

U.S. Outlook

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Date	Indicator	For	Estimate	Consensus*	Previous Period
11-Jul-2016	Labor Market Conditions Index Change	Jun	NA	NA	-4.8
12-Jul-2016	NFIB Small Business Optimism	Jun	94.0	93.9	93.8
12-Jul-2016	Wholesale Inventories MoM	May	0.2%	0.1%	0.6%
12-Jul-2016	JOLTS Job Openings	May	NA	NA	5788
13-Jul-2016	Import Price Index MoM	Jun	0.5%	0.5%	1.4%
13-Jul-2016	U.S. Federal Reserve Releases Beige Book				
14-Jul-2016	Initial Jobless Claims	09-Jul	265K	NA	254K
14-Jul-2016	PPI Final Demand MoM	Jun	0.3%	0.3%	0.4%
14-Jul-2016	PPI Ex Food and Energy MoM	Jun	0.1%	0.1%	0.3%
15-Jul-2016	Retail Sales Advance MoM	Jun	0.1%	0.1%	0.5%
15-Jul-2016	Retail Sales Ex Auto MoM	Jun	0.3%	0.4%	0.4%
15-Jul-2016	CPI MoM	Jun	0.2%	0.2%	0.2%
15-Jul-2016	CPI Ex Food and Energy MoM	Jun	0.2%	0.2%	0.2%
15-Jul-2016	Empire Manufacturing	Jul	4.0	5.0	6.0
15-Jul-2016	Industrial Production MoM	Jun	0.2%	0.2%	-0.4%
15-Jul-2016	Capacity Utilization	Jun	75.0%	75.1%	74.9%
15-Jul-2016	Business Inventories	May	0.2%	0.2%	0.1%
15-Jul-2016	U. of Mich. Sentiment	Jul P	92.5	93.5	93.5

*Consensus from Bloomberg

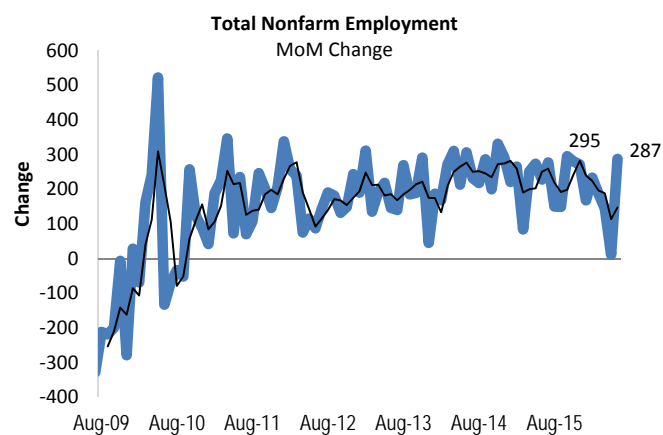
A Rock Solid U.S. Employment Report for June

A hot June employment report belies weak U.S. job growth in April and May and is an important support for the second-quarter recovery in consumer spending and GDP growth we are forecasting. While a rebound in U.S. employment growth in June was expected, the strength of the recovery was impressive and generally exceeded economists' expectations. Given the on-going decline in U.S. jobless claims and the rebound in June payrolls, the dismal May jobs report appears to be a one month aberration, as we suspected, rather than the start of a pronounced economic downturn.

According to the Bureau of Labor Statistics, the U.S. economy added another +287K net new jobs in June – a huge step up from the revised paltry +11K jobs created in May. However, the market celebration will be more muted than normal as investors brace for the global economic impacts from abroad. Moreover, it will likely

take more than one month of better job gains to convince the FOMC that another interest rate hike is warranted.

June Payrolls Come In On the Hot Side Of Expectations



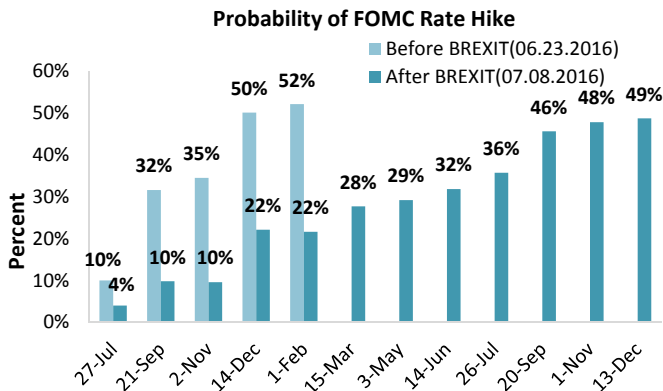
Source: U.S. Bureau of Labor Statistics

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It is important to note that this employment report reflects U.S. economic reality before the U.K. vote and also incorporates a catching-up of sorts from the lack of job growth in May and a rebound of nearly 40K striking Verizon workers returning to their jobs in June. The U.S. monthly job growth trend going forward is likely to be quite a bit lower than the June +287K increase.

Still, Fed funds futures market and the U.S. Treasury bond market have probably over-done their downward adjustment in interest rate expectations, setting up the fixed income market for somewhat higher yields ahead. The Fed funds futures markets are now pricing in just a 22% probability of the next Fed rate hike happening in December 2016. While market expectations have moved up to a near-even chance of another Fed interest rate hike by December 2017. Just a day ago the market was placing only a 12% probability on a December 2016 rate hike from the Fed and 40.5% probability of a move by December 2017, so market interest rate hike expectations are already gradually moving higher.

Is a December 2016 Rate Hike From the Fed in the Cards?



Source: Bloomberg

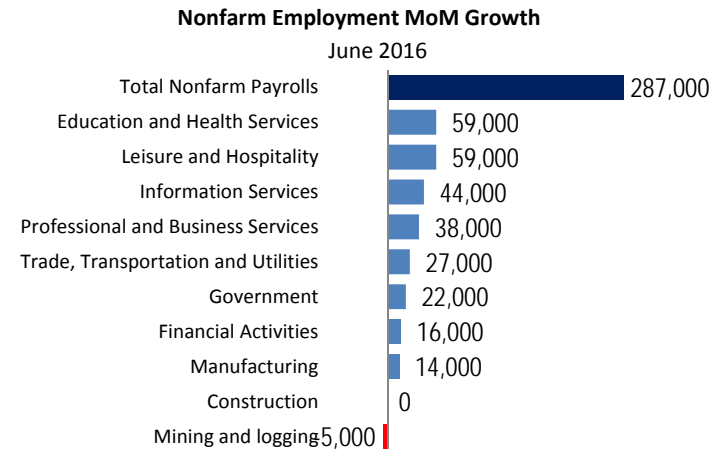
My view is that December 2016 rate hike is still on the table and actually quite possible. This view has been bolstered by the resilience of the June payroll report and the U.S. labor market recovery in general.

Looking into the details of the June payroll report, there were broad-based job gains across sectors last month with no major sector losing jobs except mining, which shedding another 5K jobs due to low energy prices and decreases in domestic production. Education and health care and leisure and hospitality sectors lead the way with a net increase of +59K each. Information and business services came in with decent gains of +44K and +38K respectively. Retail trade even added another +30K jobs

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despite the cannibalization of retail sales through on-line companies such as Amazon. Even manufacturing managed to add +14K jobs, despite the headwind of lackluster global growth and staunch competition from abroad. Construction held steady with no net job creation last month.

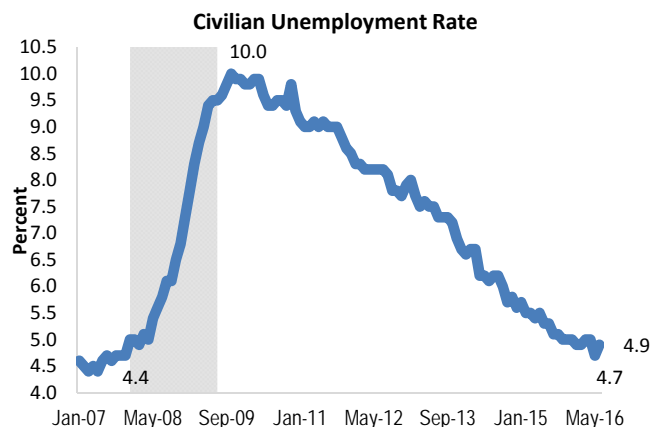
June Jobs Recovery Broad-Based Across Sectors



Source: BLS, Bank of the West Economics

The U.S. unemployment rate did tick-up to 4.9% in June from 4.7% in May, but that was due to a large influx of entrants into the labor force. The U.S. labor force increased by +414K people in June with the labor force participation rate increasing to 62.7% from 62.6% in May. This is a sign that a tightening labor market is encouraging more people to actively seeking work.

An Encouraging Increase in the Unemployment Rate



Source: U.S. Bureau of Labor Statistics

In short, just a few more employment reports like June's and genuine optimism could breakout.

Major Economic Indicators

Economic Data	History								Forecast				Yr/Yr % chg or Annual Avg.			
	2015.1	2015.2	2015.3	2015.4	2016.1	2016.2	2016.3	2016.4	2017.1	2017.2	2017.3	2017.4	2014	2015	2016	2017
Real GDP*	0.6	3.9	2.0	1.4	1.1	2.5	1.9	1.9	2.0	2.1	2.0	1.8	2.4	2.4	1.9	2.0
Personal Consumption Expenditures*	1.7	3.6	3.0	2.4	1.5	4.2	2.8	2.8	2.5	2.5	2.4	2.3	2.7	3.1	2.8	2.7
Non-residential Fixed Investment*	1.6	4.1	2.6	-2.1	-4.5	0.3	1.8	2.0	2.7	2.8	2.9	2.8	6.2	2.8	-0.6	2.4
Private Housing Starts (000s units)	978	1,158	1,158	1,135	1,151	1,195	1,200	1,220	1,240	1,250	1,280	1,300	1,001	1,107	1,192	1,268
Vehicle Sales (mill. Units, annualized)	16.7	17.1	17.8	17.8	17.1	17.1	17.0	17.1	17.0	17.0	16.9	16.9	16.4	17.3	17.1	17.0
Industrial Production*	-1.9	-2.7	1.5	-3.3	-1.6	1.4	1.9	1.8	1.7	1.8	1.7	1.7	3.7	-0.5	-0.4	1.8
Nonfarm Payroll Employment (mil.)	140.8	141.5	142.2	142.9	143.5	143.9	144.4	144.8	145.3	145.8	146.3	146.7	138.9	141.8	144.2	146.0
Unemployment rate	5.6	5.4	5.2	5.0	4.9	4.8	4.8	4.7	4.6	4.6	4.6	4.5	6.2	5.3	4.8	4.6
Consumer Price Index* (percent)	-2.9	2.4	1.4	0.8	-0.3	2.0	2.0	2.1	2.2	2.2	2.3	2.3	1.6	0.1	1.1	2.2
"Core" CPI* (percent)	1.7	2.3	1.8	2.2	2.7	1.8	1.9	2.0	2.0	2.0	2.1	2.1	1.7	1.8	2.2	2.0
PPI (finished goods)* (percent)	-11.0	3.4	-0.4	-4.8	-4.7	1.6	2.1	2.5	2.4	2.2	2.0	2.0	1.9	-3.3	-1.3	2.2
Trade Weighted Dollar (Fed BOG, major)	89.3	90.1	91.7	93.1	93.2	89.5	91.9	93.1	93.4	92.8	92.3	91.9	78.4	91.0	92.1	92.6
Crude Oil Prices -WTI (\$ per barrel)	48	58	46	42	33	45	47	46	46	46	47	48	93	49	43	47

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

Financial Data	History								Forecast				Annual Average			
	2015.1	2015.2	2015.3	2015.4	2016.1	2016.2	2016.3	2016.4	2017.1	2017.2	2017.3	2017.4	2014	2015	2016	2017
S & P 500	2,064	2,102	2,027	2,052	1,951	2,075							1,930	2,061		
Dow Jones Industrial Average	17,808	18,004	17,077	17,475	16,663	17,768							16,770	17,591		
Federal Funds Rate (effective)	0.11	0.13	0.13	0.16	0.36	0.37	0.38	0.46	0.63	0.63	0.88	0.96	0.09	0.13	0.39	0.78
Treasury-3 Month Bills (yield)	0.02	0.02	0.04	0.13	0.29	0.26	0.27	0.35	0.53	0.53	0.80	0.88	0.03	0.05	0.29	0.69
Treasury-2 Year Notes (yield)	0.60	0.61	0.69	0.84	0.84	0.78	0.65	0.80	1.04	1.06	1.31	1.41	0.46	0.69	0.77	1.21
Treasury-5 Year Notes (yield)	1.46	1.53	1.56	1.58	1.37	1.25	1.05	1.20	1.49	1.57	1.77	1.87	1.64	1.53	1.22	1.68
Treasury-10 Year Notes (yield)	1.97	2.16	2.22	2.19	1.91	1.76	1.50	1.75	2.02	2.17	2.32	2.47	2.54	2.14	1.73	2.25
Treasury-30 Year Notes (yield)	2.55	2.88	2.96	2.96	2.72	2.58	2.26	2.50	2.77	2.92	3.12	3.32	3.34	2.84	2.52	3.03
Prime Rate	3.25	3.25	3.25	3.29	3.50	3.50	3.50	3.58	3.75	3.75	4.00	4.08	3.25	3.26	3.52	3.90
Libor 3-Mo. U.S. Dollar	0.30	0.30	0.33	0.43	0.67	0.65	0.64	0.72	0.89	0.90	1.14	1.22	0.25	0.34	0.67	1.04
Mortgage-30 Year (yield)	3.72	3.82	3.95	3.90	3.74	3.60	3.50	3.64	3.91	4.06	4.21	4.36	4.17	3.85	3.62	4.14
BAA Corporate (yield)	4.50	4.83	5.24	5.42	5.30	4.67	4.35	4.62	5.00	5.16	5.32	5.60	4.85	5.00	4.74	5.27

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