BANK OF THE WEST BNP PARIBAS

U.S. Outlook

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Date	Indicator	For	Estimate	Consensus*	Previous Period
4-Jun-2018	Factory Orders	Apr	-0.6%	-0.4%	1.6%
5-Jun-2018	Markit US Services PMI	May F	55.9	NA	55.7
5-Jun-2018	Markit US Composite PMI	May F	NA	NA	55.7
5-Jun-2018	JOLTS Job Openings	Apr	NA	NA	6550
5-Jun-2018	ISM Non-Manufacturing Composite	May	57.5	57.5	56.8
6-Jun-2018	Nonfarm Productivity	1Q F	0.6%	0.7%	0.7%
6-Jun-2018	Unit Labor Costs	1Q F	2.8%	2.7%	2.7%
6-Jun-2018	Trade Balance	Apr	-$49.8b	-$51.5b	-$49.0b
7-Jun-2018	Initial Jobless Claims	02-Jun	226k	NA	221k
7-Jun-2018	Household Change in Net Worth	1Q	NA	NA	$2076b
7-Jun-2018	Consumer Credit	Apr	$15.000b	$14.000b	$11.622b
8-Jun-2018	Wholesale Inventories MoM	Apr F	0.0%	NA	0.0%

*Consensus from Bloomberg

Labor Market Is Hot. Is It Getting Too Hot?

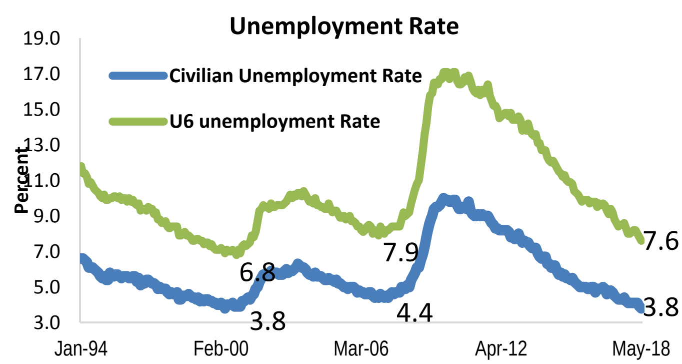
The May jobs report revealed impressive strength and breadth in U.S. job creation that blew away most economists' expectations. U.S. employers added 223K net non-farm jobs in May — a big step up from April's 159K gain. Job growth was broad-based, with no major sectors shedding net jobs last month. Education and health care (+39K), retail trade (+31K), business services (+31K), and construction (+25K) led the sectors creating net new jobs last month.

The labor market is driving a resurgence in consumer confidence and consumer spending in the second quarter that is expected to propel U.S. GDP growth close to 4.0% annualized this quarter. If you remember only one number from today's employment report, it ought to be 3.8% — that's the U.S. unemployment rate for May, and it's at the lowest level in 18 years. We forecast the U.S. unemployment rate will average a low 3.6% by the fourth quarter of 2018.

The broader U6 measure of unemployment that includes marginally attached workers and those working part-time due to economic reasons dropped to 7.6% from 8.0% in March. Taking stock of how far we have come since 2009, we should all do a round of high-fives now that we have finally arrived at our destination. I am singing the Kool and the Gang song from the 80's, "Celebration," right now — "Celebrate good times, come on!"

Other widely watched labor market metrics around unemployment are also improving rapidly. The number of unemployed workers slipped to 6.06 million. The average duration of unemployment dropped to 21.3 weeks from 23.1 weeks last month, while the median duration of unemployment dropped to 9.2 weeks from 9.8 weeks.

Tightest U.S. Labor Market in 18 Years

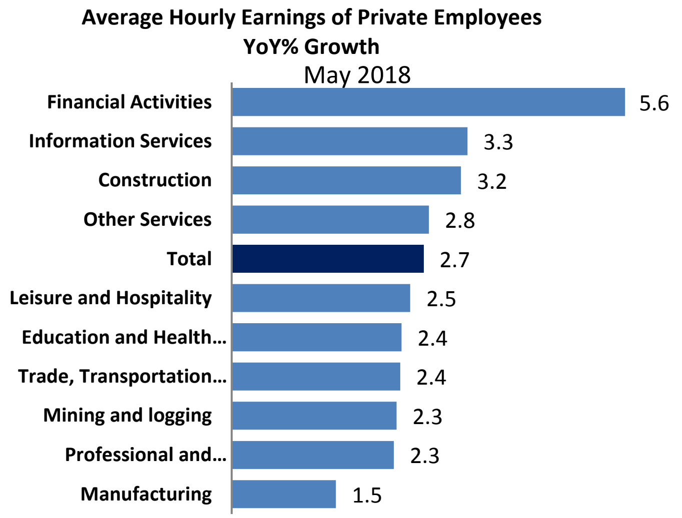


Source: U.S. Bureau of Labor Statistics

This labor market tightness is gradually moving the needle on national wage growth, too. Average hourly earnings growth picked in May, rising 0.3% to 2.71%

year-on-year from 2.56% in April. More and more employers are seeing the labor market go from a buyers' market to a sellers' market today that puts job seekers in the driver's seat.

Average Hourly Earnings Growth Jumps in May



Source: US. Bureau of Labor Statistics

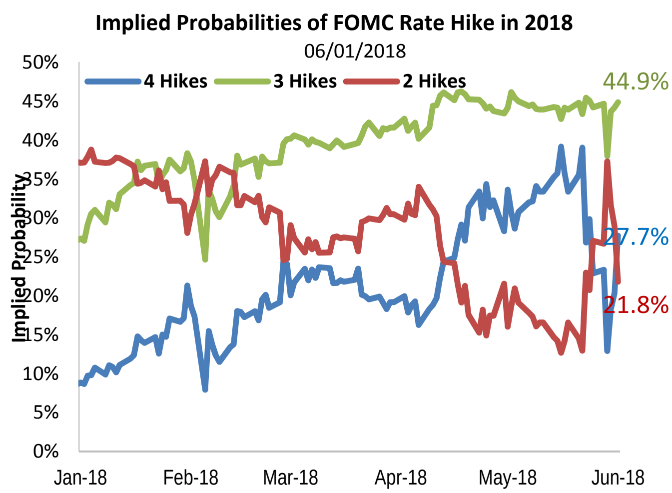
But, just as the party is getting started, the Federal Reserve starts to plan how to take away the punch bowl. From the Fed's perspective, we are absorbing labor market slack at an impressive pace that is not sustainable without fueling a jump in wage and price growth if it continues in the months ahead. The FOMC median thinks a fully employed U.S. economy with stable inflation would have an unemployment rate closer to 4.5%.

The Fed has signaled that it will tolerate a modest overshoot on core consumer inflation for a while, given the economy has been undershooting on inflation for years now. Clearly, some additional wage and price pressures would be welcome news at the Fed, but an overheating economy and labor market could force the Fed to react by slamming on the interest-rate brakes, rather than gradually tapping the brake pedal.

A June rate hike is nearly assured, and the futures market is pricing in a higher probability than it did yesterday that the Fed could raise rates four rather than three times this year. However, the market's and our baseline forecast remains at three rate hikes this year, despite the strong labor market readings today. The probability of four Fed rate hikes would be a lot higher today if it weren't for the downside risks in the second half of the year from an escalating global trade war.

The probability for four rate hikes plunged yesterday as the Trump Administration announced steel and aluminum tariffs on the EU, Canada, and Mexico, and our trading partners swiftly announced reciprocal tariff retaliation. Moreover, China tariffs are a very real possibility by the end of the month, and NAFTA renegotiations appear to be stalled.

Fed Funds Futures – Rising Probability of 4 Hikes this Year



Source: Bloomberg

We are enjoying a surge in economic growth in the second quarter that is rare in this expansion. In part, this is a bounce-back from the lackluster performance from the economy in the first quarter. It has made an already tight labor market even tighter, and is expected to fuel faster price and wage inflation in the months ahead. But it's not sustainable longer-term. Job growth will slow, if only due to the fact that open positions will be too difficult to fill, and downside risks are on the rise as trade wars loom on the horizon. And now we can add an overheating economy and a more aggressive Fed to our list of risks to the outlook.

Major Economic Indicators

	History					Forecast							Yr/Yr % chg or Annual Avg.			
Economic Data	**2017.1**	**2017.2**	**2017.3**	**2017.4**	**2018.1**	**2018.2**	**2018.3**	**2018.4**	**2019.1**	**2019.2**	**2019.3**	**2019.4**	**2016**	**2017**	**2018**	**2019**
Real GDP*	1.2	3.1	3.2	2.9	2.2	3.9	2.6	2.6	2.3	2.2	2.1	2.0	1.5	2.3	2.9	2.5
Personal Consumption Expenditures*	1.9	3.3	2.2	4.0	1.0	3.3	2.4	2.4	2.1	2.0	2.0	2.0	2.7	2.8	2.6	2.2
Non-residential Fixed Investment*	7.2	6.7	4.7	6.8	9.2	4.0	5.6	5.7	5.0	5.0	4.4	4.1	-0.6	4.7	6.4	5.1
Private Housing Starts (000s units)	1,231	1,171	1,172	1,259	1,320	1,300	1,290	1,295	1,290	1,292	1,290	1,285	1,176	1,208	1,301	1,289
Vehicle Sales (mill. Units, annualized)	17.1	16.8	17.1	17.7	17.2	17.3	17.0	16.9	16.5	16.5	16.4	16.3	17.5	17.2	17.1	16.4
Industrial Production*	1.0	5.0	-1.5	7.7	2.3	7.2	3.0	2.6	2.2	2.0	1.7	1.5	-1.2	1.6	4.0	2.6
Nonfarm Payroll Employment (mil.)	145.9	146.3	146.9	147.4	148.1	148.6	149.0	149.5	149.9	150.4	150.7	151.1	144.3	146.6	148.8	150.5
Unemployment rate	4.7	4.3	4.3	4.1	4.1	3.9	3.8	3.6	3.8	3.9	4.0	4.1	4.9	4.4	3.9	4.0
Consumer Price Index* (percent)	3.0	0.1	2.1	3.3	3.5	2.2	2.0	2.0	2.0	2.0	2.1	2.1	1.3	2.1	2.6	2.0
"Core" CPI* (percent)	2.2	0.8	1.8	2.2	3.0	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.2	1.8	2.2	2.1
PPI (finished goods)* (percent)	5.7	1.0	1.4	6.0	2.4	1.8	1.6	1.6	1.6	1.6	1.7	1.7	-1.0	3.2	2.9	1.6
Trade Weighted Dollar (Fed BOG, major)	94.4	93.0	88.3	88.9	86.5	87.3	88.3	88.1	87.8	87.4	86.9	85.8	91.6	91.2	87.6	87.0
Crude Oil Prices -WTI ($ per barrel)	52	48	48	55	63	68	66	63	62	61	61	58	43	51	65	61

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

	History					Forecast							Annual Average			
Financial Data	**2017.1**	**2017.2**	**2017.3**	**2017.4**	**2018.1**	**2018.2**	**2018.3**	**2018.4**	**2019.1**	**2019.2**	**2019.3**	**2019.4**	**2016**	**2017**	**2018**	**2019**
S & P 500	2,326	2,398	2,467	2,603	2,733								2,093	2,449		
Dow Jones Industrial Average	20,406	20,994	21,891	23,689	25,127								17,916	21,745		
Federal Funds Rate (effective)	0.70	0.95	1.15	1.20	1.44	1.71	1.88	1.96	2.13	2.38	2.38	2.38	0.39	1.00	1.75	2.32
Treasury-3 Month Bills (yield)	0.61	0.91	1.05	1.23	1.58	1.83	1.98	2.04	2.18	2.41	2.40	2.36	0.32	0.95	1.86	2.34
Treasury-2 Year Notes (yield)	1.24	1.30	1.36	1.69	2.16	2.47	2.59	2.67	2.74	2.90	2.92	2.87	0.84	1.40	2.47	2.86
Treasury-5 Year Notes (yield)	1.95	1.81	1.81	2.07	2.53	2.82	2.93	3.00	3.08	3.15	3.10	3.15	1.34	1.91	2.82	3.12
Treasury-10 Year Notes (yield)	2.45	2.26	2.24	2.37	2.76	2.94	3.05	3.15	3.30	3.53	3.52	3.50	1.84	2.33	2.98	3.46
Treasury-30 Year Notes (yield)	3.05	2.90	2.82	2.82	3.03	3.15	3.28	3.40	3.69	3.85	3.90	3.96	2.60	2.90	3.22	3.85
Prime Rate	3.80	4.05	4.25	4.29	4.52	4.75	4.98	5.06	5.23	5.48	5.48	5.48	3.51	4.10	4.83	5.42
Libor 3-Mo. U.S. Dollar	1.07	1.21	1.31	1.46	1.93	2.35	2.43	2.46	2.50	2.60	2.58	2.56	0.74	1.26	2.29	2.56
Mortgage-30 Year (yield)	4.17	3.98	3.88	3.92	4.28	4.50	4.60	4.73	4.90	5.20	5.21	5.25	3.66	3.99	4.53	5.14
BAA Corporate (yield)	4.66	4.49	4.33	4.27	4.47	4.77	4.99	5.25	5.60	5.80	6.00	6.30	4.71	4.44	4.87	5.93

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