BANK OF THE WEST
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U.S. Outlook

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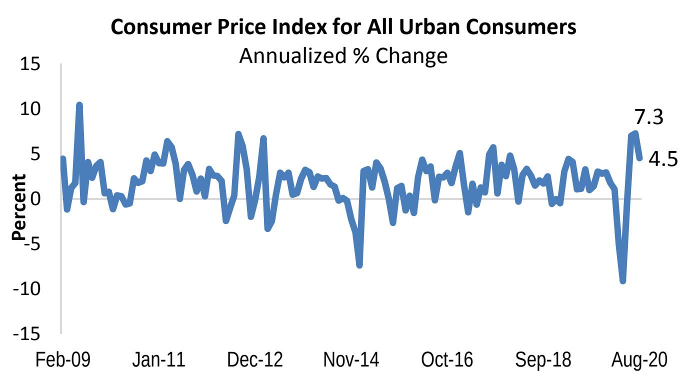
Date	Indicator	For	Estimate	Consensus*	Previous Period
15-Sep-2020	Empire Manufacturing	Sep	1.5	5.5	3.7
15-Sep-2020	Import Price Index MoM	Aug	0.6%	0.5%	0.7%
15-Sep-2020	Industrial Production MoM	Aug	1.0%	1.1%	3.0%
15-Sep-2020	Capacity Utilization	Aug	71.6%	71.7%	70.6%
16-Sep-2020	Retail Sales Advance MoM	Aug	0.9%	1.0%	1.2%
16-Sep-2020	Retail Sales Ex Auto MoM	Aug	0.8%	1.0%	1.9%
16-Sep-2020	Business Inventories	Jul	0.2%	0.2%	-1.1%
16-Sep-2020	NAHB Housing Market Index	Sep	77.0	78.0	78.0
16-Sep-2020	FOMC Rate Decision (Upper Bound)	16-Sep	0.25%	0.25%	0.25%
16-Sep-2020	FOMC Rate Decision (Lower Bound)	16-Sep	0.00%	0.00%	0.00%
16-Sep-2020	Net Long-term TIC Flows	Jul	NA	NA	$113.0b
17-Sep-2020	Building Permits	Aug	1470k	1530k	1483k
17-Sep-2020	Housing Starts	Aug	1440k	1480k	1496k
17-Sep-2020	Philadelphia Fed Business Outlook	Sep	14.0	15.0	17.2
17-Sep-2020	Initial Jobless Claims	12-Sep	895k	840k	884k
18-Sep-2020	Current Account Balance	2Q	-$167.5b	-$159.0b	-$104.2b
18-Sep-2020	Leading Index	Aug	1.1%	1.3%	1.4%
18-Sep-2020	U. of Mich. Sentiment	Sep P	73.0	75.0	74.1

*Consensus from Bloomberg

Too Early To Worry About Higher Inflation

The fear of higher inflation has captured the imagination of consumers and investors in recent months. After a very brief concern over deflation in March as the pandemic took hold, consumers have noticed rapidly rising prices at grocery stores, auto dealerships, health care providers, and at the gasoline pump, just to name a few categories.

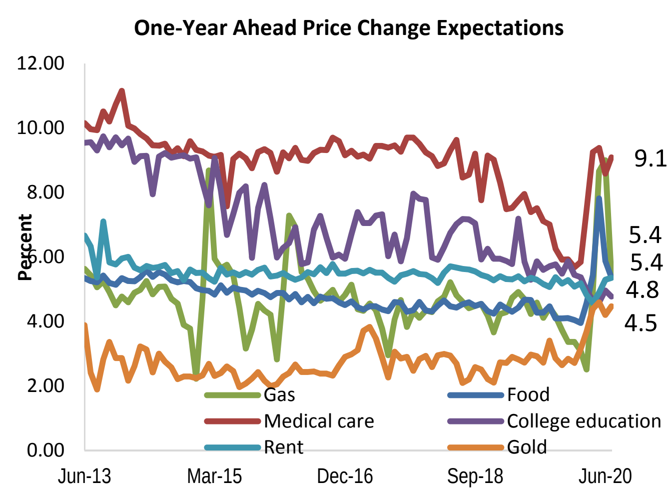
Consumer Inflation Has Spiked in Recent Months



Source: U.S. Bureau of Labor Statistics

The August Consumer Expectations Survey from the New York Fed revealed a big jump in consumer inflation expectations as consumers increasingly believed the current trend of higher inflation will continue over the next twelve months.

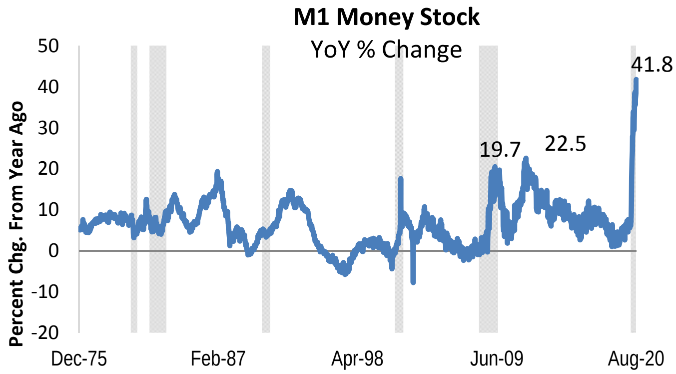
Consumers Expect Rising Inflation Just About Everywhere



Source: New York Fed Survey of Consumer Expectations

At the same time, investors have noticed the Fed's monetary policy of asset purchases that near-zero interest rates have led to an explosion of money supply growth unseen in more than 50 years. In August, the M1 money supply, which includes currency, demand deposits, and other checkable deposits, was nearly 42% above year ago levels. Milton Freidman, the well-known Monetarist, famously stated that "inflation is always and everywhere a monetary phenomenon". This is largely how it is still taught in Economics 101 classes. Financial price inflation is certainly visible today in the traditional inflation hedges such as gold, home prices and equities. However more recent economic research has shown that changes in the monetary transmission mechanism since Freidman's time and underlying structural changes in the economy itself, puts Friedman's monetary-inflation doctrine in bad need of an update.

The Money Supply Is Growing At Twice Previous Peaks



Source: Federal Reserve System

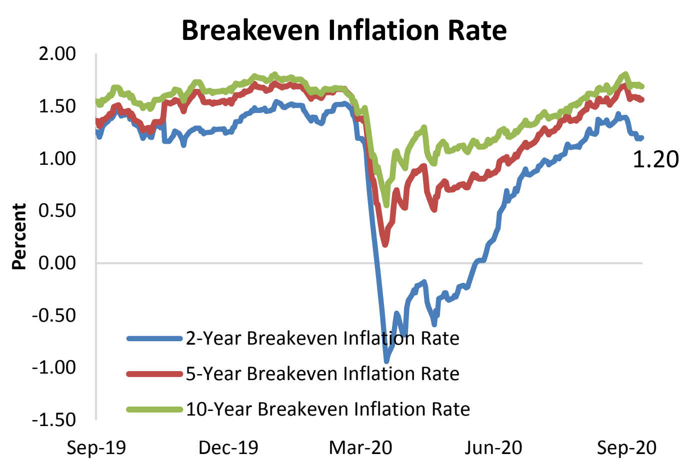
If the U.S. economy were operating at full-employment, I would be much more concerned that the explosive growth in the money supply could stoke an inflation tsunami. But there is still a tremendous amount of slack in both the labor market and the in the overall economy that will continue to put increasingly strong downward pressure on wages and prices in the quarters ahead. We still have nearly 30 million American's collecting some form of unemployment benefits. This number has barely budged since May and has actually risen by more than 2.5 million people over the last two weeks.

Moreover, fixed income investors concerns over inflation may have already peaked. The lack of a new fiscal stimulus bill and increasing signs that the reopening growth spurt could be ebbing has gotten bond investors to walk-back some of their accelerating inflation bets.

In addition, investors appear unimpressed with the Fed's new "average inflation targeting" framework rolled out to the public on August 27th. Bond market inflation expectations had been rising in anticipation of the Fed's framework announcement, but quickly reversed course after the Fed's new monetary framework was revealed.

Perhaps some investors were expecting the Fed to raise the inflation target above 2.0% or even announce some new monetary policy tools to help them achieve their new long-term goals. But since the Fed has already shot much of its monetary policy ammunition already, investors are bracing for very little change in the monetary "status quo". Finally, the Fed and investors have been here before. Investors were hedging for higher inflation in the early years after the Great Recession only to see those bets go bust when inflation never materialized. Economists have pointed to, excess global savings, globalization, demographics, and technological change as reasons why low levels of unemployment and monetary easing has been unable to stoke a higher inflationary environment since 2009.

Inflation Breakevens Drop On Fed Framework Revision



Source: Federal Reserve; Bank of the West Economics

In short, higher inflation may eventually be sustained, but it's way too early to prepare for that economic future. A short fall in aggregate demand, high unemployment and intensifying deflationary price pressures remain the primary concern ahead.

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*	2.9	1.5	2.6	2.4	-5.0	-31.7	28.8	3.1	2.0	4.0	3.3	3.3	3.0	2.2	-3.8	3.5
Personal Consumption Expenditures*	1.8	3.7	2.7	1.6	-6.9	-34.1	38.0	4.8	2.0	3.1	2.6	2.5	2.7	2.4	-3.7	4.4
Non-residential Fixed Investment*	4.2	0.0	1.9	-0.3	-6.7	-26.0	9.7	3.2	1.4	2.5	3.2	3.1	6.9	2.9	-5.6	1.3
Private Housing Starts (000s units)	1,204	1,257	1,288	1,433	1,484	1,064	1,450	1,350	1,290	1,295	1,260	1,280	1,208	1,296	1,337	1,281
Vehicle Sales (mill. Units, annualized)	16.9	17.0	17.0	16.8	15.0	11.4	14.9	14.7	14.8	15.0	15.2	15.3	17.2	16.9	14.0	15.1
Industrial Production*	-1.9	-2.3	1.1	0.4	-6.7	-43.2	27.0	8.0	6.0	5.3	4.5	4.4	3.9	0.9	-8.0	4.5
Nonfarm Payroll Employment (mil.)	150.2	150.6	151.2	151.8	151.9	133.7	137.8	139.5	140.7	142.0	143.2	144.4	146.6	150.9	140.7	142.6
Unemployment rate	3.9	3.6	3.6	3.5	3.8	13.0	8.9	7.8	7.5	7.1	6.7	6.3	4.4	3.7	8.4	6.9
Consumer Price Index* (percent)	0.9	3.0	1.8	2.4	1.2	-3.5	3.4	1.6	1.4	1.4	1.4	1.4	2.4	1.8	1.0	1.4
"Core" CPI* (percent)	2.2	2.2	2.8	2.0	2.0	-1.6	2.0	2.0	1.3	1.4	1.4	1.5	2.1	2.2	1.4	1.4
PPI (finished goods)* (percent)	-2.7	4.7	-1.2	3.0	-3.4	-10.9	6.4	2.2	0.1	0.9	1.6	1.7	3.0	0.8	-1.4	1.0
Trade Weighted Dollar (Fed BOG, major)	114.5	115.4	116.5	116.4	117.9	122.2	118.1	116.5	116.0	115.8	115.7	115.5	91.1	115.7	118.7	115.8
Crude Oil Prices -WTI ($ per barrel)	55	60	56	57	45	28	42	42	41	40	40	41	51	57	39	41

*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	3,056	2,932							2,449	2,911		
Dow Jones Industrial Average	25,147	26,096	26,676	27,537	26,554	24,571							21,745	26,364		
Federal Funds Rate (effective)	2.40	2.40	2.20	1.65	1.23	0.06	0.13	0.13	0.13	0.13	0.13	0.13	1.00	2.16	0.39	0.13
Treasury-3 Month Bills (yield)	2.44	2.35	2.03	1.61	1.10	0.14	0.10	0.11	0.12	0.13	0.13	0.14	0.95	2.11	0.36	0.13
Treasury-2 Year Notes (yield)	2.49	2.13	1.69	1.59	1.08	0.19	0.15	0.16	0.18	0.20	0.21	0.23	1.40	1.97	0.39	0.20
Treasury-5 Year Notes (yield)	2.46	2.12	1.63	1.61	1.14	0.36	0.29	0.32	0.34	0.37	0.40	0.42	1.91	1.96	0.53	0.38
Treasury-10 Year Notes (yield)	2.65	2.34	1.80	1.79	1.37	0.69	0.65	0.72	0.75	0.78	0.85	0.90	2.33	2.15	0.85	0.82
Treasury-30 Year Notes (yield)	3.01	2.78	2.29	2.25	1.87	1.38	1.35	1.47	1.52	1.56	1.64	1.70	2.90	2.58	1.52	1.60
Prime Rate	5.50	5.50	5.31	4.83	4.43	3.25	3.25	3.25	3.25	3.25	3.25	3.25	4.10	5.29	3.54	3.25
Libor 3-Mo. U.S. Dollar	2.69	2.51	2.20	1.93	1.53	0.60	0.26	0.26	0.27	0.27	0.27	0.27	1.26	2.33	0.66	0.27
Mortgage-30 Year (yield)	4.37	4.01	3.66	3.70	3.52	3.24	2.96	2.97	3.05	3.05	3.05	3.10	3.99	3.94	3.17	3.06
BAA Corporate (yield)	4.97	4.60	4.03	3.91	3.91	3.91	3.30	3.45	3.65	3.78	4.05	4.10	4.44	4.38	3.64	3.89

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