

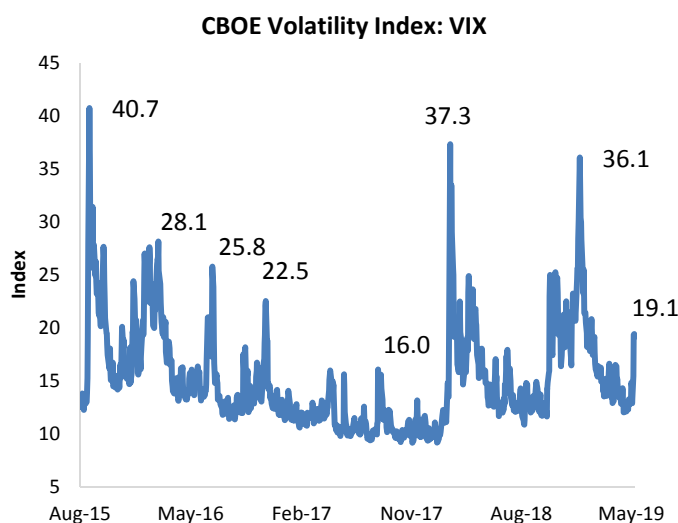
Date	Indicator	For	Estimate	Consensus*	Previous Period
14-May-2019	NFIB Small Business Optimism	Apr	102	102	101.8
14-May-2019	Import Price Index MoM	Apr	0.3%	0.8%	0.6%
15-May-2019	Retail Sales Advance MoM	Apr	0.2%	0.3%	1.6%
15-May-2019	Retail Sales Ex Auto MoM	Apr	0.7%	0.7%	1.2%
15-May-2019	Empire Manufacturing	May	7.0	8.0	10.1
15-May-2019	Industrial Production MoM	Apr	0.0%	0.1%	-0.1%
15-May-2019	Capacity Utilization	Apr	78.8%	78.8%	78.8%
15-May-2019	NAHB Housing Market Index	May	64.0	64.0	63.0
15-May-2019	Business Inventories	Mar	0.0%	0.0%	0.3%
15-May-2019	Net Long-term TIC Flows	Mar	NA	NA	\$51.9b
16-May-2019	Housing Starts	Apr	1197k	1228k	1139k
16-May-2019	Building Permits	Apr	1285k	1295k	1269k
16-May-2019	Philadelphia Fed Business Outlook	May	7.0	9.0	8.5
16-May-2019	Initial Jobless Claims	11-May	222k	NA	228k
17-May-2019	Leading Index	Apr	0.1%	0.2%	0.4%
17-May-2019	U. of Mich. Sentiment	May P	96.8	97.7	97.2

*Consensus from Bloomberg

Trouble Ahead or Another False Alarm?

U.S. President Donald Trump's tweets that he is raising tariffs on \$200 billion of Chinese imports from 10% to 25% because the Chinese "broke the deal" triggered a bout of global stock and bond market volatility not seen since December.

Stock Volatility Comes Roaring Back



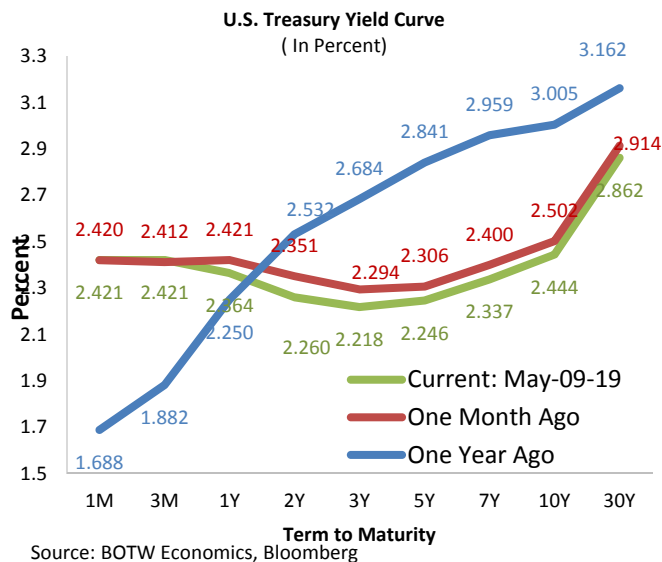
Source: Chicago Board Options Exchange

Back in December, the market had feared a near imminent recession only to see financial conditions stabilize and then thrive because the Federal Reserve stood down after previously planning 2 or 3 more quarter-point rate hikes this year.

We interpret this week's market tremors as an early warning of a tougher US and global economic environment ahead. A 2020 economic recession is not inevitable, but the window for the Fed to achieve a soft landing is closing quickly. We think the most likely outcome as we approach 2020 is a period of sluggish growth that will require support from the Fed in the form of three quarter-point rate cuts from today's levels.

While stocks had climbed to record highs on solid Q1 earnings and trade agreement optimism, the signals coming from the Treasury market have been consistently bearish about our economic future. Indeed, the Treasury yield curve has shifted lower and remains inverted between the 1- and 7-year maturities.

Treasury Yield Curve is Sinking and Inverting



Bond market inflation expectations have not returned to the 2% or higher levels seen prior to the fourth quarter’s market turmoil.

Clearly, economic conditions today aren’t all gloom and doom. The US labor market’s strength and resilience is impressive, keeping the consumer in the game a little longer. However, the tea leaves suggest a consumer spending slowdown ahead. Unit vehicle sales have been struggling so far this year, real earnings growth has continued to lag spending and delinquency rates have begun to rise on high interest loans like credit cards.

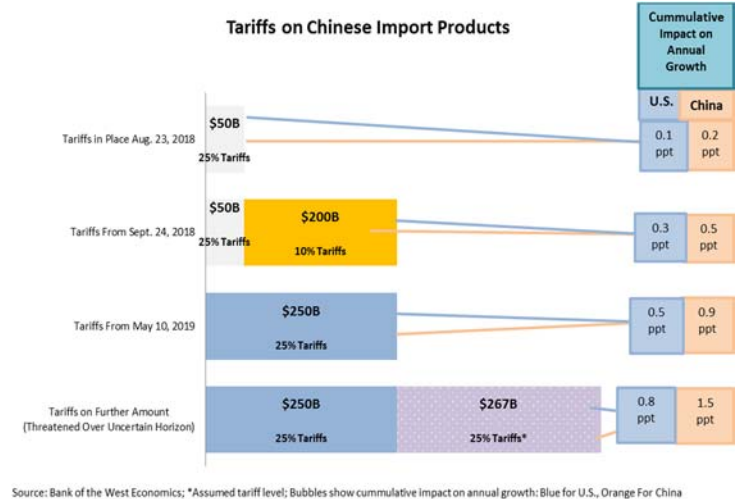
The Fed’s senior loan officer data for Q2 released earlier this week revealed another quarter of declining loan demand from both consumers and businesses.

Lower mortgage rates are failing to lift housing demand with mortgage purchase applications down 2.8% from a month ago.

Ratcheting up of punitive tariffs from 10% to 25% on \$200 billion worth of China imports on May 10th won’t in itself derail the U.S. economic expansion, but it doesn’t help either. By our estimation, the tariff hike nearly doubles the negative economic impact on both the US and China from today’s tariff levels.

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Trade War Negative Impact Could Double or Triple



If Trump doubles down and slaps 25% tariffs on the remaining \$300 billion in Chinese imports a month or two from now, our model estimates the negative economic impacts from this trade war will triple from today’s levels in a year.

My fear is that with US and global stock markets priced for perfection (assuming both a “Goldilocks” trade agreement and a U.S. soft landing), financial market dislocation could significantly darken our already downbeat economic outlook.

Probability models at the Cleveland Fed and the New York Fed that estimate the chances of a recession a year from now remain elevated at around 30%.

We have been spared widespread economic pain from erratic trade policies, ballooning Federal government budget deficits, and political dysfunction in Washington DC, largely because of the steady hand and stewardship of the Fed, but our luck may be about to run out. If it does, don’t be surprised if the Fed gets the blame. Damage is being done to our long-term economic growth potential today even if the daily economic indicators and quarterly GDP figures don’t yet reflect it. Buckle up, this is not a drill.

Key Economic and Interest Rate Forecasts

Economic Data	History					Forecast							Yr/Yr % chg or Annual Avg.			
	2018.1	2018.2	2018.3	2018.4	2019.1	2019.2	2019.3	2019.4	2020.1	2020.2	2020.3	2020.4	2017	2018	2019	2020
Real GDP*	2.2	4.2	3.4	2.2	3.2	1.7	1.5	1.5	1.0	0.6	0.5	0.5	2.2	2.9	2.5	1.0
Personal Consumption Expenditures*	0.5	3.8	3.5	2.5	1.2	2.6	2.1	1.9	1.5	1.0	1.0	1.0	2.5	2.6	2.3	1.5
Non-residential Fixed Investment*	11.5	8.7	2.5	5.4	2.7	2.9	3.3	2.5	1.5	1.5	1.5	1.5	5.3	6.9	3.7	2.0
Private Housing Starts (000s units)	1,317	1,261	1,234	1,185	1,193	1,170	1,185	1,175	1,165	1,150	1,135	1,130	1,208	1,249	1,181	1,145
Vehicle Sales (mill. Units, annualized)	17.1	17.1	16.9	17.5	16.9	16.8	16.7	16.5	16.2	15.9	15.6	15.9	17.2	17.1	16.7	15.9
Industrial Production*	2.3	4.6	5.2	4.0	-0.3	1.0	1.7	1.0	-0.5	-1.0	-1.0	-1.0	1.6	4.0	2.0	0.0
Nonfarm Payroll Employment (mil.)	148.0	148.7	149.4	150.1	150.7	151.3	151.8	152.3	152.6	152.7	152.3	152.1	146.6	149.1	151.5	152.4
Unemployment rate	4.1	3.9	3.8	3.8	3.9	3.7	3.7	3.8	3.9	4.2	4.5	4.8	4.4	3.9	3.8	4.4
Consumer Price Index* (percent)	3.2	2.1	2.0	1.5	0.9	2.1	2.1	2.1	1.8	1.8	1.7	1.6	2.1	2.4	1.7	1.9
"Core" CPI* (percent)	2.7	1.9	2.0	2.2	2.3	2.1	2.1	2.1	2.0	1.9	1.8	1.8	1.8	2.1	2.1	2.0
PPI (finished goods)* (percent)	3.8	2.7	2.0	0.5	-2.5	2.1	1.8	1.8	1.3	1.4	1.4	1.4	3.2	3.1	0.6	1.6
Trade Weighted Dollar (Fed BOG, major)	86.2	88.2	90.2	91.4	91.5	91.6	90.6	89.5	89.3	89.0	88.5	88.0	91.1	89.0	90.8	88.7
Crude Oil Prices -WTI (\$ per barrel)	63	68	70	60	55	62	60	59	58	57	54	53	51	65	59	56

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

Financial Data	History					Forecast							Annual Average			
	2018.1	2018.2	2018.3	2018.4	2019.1	2019.2	2019.3	2019.4	2020.1	2020.2	2020.3	2020.4	2017	2018	2019	2020
S & P 500	2,733	2,703	2,850	2,699	2,721								2,449	2,746		
Dow Jones Industrial Average	25,127	24,556	25,595	24,916	25,147								21,745	25,048		
Federal Funds Rate (effective)	1.45	1.74	1.92	2.22	2.40	2.40	2.40	2.40	2.29	2.04	1.79	1.63	1.00	1.83	2.40	1.94
Treasury-3 Month Bills (yield)	1.58	1.87	2.07	2.36	2.44	2.45	2.44	2.43	2.30	2.05	1.80	1.64	0.95	1.97	2.44	1.95
Treasury-2 Year Notes (yield)	2.16	2.48	2.67	2.80	2.51	2.45	2.45	2.46	2.38	2.15	1.92	1.87	1.40	2.53	2.47	2.08
Treasury-5 Year Notes (yield)	2.53	2.77	2.81	2.88	2.50	2.40	2.42	2.48	2.41	2.22	2.10	2.05	1.91	2.75	2.45	2.20
Treasury-10 Year Notes (yield)	2.76	2.92	2.92	3.04	2.65	2.55	2.60	2.68	2.62	2.51	2.30	2.28	2.33	2.91	2.62	2.43
Treasury-30 Year Notes (yield)	3.03	3.09	3.06	3.27	3.02	2.99	3.05	3.06	3.00	2.88	2.85	2.80	2.90	3.11	3.03	2.88
Prime Rate	4.53	4.80	5.01	5.28	5.50	5.50	5.50	5.50	5.38	5.13	4.87	4.69	4.10	4.90	5.50	5.02
Libor 3-Mo. U.S. Dollar	1.93	2.34	2.34	2.62	2.71	2.65	2.65	2.68	2.60	2.35	2.10	1.94	1.26	2.31	2.67	2.25
Mortgage-30 Year (yield)	4.28	4.54	4.57	4.78	4.41	4.33	4.40	4.50	4.53	4.45	4.40	4.38	3.99	4.54	4.41	4.44
BAA Corporate (yield)	4.47	4.78	4.81	5.14	5.01	4.95	5.40	5.70	6.20	6.20	6.10	6.10	4.44	4.80	5.27	6.15

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