

U.S. Outlook

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Date	Indicator	For	Estimate	Consensus*	Previous Period
21-July-2014	Chicago Fed Nat. Activity Index	JUN	N/A	N/A	0.21
22-July-2014	Consumer Price Index MoM	JUN	0.4%	0.3%	0.4%
22-July-2014	CPI Ex. Food and Energy MoM	JUN	0.2%	0.2%	0.3%
22-July-2014	FHFA House Price Index MoM	MAY	0.4%	0.3%	0.0%
22-July-2014	Existing Home Sales	JUN	5.00M	4.97M	4.89M
24-July-2014	Initial Jobless Claims	07/19	304K	N/A	302K
24-July-2014	New Home Sales	JUN	470K	480K	504K
25-July-2014	Durable Goods Orders	JUN	1.2%	0.5%	-0.9%
25-July-2014	Durable Goods Orders- Ex. Transportation	JUN	0.8%	0.5%	0.0%

*Consensus from Bloomberg

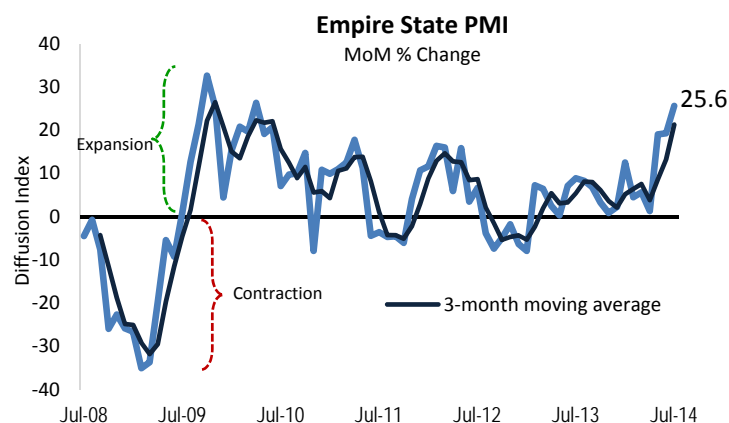
Manufacturing: A Window into the Economy

If you delve into recent industrial production and manufacturing data you'll see something striking about the health and direction of the broader economy. In short, the data suggests that overall economic growth is accelerating again in July, and, secondly and more importantly, the U.S. economy is probably closer to full capacity than many suspect. As manufacturing approaches full capacity, wage pressures will build and many businesses will be forced to redirect their profits away from stock buybacks and toward actual physical investment, which will help bolster U.S. GDP.

Get Ready for More Economic Growth

The regional manufacturing purchasing manager indexes released so far for July are pointing to an accelerating economy. Manufacturing is an important cyclical sector that often foretells the overall direction of the economy. Both the Empire State index released last week and the Philly Fed index released earlier this week beat economist expectations and signal a solid rebound in manufacturing activity in July.

July Manufacturing PMIs Have Been Strong Out of the Gate

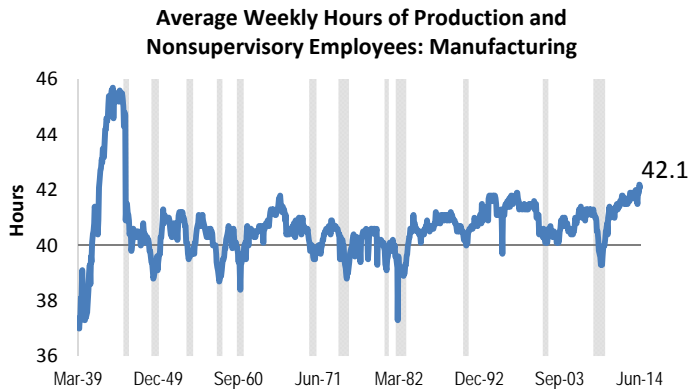


Source: Federal Reserve Bank of Philadelphia

In fact, the Empire Manufacturing index, for the New York area, registered the strongest reading since April 2010 when the expansion was just a baby. At 25.6 in July it was well above its six month average of 12.55. Consistent strength and improvement is being seen in new orders and employment. These are important signs we often search for to ensure the manufacturing improvement isn't just one and done activity, but that the pick-up in manufacturing activity has some staying power. The latest payroll report for June showed average hours worked in manufacturing at 42.1 hours, the highest reading on this indicator since World War II. The strength of manufacturing PMIs for July suggest a renewed spurt of manufacturing hiring could be just around the corner.

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Long Hours Means More Manufacturing Hiring Ahead



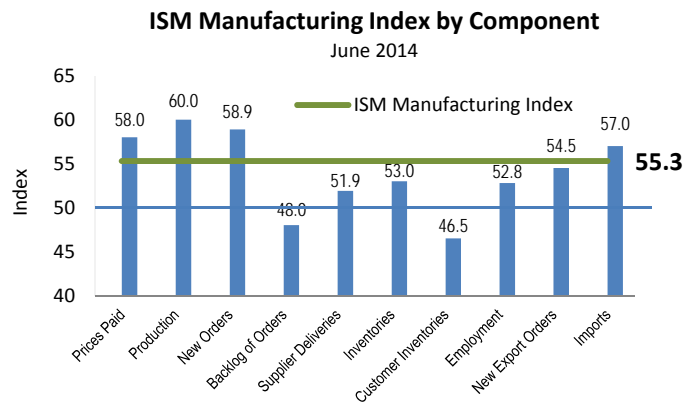
Source: U.S. Bureau of Labor Statistics

After five years of economic growth, this economic expansion may be well past middle age by historical standards, but the manufacturing measures for June and July look more like a teenaged expansion with plenty of spring in its step.

Slack Disappears and Inflation Emerges

There are also signs that inflation could be returning. More manufacturers are reporting that prices paid are on the rise. Prices received are also starting to rise, pointing to some return of pricing power for manufacturers, but so far the readings here haven't been quite as strong.

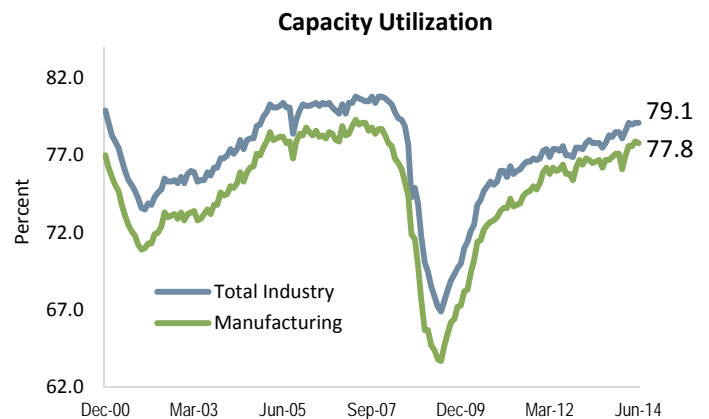
New Orders, Production & Prices Paid Robust



Source: Institute of Supply Management

With manufacturing activity, employment, and prices picking-up, can wage inflation be far behind? One measure from the industrial production report that we and the Fed monitor to get a read on how much slack is in the economy is capacity utilization. The capacity utilization numbers suggest there isn't as much additional slack in the U.S. economy as you might suspect.

Economic Slack Swiftly Disappearing



Source: Federal Reserve System

Total industry capacity utilization has jumped a full point since January to 79.1, and it's already a point above its average level during the last expansion (Nov. 2001 to Nov. 2007) of 78.1. Moreover, total industry capacity utilization is less than two points from its cyclical peak in the last expansion of 80.8.

Manufacturing capacity utilization tells an even starker story of disappearing slack. Manufacturing capacity utilization has jumped 1.7 percentage points since January to 77.8. During the last expansion manufacturing capacity utilization averaged just 76.0 and peaked at 79.1. In other words, in June, manufacturing capacity utilization was just 1.3 points lower than last expansions peak, and the Fed funds rate is still stuck at its lower bound.

The economic acceleration we are seeing in the U.S. economy appears to have stepped up its pace in July. Economic slack is disappearing rapidly based on the latest capacity utilization numbers and emerging inflation pressures, which are becoming more evident in the manufacturing sector, may prove more prolonged than many believe. Risks continue to shift toward an earlier move from the FOMC to push short-term interest rates off their lower bound. We are currently forecasting the first rate hike in the second quarter of 2015, but it could be sooner. Moreover, if recent price inflation is joined by rising wages, the pace of Fed tightening when it comes could be more aggressive as the Fed finds itself well behind the curve in normalizing interest rates.

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Major Economic Indicators

Economic Data	History				Forecast								Yr/Yr % chg or Annual Avg.			
	2013.1	2013.2	2013.3	2013.4	2014.1	2014.2	2014.3	2014.4	2015.1	2015.2	2015.3	2015.4	2012	2013	2014	2015
Real GDP*	1.1	2.5	4.1	2.6	-2.9	3.2	2.9	3.1	3.0	3.0	2.9	2.9	2.8	1.9	1.6	3.0
Personal Consumption Expenditures*	2.3	1.8	2.0	3.3	1.0	2.0	3.0	3.0	2.9	2.8	2.6	2.6	2.2	2.0	2.2	2.8
Non-residential Fixed Investment*	-4.6	4.7	4.8	5.7	-1.2	4.7	5.6	5.1	4.7	4.9	4.8	4.9	7.3	2.7	3.6	5.0
Private Housing Starts (000s units)	947	865	882	1,025	925	980	1,010	1,040	1,076	1,121	1,143	1,155	784	930	989	1,124
Vehicle Sales (mill. Units, annualized)	15.3	15.5	15.7	15.6	15.6	16.5	16.7	16.8	16.9	17.0	17.1	17.0	14.4	15.5	16.4	17.0
Industrial Production*	4.2	1.9	2.5	4.9	3.9	5.5	5.3	5.0	4.5	4.4	4.4	4.3	3.8	2.9	4.3	4.8
Nonfarm Payroll Employment (mil.)	135.5	136.1	136.6	137.2	137.8	138.5	139.2	140.0	140.7	141.4	142.2	142.9	134.1	136.4	138.9	141.8
Unemployment rate	7.7	7.5	7.2	7.0	6.7	6.2	6.1	6.0	5.9	5.8	5.7	5.6	8.1	7.4	6.3	5.8
Consumer Price Index* (percent)	1.2	0.4	2.2	1.1	1.9	3.7	2.2	2.0	1.8	1.8	1.9	1.9	2.1	1.5	2.1	2.0
"Core" CPI* (percent)	2.0	1.4	1.8	1.6	1.6	3.0	2.0	1.9	1.8	1.8	1.8	1.8	2.1	1.8	2.0	1.9
PPI (finished goods)* (percent)	0.8	-1.0	2.3	1.2	3.7	3.9	3.0	2.4	1.6	1.4	1.3	1.3	2.0	1.2	2.6	2.0
Trade Weighted Dollar (Fed BOG, major)	74.8	76.6	76.8	76.0	77.1	76.8	77.3	78.0	79.5	80.0	80.7	81.3	73.6	76.1	77.3	80.4
Crude Oil Prices -WTI (\$ per barrel)	94	94	106	98	98	103	102	101	99	99	99	98	94	98	101	99

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

Financial Data	History				Forecast								Annual Average			
	2013.1	2013.2	2013.3	2013.4	2014.1	2014.2	2014.3	2014.4	2015.1	2015.2	2015.3	2015.4	2012	2013	2014	2015
S & P 500	1,514	1,610	1,675	1,769	1,835								1,379	1,644		
Dow Jones Industrial Average	13,994	14,959	15,286	15,736	16,177								12,965	15,010		
Federal Funds Rate (effective)	0.15	0.12	0.09	0.09	0.07	0.07	0.08	0.08	0.10	0.25	0.38	0.87	0.14	0.11	0.08	0.40
Treasury-3 Month Bills (yield)	0.09	0.05	0.03	0.06	0.05	0.04	0.02	0.04	0.05	0.20	0.33	0.83	0.09	0.06	0.04	0.35
Treasury-2 Year Notes (yield)	0.26	0.27	0.37	0.33	0.37	0.38	0.50	0.62	1.00	1.06	1.29	1.59	0.28	0.31	0.47	1.24
Treasury-5 Year Notes (yield)	0.82	0.91	1.50	1.44	1.60	1.63	1.68	1.76	1.93	2.14	2.35	2.63	0.76	1.17	1.67	2.26
Treasury-10 Year Notes (yield)	1.95	1.99	2.71	2.74	2.77	2.69	2.65	2.85	3.05	3.22	3.46	3.61	1.80	2.35	2.74	3.34
Treasury-30 Year Notes (yield)	3.13	3.14	3.71	3.79	3.68	3.55	3.47	3.62	3.81	4.01	4.11	4.21	2.92	3.44	3.58	4.04
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.38	3.87	3.25	3.25	3.25	3.44
Libor 3-Mo. U.S. Dollar	0.29	0.28	0.28	0.28	0.26	0.24	0.24	0.26	0.27	0.36	0.60	0.97	0.42	0.28	0.25	0.55
Mortgage-30 Year (yield)	3.50	3.67	4.44	4.29	4.36	4.28	4.20	4.40	4.55	4.74	4.98	5.12	3.66	3.98	4.31	4.85
BAA Corporate (yield)	4.81	4.82	5.40	5.36	5.12	4.85	4.82	4.94	5.10	5.28	5.50	5.66	4.94	5.10	4.93	5.39

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