# U.S. Outlook

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| Date | Indicator | For | Estimate | Consensus* | Previous Period |
|---|---|---|---|---|---|
| 13-Dec-2016 | NFIB Small Business Optimism | Nov | 97.0 | 96.5 | 94.9 |
| 13-Dec-2016 | Import Price Index MoM | Nov | -0.2% | -0.3% | 0.5% |
| 14-Dec-2016 | Retail Sales Advance MoM | Nov | 0.2% | 0.3% | 0.8% |
| 14-Dec-2016 | Retail Sales Ex Auto MoM | Nov | 0.4% | 0.5% | 0.8% |
| 14-Dec-2016 | PPI Final Demand MoM | Nov | 0.1% | 0.1% | 0.0% |
| 14-Dec-2016 | PPI Ex Food and Energy MoM | Nov | 0.2% | 0.2% | -0.2% |
| 14-Dec-2016 | Industrial Production MoM | Nov | 0.1% | -0.1% | 0.0% |
| 14-Dec-2016 | Capacity Utilization | Nov | 75.3% | 75.1% | 75.3% |
| 14-Dec-2016 | Business Inventories | Oct | -0.1% | -0.1% | 0.1% |
| 14-Dec-2016 | FOMC Rate Decision (Upper Bound) | 14-Dec | 0.75% | 0.75% | 0.50% |
| 14-Dec-2016 | FOMC Rate Decision (Lower Bound) | 14-Dec | 0.50% | 0.50% | 0.25% |
| 15-Dec-2016 | CPI MoM | Nov | 0.2% | 0.2% | 0.4% |
| 15-Dec-2016 | CPI Ex Food and Energy MoM | Nov | 0.2% | 0.2% | 0.1% |
| 15-Dec-2016 | Current Account Balance | 3Q | -$111.6b | -$111.1b | -$119.9b |
| 15-Dec-2016 | Empire Manufacturing | Dec | 3.0 | 2.1 | 1.5 |
| 15-Dec-2016 | Initial Jobless Claims | 10-Dec | 256K | NA | 258K |
| 15-Dec-2016 | Philadelphia Fed Business Outlook | Dec | 9.0 | 8.5 | 7.6 |
| 15-Dec-2016 | Markit US Manufacturing PMI | Dec P | 53.8 | NA | 54.1 |
| 15-Dec-2016 | NAHB Housing Market Index | Dec | 62 | 63 | 63 |
| 15-Dec-2016 | Net Long-term TIC Flows | Oct | NA | NA | -$26.2b |
| 16-Dec-2016 | Housing Starts | Nov | 1240k | 1235k | 1323k |
| 16-Dec-2016 | Building Permits | Nov | 1236k | 1238k | 1229k |

*Consensus from Bloomberg

## Preview of Next Week's FOMC Decision

The reflation trade hit its stride this week as U.S. stock prices climbed to new record highs on the promise of "Trumponomics" and another nine-month extension of the ECB bond buying program through December 2017. So will next week's FOMC meeting and likely first and only rate hike of the year bring the equity markets back down to earth?

Let me recap the last FOMC meeting in November. The FOMC thought they were making good progress toward their mandate to foster maximum employment and stable prices in the United States. They thought the U.S. economy was on track to maintain moderate economic growth, a strengthening labor market, and a gradual rise in inflation toward its 2.0% inflation target, but wanted to "wait for some further progress toward its objectives".

The FOMC said it would weigh realized and expected conditions in regards to labor market conditions, inflation and inflation expectations, and financial and international developments in making their decision on raising interest rates. On all of these fronts, one can point out that further progress has been made since November. Some might even conclude a lot of progress has been made in a very short time period. Perhaps leading some FOMC voting members not only to vote for a rate hike in December, but also lead them to mark-up their dot-plot Fed funds rate projections for 2017 and 2018. Indeed the most dramatic event next week will not be the rate hike decision itself, but the news of how the FOMC's economic and interest rate projections have evolved in the post-election world. Are they factoring more growth and inflation into their outlooks, and does that mean a steeper rate hike path over the next two years?

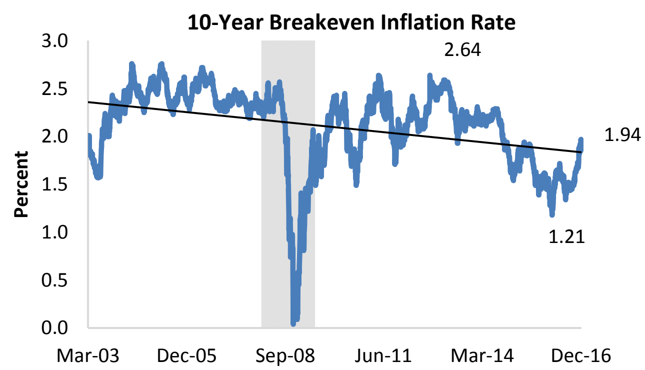
Since we really have no specifics to go on yet about any fiscal stimulus package at the Federal level, my guess is that most FOMC participants will remain cautious in their outlooks and not significantly revise their growth and inflation forecasts. Meaning the median FOMC dot-plot projection will continue to indicate two quarter-point rate increases in 2017 and three quarter point rate hikes in 2018. But don't be surprised if the median growth and inflation forecasts do creep a bit higher than those put out in September, while the corresponding FOMC statement sounds a more optimistic tone than the last one.

The FOMC meets this month under a backdrop of a synchronized global economic rebound that appears to be driven, in part, by stronger growth here in the United States. Recent economic releases point to another upward revision in third quarter U.S. GDP to around 3.4% from a second estimate of 3.2% and the initial estimate of a mere 2.9% growth. Our current forecast of 1.8% GDP in the fourth quarter would bring U.S. average GDP growth in the second half of the year up to 2.6% from a stagnant 1.1% average growth rate in the first half of 2016. It sure looks like the FOMC will be able to check the box on moderate economic growth continuing.

What about the labor market? Labor market conditions continued to strengthen across many metrics in November, so check another box for a December rate hike decision from the FOMC. But the indicator that is sure to raise some eyebrows was the sharp drop in the U.S. unemployment rate last month to 4.6% from 4.9% in October. Most economists didn't forecast such low unemployment until mid-2017 at the earliest. At the same time, more folks left the labor market, so this should lead to a lively debate around exactly how tight the labor market is today. Where is the natural rate of unemployment now? And what might be the implications for wage and inflation growth going forward. One could argue quite convincingly that this raises the risk of overshoot on consumer inflation and may mean the FOMC should step up the pace of future rate hikes.

This brings us to inflation and inflation expectations. Turns out Janet Yellen will be able to check these two boxes for a rate hike as well. Bond market 10-Yr inflation breakevens (i.e. the spread between the Treasury yield and the TIPS yield for 10-Yr bonds- a measure of bond investor inflation expectations over the next 10 years) have been soaring since the election, so bond investors have finally become convinced that inflation is coming back for good. This is a huge change in bond market expectations that is ushering in rising bond yields, a steepening yield curve, and bringing the market's Fed Funds rate hike expectations more in-line with the median FOMC views for the first time in two years.

**Bond Market Pricing In a Prolonged Return of Inflation**




Source: Federal Reserve Bank of St. Louis; Bloomberg; Bank of the West Economics

Finally, financial and international developments have only improved over the past month. There has been little adverse financial fallout from Brexit, the Italian Referendum, or the U.S. presidential election. The global economy appears to be firming. So every box on the FOMC's checklist has been checked and there is nothing holding the FOMC back from raising the Fed funds target rate range another quarter percentage point. It will be the updated economic and interest rate projections that the markets focus in on next Wednesday, as well as any hints about evolving expectations towards future inflation and rate hikes at Janet Yellen's press conference shortly following the release of the FOMC statement.

## Major Economic Indicators

| | History | | | | | | | Forecast | | | | | Yr/Yr % chg or Annual Avg. | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Economic Data** | **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* | 2.0 | 2.6 | 2.0 | 0.9 | 0.8 | 1.4 | 3.2 | 1.8 | 2.1 | 2.1 | 2.3 | 2.2 | 2.4 | 2.6 | 1.6 | 2.2 |
| Personal Consumption Expenditures* | 2.4 | 2.9 | 2.7 | 2.3 | 1.6 | 4.3 | 2.8 | 2.3 | 2.5 | 2.5 | 2.5 | 2.4 | 2.7 | 3.2 | 2.6 | 2.6 |
| Non-residential Fixed Investment* | 1.3 | 1.6 | 3.9 | -3.3 | -3.4 | 1.0 | 0.1 | 2.1 | 2.7 | 2.8 | 2.9 | 2.8 | 6.2 | 2.1 | -0.6 | 2.2 |
| Private Housing Starts (000s units) | 986 | 1,156 | 1,156 | 1,135 | 1,151 | 1,159 | 1,145 | 1,170 | 1,200 | 1,220 | 1,230 | 1,250 | 1,001 | 1,108 | 1,156 | 1,225 |
| Vehicle Sales (mill. Units, annualized) | 16.9 | 17.2 | 17.7 | 17.9 | 17.3 | 17.1 | 17.5 | 17.1 | 17.0 | 17.0 | 16.9 | 16.9 | 16.4 | 17.4 | 17.2 | 17.0 |
| Industrial Production* | -1.9 | -2.7 | 1.5 | -3.3 | -1.7 | -0.8 | 2.0 | 1.2 | 1.5 | 1.7 | 1.7 | 1.7 | 3.7 | 0.3 | -0.9 | 1.4 |
| Nonfarm Payroll Employment (mil.) | 140.8 | 141.5 | 142.2 | 142.9 | 143.5 | 144.0 | 144.6 | 145.1 | 145.6 | 146.1 | 146.6 | 147.1 | 138.9 | 141.8 | 144.3 | 146.4 |
| Unemployment rate | 5.6 | 5.4 | 5.2 | 5.0 | 4.9 | 4.9 | 4.9 | 4.9 | 4.8 | 4.8 | 4.5 | 4.7 | 6.2 | 5.3 | 4.9 | 4.7 |
| Consumer Price Index* (percent) | -2.9 | 2.4 | 1.4 | 0.8 | -0.3 | 2.5 | 1.6 | 2.1 | 2.2 | 2.2 | 2.3 | 2.3 | 1.6 | 0.1 | 1.2 | 2.2 |
| "Core" CPI* (percent) | 1.7 | 2.3 | 1.8 | 2.2 | 2.7 | 2.1 | 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 | -5.3 | 3.6 | 1.5 | 2.5 | 2.4 | 2.2 | 2.0 | 2.0 | 1.9 | -3.3 | -1.1 | 2.3 |
| Trade Weighted Dollar (Fed BOG, major) | 89.2 | 90.0 | 91.5 | 92.9 | 93.2 | 89.5 | 90.3 | 92.8 | 96.0 | 97.4 | 98.5 | 98.2 | 78.4 | 90.9 | 91.4 | 97.5 |
| Crude Oil Prices -WTI ($ per barrel) | 48 | 58 | 46 | 42 | 33 | 45.5 | 44.9 | 49 | 52 | 53 | 54 | 55 | 93 | 49 | 43 | 54 |

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

| | History | | | | | | | Forecast | | | | | Annual Average | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Financial Data** | **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 | 2,162 | | | | | | 1,930 | 2,061 | | |
| Dow Jones Industrial Average | 17,808 | 18,004 | 17,077 | 17,475 | 16,663 | 17,764 | 18,372 | | | | | | 16,770 | 17,591 | | |
| Federal Funds Rate (effective) | 0.11 | 0.13 | 0.13 | 0.16 | 0.36 | 0.37 | 0.39 | 0.46 | 0.63 | 0.63 | 0.88 | 0.96 | 0.09 | 0.13 | 0.39 | 0.77 |
| Treasury-3 Month Bills (yield) | 0.02 | 0.02 | 0.04 | 0.13 | 0.29 | 0.26 | 0.30 | 0.43 | 0.60 | 0.60 | 0.85 | 0.93 | 0.03 | 0.05 | 0.32 | 0.75 |
| Treasury-2 Year Notes (yield) | 0.60 | 0.61 | 0.69 | 0.84 | 0.84 | 0.77 | 0.73 | 0.93 | 1.20 | 1.28 | 1.39 | 1.49 | 0.46 | 0.69 | 0.82 | 1.34 |
| Treasury-5 Year Notes (yield) | 1.46 | 1.53 | 1.56 | 1.58 | 1.37 | 1.24 | 1.13 | 1.47 | 1.91 | 1.99 | 2.09 | 2.19 | 1.64 | 1.53 | 1.30 | 2.05 |
| Treasury-10 Year Notes (yield) | 1.97 | 2.16 | 2.22 | 2.19 | 1.91 | 1.75 | 1.56 | 1.99 | 2.46 | 2.54 | 2.69 | 2.84 | 2.54 | 2.14 | 1.80 | 2.63 |
| Treasury-30 Year Notes (yield) | 2.55 | 2.88 | 2.96 | 2.96 | 2.72 | 2.57 | 2.28 | 2.75 | 3.17 | 3.30 | 3.48 | 3.64 | 3.34 | 2.84 | 2.58 | 3.40 |
| 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 | 0.81 | 0.90 | 1.04 | 1.05 | 1.22 | 1.30 | 0.25 | 0.34 | 0.76 | 1.15 |
| Mortgage-30 Year (yield) | 3.72 | 3.82 | 3.95 | 3.90 | 3.74 | 3.59 | 3.45 | 3.88 | 4.33 | 4.41 | 4.56 | 4.71 | 4.17 | 3.85 | 3.67 | 4.50 |
| BAA Corporate (yield) | 4.50 | 4.83 | 5.24 | 5.42 | 5.30 | 4.66 | 4.26 | 4.57 | 4.99 | 5.09 | 5.29 | 5.54 | 4.85 | 5.00 | 4.70 | 5.23 |

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