

U.S. Outlook

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Date	Indicator	For	Estimate	Consensus*	Previous Period
28-July-2014	Pending Home Sales MoM	JUN	-1.8%	0.0%	6.1%
29-July-2014	S&P/Case-Shiller 20 City Index MOM	MAY	0.30%	0.50%	0.19%
29-July-2014	Consumer Confidence Index	JUL	85.0	85.5	85.2
30-July-2014	ADP Employment Change	JUL	235K	225K	281K
30-July-2014	GDP Annualized QoQ	2Q	3.2%	2.9%	-2.9%
30-July-2014	GDP Price Index	2Q	1.8%	1.8%	1.3%
30-July-2014	Fed QE Pace	JUL	\$25B	\$25B	\$35B
30-July-2014	FOMC Rate Decision	JUL	0.25%	0.25%	0.25%
31-July-2014	Employment Cost Index	2Q	0.5%	0.5%	0.3%
31-July-2014	Initial Jobless Claims	07/26	290K	N/A	284K
31-July-2014	Chicago Purchasing Manager Index	JUL	63.5	63.1	62.6
1-August-2014	Nonfarm Payrolls	JUL	235K	225K	288K
1-August-2014	Manufacturing Payrolls	JUL	20K	15K	16K
1-August-2014	Unemployment Rate	JUL	6.0%	6.1%	6.1%
1-August-2014	Average Hourly Earnings MoM	JUL	0.2%	0.2%	0.2%
1-August-2014	Average Weekly Hours	JUL	34.5	34.5	34.5
1-August-2014	Personal Income	JUN	0.4%	0.4%	0.4%
1-August-2014	Personal Spending	JUN	0.4%	0.4%	0.2%
1-August-2014	PCE Deflator MoM	JUN	0.2%	0.2%	0.2%
1-August-2014	PCE Core MoM	JUN	0.1%	0.2%	0.2%
1-August-2014	Univ. of Michigan Confidence	JUL	82.0	81.4	81.3

*Consensus from Bloomberg

Don't Get Complacent About the Deficit

The volume of political dialogue surrounding the U.S. budget deficit and debt has dropped a few notches with the economy strengthening, tax revenues on the rise, and the tax ceiling suspended until March 15, 2015. Federal deficits have declined for five consecutive years, from a 2009 peak of 9.8% of GDP. Our current forecast is a Federal deficit of around \$495 billion in FY 2014 (nearly a 30% improvement from FY 2013), falling again to \$460 billion in 2015. From a longer-term perspective, however, our deficit and debt outlook under current law doesn't look so good.

In this week's US Outlook report, we highlight some of the takeaways from the CBO's July Long-Term Budget Outlook that drives home the message that critical decisions must be made by our political leaders (hopefully sooner rather than later) which will have wide-ranging

effects not only on the country's finances, but our economic future as well. We are not out of the woods on our Federal budget problems despite Sequestration spending cuts and the return to growth.

Although tax revenues have risen 13% from a year ago, and Federal revenues as a share of the economy are slightly higher than the average from 1974 to 2013, Federal spending increases will quickly wipe-out any measurable improvement in longer-term deficits and debt. Federal spending is projected to outdistance economic growth, rising to nearly 26% of GDP over the next 25 years, pushing the deficit up to 6.4% of GDP. This is double its average over the past 40 years.

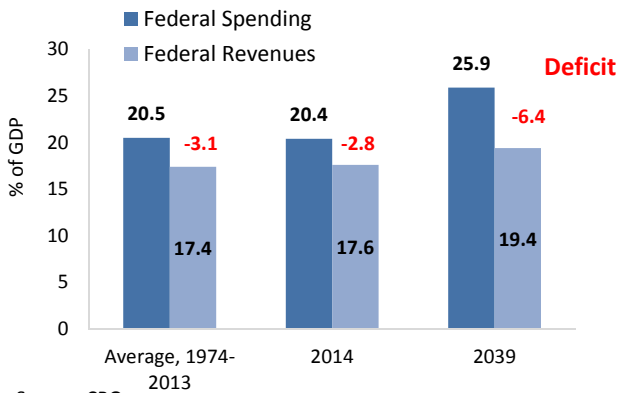
Federal debt held by the public is expected to rise to at least 106% of GDP and may even surpass the levels seen following the end of World War II. If interest rates,

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productivity growth, health care spending, and mortality rates work against us more than expected, the CBO estimates the debt held by the public could jump as high as 159% of GDP.

Federal Spending Will Soon Push Deficits Higher

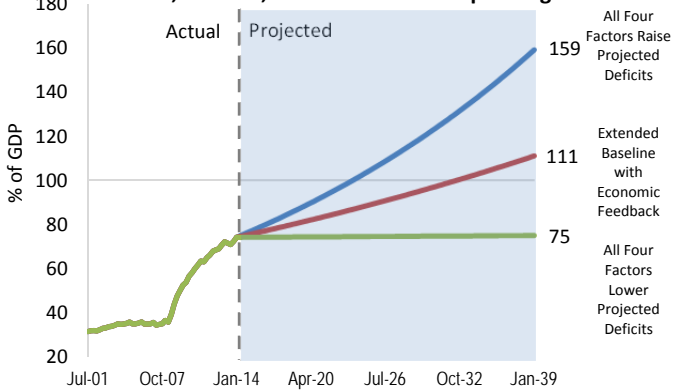
Spending, Revenues, and Deficits Under CBO's Extended Baseline, Compared with Past Averages



Source: CBO

Federal Debt Projected to Explode

Fed Debt Given Diff. Rates of Mortality Decline, Prod. Growth, Interest, & Fed Health Care Spending Growth



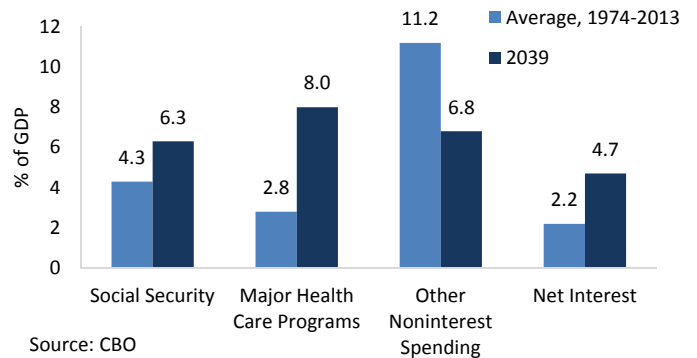
Source: CBO

Federal Spending on Social Security, Health Care Programs, and to some extent interest on the debt drives the increase in overall spending and debt. Social Security spending as a share of our economy is expected to rise about 50% over the next 25 years, while spending on health care as a share of the economy is expected to increase 185% over the period, and net interest on our debt is expected to double. Being frugal with discretionary spending won't be enough either. Squeezing other non-interest spending from the 40-year historical average of 11.2% of GDP to 6.8% by 2039 (a 40% cut) does little to change the dismal arithmetic. This leaves little room for a defense budget and the myriad of other important Federal programs.

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Entitlements and Interest Swallow The Rest of the Budget

Federal Spending Under CBO's Extended Baseline

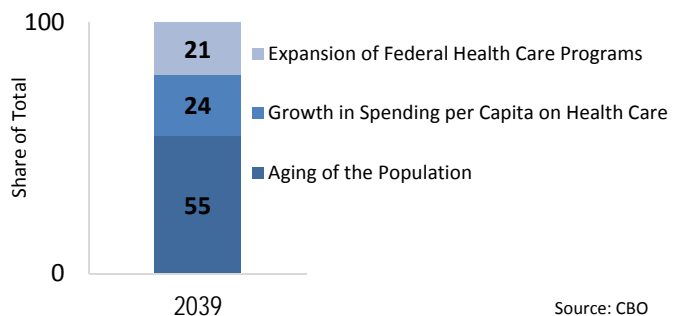


Source: CBO

The CBO estimates that about 55% of the increase in spending on Social Security and Health Care over the next 25 years will be due to an aging population, about a quarter will be due to projected increases in per capita health care spending, while another fifth will be due to expansion of the Federal health care programs under the Affordable Care Act.

An Aging Population Making Entitlements Unsustainable?

Causes of Projected Growth in Social Security and Major Health Care Programs



Source: CBO

Bottom-line? We should not be complacent about our Federal finances even with the improvement in the Federal deficits we have seen over the past two years. Rarely has this country faced as dire a financial outlook.

If anything near these debt projections comes to pass, you can bet there will be negative long-term economic growth implications from slow potential growth, higher interest rates and inflation, along with a weaker US dollar. Our entitlement spending problem will have to be faced head on. Revenue enhancements may need to be considered. With an aging population, we are unlikely to grow our way out of this problem, as we have in the past. Nor will steep discretionary spending cuts be enough to turn the tide. The clock is ticking and the longer we wait to address these budget problems, the more economically painful the ultimate solution will need to be.

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