U.S. Outlook

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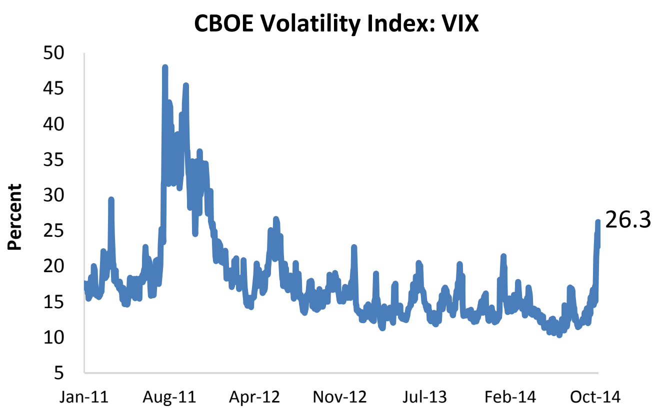
Date	Indicator	For	Estimate	Consensus*	Previous Period
21-October -2014	Existing Home Sales	SEP	5.07M	5.10M	5.05M
22-October -2014	Consumer Price Index MoM	SEP	0.0%	0.0%	-0.2%
22-October -2014	CPI Ex. Food and Energy MoM	SEP	0.1%	0.2%	0.0%
23-October -2014	Initial Jobless Claims	10/18	273K	N/A	264K
23-October -2014	FHFA House Price Index MoM	AUG	0.1%	0.4%	0.1%
23-October -2014	Leading Index	SEP	0.6%	0.7%	0.2%
23-October -2014	Chicago Fed Nat Activity Index	SEP	N/A	N/A	-0.21
23-October -2014	Kansas City Fed Mfg Index	OCT	N/A	N/A	6
24-October -2014	New Home Sales MoM	SEP	450K	470K	504K

*Consensus from Bloomberg

Factoring a Global Downturn into U.S. Outlook

Financial market volatility has returned with a vengeance. The S&P 500 is down about 6.0% over the past month. The financial carnage in Europe has been even more dramatic. The German DAX and French CAC index have both lost over 10% in U.S. dollar terms. The CBOE VIX index, a measure of S&P 500 market volatility, shot up to 26.3 on Wednesday, its highest level since 2011.

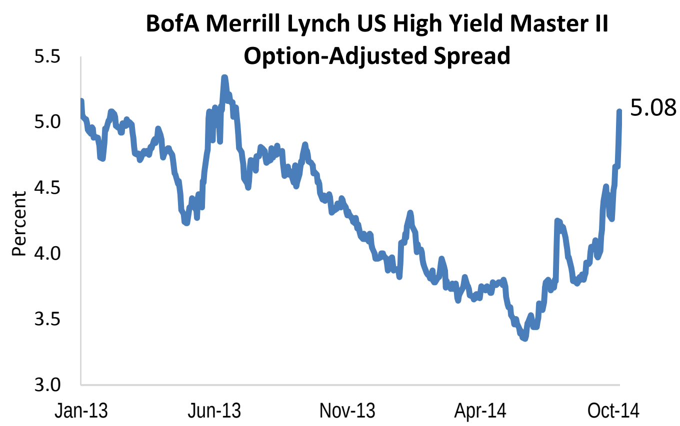
VIX Index Signals Volatility Could Be Around for a While



Source: Chicago Board Options Exchange

Bond investors have become far more risk adverse as well. High-yield corporate bond spreads widened out to 5.08 percentage points this week, up from a modest 3.35 percentage points as recently as June. This is the highest credit-risk spread on these securities in over a year.

Bond Investors Become More Adverse to Credit-Risk



Source: BofA Merrill Lynch

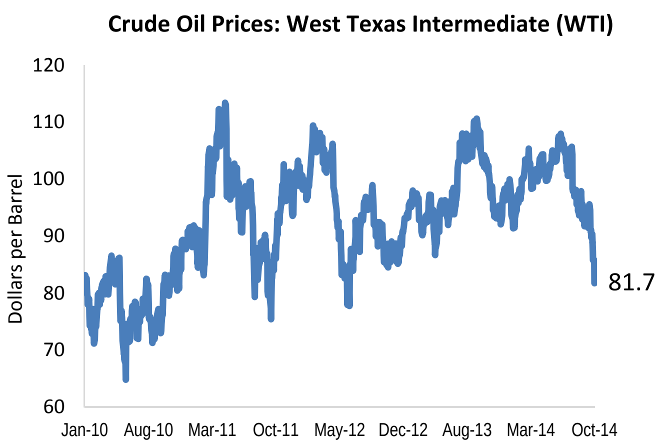
Flight to safety into U.S. Treasury bonds has been massive. The 10-Year Treasury yield traded below 2.0 percent for brief periods on Wednesday and Thursday for the first time since May 21, 2013, before Bernanke signaled the Federal Reserve was planning to reduce its monthly asset purchases.

Markets are clearly concerned about the growth and inflation outlook for Europe, and trying to gauge the implications for the U.S. economy, inflation, and Fed monetary policy. In today's outlook report, we incorporate the shifting global economic and inflation outlook into our view on the U.S. economy, interest rates, and inflation.

Europe's growth problems are immense. The German growth engine appears to be faltering at a time when Europe's economy remains heavily dependent on solid growth continuing there. In fact, the economic data out of Germany for August look downright recessionary. German retail sales were up only 0.1% from a year ago in August. German factory orders dropped 5.7% on the month, industrial production plunged 4.0%, while German exports were off 5.7% in August alone. This disappointing factory performance for Germany has been matched by equally large declines in German business confidence.

A third recession in less than six years in the Eurozone, even if shallow and brief, could spread deflationary pressures across the globe. We have already seen widespread and deep declines in global oil, agricultural, and base metal prices.

Drop in Oil and Other Commodities Adds To Deflation Risk



Source: U.S. Energy Information Administration

With Eurozone unemployment already at 11.5 percent, higher than at the end of the "Great Recession", any uptick in labor market slack would prolong and deepen Europe's deflationary problems. Eurozone consumer inflation was confirmed at a low 0.3 percent through September. The signals coming from Europe's bond market are gloomy. The German 10-Year sovereign bond yield hit a record low 0.75 percent this week. And negative two-year bond yields can be found in Germany, Netherlands, and Switzerland.

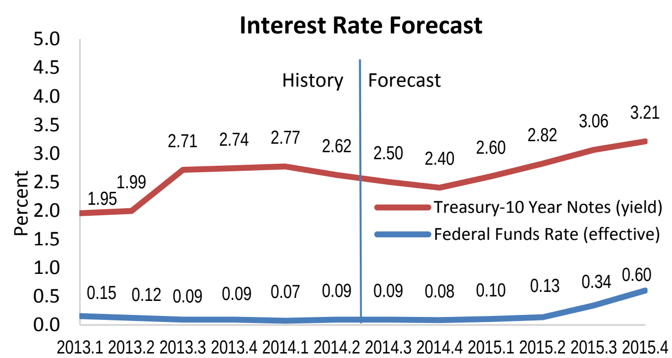
Impacts on the US Outlook

We have bumped up our forecast for the U.S. trade-weighted dollar in 2015 due to the real growth divergence we expect between the United States and most other developed economies. A stronger dollar combined with a weaker outlook for U.S. oil prices and other commodities has caused us to cut our U.S. consumer inflation forecasts over the next few quarters. We now expect consumer price inflation of only 1.2 percent in 2015 down from 1.7 percent in 2014. Core-CPI inflation is also expected to remain far away from the Fed's 2.0 percent target at just 1.5 percent. As economists and the Fed cut their inflation forecasts for next year, I expect the FOMC focus to shift away from the labor market back toward guarding its inflation mandate and target.

Add to the mix more downside global growth risks and financial market volatility, and it's not hard to envision another delay in raising short-term interest rates.

As a result, we cut our long-term and short-term interest rate forecasts for 2015. We now see the 10-Yr Treasury yield averaging just 2.4 percent in the fourth quarter of 2014, rising to around 3.21 percent by the fourth quarter of next year. On the short-end, we have pushed back our expectations for the first Fed funds interest rate hike into the third quarter of 2015, even as the unemployment rate in the United States is expected to fall to 5.5 percent. With inflation remaining well below the Fed's target, there will be little incentive for the Fed to push up short-term interest rates at an urgent pace. We now see the effective Fed funds rate averaging just 0.6 percent in the fourth quarter of next year.

U.S. Interest Rate Forecasts Come Down



Source: Fed Reserve; BOTW Economics

Despite these changes to our inflation, interest rate, and monetary policy outlook for next year, the real GDP growth outlook for the United States remains largely intact. We expect lower consumer inflation, interest rates, and oil prices, to help sustain the recovery in consumer spending and the housing market. Meanwhile, the stronger dollar and weaker global growth outlook will weigh a bit more on U.S. manufacturing and exports, corporate profits, and business investment spending. At this point the offsetting impacts look likely to cancel each other out. We still expect U.S. GDP growth of around 3.0 percent over the next six quarters.

Major Economic Indicators

	History								Forecast				Yr/Yr % chg or Annual Avg.			
Economic Data	**2013.1**	**2013.2**	**2013.3**	**2013.4**	**2014.1**	**2014.2**	**2014.3**	**2014.4**	**2015.1**	**2015.2**	**2015.3**	**2015.4**	**2012**	**2013**	**2014**	**2015**
Real GDP*	2.7	1.8	4.5	3.5	-2.1	4.6	3.1	2.9	3.0	3.0	2.9	2.9	2.3	2.2	2.2	3.1
Personal Consumption Expenditures*	3.6	1.8	2.0	3.7	1.2	2.5	1.8	2.8	2.9	2.8	2.7	2.7	1.8	2.4	2.2	2.7
Non-residential Fixed Investment*	1.5	1.6	5.5	10.4	1.6	9.7	7.1	5.6	4.9	4.9	4.9	4.9	7.2	3.0	6.2	5.7
Private Housing Starts (000s units)	947	865	882	1,025	925	985	1,023	1,040	1,096	1,100	1,121	1,143	784	930	993	1,115
Vehicle Sales (mill. Units, annualized)	15.3	15.5	15.7	15.6	15.6	16.5	16.7	16.8	17.0	17.1	17.2	17.3	14.4	15.5	16.4	17.2
Industrial Production*	4.2	1.9	2.5	4.9	3.9	5.5	2.7	4.5	3.5	3.3	3.3	3.2	3.8	2.9	4.0	3.7
Nonfarm Payroll Employment (mil.)	135.5	136.1	136.6	137.2	137.8	138.5	139.1	139.7	140.4	141.4	141.7	142.3	134.1	136.4	138.8	141.4
Unemployment rate	7.7	7.5	7.2	7.0	6.7	6.2	6.1	5.8	5.7	5.6	5.5	5.5	8.1	7.4	6.2	5.6
Consumer Price Index* (percent)	1.2	0.4	2.2	1.1	1.9	3.0	0.5	0.9	0.5	1.7	1.9	1.9	2.1	1.5	1.7	1.2
"Core" CPI* (percent)	2.0	1.4	1.8	1.6	1.6	2.5	0.9	1.1	1.6	1.7	1.7	1.8	2.1	1.8	1.7	1.5
PPI (finished goods)* (percent)	0.8	-1.0	2.3	1.2	3.9	3.7	-0.3	-0.1	0.0	0.3	1.0	1.1	2.0	1.2	2.0	0.4
Trade Weighted Dollar (Fed BOG, major)	74.8	76.6	76.8	76.0	77.1	76.6	77.0	80.5	82.0	82.5	83.2	83.8	73.6	76.1	77.8	82.9
Crude Oil Prices -WTI ($ per barrel)	94	94	106	98	99	103	98	85	87	87	89	90	94	98	96	88

*Quarterly Data Percent Change At Annual Rate; Annual Data Year-on-Year % Chg, or Annual Average.

	History								Forecast				Annual Average			
Financial Data	**2013.1**	**2013.2**	**2013.3**	**2013.4**	**2014.1**	**2014.2**	**2014.3**	**2014.4**	**2015.1**	**2015.2**	**2015.3**	**2015.4**	**2012**	**2013**	**2014**	**2015**
S & P 500	1,514	1,610	1,675	1,769	1,835	1,900	1,976						1,379	1,644		
Dow Jones Industrial Average	13,994	14,959	15,286	15,736	16,177	16,604	16,954						12,965	15,010		
Federal Funds Rate (effective)	0.15	0.12	0.09	0.09	0.07	0.09	0.09	0.08	0.10	0.13	0.34	0.60	0.14	0.11	0.08	0.29
Treasury-3 Month Bills (yield)	0.09	0.05	0.03	0.06	0.05	0.03	0.03	0.03	0.03	0.11	0.34	0.66	0.09	0.06	0.04	0.29
Treasury-2 Year Notes (yield)	0.26	0.27	0.37	0.33	0.37	0.42	0.52	0.46	0.74	0.90	1.13	1.43	0.28	0.31	0.44	1.05
Treasury-5 Year Notes (yield)	0.82	0.91	1.50	1.44	1.60	1.66	1.70	1.64	1.70	1.91	2.12	2.40	0.76	1.17	1.65	2.03
Treasury-10 Year Notes (yield)	1.95	1.99	2.71	2.74	2.77	2.62	2.50	2.40	2.60	2.82	3.06	3.21	1.80	2.35	2.57	2.92
Treasury-30 Year Notes (yield)	3.13	3.14	3.71	3.79	3.68	3.44	3.27	3.12	3.43	3.63	3.73	3.83	2.92	3.44	3.38	3.66
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.38	3.87	3.25	3.25	3.25	3.44
Libor 3-Mo. U.S. Dollar	0.29	0.28	0.28	0.28	0.26	0.25	0.24	0.24	0.25	0.28	0.49	0.75	0.42	0.28	0.25	0.44
Mortgage-30 Year (yield)	3.50	3.67	4.44	4.29	4.36	4.23	4.14	4.07	4.27	4.46	4.70	4.84	3.66	3.98	4.20	4.57
BAA Corporate (yield)	4.81	4.82	5.40	5.36	5.12	4.82	4.74	4.73	4.78	4.94	5.16	5.32	4.94	5.10	4.85	5.05

Source: Bank of the West Economics, Bloomberg, Federal Reserve