

# U.S. Outlook

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Date	Indicator	For	Estimate	Consensus*	Previous Period
21-Sep-2015	Existing Home Sales	Aug	5.6M	5.5M	5.6M
22-Sep-2015	FHFA House Price Index MoM	Jul	0.4%	0.4%	0.2%
22-Sep-2015	Richmond Fed Manufact. Index	Sep	-2	3	0
23-Sep-2015	Markit US Mfg. PMI	Sep P	52.8	53.2	53.0
24-Sep-2015	Chicago Fed Nat Activity Index	Aug	NA	NA	0.3
24-Sep-2015	Initial Jobless Claims	19-Sep	271K	NA	264K
24-Sep-2015	Durable Goods Orders	Aug	-2.7%	-2.2%	2.2%
24-Sep-2015	Durables Ex Transportation	Aug	-0.3%	0.2%	0.4%
24-Sep-2015	New Home Sales	Aug	506K	515K	507K
24-Sep-2015	Kansas City Fed Manf. Activity	Sep	NA	NA	-9
25-Sep-2015	GDP Annualized QoQ	2Q T	3.8%	3.7%	3.7%
25-Sep-2015	GDP Price Index	2Q T	2.1%	2.1%	2.1%
25-Sep-2015	Markit US Composite PMI	Sep P	NA	NA	55.7
25-Sep-2015	Markit US Services PMI	Sep P	55.6	55.5	56.1
25-Sep-2015	U. of Mich. Sentiment	Sep F	86.2	87.0	85.7

\*Consensus from Bloomberg

## Low Inflation Gets the Fed's Attention

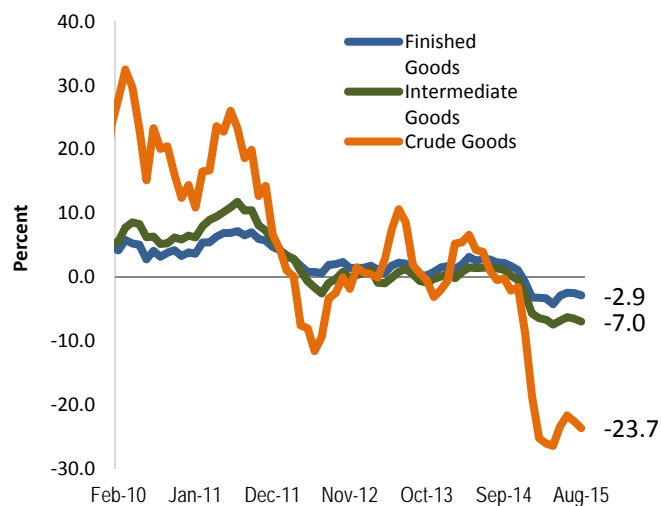
The Fed cited risks to the U.S. economic outlook from global economic and financial developments, but what really got the Fed to hold off on raising interest rates in September was the recent behavior and near-term outlook for U.S. inflation. The Fed looked past an improving U.S. labor market this week to refocus its attention on the inflation side of their dual mandate. Despite sticking to their transitory story on low U.S. inflation, the Federal Reserve appears a bit more worried about their confidence in that inflation outlook. Not only did the FOMC lower their median projections for PCE inflation over the next three years, they now have little confidence that the PCE deflator will return to their 2.0 percent long-run objective until the year 2018.

So, now is the perfect time to review how bad the deflation picture has gotten in the U.S. recently. Producer prices are the weakest we have seen since 2009. Crude goods producer prices are now down 24% from a year ago, and finished goods producer prices are almost 3% lower than last year at this time. Producer price declines often leads to weaker consumer inflation down the road. If deflation becomes entrenched, it can lead to lower demand, reinforcing the downward spiral in prices and the

economy. Moreover, the Fed's toolkit to fight deflation is limited.

## U.S. Producer Prices are Plunging

Producer Prices by Stage of Processing  
YoY % Change, Seasonal Adjusted Data

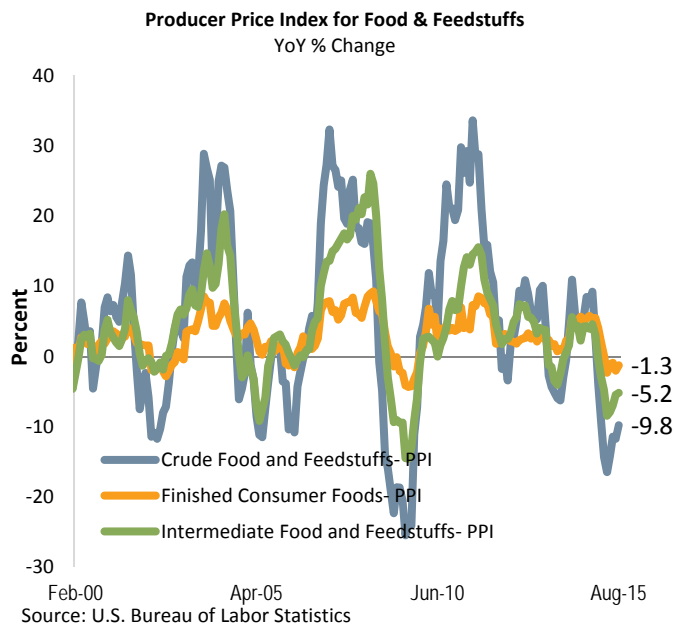


Source: U.S. Bureau of Labor Statistics

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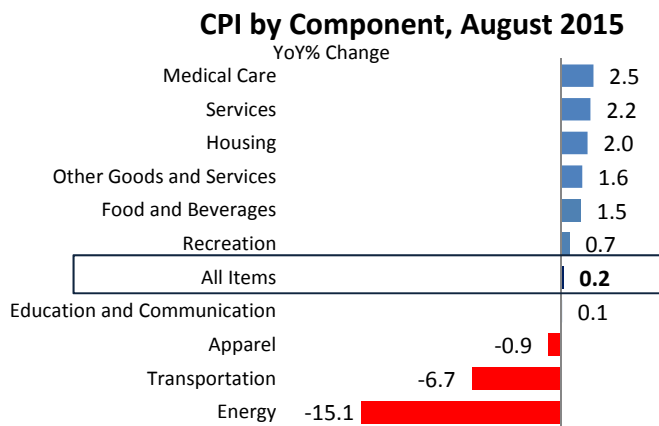
And it's not just energy prices that are driving the declines. Even producer food prices are dropping at a steady pace.

**Even Producer Food Prices Are Dropping At a Steady Pace**



Moreover, the worst probably isn't over. Not only did consumer prices fall 0.1% last month, undershooting economist consensus expectations, but the drop in gasoline prices so far for September should be enough to push consumer price inflation down by another 0.2% in September.

**U.S. Consumer Deflation Seeping into More Sectors**



From a year ago, U.S. consumer inflation is now just 0.2% above year ago levels, about where Europe's consumer inflation rate was when the ECB started contemplating their own Quantitative Easing program. As you can see in

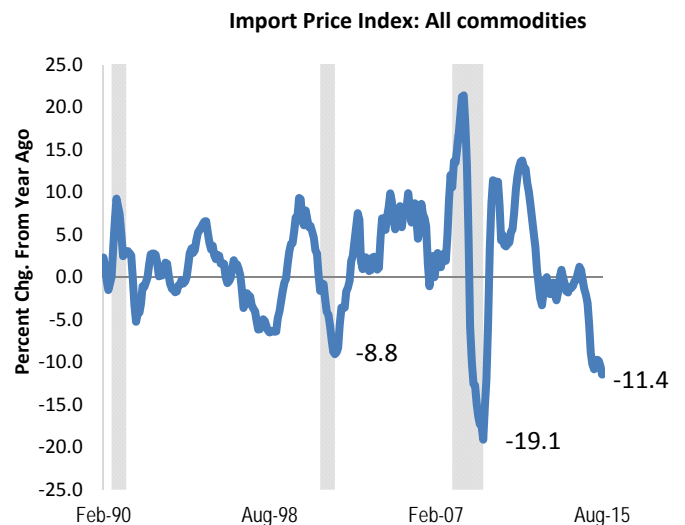
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the chart, deflation has crept into several sectors now, including energy, transport, and apparel, while inflation is slowing in all sectors including medical care, services, and housing.

We have cut our own inflation forecasts as a result of these recent trends. We now see U.S. consumer prices dropping 0.1% in 2015 with a slower climb over subsequent years. Producer prices of finished goods are forecasted to drop 3.6% this year, before slowly recovering to +0.9% in 2016 as energy prices stabilize.

A rise in interest rates now could aggravate these trends by pushing the U.S. dollar even higher and creating more deflationary pressures from abroad. Import price inflation has been plunging as well. Both the decline in producer prices and drop in import prices tends to put downward pressure on consumer inflation all else being equal. Even if a tightening labor market were to start pushing up wages, it is doubtful it would overwhelm the headwinds against higher price inflation over the near-term.

**Import Price Deflation Likely To Continue For Sometime**



So while China's recent turmoil and tightening of global financial conditions are somewhat concerning for the Fed, it is likely the deteriorating inflation outlook that got the FOMC's attention and reduced their confidence that U.S. inflation will soon return to their long-run objective pace of 2.0%. Until they see more signs that energy and commodity prices are stabilizing or turning around, the Fed could remain in a holding pattern.

## Major Economic Indicators

Economic Data	History				Forecast								Yr/Yr % chg or Annual Avg.			
	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*	-0.9	4.6	4.3	2.1	0.6	3.7	2.4	2.7	2.6	2.7	2.7	2.7	1.5	2.4	2.5	2.7
Personal Consumption Expenditures*	1.3	3.8	3.5	4.3	1.7	3.1	3.0	3.2	3.0	3.0	2.9	2.8	1.7	2.7	3.1	3.1
Non-residential Fixed Investment*	8.3	4.4	9.0	0.7	1.6	3.2	4.8	5.0	4.7	4.6	4.6	4.1	3.0	6.2	3.4	4.7
Private Housing Starts (000s units)	934	984	1,029	1,055	978	1,155	1,200	1,220	1,225	1,235	1,240	1,260	928	1,001	1,138	1,240
Vehicle Sales (mill. Units, annualized)	15.7	16.5	16.7	16.8	16.6	17.1	17.5	17.3	17.3	17.3	17.2	17.2	15.5	16.4	17.1	17.3
Industrial Production*	3.6	5.7	3.9	4.7	-0.3	-2.6	2.4	2.8	3.0	3.0	3.3	3.3	1.9	3.7	1.6	2.6
Nonfarm Payroll Employment (mil.)	137.8	138.6	139.4	140.2	141.0	141.6	142.3	143.0	143.6	144.3	145.0	145.7	136.4	139.0	142.0	144.7
Unemployment rate	6.6	6.2	6.1	5.7	5.6	5.4	5.2	5.0	4.9	4.8	4.8	4.7	7.4	6.2	5.3	4.8
Consumer Price Index* (percent)	2.1	2.4	1.2	-0.9	-3.1	3.0	-0.5	1.8	2.0	2.0	2.0	2.1	1.5	1.6	-0.1	1.7
"Core" CPI* (percent)	1.8	2.2	1.4	1.5	1.7	2.5	1.2	1.5	1.9	1.9	2.0	2.0	1.8	1.7	1.7	1.8
PPI (finished goods)* (percent)	4.1	3.5	0.4	-5.1	-11.2	3.6	-6.0	1.7	1.7	1.7	1.8	1.8	1.2	1.9	-3.6	0.9
Trade Weighted Dollar (Fed BOG, major)	76.9	76.4	77.5	82.5	89.3	90.0	91.7	91.9	92.0	92.0	92.7	92.6	75.9	78.4	90.7	92.3
Crude Oil Prices -WTI (\$ per barrel)	99	103	98	73	48	58	47	48	54	56	58	59	98	93	50	57

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

Financial Data	History				Forecast								Annual Average			
	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	2,102							1,644			
Dow Jones Industrial Average	16,177	16,604	16,954	17,345	17,808	18,004							15,010			
Federal Funds Rate (effective)	0.07	0.09	0.09	0.10	0.11	0.12	0.14	0.21	0.46	0.71	0.96	1.21	0.11	0.09	0.15	0.84
Treasury-3 Month Bills (yield)	0.05	0.03	0.03	0.02	0.02	0.02	0.05	0.10	0.40	0.65	0.90	1.15	0.06	0.03	0.05	0.78
Treasury-2 Year Notes (yield)	0.37	0.42	0.52	0.54	0.60	0.61	0.70	0.94	1.33	1.62	1.87	2.15	0.31	0.46	0.71	1.75
Treasury-5 Year Notes (yield)	1.60	1.66	1.70	1.60	1.46	1.53	1.56	1.80	2.29	2.49	2.74	2.87	1.17	1.64	1.59	2.60
Treasury-10 Year Notes (yield)	2.77	2.62	2.50	2.28	1.97	2.16	2.22	2.45	2.71	2.84	2.95	3.18	2.35	2.54	2.20	2.92
Treasury-30 Year Notes (yield)	3.68	3.44	3.27	2.97	2.55	2.88	2.97	3.21	3.31	3.37	3.50	3.63	3.44	3.34	2.90	3.45
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.50	3.75	4.00	4.25	4.50	3.25	3.25	3.31	4.13
Libor 3-Mo. U.S. Dollar	0.26	0.25	0.24	0.25	0.30	0.30	0.32	0.39	0.65	0.90	1.15	1.40	0.28	0.25	0.33	1.03
Mortgage-30 Year (yield)	4.36	4.23	4.14	3.96	3.72	3.82	3.96	4.17	4.42	4.55	4.66	4.89	3.98	4.17	3.92	4.63
BAA Corporate (yield)	5.12	4.82	4.74	4.73	4.50	4.83	5.24	5.48	5.55	5.70	5.82	6.05	5.10	4.86	5.01	5.78

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