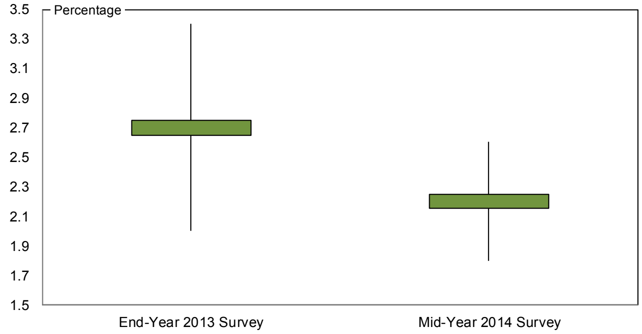
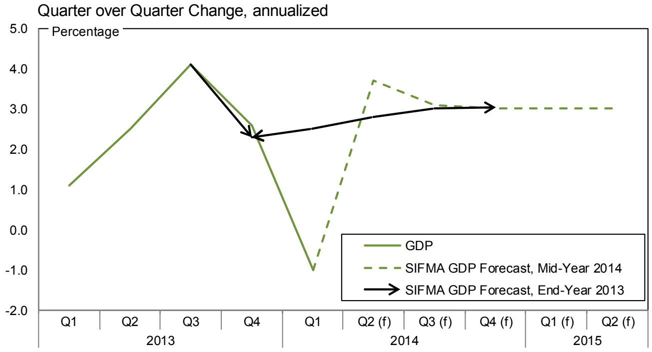
**Full Year 2014 GDP Growth Estimates**
End-Year 2013 vs Mid-Year 2014



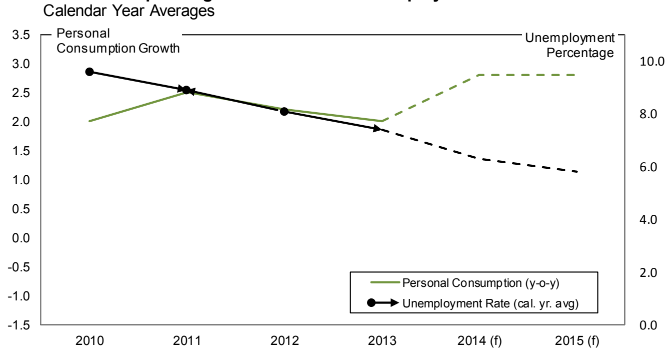

Sources: Responses to the SIFMA Economic Advisory Roundtable End-Year 2013 and Mid-Year 2014 Economic Outlook Survey

**Real GDP Growth Rate**
Quarter over Quarter Change, annualized




*(f) Forecast
Source: Actuals: Bureau of Economic Analysis; Forecasts: Median Response to the SIFMA Economic Advisory Roundtable Mid-Year 2014 Economic Outlook Survey

**Consumer Spending Growth Rate and Unemployment Rate**
Calendar Year Averages




*(f) Forecast
Source: Actuals: Bureau of Economic Analysis (Personal Consumption) & Bureau of Labor Statistics (Unemployment); Forecasts: Median Response to the SIFMA Economic Advisory Rountable Mid-Year 2014 Economic Outlook Survey

## GEOPOLITICAL CONCERNS, MONETARY POLICY, SEVERE WEATHER WEIGH ON FORECAST

SIFMA's Economic Advisory Roundtable forecasted that the U.S. economy will grow at a 2.2 percent rate in full-year 2014. Geopolitical concerns and monetary policy uncertainty, on top of the negative impact of severe weather in the first quarter, contributed to a lowered outlook for 2014, compared to the Roundtable's previous prediction of 2.7 percent. A rebound to 3.1 percent GDP growth was forecast for full-year 2015.[1]

## Forecast Highlights

**MONETARY POLICY** Expectations for the Federal Open Market Committee (FOMC) to maintain its current 0.0 to 0.25 percent target federal funds rate range through mid-year 2015 have persisted, with half the respondents now expecting the first rate hike in 2Q'15, 40 percent in the second half of 2015, and the remaining 10 percent in 1Q'16. Opinions diverged significantly on when the FOMC would begin shrinking the Federal Reserve's balance sheet by curtailing reinvestment of proceeds from its asset holdings. There continues to be near unanimity, however, that the FOMC securities purchases will cease by the end of 2014.

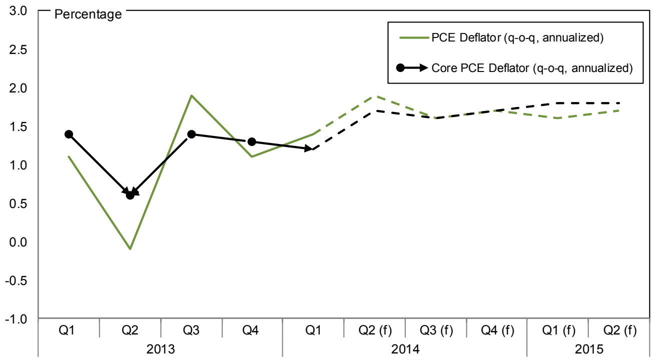
**THE ECONOMY** The median mid-year forecast called for 2014 gross domestic product (GDP) to grow by 2.2 percent on a year-over-year and fourth quarter-to-fourth quarter basis, weaker than predicted in the end-year survey.[2] Survey respondents noted that the unusually harsh winter played a significant role in weak 1Q'14 GDP. All agreed that the weather lowered GDP by at least 50 basis points, with a majority estimating at least a 100 basis point impact and a significant minority of respondents believing the impact to be greater than 200 basis points.

Respondents expected 2Q'14 GDP growth to be 3.7 percent on an annualized basis, before slowing to 3.1 percent and 3.0 percent, respectively, in 3Q'14 and 4Q'14.[3] For full-year 2015, GDP growth was expected climb slightly to 3.1 percent, while the first two quarters of 2015 were expected to remain at 3.0 percent annualized GDP growth.[4]

Unemployment was expected to continue to improve in 2014. Survey respondents forecast the full-year average unemployment rate will decline to 6.3 percent in 2014 and further fall to 5.8 percent in 2015.[5] Full-year non-farm payroll employment gains were expected to reach 2.4 million jobs in 2014[6] and 2015.[7] Expectations for consumer

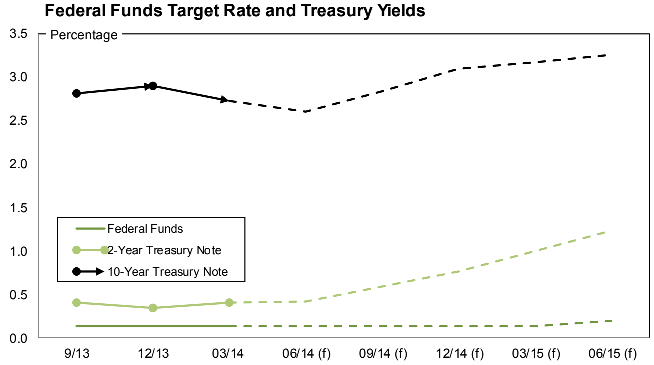
[1] The survey was conducted from May 28, 2014 to June 10, 2014. The forecasts discussed in the text and appearing in the accompanying data tables and graphs are the median values of the individual member firms' submissions, unless otherwise specified.
[2] The full-year 2014 GDP growth forecasts ranged from 1.8 percent to 2.6 percent and on a fourth-quarter-to-fourth quarter basis ranged from 1.8 percent to 2.6 percent.
[3] On a quarterly basis, annualized GDP growth forecasts ranged from 2.9 percent to 5.0 percent in 2Q'14, from 2.0 percent to 3.5 percent in 3Q'14, and from 2.5 percent to 3.7 percent in 4Q'14.
[4] The full-year 2015 GDP growth forecasts ranged from 2.6 percent to 3.8 percent. On a quarterly basis, annualized GDP growth forecasts ranged from 2.5 percent to 3.8 percent in 1Q'15, and 2.5 percent to 3.9 percent in 2Q'15.
[5] The full-year 2014 average unemployment rate forecast ranged from 5.7 percent to 6.5 percent and for 2015 ranged from 5.4 percent to 6.2 percent.
[6] The full-year 2014 non-farm payroll employment growth forecasts ranged from 2.2 million jobs to 3.3 million jobs.
[7] The full-year 2015 non-farm payroll employment growth forecasts ranged from 2.1 million jobs to 2.8 million jobs.

**PCE Deflator & Core PCE Deflator**




*(f) Forecast
Source: Actuals: Bureau of Economic Analysis; Forecasts: Median Response to the SIFMA Economic Advisory Roundtable Mid-Year 2014 Economic Outlook Survey

**Federal Funds Target Rate and Treasury Yields**




*(f) Forecast
Source: Actuals: Bureau of Economic Analysis, Federal Reserve; Forecasts: Median Response to the SIFMA Economic Advisory Roundtable Mid-Year 2014 Economic Outlook Survey

spending trends improved from end-year 2013, with personal consumption estimated to rise by 2.8 percent in 2014 (compared to the median expectation of 2.5 percent in the previous survey), and remain the same, at 2.8 percent, in 2015.[8]

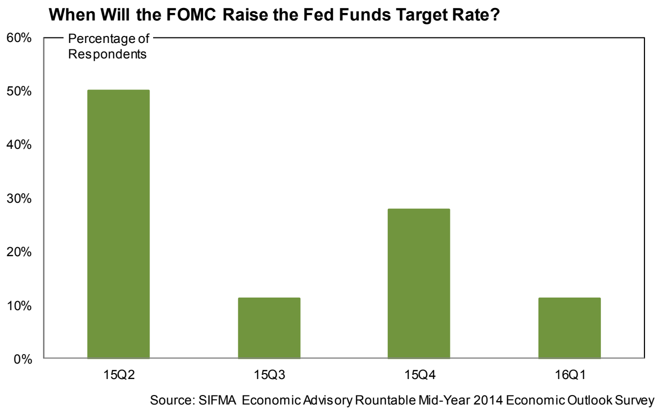
The business capital investment growth estimate for full-year 2014 weakened considerably to 3.6 percent from the 5.0 percent forecasted at end-year; however, improvement is expected in 2015, with a median forecast of 5.7 percent growth.[9] The outlook for state and local government spending weakened considerably, however, with a median estimate of 0.2 percent growth in 2014 (versus 1.2 percent forecast at end-year), followed by 1.3 percent growth in 2015.[10]

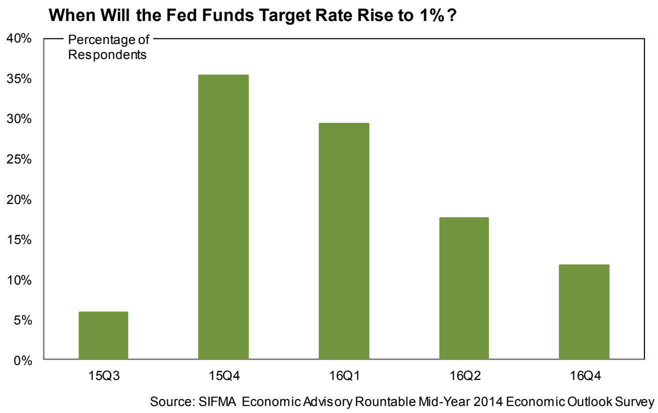
The median forecast for "headline" inflation, measured by the personal consumption expenditures (PCE) chain price index, strengthened slightly from year-end, with 1.5 percent growth expected for full-year 2014 (compared to 1.3 percent previously forecast) and 1.8 percent for full-year 2015.[11] The median forecast for the core PCE chain price index was 1.4 percent (down slightly from 1.5 percent last year) for full-year 2014, and 1.8 percent forecast for full-year 2015.[12]

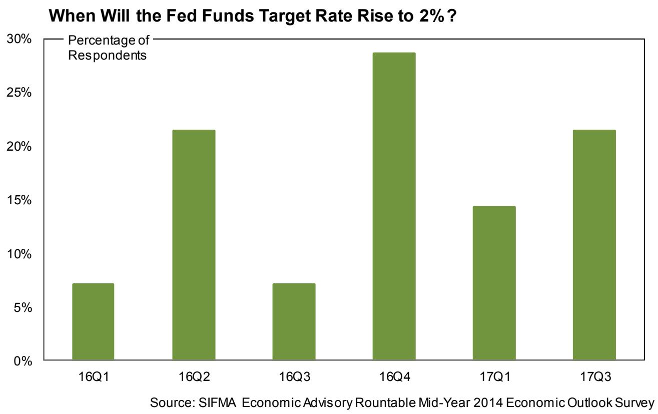
The outlook for inflation remains moderate for 2014. Approximately 70 percent of respondents expressed no concern about inflation in the second half of 2014, with the balance expressing "moderate worry." Respondents were unanimous about not being worried about deflation in the second half of 2014. Economic slack/employment continued to be the dominant factor in the inflation outlook, followed by global economic conditions; these factors were the same noted in both surveys in 2013. The Federal Reserve's balance sheet and fiscal policy/deficit trends were ranked third and fourth in importance, as in last year's surveys. Respondents noted that wage pressure, along with rising shelter and medical care costs, would cause "core inflation to firm," while another respondent noted that businesses would continue to "lack pricing power until wage and salary growth income growth approaches 6 percent annually."

**INTEREST RATES** As referenced earlier, the Roundtable expected the FOMC to maintain its 0.0 to 0.25 percent target federal funds rate through 2014 and early 2015, although there was a notable range of expectations. Approximately half of respondents expected the first rate hike to occur in the second quarter of 2015, a third in 4Q'15 and the remainder split between 3Q'15 and 1Q'16. As of June 10, 2014 (the end of the survey period), the 10-year U.S. Treasury yield was 2.64 percent; and the median forecasts for 10-year Treasury rates were 2.60 percent in June 2014, 2.83 percent in September 2014, 3.10 percent in December 2014, 3.17 percent in March 2015, and 3.26 percent in June 2015.[13] Survey respondents were divided on the source of the greatest impact on long-term Treasury yields in 2014; the most frequently cited "greatest impact" was expected from inflation or

[8] Personal consumption growth forecasts ranged from 2.5 percent to 3.0 percent in 2014, and 2.3 percent to 3.5 percent in 2015.
[9] The full-year 2014 business fixed investment forecasts ranged from 2.4 percent to 5.2 percent and for 2015 ranged from 3.2 percent to 8.2 percent.
[10] The full-year 2014 real state and local government spending forecasts ranged from (1.9) percent to 0.6 percent and for 2015 ranged from (1.8) percent to 3.5 percent.
[11] The full-year 2014 PCE deflator forecasts ranged from 1.3 percent to 1.8 percent and for 2015, from 0.8 percent to 2.3 percent.
[12] The full-year 2014 core PCE deflator forecasts ranged from 1.3 percent to 1.6 percent and for 2015, from 0.8 percent to 2.4 percent.
[13] The average 10-year Treasury yield forecasts ranged from 2.50 percent to 3.00 percent for June 2014, from 2.50 percent to 3.30 percent for September 2014, from 2.55 percent to 3.65 percent for December 2014; from 2.60 percent to 3.55 percent in March 2015, and from 2.65 percent to 3.68 percent for June 2015.




inflationary expectations (25 percent), followed by FOMC interest rate policy (19 percent) and credit mark risk aversion / flight to quality (19 percent).

A little more than 80 percent of respondents expected the Treasury yield curve (Fed funds-to-ten year Treasury yield spread) to steepen through the second half of 2014, with the remainder split between expecting no change and expecting the curve to flatten. Nearly 90 percent of survey respondents expected the TED (Treasury bill less LIBOR) spread to remain the same in the second half of 2014, with the balance split between widening and narrowing.

Opinions diverged over the path of investment-grade (IG) and high-yield (HY) spreads. Nearly two-thirds of respondents expected IG spreads to remain unchanged in the second half of 2014, while a fifth expected spreads to widen and the balance to narrow. Half of respondents, however, expected HY spreads to widen, followed by a little over 40 percent expecting to remain unchanged. One respondent noted that at the rate "corporate debt continues to ou[t]pace profits by more than several percentage points, corporate bond yield spreads should widen and the high-yield defaults may rise."

Respondents noted significant risks to the market in reaction to the Fed's monetary policy; one respondent noted that the market's reach for yield would "create some problems for the Fed as they consider normalizing monetary policy."

Respondents were also questioned as to the impact of long-term bond yields in the second half of 2014 from the surprise drop in the deficit as a share of GDP in fiscal year 2014: two-thirds expected little to no impact to long-term yields, with the remainder expressing that the deficit had, at best, placed downward pressure on rates. One respondent noted that while Treasury supply was "limited for the time being, deficits are expected to rise again, implying future supply of [Treasuries]." Another noted that "the problem with the budget has always been long-term in nature. . . lower [government] borrowing should help offset any impact of [tapering]."

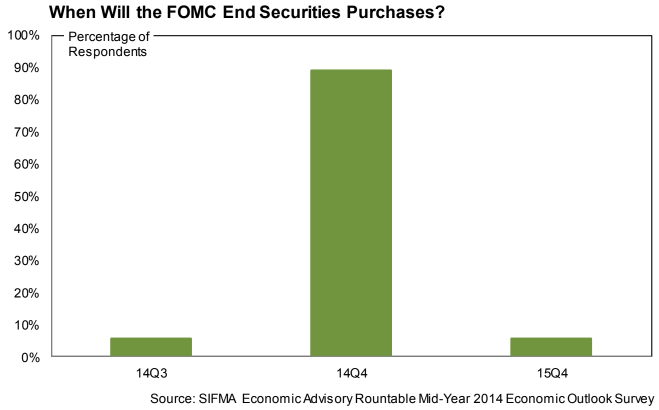
## Monetary Policy

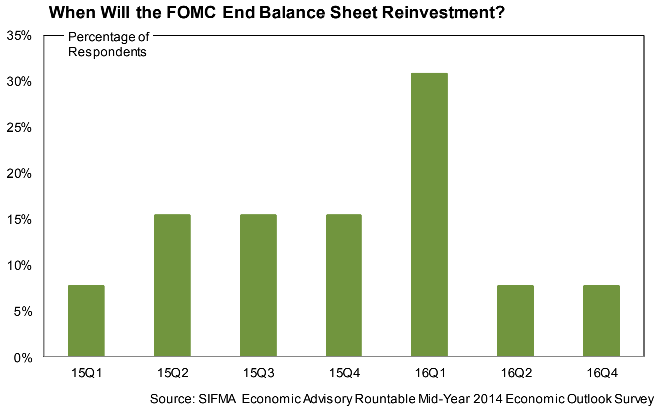
The FOMC continues to scale back the pace of its asset purchases, and began shifting its focus away from numeric thresholds (e.g., the unemployment threshold of 6.5 percent), to a more nuanced view of labor market conditions.

Respondents were nearly unanimous that the asset purchase program would end in the fourth quarter of 2014, with the median expectation that the Fed's balance sheet would reach $4.5 trillion by the time asset purchases ended.[14] As of June 4, the balance sheet was $4.3 trillion, compared to the approximately $500 billion held in December 2008 prior to the start of asset purchases.

Although the FOMC has so far been silent as to the order in which rates would rise and its balance sheet would shrink, both the San Francisco Fed President John Williams and New York Fed Presi-

[14] Expectations of the size of the balance sheet ranged from $4.3 trillion to $5.0 trillion.




dent William Dudley recently indicated their preferences for raising rates prior to shrinking the balance sheet. Survey respondents largely agreed with this order, with nearly three-quarters expecting a rate hike prior to the end of asset reinvestment of the Fed's balance sheet; slightly less than 20 percent expecting the converse, and one respondent expecting both to happen in the same quarter.

Regarding the timing to the first hike in the federal funds target rate, no respondent expects the first rate hike earlier than mid-2015, as noted earlier. Inflation expectations, followed closely by labor market conditions are expected to play the most important factors behind the first rate hike.

Respondents were asked when the target federal funds rate would reach 1 percent: one respondent expected the rate to be reached as early as the third quarter of 2015, 35 percent expected in the fourth quarter of 2015, 29 percent in the first quarter of 2016, and the remainder later in 2016. Opinions diverged even more on the timing of the 2 percent target federal funds rate threshold, with 28 percent of respondents expecting a 2 percent target federal funds rate in the fourth quarter of 2016, although expectations ranged from the first quarter of 2016 to the third quarter of 2017.

When asked about what the FOMC could do to improve communicating its forward guidance, respondents expressed a range of opinions. Some expressed a desire for more clarity and consistency; others expressed the opposite, noting that not doing more "enhances [the Fed's] flexibility." Some preferred additional quantitative metrics (e.g., an inflation measure, a lower threshold for the PCE deflator); others preferred more qualitative factors (e.g., more general employment measures, evaluations of slack remaining, improvement of communication of the Fed's dashboard).

One respondent noted that the Fed "needed to be aware of possible financial market reactions. . . [t]he rest of the world is expected to be sensitive to what the Fed does and how rapidly it moves."

## Risks to Growth: Housing, Corporate Capital Expenditures and Consumer Spending on the Upside; Global Slowdown and Geopolitical Risk on the Downside

The normalization of private credit markets took center stage outlook for bolstering GDP growth in the second half of 2014, with half the respondents considering it the most important factor, followed by business and real estate market adjustments. To a lesser extent, FOMC interest rate actions and China were also considered important factors.

Upside and downside risks to the growth forecasts varied among respondents, although housing was one of the most frequently cited upside *and* downside risk. Stronger than expected corporate capital expenditures, recovery of the housing market, and consumer spending were the most oft-cited upside risks to the economic forecast. Other upside factors cited were the job market, global economic recovery, and "animal spirits starting to run."

Global economic slowdown, geopolitical risks and weaker than expected housing recovery were the main downside risks to the economic outlook. Respondents also noted that rising commodity prices or premature Fed tightening would be downside factors.

## Washington DC Gridlock

Respondents were asked to rank the impact of "gridlock" on a number of economically significant issues pending in Washington DC. As in our prior survey, corporate tax reforms, followed by immigration reform, were noted as the two pending issues with the greatest impact. One respondent noted that "the tax code needs to be shredded and completely revamped." Trade talks were also identified as important, with Asia talks (China, ASEAN, etc.) ranking slightly higher than talks with the EU and NAFTA. As in the previous survey, respondents noted that a long-term budget plan was also important, with one Roundtable member opining that it would remain much more important than any other issue; despite having "plenty of time to address [the budget]. . . it would be nice to have a plan."

Other policy-related issues that merited commentary were: GSE reform, banking regulation, healthcare reform, and federal appropriations.

### Impact of Regulatory Policy

When asked about the impact of concern or uncertainty over the direction of financial regulatory policy generally, and the Volcker rule specifically, on 2014 economic growth, 36 percent of respondents estimated no impact, while 60 percent estimated a negative impact of up to 50 basis points , and the balance a negative impact greater than 50 basis points on US GDP growth.

### Oil Prices

Panelists placed an 80 percent chance on WTI oil prices remaining between $85 and $115 per barrel in 2014, with a 10 percent chance of prices moving either below $85 or above $115 per barrel. The most likely scenario – oil prices remaining between $85 and $115 per barrel – was expected to have no effect on GDP growth. The sub-$85 per barrel scenario was predicted to boost GDP growth by approximately 95 basis points, while the $115+ per barrel scenario would have the effect of reducing GDP growth by 31 basis points. It should be noted that the Roundtable survey period ended early June, prior to recent geopolitical events.

# SIFMA ECONOMIC ADVISORY ROUNDTABLE FORECAST

Inflation adjusted year-over-year percentage change, unless otherwise specified.

| | 2014 | 2015 |
|---|---|---|
| Real GDP | 2.2 | 3.1 |
| Real GDP (4Q – 4Q) | 2.2 | N/A |
| CPI | 1.8 | 1.9 |
| CPI (4Q – 4Q) | 1.9 | N/A |
| Core CPI | 1.8 | 2.1 |
| Core CPI (4Q – 4Q) | 2.0 | N/A |
| PCE deflator | 1.5 | 1.8 |
| PCE deflator (4Q – 4Q) | 1.7 | N/A |
| Core PCE deflator | 1.4 | 1.8 |
| Core PCE deflator (4Q – 4Q) | 1.6 | N/A |
| Personal Consumption | 2.8 | 2.8 |
| Nonresidential Fixed Investment | 3.6 | 5.7 |
| Housing Starts (millions) | 1.0 | 1.2 |
| Real State & Local Government Spending | 0.2 | 1.3 |
| Current Account Deficit ($ billions) | 381.5 | 401.8 |
| New Home Sales (millions of units) | 0.5 | 0.5 |
| Existing Home Sales (millions of units) | 4.9 | 5.2 |
| Nonfarm Payroll Employment (change in millions) | 2.4 | 2.4 |
| Unemployment Rate (calendar year average) | 6.3 | 5.8 |
| Federal Budget (FY, $ billions) | (490.0) | (472.5) |

## Quarter-to-Quarter % Changes in Annual Rates

| | 2014 | | | 2015 | |
|---|---|---|---|---|---|
| | II | III | IV | I | II |
| Real GDP | 3.7 | 3.1 | 3.0 | 3.0 | 3.0 |
| CPI | 2.5 | 1.9 | 1.9 | 1.9 | 2.0 |
| Core CPI | 2.2 | 1.8 | 1.9 | 2.0 | 2.0 |
| PCE deflator | 1.9 | 1.6 | 1.7 | 1.6 | 1.7 |
| Core PCE deflator | 1.7 | 1.6 | 1.7 | 1.8 | 1.8 |
| Personal Consumption | 3.2 | 2.7 | 2.6 | 2.7 | 2.7 |
| Nonresidential Fixed Investment | 6.0 | 5.7 | 5.8 | 5.6 | 5.6 |

## Interest Rates (monthly average %)

| | Jun. '14 | Sep. '14 | Dec. '14 | Mar. '15 | Jun. '15 |
|---|---|---|---|---|---|
| Fed Funds | 0.13 | 0.13 | 0.13 | 0.13 | 0.19 |
| 2 Year Treasury Note | 0.42 | 0.59 | 0.76 | 1.0 | 1.23 |
| 10 Year Treasury Note | 2.60 | 2.83 | 3.10 | 3.17 | 3.26 |
| 30 Year Fixed-Rate Home Mortgages | 4.20 | 4.45 | 4.65 | 4.76 | 4.96 |

## Exchange Rates (monthly average %)

| | Jun. '14 | Sep. '14 | Dec. '14 | Mar. '15 | Jun. '15 |
|---|---|---|---|---|---|
| Yen/Dollar | 102.7 | 104.0 | 105.0 | 106.0 | 105.5 |
| Dollar/Euro | 1.37 | 1.35 | 1.32 | 1.30 | 1.28 |

## ECONOMIC ADVISORY ROUNDTABLE

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**John Lonski**
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**Scott J. Brown**
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**Bethann Bovino**
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