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U.S. Outlook

SCOTT ANDERSON, Ph.D | Chief Economist | 415.765.8020
www.bankofthewest.com

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Date	Indicator	For	Estimate	Consensus*	Previous Period
27-April-2015	Markit US Composite PMI	Apr P	NA	NA	59.2
27-April-2015	Dallas Fed Manf. Activity	Apr	NA	-12.0	-17.4
28-April-2015	S&P/Case Shiller 20 City MoM SA	Feb	0.80%	0.75%	0.87%
28-April-2015	Consumer Confidence Index	Apr	102.0	102.5	101.3
29-April-2015	GDP Annualized QoQ	1Q A	1.3%	1.0%	2.2%
29-April-2015	Personal Consumption	1Q A	2.0%	1.8%	4.4%
29-April-2015	GDP Price Index	1Q A	0.5%	0.5%	0.1%
29-April-2015	Pending Home Sales MoM	Mar	1.8%	1.0%	3.1%
29-April-2015	FOMC Rate Decision (Upper Bound)	Apr 29	0.25%	0.25%	0.25%
29-April-2015	FOMC Rate Decision (Lower Bound)	Apr 29	0.00%	0.00%	0.00%
30-April-2015	Employment Cost Index	1Q	0.6%	0.6%	0.6%
30-April-2015	Personal Income	Mar	0.3%	0.2%	0.4%
30-April-2015	Personal Spending	Mar	0.5%	0.5%	0.1%
30-April-2015	PCE Deflator MoM	Mar	0.2%	0.2%	0.2%
30-April-2015	PCE Core MoM	Mar	0.1%	0.1%	0.1%
30-April-2015	Initial Jobless Claims	Apr 25	297K	NA	295K
30-April-2015	Chicago Purchasing Manager	Apr	49.0	50.0	46.3
01-May-2015	Construction Spending MoM	Mar	0.3%	0.5%	-0.1%
01-May-2015	ISM Manufacturing	Apr	52.0	52.0	51.5
01-May-2015	U. of Mich. Sentiment	Apr F	96.0	96.0	95.9
01-May-2015	Wards Total Vehicle Sales	Apr	17.00M	16.90M	17.05M

*Consensus from Bloomberg

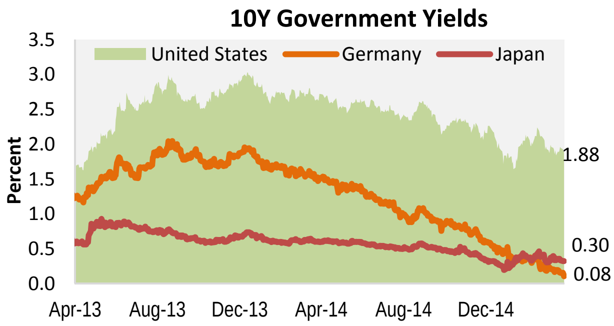
Monetary Policy Tighter Without Tightening

With the April FOMC meeting on tap for next week, and everyone, including me, looking for the Fed to delay somewhat its initial rate hike until September, I thought now would be a good time to add some points to the go-slow approach currently being touted by Chair Yellen, and many other Fed presidents and governors.

Many have cited the U.S. growth slowdown in Q1, and the downside risks from Europe, China, and a strong U.S. dollar. These factors alone are pretty good reasons to remain cautious as the Fed normalizes interest rates.

Others look at the dramatic drop in global interest rates and ask: How can the Fed raise interest rates when the rest of the world is moving in the opposite direction?

U.S. Interest Rates Out-of-Line With The Rest of the World?

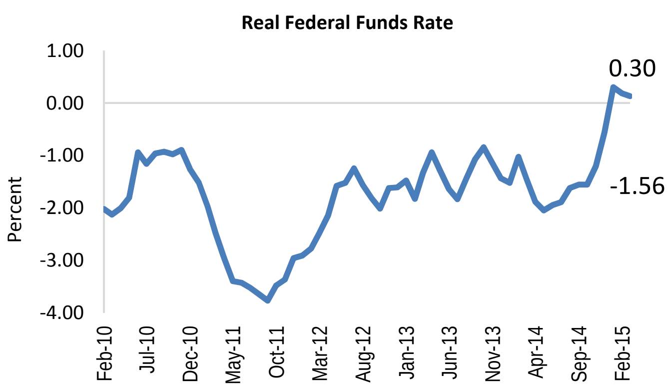


Source: Bloomberg

All good points, but here are a few more you might not yet have considered.

Low inflation has already pushed inflation-adjusted, or real, interest rates higher without the Fed even touching the Fed funds target rate. And from Economics 101, its real interest rates that matter for the economy and spending.

Low Inflation has Already Raised U.S. Interest Rates



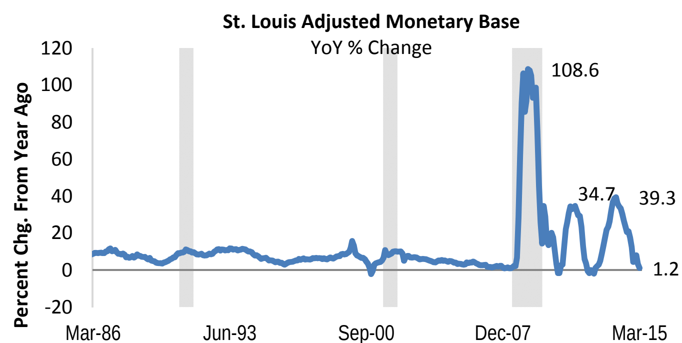
Source: Federal Reserve System

While the Fed maintains that raising short-term interest rates off the floor isn't tightening, but merely "normalizing" short-term interest rates, don't get caught up in the semantics, **normalizing is tightening**, especially since rates have been at the zero bound for so long. Our macroeconomic models tell us that higher real interest rates always reduce interest sensitive spending, not just when interest rates move above **normal** levels. Or in economist speak- the relationship between real interest rates and interest sensitive spending is linear, not non-linear.

Moreover, I suspect the interest rate sensitivity of housing demand, and even real consumer spending could be higher today than it has been in the past. When interest rates were higher, say in the four to five percent range, a quarter percentage point move in the Fed funds rate, up or down, didn't make a lot of difference. But when short-term interest rates are measured in the hundredth's place, suddenly a 0.25 percentage point move becomes a huge deal. Everyone has been conditioned to the "new normal" low-interest rate environment, any significant deviation from that reality will likely have significant real world impacts – and not the positive kind.

Let's not forget that the tapering of the Fed's large-scale asset purchases that began last February and finally the end of QE3 asset purchases last October were the first initial foray into monetary tightening. Indeed, if one looks at high-powered money, what economist call the monetary base, which includes currency in circulation, vault cash, and bank reserves held at the Fed, you can clearly see the monetary stimulus of QE1, QE2, and QE3, has now completely disappeared. The monetary base's growth has gone from 39% to 1.2% in little over a year.

Monetary Base Growth Slows to a Crawl



Source: Federal Reserve Bank of St. Louis

The idea is that stepped up lending from the banking sector will fill the void and keep the broader money supply, liquidity, and demand deposits growing. But without stronger bank lending trends, the Fed's end of QE3 may be all the tightening the economy can absorb.

Bottom-line: the U.S. economy is probably resilient enough to withstand a few token rate hikes from the FOMC today, but beyond that, it's difficult to say with much certainty. If Europe and the global economy improve, U.S. inflation increases, and bank lending continues to recover, the Fed will be in a good position to continue the interest rate normalization process, but for now a "go-slow" snail's pace approach appears prudent.

Major Economic Indicators

	History				Forecast								Yr/Yr % chg or Annual Avg.			
Economic Data	**2014.1**	**2014.2**	**2014.3**	**2014.4**	**2015.1**	**2015.2**	**2015.3**	**2015.4**	**2016.1**	**2016.2**	**2016.3**	**2016.4**	**2013**	**2014**	**2015**	**2016**
Real GDP*	-2.1	4.6	5.0	2.2	1.3	2.9	2.9	3.0	2.7	2.8	2.7	2.7	2.2	2.4	2.7	2.8
Personal Consumption Expenditures*	1.2	2.5	3.2	4.4	2.0	3.8	3.5	3.4	3.1	3.1	2.9	2.8	2.4	2.5	3.3	3.2
Non-residential Fixed Investment*	1.6	9.7	8.9	4.7	2.2	2.8	5.0	5.0	4.7	4.6	4.6	4.2	3.0	6.3	4.6	4.7
Private Housing Starts (000s units)	925	985	1,030	1,063	969	1,050	1,101	1,133	1,145	1,170	1,230	1,250	930	1,004	1,063	1,199
Vehicle Sales (mill. Units, annualized)	15.7	16.5	16.7	16.8	16.6	17.1	17.2	17.2	17.2	17.2	17.3	17.3	15.5	16.4	17.0	17.2
Industrial Production*	3.9	5.7	4.1	4.6	-1.0	2.0	3.3	3.2	3.4	3.4	3.4	3.4	2.9	4.2	2.4	3.3
Nonfarm Payroll Employment (mil.)	137.8	138.6	139.4	140.2	141.0	141.8	142.7	143.5	144.3	145.1	145.9	146.6	136.4	139.0	142.3	145.5
Unemployment rate	6.6	6.2	6.1	5.7	5.6	5.4	5.2	5.1	5.0	4.9	4.9	4.9	7.4	6.2	5.3	4.9
Consumer Price Index* (percent)	2.1	2.4	1.2	-0.9	-3.0	1.7	1.9	1.9	1.9	1.9	2.0	2.1	1.5	1.6	0.1	1.9
"Core" CPI* (percent)	1.8	2.2	1.4	1.5	1.9	1.8	1.8	1.9	1.9	1.9	2.0	2.0	1.8	1.7	1.8	1.9
PPI (finished goods)* (percent)	4.1	3.5	0.4	-5.1	-11.5	0.3	1.0	1.1	1.3	1.3	1.4	1.4	1.2	1.3	0.3	1.8
Trade Weighted Dollar (Fed BOG, major)	76.9	76.4	77.5	82.2	89.3	90.0	90.4	90.7	91.0	91.8	92.5	92.4	76.1	78.3	90.1	91.9
Crude Oil Prices -WTI ($ per barrel)	99	103	98	76	50	52	54	55	62	63	64	65	98	94	53	64

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

	History				Forecast								Annual Average			
Financial Data	**2014.1**	**2014.2**	**2014.3**	**2014.4**	**2015.1**	**2015.2**	**2015.3**	**2015.4**	**2016.1**	**2016.2**	**2016.3**	**2016.4**	**2013**	**2014**	**2015**	**2016**
S & P 500	1,835	1,900	1,976	2,009	2,064								1,644			
Dow Jones Industrial Average	16,177	16,604	16,954	17,345	17,808								15,010			
Federal Funds Rate (effective)	0.07	0.09	0.09	0.10	0.11	0.13	0.21	0.46	0.88	1.13	1.38	1.71	0.11	0.08	0.23	1.27
Treasury-3 Month Bills (yield)	0.05	0.03	0.03	0.02	0.02	0.05	0.11	0.36	0.78	1.03	1.28	1.61	0.06	0.03	0.14	1.18
Treasury-2 Year Notes (yield)	0.37	0.42	0.52	0.54	0.60	0.65	0.88	1.08	1.55	1.85	2.10	2.43	0.31	0.45	0.80	1.98
Treasury-5 Year Notes (yield)	1.60	1.66	1.70	1.60	1.46	1.53	1.72	2.00	2.44	2.64	2.89	3.02	1.17	1.63	1.68	2.75
Treasury-10 Year Notes (yield)	2.77	2.62	2.50	2.28	1.97	2.17	2.35	2.51	2.71	2.84	2.95	3.18	2.35	2.54	2.25	2.92
Treasury-30 Year Notes (yield)	3.68	3.44	3.27	2.97	2.55	2.75	2.90	3.05	3.16	3.27	3.40	3.53	3.44	3.34	2.81	3.34
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.33	3.58	4.00	4.25	4.50	4.83	3.25	3.25	3.35	4.40
Libor 3-Mo. U.S. Dollar	0.26	0.25	0.24	0.25	0.30	0.27	0.33	0.58	1.00	1.25	1.50	1.83	0.28	0.25	0.36	1.40
Mortgage-30 Year (yield)	4.36	4.23	4.14	3.96	3.72	3.92	4.16	4.30	4.52	4.65	4.76	4.99	3.98	4.19	4.02	4.73
BAA Corporate (yield)	5.12	4.82	4.74	4.73	4.50	4.62	4.70	4.87	5.05	5.20	5.32	5.55	5.10	4.86	4.68	5.28

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