August 1, 2014

U.S. Outlook

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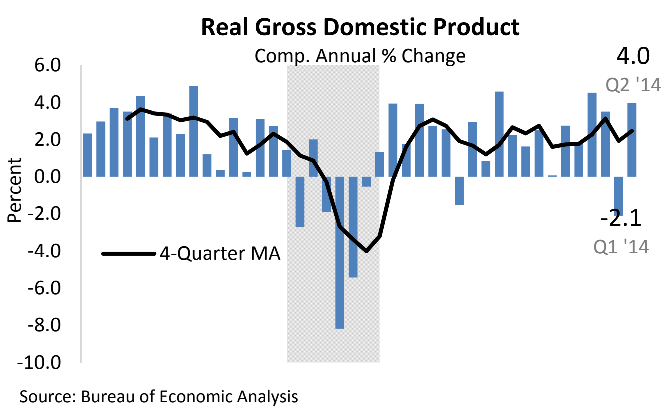
Date	Indicator	For	Estimate	Consensus*	Previous Period
04-August-2014	ISM New York	JUL	N/A	N/A	60.5
05-August-2014	ISM Non-Manufacturing PMI	JUL	56.0	56.5	56.0
05-August-2014	Factory Orders	JUN	0.6%	0.6%	-0.5%
06-August-2014	Trade Balance	JUN	-$45.0B	-$44.0B	-$44.4B
07-August-2014	Initial Jobless Claims	08/02	300K	N/A	302K
07-August-2014	Consumer Credit	JUN	$19.0B	$18.3B	$19.6B
08-August-2014	Nonfarm Productivity	Q2	1.7%	1.3%	-3.2%
08-August-2014	Unit Labor Costs	Q2	1.8%	1.2%	5.7%
08-August-2014	Wholesale Inventories	JUN	0.8%	0.6%	0.5%

*Consensus from Bloomberg

Stronger U.S. Growth in Q2: Is It Sustainable?

We got an exciting second-quarter GDP report this week. The nation's most important economic indicator, the real GDP, grew at an annualized rate of 4.0 percent, according to the Bureau of Economic Analysis, rebounding from a 2.1 percent decline in the first quarter. The first-quarter GDP reading was revised up from negative 2.9 percent reported in June. The second-quarter advance estimate was considerably higher than economists' consensus expectations of 3.0 percent. But before we get too excited about this encouraging and greater-than-expected economic release, let's take a closer look at the changes in the main components of the most comprehensive economic indicator.

GDP Growth is the Second Highest Since Q4 2011

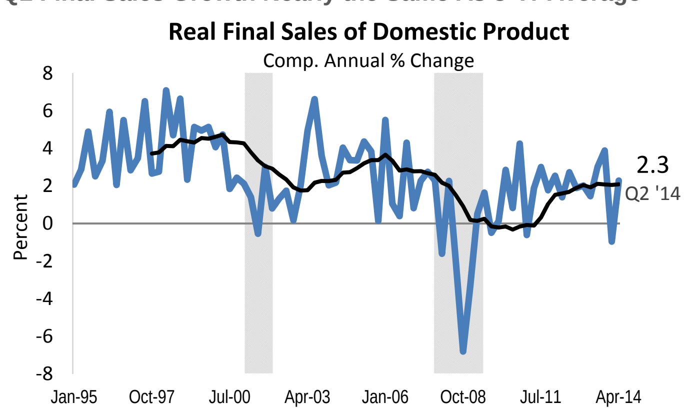


Source: Bureau of Economic Analysis

The surge in second-quarter real GDP was driven to a considerable extent by the accumulation of private inventory; increase in consumer spending; surge in residential and non-residential fixed investment; and acceleration of state and local government spending, partially offset by decreases in federal spending and rapid growth in imports.

The change in inventories contributed an outsized 1.7 percentage points to the change in real GDP in the second quarter, after being a 1.2 percentage-point drag in the first quarter. In fact, if we exclude the change in inventories from GDP growth, we get a more moderate 2.3 percent growth in real final sales, about the same rate of growth in final sales we have seen over the past three years. This raises a question of whether or not the second quarter growth rebound is sustainable or is it another flash-in-the-pan or false-dawn?

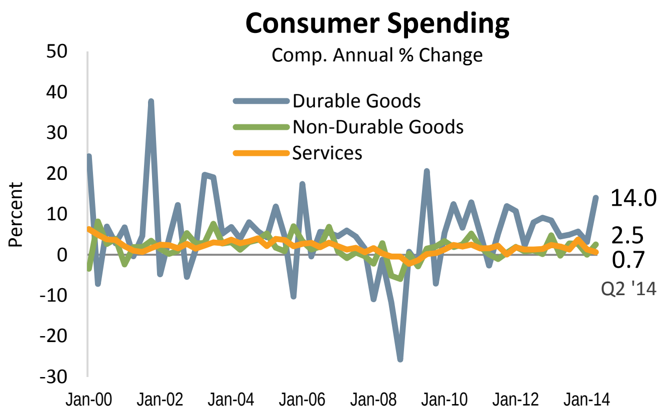
Q2 Final Sales Growth Nearly the Same As 3-Yr Average



Source: Bureau of Economic Analysis

One big reason for optimism is the health of the consumer. Real consumer spending, accounting for over two-thirds of the economy, rose 2.5 percent this quarter after a modest 1.2 percent increase in the first quarter. Notably, durable goods consumption jumped a sharp 14.0 percent on an annualized basis; nondurables spending increased a respectable 2.5 percent, while services consumption only rose a slight 0.7 percent. Robust vehicle sales, which reached a cyclical-high 16.9 million units last month, was a major reason for the surge in non-durable goods spending. Stronger consumer spending is one of the cornerstones of our 2014 U.S. growth forecast. We expect consumer spending to accelerate further to 3.2 percent in the months ahead.

Durable Goods Consumption Growth is at a 5-year High



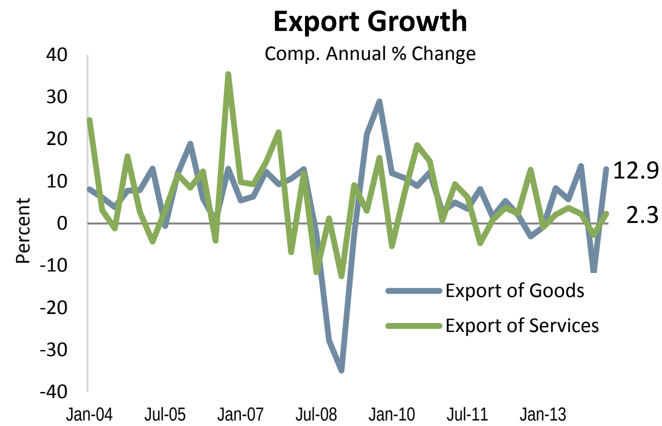
Source: Bureau of Economic Analysis

Another encouraging signal, nonresidential fixed investment, a broad measure of business spending, grew at a solid 5.5 percent pace in the second quarter. Investment in equipment, a sub-component of fixed investment, showed the greatest percentage increase of 7.0 percent following a 1.0 percent decline in the first quarter on expiring tax incentives. This suggests to me that businesses are more optimistic about the future and are more willing to expand their business operations through investment and hiring.

Another positive development is the return of government spending growth. State and local government spending grew strongly, rising 3.1 percent in the second quarter. Federal spending, in contrast, remained weak, contracting 0.8 percent as nondefense expenditures declined 3.7 percent.

Foreign demand for U.S exports also appears to be returning. Real exports of goods and services jumped 9.5 percent in the second quarter, following a 9.2 percent decline in the previous quarter. Exports of manufactured goods increased at a whopping 12.9 percent pace, the second fastest since 2010. Exports of services also turned positive in the second quarter, increasing at an annualized 2.3 percent.

Goods Exports Growth the Second Highest Since Q4 2010



Source: Bureau of Economic Analysis

Imports jumped as well, rising 11.7 percent, widening the U.S. trade deficit, but this just provided more proof that the U.S. consumer is out there shopping.

Real residential fixed investment, a measure of homebuilding, also rebounded at an annualized rate of 7.5 percent in the second quarter, after a 5.3 percent decline during the previous quarter that was primarily due to severe winter conditions. Homebuilding is clearly slowing down, but it is not plunging as the first-quarter data may have led some to believe.

Finally, price inflation is starting to move higher. The GDP price deflator, the broadest price index in the economy, increased at an annualized 2.0 percent pace in the second quarter, the highest since 2011. This figure is more in keeping with Fed's inflationary target — something that Yellen would love to see every quarter.

The pieces of the puzzle appear to be falling into place for a more sustainable improvement in U.S. economic growth in the quarters ahead. However, it may be a while before we see another 4.0 percent growth handle on U.S. GDP. We are forecasting a more sustainable 3.0 percent real GDP growth rate over the next four quarters. A quicker pace of consumer, business, and government spending is the foundation of our growth forecast over the near-term, while improving export performance should be the icing on the cake. Enjoy the brief spell on normalcy!

Major Economic Indicators

	History						Forecast						Yr/Yr % chg or Annual Avg.			
Economic Data	**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*	2.7	1.8	4.5	3.5	-2.1	4.0	3.0	3.0	3.0	3.0	2.9	2.9	2.3	2.2	2.1	3.1
Personal Consumption Expenditures*	3.6	1.8	2.0	3.7	1.2	2.5	3.2	3.1	2.9	2.8	2.7	2.7	1.8	2.4	2.4	2.9
Non-residential Fixed Investment*	1.5	1.6	5.5	10.4	1.6	5.5	6.0	5.3	4.9	4.9	4.9	4.9	7.2	3.0	5.2	5.2
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	6.0	5.9	5.8	5.7	5.6	5.5	8.1	7.4	6.2	5.7
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	76.6	76.8	77.0	79.0	79.5	80.2	80.8	73.6	76.1	76.9	79.9
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.

	History						Forecast						Annual Average			
Financial Data	**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	1,900							1,379	1,644		
Dow Jones Industrial Average	13,994	14,959	15,286	15,736	16,177	16,604							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	0.52	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	1.70	1.80	1.93	2.14	2.35	2.63	0.76	1.17	1.68	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	3.42	3.62	3.81	4.01	4.11	4.21	2.92	3.44	3.57	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