

| Date       | Indicator                                | For    | Estimate  | Consensus* | Previous Period |
|------------|--|--------|-----------|------------|-----------------|
| 2-Mar-2020 | Markit US Manufacturing PMI              | Feb F  | 50.8      | NA         | 50.8            |
| 2-Mar-2020 | Construction Spending MoM                | Jan    | 0.8%      | 0.6%       | -0.2%           |
| 2-Mar-2020 | ISM Manufacturing                        | Feb    | 51.3      | 50.5       | 50.9            |
| 3-Mar-2020 | Wards Total Vehicle Sales                | Feb    | 16.80m    | 16.80m     | 16.84m          |
| 4-Mar-2020 | ADP Employment Change                    | Feb    | 180k      | 170k       | 291k            |
| 4-Mar-2020 | Markit US Services PMI                   | Feb F  | 49.5      | 49.5       | 49.4            |
| 4-Mar-2020 | Markit US Composite PMI                  | Feb F  | NA        | NA         | 49.6            |
| 4-Mar-2020 | ISM Non-Manufacturing Index              | Feb    | 54.5      | 55.0       | 55.5            |
| 4-Mar-2020 | U.S. Federal Reserve Releases Beige Book |        |           |            |                 |
| 5-Mar-2020 | Nonfarm Productivity                     | 4Q F   | 1.4%      | 1.4%       | 1.4%            |
| 5-Mar-2020 | Unit Labor Costs                         | 4Q F   | 1.4%      | 1.4%       | 1.4%            |
| 5-Mar-2020 | Initial Jobless Claims                   | 29-Feb | 216k      | 215k       | 219k            |
| 5-Mar-2020 | Factory Orders                           | Jan    | -0.2%     | -0.2%      | 1.8%            |
| 6-Mar-2020 | Trade Balance                            | Jan    | -\$46.0b  | -\$48.0b   | -\$48.9b        |
| 6-Mar-2020 | Change in Nonfarm Payrolls               | Feb    | 185k      | 175k       | 225k            |
| 6-Mar-2020 | Change in Manufacturing Payrolls         | Feb    | -8k       | -2k        | -12k            |
| 6-Mar-2020 | Unemployment Rate                        | Feb    | 3.6%      | 3.5%       | 3.6%            |
| 6-Mar-2020 | Average Hourly Earnings MoM              | Feb    | 0.3%      | 0.3%       | 0.2%            |
| 6-Mar-2020 | Average Weekly Hours All Employees       | Feb    | 34.3      | 34.3       | 34.3            |
| 6-Mar-2020 | Wholesale Inventories MoM                | Jan F  | -0.2%     | NA         | -0.2%           |
| 6-Mar-2020 | Consumer Credit                          | Jan    | \$16.000b | \$17.000b  | \$22.055b       |

\*Consensus from Bloomberg

## Panic Hits Wall Street This Week

Financial markets have gone from irrational exuberance over the last four months to panic in the short space of a week and a half. At the time of this writing the U.S. equity market has lost about 15% of its value from the record highs reached just nine days ago and has drop about 13% in the last five trading days. To give you a sense of the panic in the air around the coronavirus's potential impacts on the global economy and corporate profits, one only needs to glance at the VIX index. The VIX is a volatility index constructed from the S&P 500 that reached a level of 49 on Friday, a 169% increase from just 5 days ago and the highest level of this index going all the way back to financial crisis of 2008. This mean stock investors are bracing for daily stock price movements over the next 30-days that exceed anything we have so far in this expansion, including the 15.0% stock market selloff of

December 2018, when equity investors last feared imminent recession.

It's all about Covid-19 right now, and the market is ignoring U.S. economic data that actually looks to be coming in on the strong side so far. Our baseline scenario is that the Covid-19 virus reaches at least modest pandemic status and begins spreading more widely in the United States as well. So why are the financial markets hitting the panic button right now? The Covid-19 virus represents a serious demand and supply shock to the global and U.S. economies, if it continues to spread and quarantines follow it around the global.

Supply chains in China and South Korea already appears to be disrupted to some extent and those disruptions could swiftly spread to the U.S. and Europe as well. Production

for manufacturers and information technology industries could be temporarily idled across many parts of the world. Inventories for wholesalers and retailers could begin to thin out, impacting sales. China last week was still operating at about 50-60% of its capacity. China could see its year-on-year GDP growth fall to only 3.0% in the first quarter from 6.1% in Q4. A record low for China in modern times. Last week, we cut our 2020 GDP growth forecast for China and Japan to 5.5% and 0.3%, respectively. This week we take a knife to our baseline U.S. growth outlook for this year.

We expect the negative economic impact from the financial contagion and Coronavirus to fall more in the second quarter in the U.S. than the first quarter. We cut our U.S. GDP growth forecast for the second quarter to 1.2% annualized from 1.6% previously as we expect further deterioration in U.S. consumer and business spending growth into the summer. We now forecast real consumer spending growth of just 1.3% annualized in the second quarter down from about 1.8% in Q1. For the full year, we see U.S. GDP growth of 1.7% year/year or 1.3% Q4/Q4 in 2020.

Demand has already dropped sharply for firms operating in the automobile production, airlines, travel and tourism, and leisure and hospitality sectors. The Port of Los Angeles, the largest port in the United States with the closest ties to economic activity in Asia, is forecasting container traffic in Q1 to be 15% lower than a year ago and is currently running 25% lower than a year ago so far in February.

Risk of a 2020 recession in the U.S. is rising. I would put the risk today at least as high as it got last summer at around 40%. Financial contagion, touched off by the coronavirus fear could itself, become its own catalyst of recession this year. Stock prices declines will dent household wealth and dampen consumer confidence and spending the longer it continues. Add to that the reduction in consumer spending from widening coronavirus quarantines in the U.S. and consumer's fear of going out to shop and you have all the ingredients you need for a good old fashioned recession right here in the

U.S. At the same time, business and consumer credit conditions will likely tighten. Corporate high-yield bond spreads are widening in tandem with the stock market selloff, which is already working to tighten financial conditions for firms. If the financial volatility is sustained, it won't be long before the banks will have to control their credit loss exposures as well.

How will the Federal Reserve respond to this new downside risk to the U.S. economy? For now the Fed remains in wait and see mode, saying it's too early to gauge the extent of the downside impacts on U.S. growth. Indeed, recent economic indicators suggest the U.S. economy got off to a pretty strong start with improvements in personal income growth, PMI measures, and consumer confidence. It may take another month or two of downbeat U.S. economic data for the FOMC majority to come around to another rate cut. Financial panics have a history of coming and going very rapidly with little long-term impact on the economic outlook. Still we think the U.S. economic data in Q2 will be weak enough to convince even the skeptics on the Committee that the best course of action is another couple of interest rate cuts.

In short, we added another rate cut from the Federal Reserve in 2020. We expect a quarter point cut at the June meeting and another in December with no interest rate increases in 2021. In other words, lower interest rates for longer. The Fed funds futures market is being even more aggressive, expecting at least 3 quarter point rate cuts before the election this year and nearly 4 rate cuts by the end of the year. The 10-year Treasury yield, which influences many other long-term rates, including mortgage rates, hit a record low on Friday of 1.16 percent. We would expect a run at the 1.0% level over the near-term and now see the 10-year Treasury yield remaining below 1.5% until the second quarter of 2021. While the financial market's negative reaction to the Covid-19 virus is probably a bit overdone at this point, i.e. a worst case scenario is already being priced in, the direction certainly isn't. The downside economic and financial risks have intensified sharply since the beginning of the year.

**Key Economic and Interest Rate Forecasts**

| Economic Data                           | History |        |        |        | Forecast |        |        |        |        |        |        |        | Yr/Yr % chg or Annual Avg. |       |       |       |
|---|---------|--------|--------|--------|----------|--------|--------|--------|--------|--------|--------|--------|----------------------------|-------|-------|-------|
|   | 2019.1  | 2019.2 | 2019.3 | 2019.4 | 2020.1   | 2020.2 | 2020.3 | 2020.4 | 2021.1 | 2021.2 | 2021.3 | 2021.4 | 2018                       | 2019  | 2020  | 2021  |
| Real GDP*                               | 3.1     | 2.0    | 2.1    | 2.1    | 1.7      | 1.2    | 1.2    | 1.1    | 1.3    | 1.2    | 1.3    | 1.3    | 2.9                        | 2.3   | 1.7   | 1.2   |
| Personal Consumption Expenditures*      | 1.1     | 4.6    | 3.2    | 1.7    | 1.8      | 1.3    | 1.4    | 1.4    | 1.5    | 1.5    | 1.7    | 1.7    | 3.0                        | 2.6   | 2.0   | 1.5   |
| Non-residential Fixed Investment*       | 4.4     | -1.0   | -2.3   | -2.3   | 2.7      | -0.3   | 0.7    | 0.7    | 2.1    | 2.1    | 2.1    | 2.2    | 6.4                        | 2.1   | 0.0   | 1.5   |
| Private Housing Starts (000s units)     | 1,213   | 1,256  | 1,282  | 1,449  | 1,344    | 1,318  | 1,285  | 1,255  | 1,220  | 1,200  | 1,212  | 1,245  | 1,208                      | 1,300 | 1,301 | 1,219 |
| Vehicle Sales (mill. Units, annualized) | 16.9    | 17.0   | 17.0   | 16.8   | 16.6     | 16.3   | 16.0   | 15.9   | 16.2   | 16.2   | 16.4   | 16.4   | 17.2                       | 16.9  | 16.2  | 16.3  |
| Industrial Production*                  | -1.9    | -2.3   | 1.1    | 0.1    | -1.2     | -2.0   | -0.8   | -0.5   | 1.3    | 1.3    | 1.4    | 1.5    | 3.9                        | 0.8   | -0.8  | 0.5   |
| Nonfarm Payroll Employment (mil.)       | 150.2   | 150.6  | 151.2  | 151.8  | 152.3    | 152.8  | 153.1  | 153.3  | 153.6  | 153.8  | 154.1  | 154.5  | 146.6                      | 150.9 | 152.9 | 154.0 |
| Unemployment rate                       | 3.9     | 3.6    | 3.6    | 3.5    | 3.6      | 3.6    | 3.7    | 3.8    | 4.0    | 4.1    | 4.1    | 4.1    | 4.4                        | 3.7   | 3.7   | 4.1   |
| Consumer Price Index* (percent)         | 0.9     | 3.0    | 1.8    | 2.4    | 1.8      | 1.4    | 0.9    | 0.7    | 1.8    | 2.1    | 2.2    | 2.2    | 2.4                        | 1.8   | 1.7   | 1.6   |
| "Core" CPI* (percent)                   | 2.2     | 2.2    | 2.8    | 2.0    | 2.2      | 1.9    | 1.8    | 1.8    | 1.9    | 2.0    | 2.0    | 2.0    | 2.1                        | 2.2   | 2.1   | 1.9   |
| PPI (finished goods)* (percent)         | -2.3    | 5.3    | -2.1   | 3.2    | 1.9      | -2.5   | -0.5   | -0.5   | 0.6    | 1.7    | 2.6    | 2.7    | 3.1                        | 0.8   | 0.6   | 0.7   |
| Trade Weighted Dollar (Fed BOG, major)  | 91.5    | 92.2   | 92.1   | 92.3   | 91.9     | 91.5   | 90.5   | 90.0   | 89.5   | 88.7   | 89.0   | 89.3   | 91.1                       | 92.0  | 91.0  | 89.1  |
| Crude Oil Prices -WTI (\$ per barrel)   | 55      | 60     | 56     | 57     | 54       | 45     | 47     | 48     | 50     | 52     | 55     | 56     | 51                         | 57    | 48    | 53    |

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

| Financial Data                 | History |        |        |        | Forecast |        |        |        |        |        |        |        | Annual Average |        |      |      |
|--------------------------------|---------|--------|--------|--------|----------|--------|--------|--------|--------|--------|--------|--------|----------------|--------|------|------|
|                                | 2019.1  | 2019.2 | 2019.3 | 2019.4 | 2020.1   | 2020.2 | 2020.3 | 2020.4 | 2021.1 | 2021.2 | 2021.3 | 2021.4 | 2018           | 2019   | 2020 | 2021 |
| S & P 500                      | 2,721   | 2,882  | 2,958  | 3,083  |          |        |        |        |        |        |        |        | 2,449          | 2,911  |      |      |
| Dow Jones Industrial Average   | 25,147  | 26,096 | 26,676 | 27,537 |          |        |        |        |        |        |        |        | 21,745         | 26,364 |      |      |
| Federal Funds Rate (effective) | 2.40    | 2.40   | 2.20   | 1.65   | 1.63     | 1.54   | 1.38   | 1.29   | 1.13   | 1.13   | 1.13   | 1.13   | 1.00           | 2.16   | 1.46 | 1.13 |
| Treasury-3 Month Bills (yield) | 2.44    | 2.35   | 2.03   | 1.61   | 1.55     | 1.46   | 1.31   | 1.26   | 1.10   | 1.10   | 1.10   | 1.11   | 0.95           | 2.11   | 1.40 | 1.10 |
| Treasury-2 Year Notes (yield)  | 2.49    | 2.13   | 1.69   | 1.59   | 1.42     | 1.20   | 1.23   | 1.21   | 1.19   | 1.20   | 1.28   | 1.28   | 1.40           | 1.97   | 1.27 | 1.24 |
| Treasury-5 Year Notes (yield)  | 2.46    | 2.12   | 1.63   | 1.61   | 1.43     | 1.16   | 1.24   | 1.24   | 1.28   | 1.35   | 1.40   | 1.48   | 1.91           | 1.96   | 1.27 | 1.38 |
| Treasury-10 Year Notes (yield) | 2.65    | 2.34   | 1.80   | 1.79   | 1.60     | 1.39   | 1.43   | 1.44   | 1.48   | 1.53   | 1.62   | 1.63   | 2.33           | 2.15   | 1.47 | 1.57 |
| Treasury-30 Year Notes (yield) | 3.01    | 2.78   | 2.29   | 2.25   | 2.07     | 1.82   | 1.88   | 1.90   | 1.96   | 2.03   | 2.12   | 2.13   | 2.90           | 2.58   | 1.92 | 2.06 |
| Prime Rate                     | 5.50    | 5.50   | 5.31   | 4.83   | 4.75     | 4.66   | 4.50   | 4.41   | 4.25   | 4.25   | 4.25   | 4.25   | 4.10           | 5.29   | 4.58 | 4.25 |
| Libor 3-Mo. U.S. Dollar        | 2.69    | 2.51   | 2.20   | 1.93   | 1.73     | 1.64   | 1.48   | 1.46   | 1.30   | 1.32   | 1.33   | 1.31   | 1.26           | 2.33   | 1.58 | 1.32 |
| Mortgage-30 Year (yield)       | 4.37    | 4.01   | 3.66   | 3.70   | 3.70     | 3.54   | 3.58   | 3.59   | 3.58   | 3.53   | 3.62   | 3.63   | 3.99           | 3.94   | 3.60 | 3.59 |
| BAA Corporate (yield)          | 4.97    | 4.60   | 4.03   | 3.91   | 3.69     | 3.54   | 3.83   | 4.14   | 4.48   | 4.78   | 4.87   | 4.85   | 4.44           | 4.38   | 3.80 | 4.75 |

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