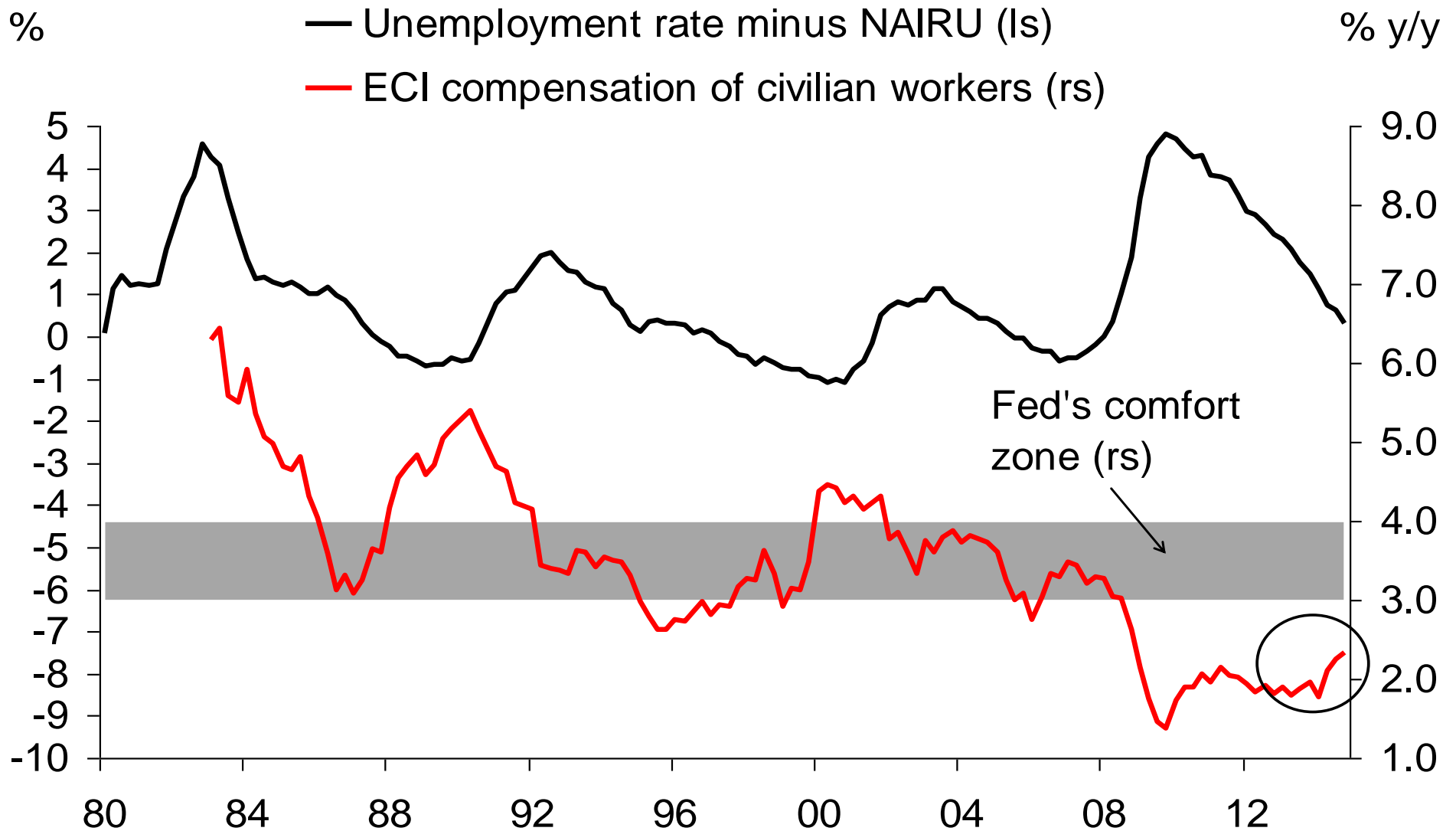


Market view on inflation prospects very different from economists' and households'



Sources: U.Mich, Bloomberg Finance LP, Phil Fed, Haver Analytics, DB Global Markets Research

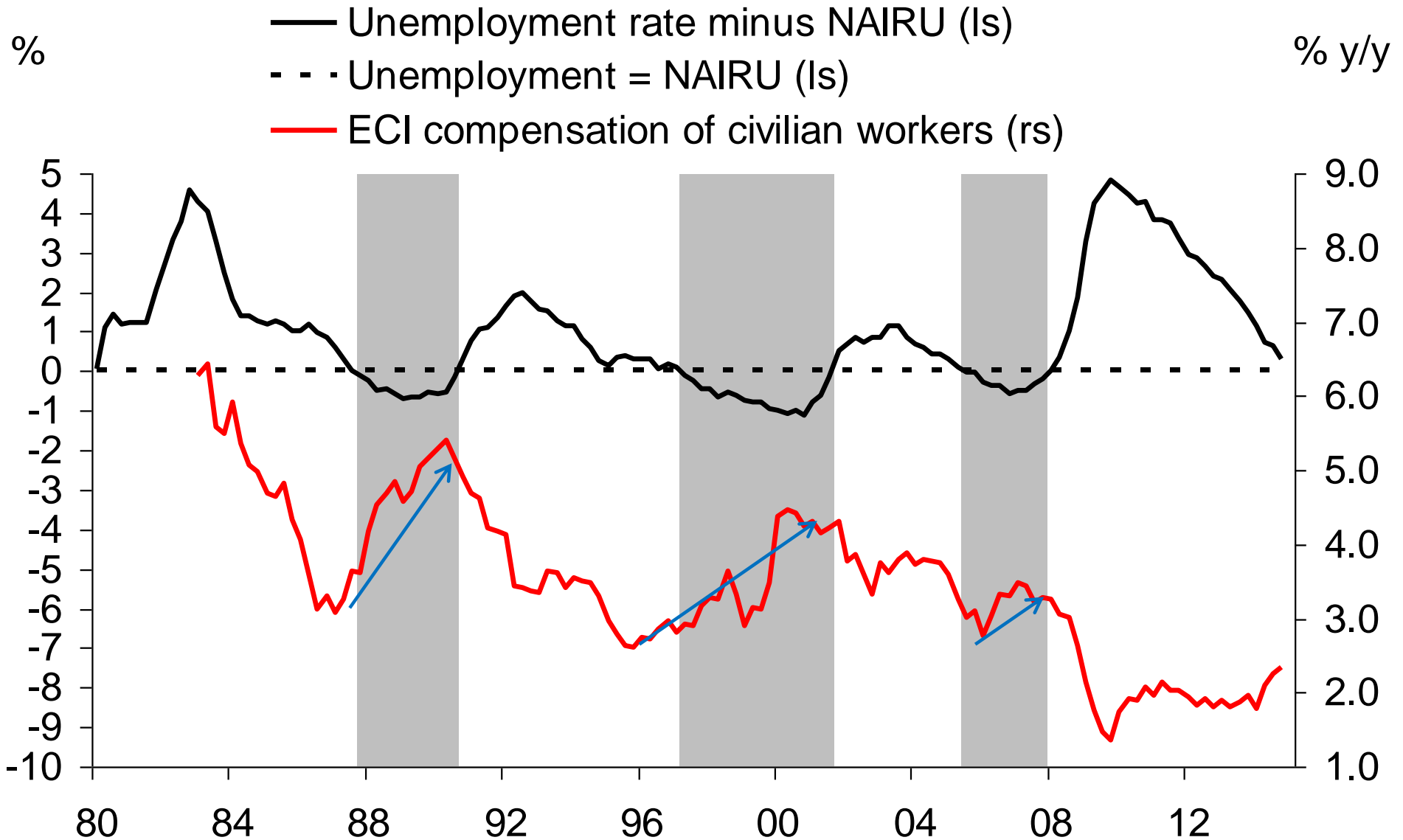
Wage inflation has not moved much as labor market has tightened



Sources: BLS, CBO, Haver Analytics, DB Global Markets Research

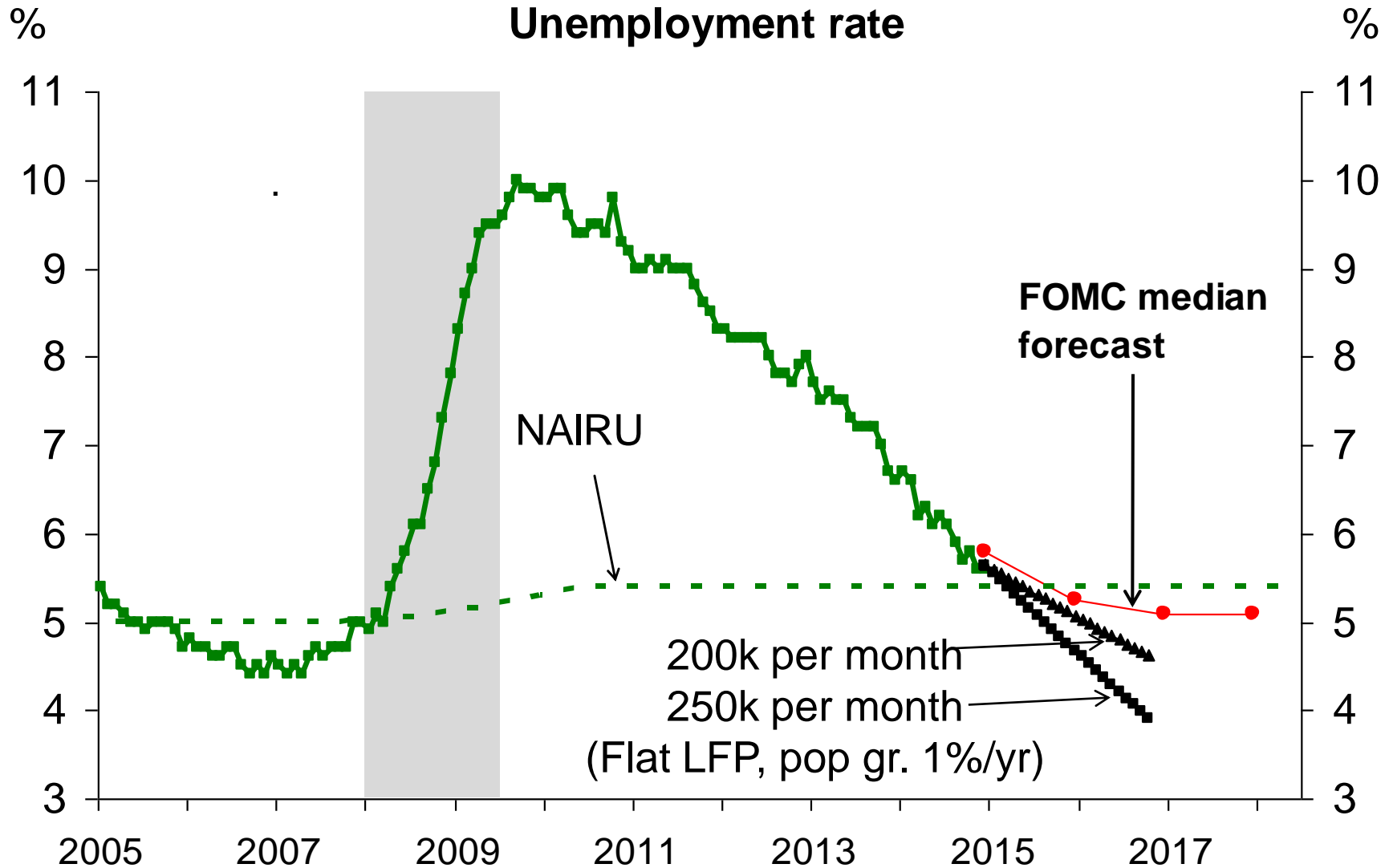


Phillips curve is not dead



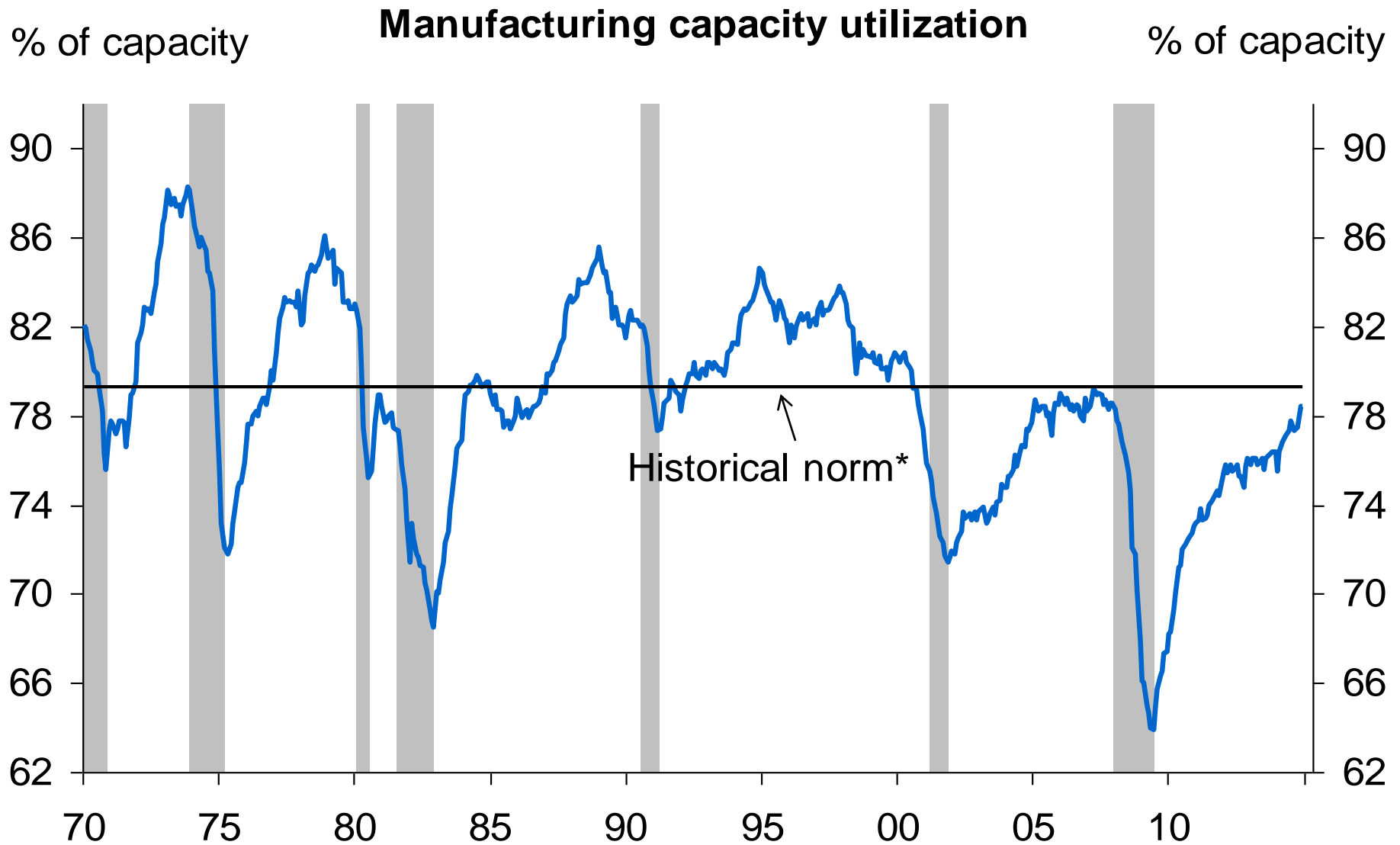
Sources: BLS, CBO, Haver Analytics, DB Global Markets Research

Labor market tightening at an impressive rate



Sources: FOMC, BLS, Haver Analytics, DB Global Markets Research

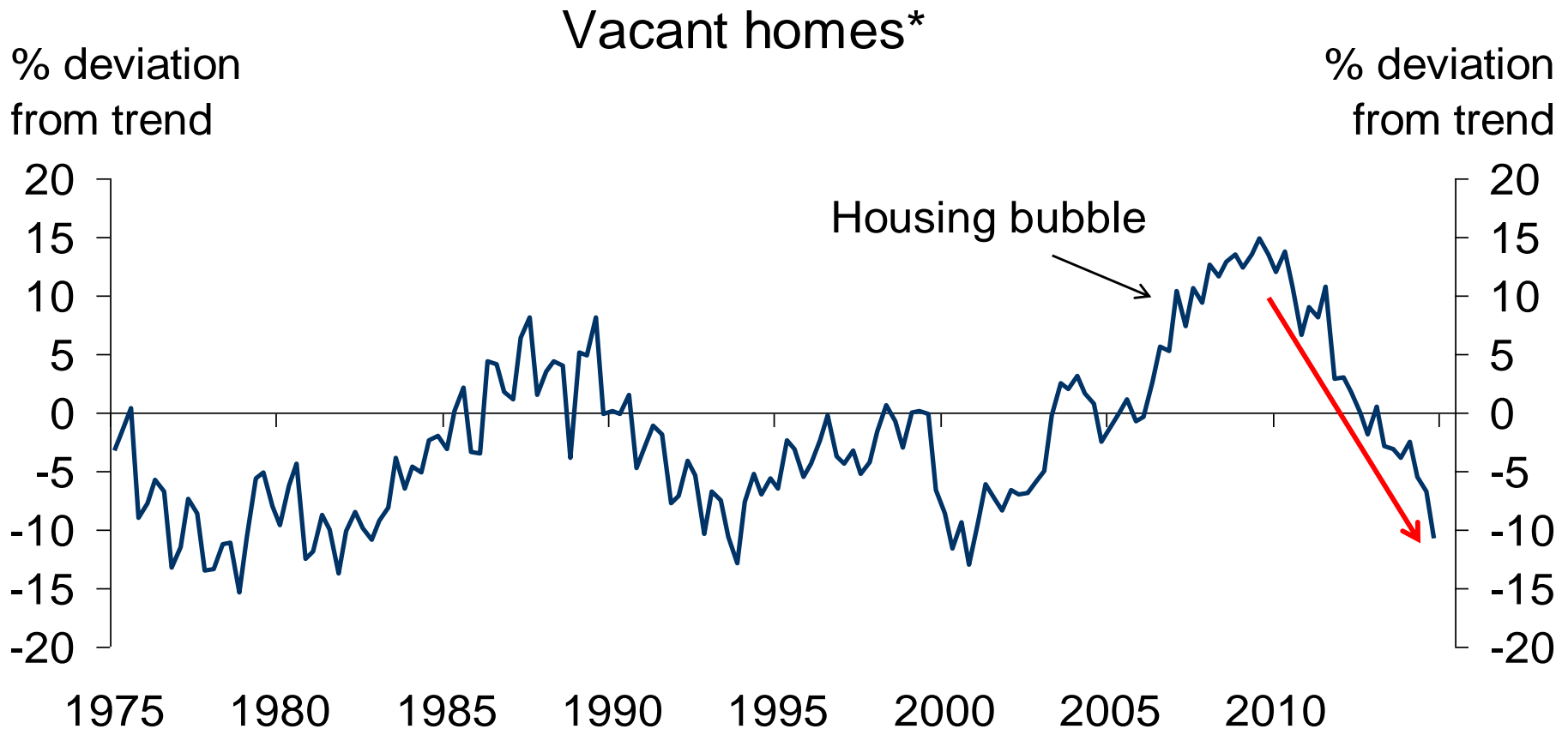
Capacity utilization close to historical norm



*30-year pre-crisis average

Source: FRB , Haver Analytics, Deutsche Bank Research

Housing market tightening: vacancies well below trend



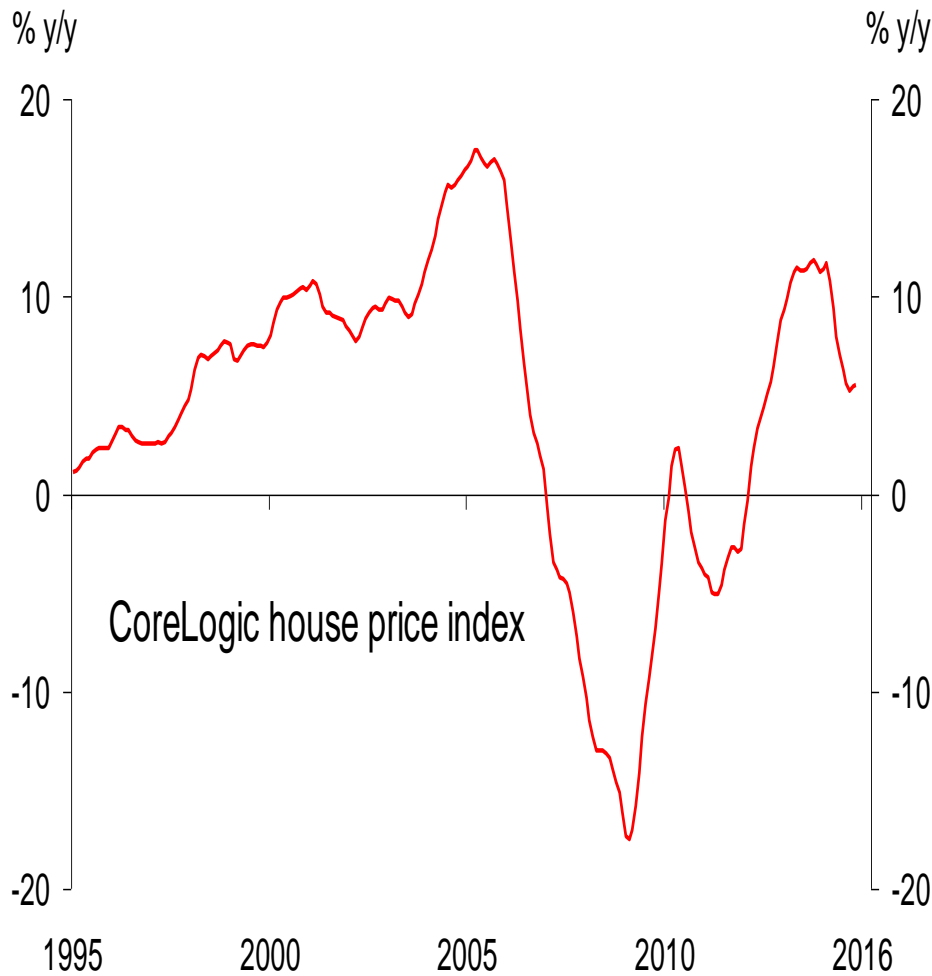
*Includes homes for sale, homes for rent, and homes held off the market for other reasons; excludes seasonal homes and second homes not used as primary residence.

Source: NAHB, BEA, Haver Analytics, DB Global Markets Research

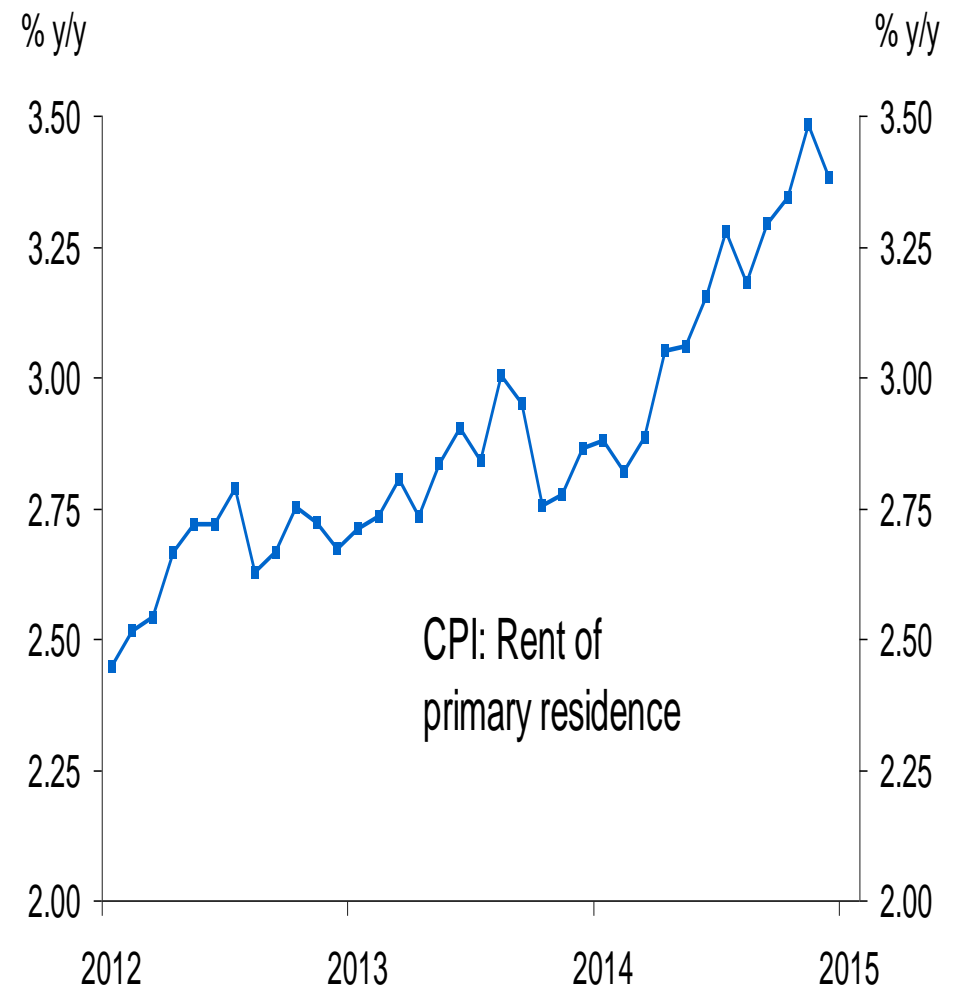
Housing market is tightening: Price and rent action



Home prices rising



Rents accelerating



Sources: Core Logic, BLS, Haver Analytics, DB Global Markets Research

Euro risk



- Cost of Grexit especially high for Greece
- Cost of Grexit for the rest of rest of euro area more manageable
 - Direct costs are small
 - Indirect costs more substantial (premiums on periphery debt).
- For EA, cost of Grexit must be balanced against moral hazard costs of giving in too much
 - Backsliding on needed structural reforms to deal with fundamental competitiveness problems will also raise premiums on periphery debt.
- Key risk is political miscalculation

Source: DB Global Markets Research

Conclusions



- Robust US GDP growth means slack diminishing quickly
- Euro risk is real, but may be easily overplayed.
- Puzzle resolution: Subdued market interest rate and inflation expectations could be revised quickly as oil prices stabilize and wages accelerate.
- Probability of Fed rate hikes by this summer substantially higher than currently priced into the market.

Source: DB Global Markets Research



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- **Peter Hooper** joined Deutsche Bank Securities in 1999 as Chief US Economist. He became Chief Economist and co-head of global economics in 2006. Prior to joining Deutsche Bank, Hooper enjoyed a distinguished 26-year career at the Federal Reserve Board in Washington, D.C. While rising to senior levels of the Fed staff, he held numerous positions, including as an economist on the FOMC. Hooper and his team produce weekly and quarterly publications for Deutsche Bank with a focus on US and global economic developments and Fed policy; he also comments on US and global economic and financial developments in the news media.
- Hooper currently serves as a member of the Economic Advisory Panel of the Federal Reserve Bank of New York, a member and former chairman of the Economic Advisory Committee of the American Bankers Association, a founding member of the US Monetary Policy Forum, a member of the Economic Leadership Council for the University of Michigan, and a member of the Forecasters' Club of New York. Hooper earned a BA in Economics (cum laude) from Princeton University and an MA and Ph.D. in Economics from University of Michigan. He has published numerous books, journal articles, and reviews on economics and policy analysis.



Appendix 1

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