

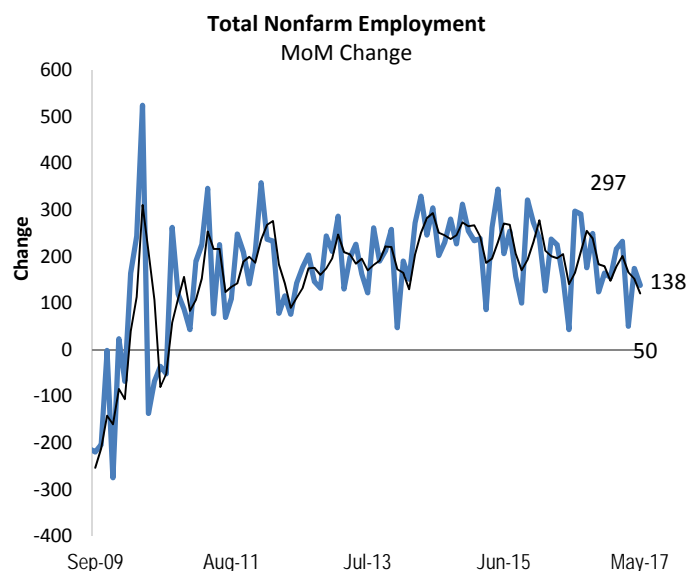
Date	Indicator	For	Estimate	Consensus*	Previous Period
5-Jun-2017	Nonfarm Productivity	1Q F	0.0%	-0.2%	-0.6%
5-Jun-2017	Unit Labor Costs	1Q F	2.4%	2.5%	3.0%
5-Jun-2017	Markit US Services PMI	May F	NA	NA	54.0
5-Jun-2017	Markit US Composite PMI	May F	NA	NA	53.9
5-Jun-2017	ISM Non-Manufacturing Composite	May	57.1	57.0	57.5
5-Jun-2017	Labor Market Conditions Index Change	May	NA	NA	3.5
5-Jun-2017	Factory Orders	Apr	-0.2%	-0.2%	0.5%
6-Jun-2017	JOLTS Job Openings	Apr	NA	NA	5743
7-Jun-2017	Consumer Credit	Apr	\$15.000b	\$15.000b	\$16.431b
8-Jun-2017	Initial Jobless Claims	03-Jun	241K	NA	248K
8-Jun-2017	Household Change in Net Worth	1Q	NA	NA	\$2043b
9-Jun-2017	Wholesale Inventories MoM	Apr F	0.3%	-0.3%	-0.3%

*Consensus from Bloomberg

Job Creation Disappoints in May

Stephen Curry couldn't have provided a better head fake for markets this morning. A blowout ADP employment report yesterday (+253K jobs) whet investors' appetites for another strong payroll report for May that would likely beat analysts' expectations for 182K jobs on the month. But when the actual numbers were released with just 138K jobs created last month (44K shy of consensus expectations, along with a net downward revision in job creation for March and April, too), the new figures left behind some confusion and uneasiness about the true underlying strength of the U.S. labor market. The three-month moving average of monthly job creation slipped to just 121K. Over the past 12 months, monthly job creation in the U.S. has averaged 181K. So recent job creation performance is a clear step down from where we have been.

Job Creation Takes a Step Down - Just a Blip or Something Else?

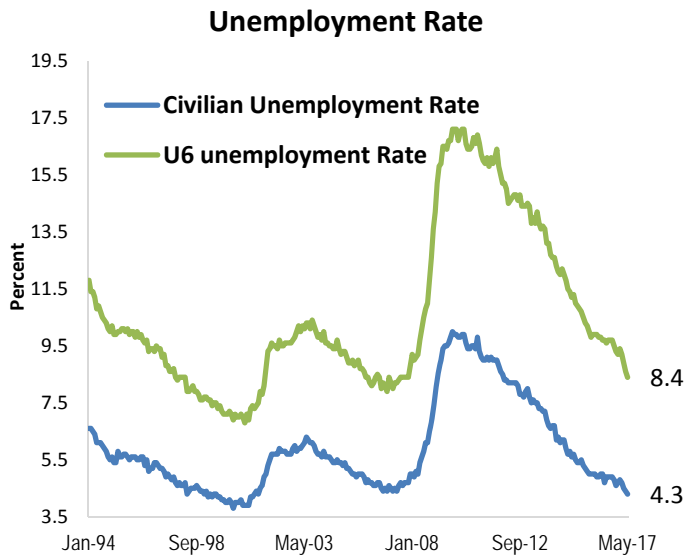


Source: U.S. Bureau of Labor Statistics

Adding to the confusion, the U.S. unemployment rate unexpectedly dropped another tenth of a percentage point last month to a low 4.3%, while the broader U6 measure of unemployment fell another two-tenths of a percentage point to 8.4%. The U.S. unemployment rate has now dropped by a half a percentage point since the beginning of the year, while

the U6 measure of unemployment has dropped a full percentage point. Surely this is a sign of labor market strength that will force the Fed into raising interest rates again in June, and stick to the tightening path and balance sheet unwind they have been preparing the markets for all year, right?

Unemployment Rates Low and Getting Lower Quickly

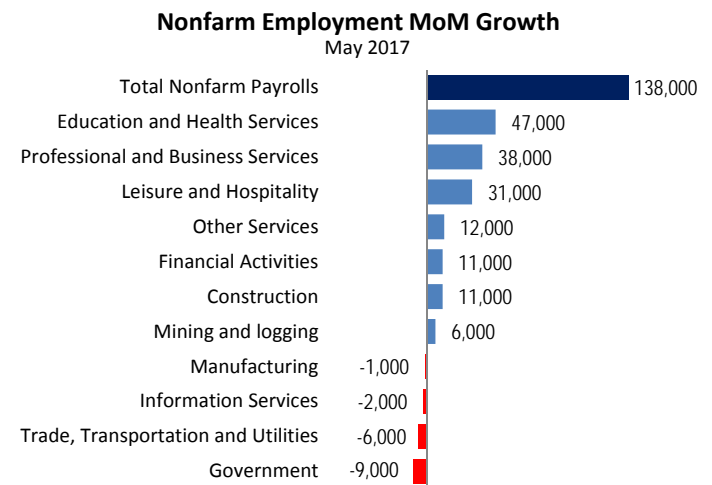


Source: U.S. Bureau of Labor Statistics

That is until you read into the details of what pushed the unemployment rate down last month. Hint: It wasn't job growth — household employment used to calculate the unemployment rate actually declined by 233K jobs last month. No, it was the 429K person drop in the labor force that pushed the unemployment rates lower last month. A large drop in the labor force is not something you expect to see in a red-hot labor market, but it could also be a more benign symptom of an aging labor force.

Breaking down the details on where net jobs were created and destroyed last month also doesn't paint an entirely convincing story of labor market resilience. Outside of education and health care (+47K), professional and business services (+38K), and leisure and hospitality (+31K), job growth was extremely tepid. Mild net job losses occurred for manufacturing (-1K), information (-2K), retail trade (-6K), and state government (-9K).

Not Much Job Growth Outside of Health Care and Food Service



Source: BLS, Bank of the West Economics

So the puzzle for the Fed, as the June FOMC decision approaches, is this: Is the U.S. labor market too hot, too cold, or just right, for another quarter-point rate hike?

My take is that the FOMC will likely look past today's less-than-ideal payroll report and move forward with the rate hike in June, but it will put many Fed officials on alert for more signs of economic disappointment ahead. The fed funds futures still puts an 87.6% probability of a June rate hike from the Fed after today's jobs release. The drop in the U.S. unemployment rate, for whatever reason, will likely trump a job growth number that undershoots expectations at this point in the economic cycle in many FOMC members' minds.

However, the wider trade deficit and decline in export growth in April could force some downward revisions in Q2 GDP forecasts and could theoretically upset or delay current plans of another rate hike in September. That's especially true if other economic and labor market indicators in the future confirm the downbeat message we received today from the May payroll report and are part of a larger economic trend. For now, such evidence remains pretty scarce. The fed funds futures probability of a September rate hike from the Fed sank to just 26.4% this morning.

Indeed, Janet Yellen has said that job growth was running ahead of its sustainable pace. Many analysts, including our team, have been forecasting a moderation in monthly job creation as the unemployment rate in more and more markets sinks below the full-employment level. After all you can't hire new workers if there are no new workers to be had. I do have one request for the Bureau of Labor Statistics, though, if at all possible: Let's keep the head fakes to the NBA finals from now on. Go Warriors!

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Major Economic Indicators

Economic Data	History					Forecast							Yr/Yr % chg or Annual Avg.			
	2016.1	2016.2	2016.3	2016.4	2017.1	2017.2	2017.3	2017.4	2018.1	2018.2	2018.3	2018.4	2015	2016	2017	2018
Real GDP*	0.8	1.4	3.5	2.1	1.2	3.0	2.3	2.2	2.3	2.3	2.4	2.4	2.6	1.6	2.2	2.4
Personal Consumption Expenditures*	1.6	4.3	3.0	3.5	0.6	3.2	2.5	2.4	2.4	2.4	2.4	2.4	3.2	2.7	2.5	2.5
Non-residential Fixed Investment*	-3.4	1.0	1.4	0.9	11.4	3.6	2.9	2.8	2.8	3.4	3.9	4.4	2.1	-0.5	4.4	3.2
Private Housing Starts (000s units)	1,153	1,158	1,150	1,248	1,242	1,250	1,255	1,261	1,263	1,265	1,275	1,285	1,108	1,177	1,252	1,272
Vehicle Sales (mill. Units, annualized)	17.3	17.1	17.5	18.0	17.2	17.1	17.1	17.0	16.9	16.9	16.8	16.8	17.4	17.5	17.1	16.9
Industrial Production*	-1.3	-0.7	0.8	0.7	1.8	5.5	2.4	2.5	2.4	2.3	2.2	2.2	0.3	-1.2	2.1	2.6
Nonfarm Payroll Employment (mil.)	143.4	144.0	144.7	145.2	145.7	146.3	146.8	147.3	147.8	148.3	148.8	149.4	141.8	144.3	146.5	148.6
Unemployment rate	4.9	4.9	4.9	4.7	4.7	4.4	4.3	4.2	4.1	4.1	4.2	4.3	5.3	4.9	4.4	4.2
Consumer Price Index* (percent)	0.1	2.3	1.8	3.0	3.1	2.0	2.3	2.3	2.3	2.2	2.2	2.2	0.1	1.3	2.5	2.3
"Core" CPI* (percent)	2.5	2.1	2.1	2.0	2.5	2.2	2.1	2.1	2.2	2.2	2.2	2.3	1.8	2.2	2.2	2.2
PPI (finished goods)* (percent)	-3.9	3.0	1.7	3.4	6.3	3.0	2.7	2.5	2.4	2.1	2.0	2.1	-3.3	-1.0	3.7	2.4
Trade Weighted Dollar (Fed BOG, major)	93.2	89.5	90.3	93.3	94.5	94.8	96.0	95.7	96.2	96.8	96.2	96.0	90.9	91.6	95.3	96.3
Crude Oil Prices -WTI (\$ per barrel)	33	45	45	49	52	49	50	50	51	51	52	53	50	43	50	52

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

Financial Data	History					Forecast							Annual Average			
	2016.1	2016.2	2016.3	2016.4	2017.1	2017.2	2017.3	2017.4	2018.1	2018.2	2018.3	2018.4	2015	2016	2017	2018
S & P 500	1,951	2,075	2,162	2,185	2,326								2,061	2,093		
Dow Jones Industrial Average	16,663	17,764	18,372	18,865	20,406								17,591	17,916		
Federal Funds Rate (effective)	0.36	0.37	0.39	0.45	0.70	0.94	1.21	1.38	1.46	1.71	1.96	2.13	0.13	0.39	1.06	1.81
Treasury-3 Month Bills (yield)	0.29	0.26	0.30	0.43	0.61	0.85	1.15	1.34	1.47	1.73	1.92	2.17	0.05	0.32	0.99	1.82
Treasury-2 Year Notes (yield)	0.84	0.77	0.73	1.01	1.24	1.28	1.51	1.70	1.94	2.21	2.35	2.61	0.69	0.84	1.43	2.28
Treasury-5 Year Notes (yield)	1.37	1.24	1.13	1.61	1.95	1.85	2.10	2.30	2.64	2.87	3.03	3.30	1.53	1.34	2.05	2.96
Treasury-10 Year Notes (yield)	1.91	1.75	1.56	2.14	2.45	2.33	2.55	2.75	3.07	3.27	3.44	3.70	2.14	1.84	2.52	3.37
Treasury-30 Year Notes (yield)	2.72	2.57	2.28	2.83	3.05	2.98	3.23	3.43	3.72	3.92	4.09	4.35	2.84	2.60	3.17	4.02
Prime Rate	3.50	3.50	3.50	3.55	3.80	4.06	4.32	4.50	4.60	4.85	5.00	5.25	3.26	3.51	4.17	4.93
Libor 3-Mo. U.S. Dollar	0.62	0.64	0.79	0.92	1.07	1.19	1.47	1.65	1.73	1.97	2.15	2.40	0.34	0.74	1.35	2.06
Mortgage-30 Year (yield)	3.74	3.59	3.45	3.84	4.17	4.17	4.38	4.58	4.90	5.10	5.29	5.55	3.85	3.66	4.33	5.21
BAA Corporate (yield)	5.30	4.66	4.26	4.64	4.66	4.57	4.86	5.15	5.52	5.75	5.92	6.18	5.00	4.71	4.81	5.84

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