BANK OF THE WEST
BNP PARIBAS

U.S. Outlook

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Date	Indicator	For	Estimate	Consensus*	Previous Period
18-Sep-2017	NAHB Housing Market Index	Sep	68.0	67.0	68.0
18-Sep-2017	Net Long-term TIC Flows	Jul	NA	NA	$34.4b
19-Sep-2017	Housing Starts	Aug	1132k	1175k	1155k
19-Sep-2017	Building Permits	Aug	1215k	1220k	1230k
19-Sep-2017	Current Account Balance	2Q	-$110.9b	-$112.4b	-$116.8b
19-Sep-2017	Import Price Index MoM	Aug	0.4%	0.4%	0.1%
20-Sep-2017	Existing Home Sales	Aug	5.41m	5.46m	5.44m
20-Sep-2017	FOMC Rate Decision (Upper Bound)	20-Sep	1.25%	1.25%	1.25%
20-Sep-2017	FOMC Rate Decision (Lower Bound)	20-Sep	1.00%	1.00%	1.00%
21-Sep-2017	Initial Jobless Claims	16-Sep	310k	300k	284K
21-Sep-2017	Philadelphia Fed Business Outlook	Sep	17.1	16.6	18.9
21-Sep-2017	FHFA House Price Index MoM	Jul	0.2%	NA	0.1%
21-Sep-2017	Leading Index	Aug	0.5%	0.2%	0.3%
21-Sep-2017	Household Change in Net Worth	2Q	NA	NA	$2347b
22-Sep-2017	Markit US Manufacturing PMI	Sep P	52.6	53.0	52.8
22-Sep-2017	Markit US Services PMI	Sep P	55.8	55.7	56.0
22-Sep-2017	Markit US Composite PMI	Sep P	NA	NA	55.3

*Consensus from Bloomberg

Biggest FOMC Meeting of the Year on Tap

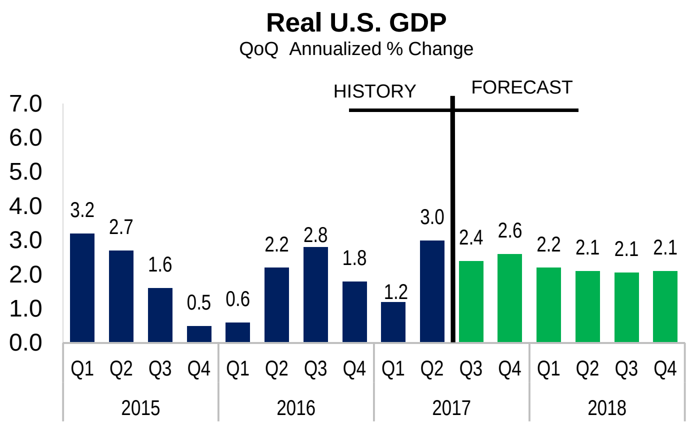
There are a lot of moving parts to incorporate into my forecasts today. The two I will focus on in this report are the impacts of hurricanes Harvey and Irma on our U.S. GDP forecasts and GDP component forecasts, and the second is our evolving view of the Federal Reserve's rate hike path and the downstream implications for U.S. interest rates in 2018.

While the damage from hurricanes Harvey and Irma are still being tallied, we are making some adjustments to our GDP forecasts for Q3, Q4, and Q1 2018. We are estimating a 0.6 percentage point subtraction from U.S. GDP in the third quarter due to both hurricanes. Prior to the hurricanes we were forecasting 3.0% real GDP growth in Q3; we now expect GDP growth of 2.4% in the third quarter. We anticipate adverse hits to real consumer spending, structural investment, residential investment, and government spending, as well as reduced growth in international trade (both imports and exports) as port activity gets disrupted.

We expect two-thirds of the lost growth from the hurricanes to be made up in the fourth quarter as economic activity returns and rebuilding begins. We pushed up our real GDP growth forecast for Q4 by 0.4 percentage points to 2.6% from 2.2%. Consumer spending should rebound strongly, and residential and structural investment will be bolstered as the housing and commercial building stock needs to be rebuilt in Florida and the Gulf Coast region.

Some of the added growth from rebuilding is expected to spill over into the first quarter of 2018. We moved up our GDP growth forecast for the first quarter by 0.2 percentage points to 2.2% from 2.0% originally. On an annual year-on-year basis, one will hardly notice any impact of the hurricanes at all on U.S. GDP growth, as the negative and positive impacts largely cancel out.

Factoring the Hurricanes into Our Forecast for the Economy



Source: Bureau of Economic Analysis

While the hurricanes add another element of economic uncertainty into the near-term outlook, they should be largely overlooked by monetary policy makers when they meet next week to decide on the proper level and path for U.S. interest rates and the timing of the Fed's balance sheet normalization program.

The FOMC is meeting next week and is widely expected to hold interest rates steady and announce the start of its balance sheet reduction plan beginning in October. Both actions have been well telegraphed in advance through Fed statements and minutes and through policymaker speeches. We don't expect any surprises in the announcement itself, but once the execution of the plan gets underway we will need to closely monitor the reaction in the fixed income market— both at the long and short end of the curve— to see if the reaction is as benign as the FOMC has advertised it will be. Any adverse reaction may trigger adjustments to the balance sheet reduction plan down the road.

Even so, we are calling this the biggest FOMC meeting of the year because of the impact it could have on interest rate and inflation expectations into 2018 and beyond. We are looking forward with great interest into the revised economic and interest rate projections, i.e. the revised dot-plot, to see how Fed thinking on the proper rate hike path for 2018 and 2019 has evolved following five consecutive months of core inflation running well below Fed expectations and after years of running below the Fed's target. Yellen's press conference should shed additional light on how interest rate policy might evolve next year.

The turnover expected on the Federal Reserve Board with perhaps 4 vacant board seats to be filled adds another element of interest rate uncertainty. Should those seats be filled by more dovish board members, the FOMC dot-plot could change beyond recognition.

We have become increasingly uncomfortable with the FOMC dot-plot median that was presented at the June FOMC meeting, which indicated 3 additional rate hikes in 2018 and 2019. We still expect one more quarter-point hike from the FOMC in December, but no longer align with the Fed median for 2018 and 2019. We forecast only two quarter-point hikes now for 2018 and 2019.

The primary reason is our forecast for inflation has evolved towards a slower pick-up for core inflation. We also expect crude oil prices to remain lower for longer and see less prospect for a big pick-up in U.S. wage inflation to push consumer prices higher.

We take the bond market's signals seriously. Bond market inflation expectations remain well below historical norms, and the 2-10 Treasury spread has narrowed since the beginning of the year. This is a sign that the Fed could be pushing too hard to normalize monetary conditions, and the growth and inflation outlooks are at risk. Both bond market signals council a go-slow approach from the FOMC going forward.

Finally, ongoing balance sheet reduction at the same time Fed funds rate hikes continue at the same pace as this year might be too much tightening too soon for the expansion to bear without adverse consequences. In short, we think a scaling back of the median dot-plot to two rate hikes a year would make more sense for 2018 and 2019. The Fed has done a good job managing expectations as short-term rates have risen above 1.0%; however, the path going forward is much more treacherous than the one we just left behind.

Major Economic Indicators

Economic Data	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
	History						Forecast						Yr/Yr % chg or Annual Avg.			
Real GDP*	0.6	2.2	2.8	1.8	1.2	3.0	2.4	2.6	2.2	2.1	2.1	2.1	2.6	1.5	2.2	2.3
Personal Consumption Expenditures*	1.8	3.8	2.8	2.9	1.9	3.3	2.4	2.9	2.4	2.2	2.1	2.1	3.2	2.7	2.7	2.5
Non-residential Fixed Investment*	-4.0	3.3	3.4	0.2	7.2	6.9	2.7	3.7	3.0	3.4	3.9	4.4	2.1	-0.6	4.3	3.6
Private Housing Starts (000s units)	1,153	1,158	1,150	1,248	1,238	1,165	1,230	1,256	1,263	1,265	1,275	1,285	1,108	1,177	1,222	1,272
Vehicle Sales (mill. Units, annualized)	17.3	17.2	17.5	17.8	17.1	16.8	16.8	16.8	16.7	16.6	16.6	16.5	17.4	17.5	16.9	16.6
Industrial Production*	-1.3	-0.7	0.8	0.7	1.6	5.2	1.8	1.9	2.2	2.3	2.2	2.2	0.3	-1.2	1.9	2.3
Nonfarm Payroll Employment (mil.)	143.4	144.0	144.7	145.2	145.7	146.2	146.7	147.2	147.7	148.2	148.7	149.2	141.8	144.3	146.5	148.4
Unemployment rate	4.9	4.9	4.9	4.7	4.7	4.4	4.3	4.2	4.2	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	-0.3	1.9	2.2	2.2	2.0	2.0	2.0	0.1	1.3	2.0	1.9
"Core" CPI* (percent)	2.5	2.1	2.1	2.0	2.5	0.6	1.9	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	0.4	3.2	2.8	2.1	1.8	1.6	1.6	-3.3	-1.0	3.3	2.1
Trade Weighted Dollar (Fed BOG, major)	93.2	89.5	90.3	93.5	94.5	93.1	89.0	89.7	90.2	90.5	90.2	90.0	90.9	91.6	91.6	90.2
Crude Oil Prices -WTI ($ per barrel)	33	45	45	49	52	48	47	48	49	49	50	50	50	43	49	50

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

Financial Data	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
	History						Forecast						Annual Average			
S & P 500	1,951	2,075	2,162	2,185	2,326	2,398							2,061	2,093		
Dow Jones Industrial Average	16,663	17,764	18,372	18,865	20,406	20,994							17,591	17,916		
Federal Funds Rate (effective)	0.36	0.37	0.39	0.45	0.70	0.94	1.15	1.21	1.38	1.46	1.63	1.71	0.13	0.39	1.00	1.55
Treasury-3 Month Bills (yield)	0.29	0.26	0.30	0.43	0.61	0.91	1.03	1.10	1.28	1.38	1.57	1.67	0.05	0.32	0.91	1.48
Treasury-2 Year Notes (yield)	0.84	0.77	0.73	1.01	1.24	1.30	1.33	1.45	1.71	1.92	2.17	2.29	0.69	0.84	1.33	2.02
Treasury-5 Year Notes (yield)	1.37	1.24	1.13	1.61	1.95	1.81	1.82	1.92	2.18	2.36	2.58	2.69	1.53	1.34	1.88	2.45
Treasury-10 Year Notes (yield)	1.91	1.75	1.56	2.14	2.45	2.26	2.28	2.44	2.68	2.90	3.06	3.17	2.14	1.84	2.36	2.95
Treasury-30 Year Notes (yield)	2.72	2.57	2.28	2.83	3.05	2.90	2.88	3.01	3.27	3.52	3.75	3.84	2.84	2.60	2.96	3.60
Prime Rate	3.50	3.50	3.50	3.55	3.80	4.05	4.25	4.30	4.50	4.55	4.75	4.82	3.26	3.51	4.10	4.66
Libor 3-Mo. U.S. Dollar	0.62	0.64	0.79	0.92	1.07	1.21	1.31	1.36	1.51	1.59	1.75	1.83	0.34	0.74	1.24	1.67
Mortgage-30 Year (yield)	3.74	3.59	3.45	3.84	4.17	3.98	3.95	4.14	4.40	4.62	4.80	4.98	3.85	3.66	4.06	4.70
BAA Corporate (yield)	5.30	4.66	4.26	4.64	4.66	4.49	4.36	4.60	4.90	5.13	5.32	5.48	5.00	4.71	4.53	5.21

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