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U.S. Outlook

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Date	Indicator	For	Estimate	Consensus*	Previous Period
13-Jun-2017	NFIB Small Business Optimism	May	104.9	105.0	104.5
13-Jun-2017	PPI Final Demand MoM	May	0.1%	0.0%	0.5%
13-Jun-2017	PPI Ex Food and Energy MoM	May	0.2%	0.2%	0.4%
14-Jun-2017	CPI MoM	May	0.1%	0.0%	0.2%
14-Jun-2017	CPI Ex Food and Energy MoM	May	0.2%	0.2%	0.1%
14-Jun-2017	Retail Sales Advance MoM	May	0.1%	0.1%	0.4%
14-Jun-2017	Retail Sales Ex Auto MoM	May	0.2%	0.2%	0.3%
14-Jun-2017	Business Inventories	Apr	0.1%	-0.1%	0.2%
14-Jun-2017	FOMC Rate Decision (Upper Bound)	14-Jun	1.25%	1.25%	1.00%
14-Jun-2017	FOMC Rate Decision (Lower Bound)	14-Jun	1.00%	1.00%	0.75%
15-Jun-2017	Import Price Index MoM	May	0.0%	-0.1%	0.5%
15-Jun-2017	Empire Manufacturing	Jun	4.0	5.0	-1.0
15-Jun-2017	Initial Jobless Claims	10-Jun	243K	NA	245K
15-Jun-2017	Philadelphia Fed Business Outlook	Jun	23.0	25.0	38.8
15-Jun-2017	Industrial Production MoM	May	0.0%	0.1%	1.0%
15-Jun-2017	Capacity Utilization	May	76.7%	76.8%	76.7%
15-Jun-2017	NAHB Housing Market Index	Jun	69	70	70
15-Jun-2017	Net Long-term TIC Flows	Apr	NA	NA	$59.8b
16-Jun-2017	Housing Starts	May	1210k	1220k	1172k
16-Jun-2017	Building Permits	May	1242k	1250k	1228k
16-Jun-2017	Labor Market Conditions Index Change	May	NA	3.0	3.5
16-Jun-2017	U. of Mich. Sentiment	Jun P	97.3	97.1	97.1

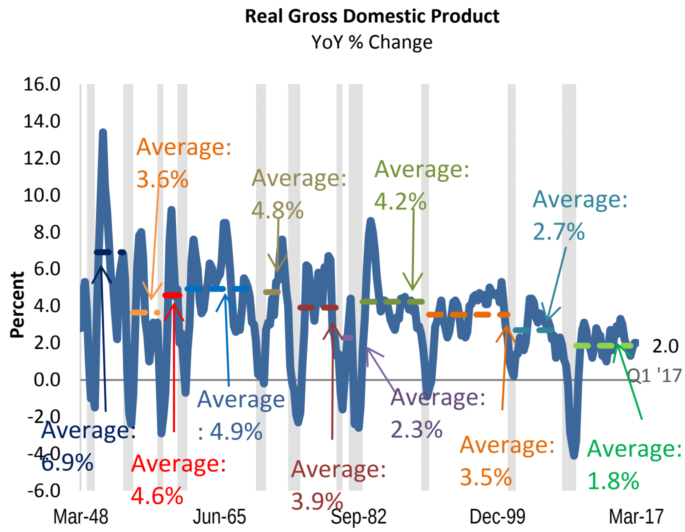
*Consensus from Bloomberg

Why 3.0% GDP Growth Looks Like a Long Shot

President Trump talks about returning the United States to 3.0% GDP growth or better. In fact, it is baked into his FY 2018 budget plan that by 2021, the first year of the president's possible second term, the U.S. economy will be returning to this growth milestone. It is projected that such faster growth could cut the cumulative U.S. federal government deficit over the next 10 years by $2.0 trillion. Many mainstream economists, including myself, believe such a strong growth rate over the medium term is highly unlikely, bordering on delusional. In this week's Outlook report we explore why this 3.0% growth assumption in the president's budget looks like a real long shot.

But before we look into our economic future, let's first take a peek back at where we have been. GDP growth in the current expansion has averaged a modest 1.8% per year. This is the lowest expansion average growth rate for the U.S. economy in the postwar period. Even in the early 2000s expansion, annual growth averaged 2.7%, with periods exceeding 4.0%. The 1990s expansion is the longest U.S. postwar expansion on record, averaging a remarkable 3.5% growth rate that lasted 40 quarters.

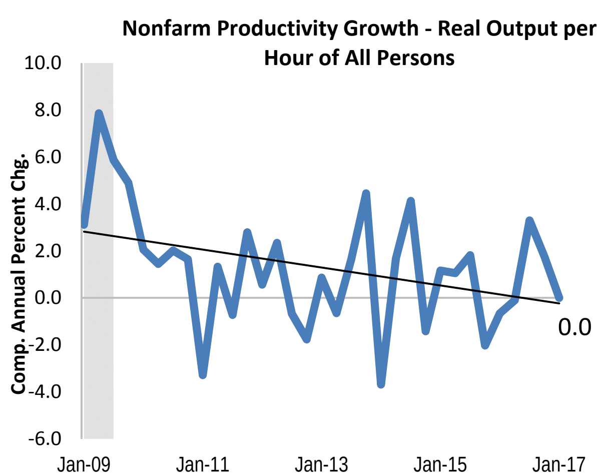
Slowest Expansion in the Postwar Period



Source: U.S. Bureauof Economic Analysis

Economic theory tells us that long-term potential economic growth is driven by two fundamental factors: productivity and labor force growth. Productivity is often defined by the amount of output you get from each unit of labor input. By combining labor, capital, technology, and an educated workforce with solid institutions, the rule of law, liquid financial markets, and a modern transportation infrastructure, you can increase your country's productivity growth. All else equal, rising productivity growth boosts the economy's potential long-term growth rate and workers' ability to boost their real wages and standards of living. Unfortunately, labor productivity has been moving in the wrong direction today.

U.S. Productivity Growth Grinds to a Halt

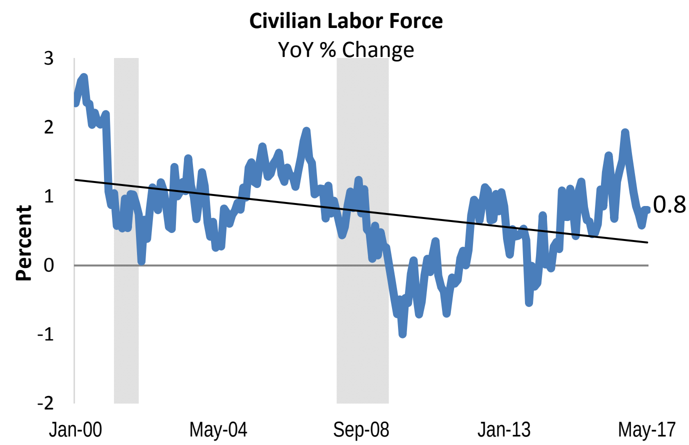


Source: Bureau of Labor Statistics

In fact, nonfarm productivity growth defined as real output per hour worked was 0.0% at an annual rate in the first quarter, and the trend has been on a steep downward slide throughout the current expansion.

If that wasn't bad enough, the second fundamental component of potential economic growth – labor force growth – has also been on a downward trend, as our population ages and population growth slows. Labor force growth over the past 12 months is a modest 0.8%. The Congressional Budget Office estimates potential labor force growth in the U.S. just 10 years from now will average 0.3% per year. In comparison, the U.S. labor force grew at a 1.5% annual rate on average from 1967 to 2016.

U.S. Labor Force Struggling to Grow



Source: Bureau of Labor Statistics

In short, both factors, productivity and labor force growth, are moving in the wrong direction today and don't have much prospect for improvement ahead. As a result, the Federal Reserve estimates U.S. potential GDP growth today at around 1.6% per year; and that number is likely to slip even further, perhaps to just above 1.0% or so a year, without a surge in productivity growth in the years ahead. Stagnating labor quality, an aging population and infrastructure with reduced public and private investment, and a flat labor force participation rate for women make a surge in productivity nearly impossible to achieve. Three percent GDP growth on a sustained basis would be tremendous, but the current and future speed limit of the U.S. economy appears to be far lower than that today, making the economic assumptions around the president's FY 2018 budget plan a fantasy.

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	2.9	2.3	2.0	1.9	2.1	2.0	2.2	2.6	1.6	2.2	2.1
Personal Consumption Expenditures*	1.6	4.3	3.0	3.5	0.6	3.2	2.7	2.4	2.2	2.2	2.1	2.1	3.2	2.7	2.6	2.4
Non-residential Fixed Investment*	-3.4	1.0	1.4	0.9	11.4	2.4	2.9	2.8	2.7	3.4	3.9	4.4	2.1	-0.5	4.2	3.2
Private Housing Starts (000s units)	1,153	1,158	1,150	1,248	1,242	1,198	1,230	1,256	1,263	1,265	1,275	1,285	1,108	1,177	1,232	1,272
Vehicle Sales (mill. Units, annualized)	17.3	17.1	17.5	18.0	17.2	16.8	17.1	17.0	16.9	16.8	16.8	16.7	17.4	17.5	17.0	16.8
Industrial Production*	-1.3	-0.7	0.8	0.7	1.8	6.0	1.8	1.9	2.2	2.3	2.2	2.2	0.3	-1.2	2.1	2.4
Nonfarm Payroll Employment (mil.)	143.4	144.0	144.7	145.2	145.7	146.2	146.7	147.1	147.6	148.0	148.5	148.9	141.8	144.3	146.4	148.2
Unemployment rate	4.9	4.9	4.9	4.7	4.7	4.3	4.2	4.1	4.1	4.0	4.1	4.2	5.3	4.9	4.3	4.1
Consumer Price Index* (percent)	0.1	2.3	1.8	3.0	3.1	0.5	2.1	2.1	2.1	2.1	2.1	2.1	0.1	1.3	2.2	2.0
"Core" CPI* (percent)	2.5	2.1	2.1	2.0	2.5	1.0	2.0	2.0	2.1	2.1	2.1	2.1	1.8	2.2	1.9	2.0
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	1.13	1.21	1.46	1.71	1.96	2.13	0.13	0.39	0.99	1.81
Treasury-3 Month Bills (yield)	0.29	0.26	0.30	0.43	0.61	0.87	1.08	1.16	1.41	1.67	1.92	2.08	0.05	0.32	0.93	1.77
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	2.45	2.61	0.69	0.84	1.43	2.30
Treasury-5 Year Notes (yield)	1.37	1.24	1.13	1.61	1.95	1.80	2.00	2.20	2.50	2.72	2.92	3.15	1.53	1.34	1.99	2.82
Treasury-10 Year Notes (yield)	1.91	1.75	1.56	2.14	2.45	2.23	2.45	2.65	2.92	3.12	3.36	3.55	2.14	1.84	2.45	3.24
Treasury-30 Year Notes (yield)	2.72	2.57	2.28	2.83	3.05	2.88	3.13	3.33	3.57	3.77	4.01	4.20	2.84	2.60	3.10	3.89
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	1.39	1.47	1.73	1.97	2.22	2.40	0.34	0.74	1.28	2.08
Mortgage-30 Year (yield)	3.74	3.59	3.45	3.84	4.17	4.07	4.28	4.48	4.75	4.95	5.19	5.40	3.85	3.66	4.25	5.07
BAA Corporate (yield)	5.30	4.66	4.26	4.64	4.66	4.57	4.80	5.10	5.43	5.65	5.88	6.07	5.00	4.71	4.78	5.76

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