U.S. Outlook

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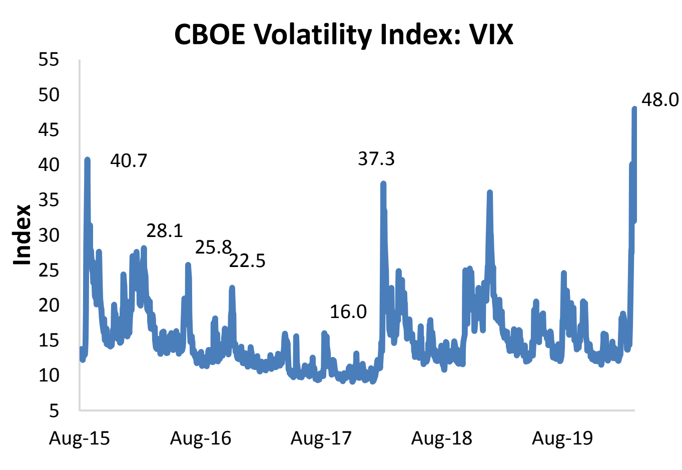
Date	Indicator	For	Estimate	Consensus*	Previous Period
10-Mar-2020	NFIB Small Business Optimism	Feb	102.8	103.0	104.3
11-Mar-2020	CPI MoM	Feb	-0.1%	0.0%	0.1%
11-Mar-2020	CPI Ex Food and Energy MoM	Feb	0.1%	0.2%	0.2%
12-Mar-2020	PPI Final Demand MoM	Feb	-0.2%	-0.1%	0.5%
12-Mar-2020	PPI Ex Food and Energy MoM	Feb	0.1%	0.2%	0.5%
12-Mar-2020	Initial Jobless Claims	07-Mar	218k	NA	216k
12-Mar-2020	Household Change in Net Worth	4Q	NA	NA	$574b
13-Mar-2020	Import Price Index MoM	Feb	-1.0%	-0.9%	0.0%
13-Mar-2020	U. of Mich. Sentiment	Mar P	97.0	96.4	101.0

*Consensus from Bloomberg

Treasury Yields Crash – Ignoring Strong Jobs Report

The Coronavirus itself is a serious threat to both the U.S. and global economic expansion. It is both a supply and demand shock to global growth as producers face supply-chain disruptions and service and retail businesses see a sharp drop in consumer demand as more and more people self-isolate to protect themselves from the rapidly spreading infection. But the virus and the global economic shock it is creating is also starting to touch off financial market contagion and volatility the likes he haven't seen since the Global Financial Crisis of 2007 and 2008.

Add Financial Market Contagion To Your List of Risks

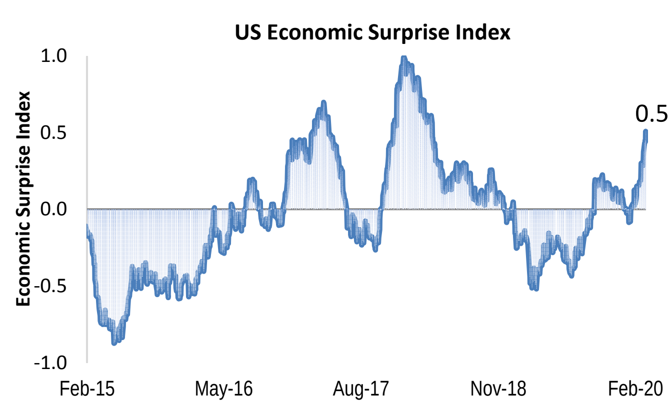


Source: Chicago Board Options Exchange

This additional financial shock adds a new dangerous element to an already uncertain and negative economic outlook, and will likely prompt economic forecasters to embark on another round of global and U.S. GDP growth forecast cuts as the market turbulence and equity market losses continue to mount. Already it appears the economic and financial market shock from the Coronavirus will be far higher than the one we saw from the U.S/China trade war last year, calling for an aggressive monetary policy and fiscal policy response from all the major economies of the world.

For now, the financial market volatility is based on very little hard economic evidence. Indeed in the United States, the economic indicators continue to beat economists' expectations.

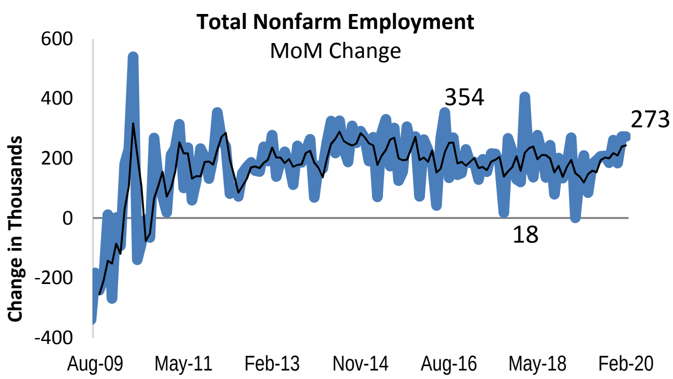
U.S. Indicators Have Been Stronger Than Expected



Source: Bloomberg

Just this morning we received an incredibly strong employment report for February. According to the Bureau of Labor Statistics, total non-farm payrolls increased by 273k jobs last month with payroll gains for January and December revised up by a net 85k jobs. The job growth was strong enough to push the unemployment rate down to 3.5% from 3.6% in January, further tightening the U.S. labor market.

Job Creation Has Been On An Upswing Since Last Spring



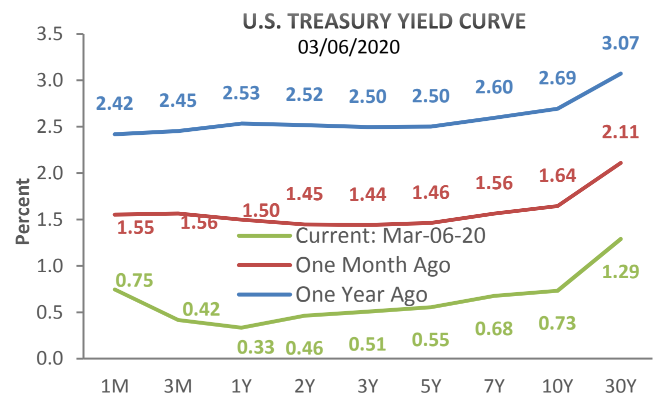
Source: U.S. Bureau of Labor Statistics

The news was good on the income front as well as both average weekly hours improved to 34.4 from 34.3 and average hourly earnings increased 0.3% up from 0.2% in January.

But past performance is no guarantee of future results. The Coronavirus is propagating quickly into a global economic shock. The Global Markit PMIs for Manufacturing and Services for February dropped to 47.2 and 47.1 respectively, both firmly in contraction territory. The global economic outlook continues to deteriorate. Global GDP growth is now likely to be in the range of 1.0 to 2.0% in 2020, that is down from the IMF's forecast at the beginning of the year of 3.3% and the 2.9% pace seen last year during the trade war headwinds.

We expect a sharp slowdown in U.S. economic growth in Q2 to around 0.8% with little to no recovery in the second half of the year. U.S. growth will be held up at a meager pace by some consumer spending growth, government spending, and residential construction as mortgage rates hit all-time lows in the second quarter. Investors are rushing for places to hide and so far finding sanctuary in U.S Treasury bonds. The long-end of the U.S. Treasury yield curve has never been so low, even at the height of the financial crisis and Great Recession.

Treasury Yield Curve Crashes



Source: BOTW Economics, Bloomberg

Fed funds futures are pricing in Fed rate cuts all the way to the lower bound by the end of the year with an implied yield of 0.195%. Our Fed forecast is that we will see another 25 basis point cut from the Fed at their April meeting and another 25 basis point cut at their June meeting. I think today's employment report was too strong for the Fed to cut again at the March FOMC meeting, given they just did 50 basis points in cuts this week. Moreover, if the U.S. economic indicators for March and April show growing evidence a contraction is underway or imminent, the Fed will not hesitate to move the Fed funds rate to their lower bound of between 0 and 25 basis points before year end.

In short, the bond market is already pricing in a worst case scenario, a U.S. and global recession in 2020 with emergency monetary stimulus from the Fed to help cushion the fall. The flatness of the yield curve at the long-end, suggests the market believes the Fed's efforts to avert a recession will be unsuccessful. However, more economic data, probably not received before April or May, will be needed to confirm or deny the market's bearish call. The market recession signal here is quite strong and getting louder by the day. We see growing risk of a U.S. recession as well and put the probability of a recession within the next 12 months at near 50%.

Key Economic and Interest Rate Forecasts

	History				Forecast								Yr/Yr % chg or Annual Avg.			
Economic Data	**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	0.8	1.0	1.0	1.3	1.2	1.3	1.3	2.9	2.3	1.5	1.2
Personal Consumption Expenditures*	1.1	4.6	3.2	1.7	1.8	1.1	1.4	1.4	1.5	1.5	1.7	1.7	3.0	2.6	1.9	1.5
Non-residential Fixed Investment*	4.4	-1.0	-2.3	-2.3	2.0	-1.2	0.3	0.7	2.1	2.1	2.1	2.2	6.4	2.1	-0.4	1.4
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.

	History				Forecast								Annual Average			
Financial Data	**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	1.46	0.79	0.63	0.63	0.63	0.63	0.63	0.63	1.00	2.16	0.88	0.63
Treasury-3 Month Bills (yield)	2.44	2.35	2.03	1.61	1.41	0.74	0.59	0.60	0.60	0.60	0.60	0.61	0.95	2.11	0.84	0.60
Treasury-2 Year Notes (yield)	2.49	2.13	1.69	1.59	1.33	0.62	0.66	0.66	0.66	0.68	0.78	0.78	1.40	1.97	0.82	0.73
Treasury-5 Year Notes (yield)	2.46	2.12	1.63	1.61	1.34	0.73	0.73	0.73	0.78	0.85	0.90	0.98	1.91	1.96	0.88	0.88
Treasury-10 Year Notes (yield)	2.65	2.34	1.80	1.79	1.51	0.96	0.93	0.93	1.03	1.03	1.12	1.13	2.33	2.15	1.08	1.08
Treasury-30 Year Notes (yield)	3.01	2.78	2.29	2.25	1.98	1.61	1.58	1.59	1.71	1.73	1.82	1.83	2.90	2.58	1.69	1.77
Prime Rate	5.50	5.50	5.31	4.83	4.58	3.91	3.75	3.75	3.75	3.75	3.75	3.75	4.10	5.29	4.00	3.75
Libor 3-Mo. U.S. Dollar	2.69	2.51	2.20	1.93	1.64	0.99	0.73	0.80	0.80	0.82	0.83	0.81	1.26	2.33	1.04	0.82
Mortgage-30 Year (yield)	4.37	4.01	3.66	3.70	3.61	3.26	3.18	3.18	3.23	3.23	3.24	3.28	3.99	3.94	3.31	3.25
BAA Corporate (yield)	4.97	4.60	4.03	3.91	3.60	3.66	3.73	3.93	4.03	4.28	4.37	4.35	4.44	4.38	3.73	4.26

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