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U.S. Outlook

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Date	Indicator	For	Estimate	Consensus*	Previous Period
15-September-2014	Empire State Mfg Index	SEP	15.00	16.00	14.69
15-September-2014	Industrial Production MoM	AUG	0.3%	0.3%	0.4%
15-September-2014	Capacity Utilization	AUG	79.3%	79.3%	79.2%
16-September-2014	Producer Price Index MoM	AUG	-0.1%	0.1%	0.1%
16-September-2014	PPI Ex. Food and Energy MoM	AUG	0.1%	0.1%	0.2%
17-September-2014	Consumer Price Index MoM	AUG	0.0%	0.0%	0.1%
17-September-2014	CPI Ex. Food and Energy MoM	AUG	0.1%	0.2%	0.1%
17-September-2014	Current Account Balance	Q2	-$-115.2B	-$113.3B	-$111.2B
17-September-2014	NAHB Housing Market Index	SEP	54	56	55
17-September-2014	FED QE3 Pace	SEP	$15B	$15B	$25B
17-September-2014	FOMC Rate Decision	09/17	0.25%	0.25%	0.25%
18-September-2014	Initial Jobless Claims	09/13	310K	N/A	315K
18-September-2014	Housing Starts	AUG	1,017K	1,035K	1,093K
18-September-2014	Building Permits	AUG	1,025K	1,053K	1,057K
19-September-2014	Leading Index	AUG	0.4%	0.4%	0.9%

*Consensus from Bloomberg

It's All About the Labor Market

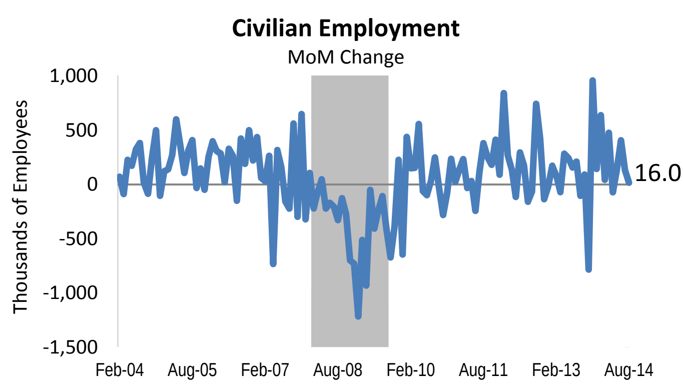
With the Federal Open Market Committee meeting next week and releasing its latest forecasts on the economy and Fed funds rate, markets will be probing for signs that the Fed may move up its timetable for the first interest rate hike. The headline unemployment rate has dropped faster than many FOMC members expected this year, suggesting the Fed might be closer to its goal of full-employment and should be considering moving interest rates off the lower-bound about now. Last December, the FOMC central tendency forecast for the unemployment rate for the fourth quarter of 2014 was between 6.3 and 6.6 percent. In August, the unemployment rate was already well below that range at 6.1 percent.

Two things to look for in next week's statement from the Fed. Will the Fed remove its "considerable time" language on holding the Fed funds rate in its current range? Or change the characterization of the labor market from "significant" underutilization of labor resources, both of which could be a signal to the markets that the Fed is getting closer to raising short-term interest rates. Indeed, the 10-Year Treasury yield has moved up about 20 basis points over the last two weeks, a nod to rising expectations of a rate hike in the not-too-distant future.

Yet, there are many reasons I remain skeptical that the September FOMC statement will change much, if at all.

The drop in the unemployment rate in August to 6.1 percent was due to a lack of labor force growth and not a burst of new job creation. The household survey of employment, the survey from which the unemployment rate is calculated, has faltered over the last two months.

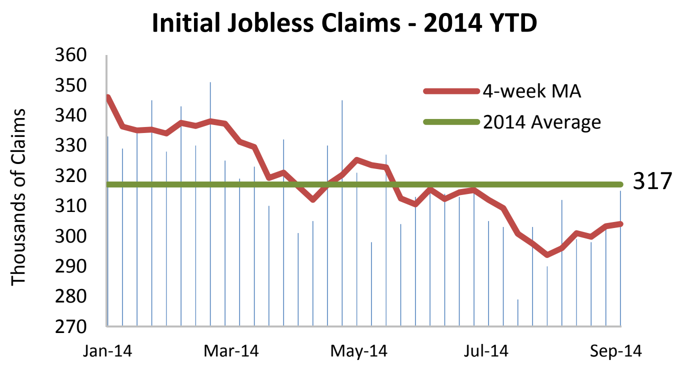
Household Employment Falters in July and August



Source: U.S. Bureau of Labor Statistics

Moreover, initial jobless claims reversed course over the past month, and are beginning to rise again. Last week's figure wasn't much different from the 2014 average.

Initial Jobless Claims Trending Higher Over Past Month

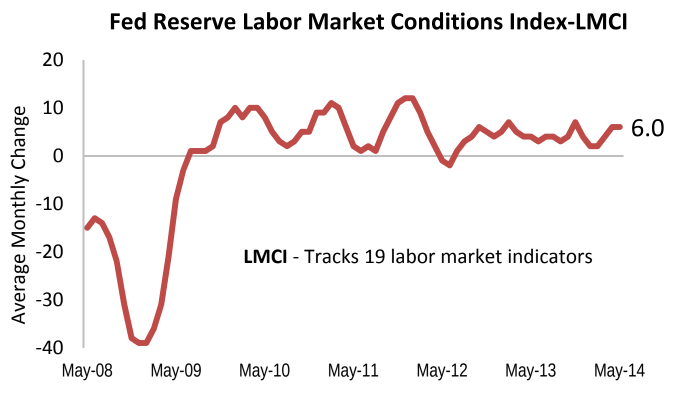


Source: US Employment & Training Administration

These are just a few recent indications that the burst of job creation earlier this summer might not be a permanent fixture of our economic future.

At the same time, it's important to remember Fed Chair Janet Yellen, remains the most important member of the FOMC (Not all votes are created equally). Many of her dashboard indicators of the labor market reveal a mixed picture of labor market progress. A new labor market indicator added to her dashboard during her Jackson Hole speech, the composite labor-market conditions index, designed to distill 19 separate labor market indicators, still shows mixed signals.

Mediocre Labor Market Conditions Remain



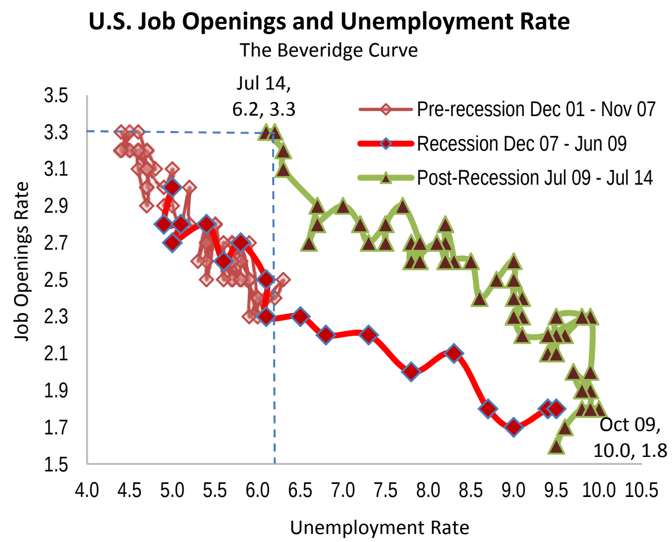
Source: Federal Reserve

Despite the frustration of Philadelphia Fed President Plosser (who dissented at the last meeting) toward the time dependency of the Fed funds target rate language, no one can deny it has been effective at holding down short-term interest rate expectations. Fed funds futures rate hike expectations over the next two years remain well below the median forecast from the Fed's June dot-plot from the Summary of Economic Projections (SEP).

In short, a change in language here might work against the Fed's objectives to strengthen labor market conditions, especially if it leads to higher and more volatile, long-term interest rates today. Last week, mortgage applications swooned as mortgage rates ticked up just fractionally, demonstrating the sensitivity of demand to higher rates.

Finally, analysts have pointed to the 22 percent year-on-year increase in job openings as a sign of better job growth ahead. To some extent that's true, but hiring remains muted, up only 8.0 percent over the last year. A look at the Beveridge Curve, which plots job vacancy rates against the unemployment rate over time, shows a clear shift in the curve to the right since the end of the Great Recession. This is a strong indication that our labor market is not the same as it used to be. It is more inefficient in matching the unemployed to jobs, perhaps because of a job skills mismatch, labor immobility, or the perceived skill degradation of the long-term unemployed. Caution in evaluating current labor market progress is still warranted in my opinion.

U.S. Labor Market Inefficiency Clearly Evident



Source: BLS,

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*	2.7	1.8	4.5	3.5	-2.1	4.2	3.1	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	2.1	2.9	2.9	2.8	2.7	2.7	1.8	2.4	2.3	2.7
Non-residential Fixed Investment*	1.5	1.6	5.5	10.4	1.6	8.4	7.4	5.5	4.9	4.9	4.9	4.9	7.2	3.0	6.0	5.6
Private Housing Starts (000s units)	947	865	882	1,025	925	997	1,040	1,096	1,100	1,121	1,143	1,155	784	930	1,015	1,130
Vehicle Sales (mill. Units, annualized)	15.3	15.5	15.7	15.6	15.6	16.5	17.0	17.1	17.2	17.3	17.4	17.4	14.4	15.5	16.6	17.3
Industrial Production*	4.2	1.9	2.5	4.9	3.9	5.5	5.5	5.0	4.5	4.4	4.4	4.3	3.8	2.9	4.4	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	77.1	78.0	79.0	79.5	80.2	80.8	73.6	76.1	77.2	79.9
Crude Oil Prices -WTI ($ per barrel)	94	94	106	98	99	103	98	95	97	97	97	96	94	98	99	97

*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	1,900							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	0.03	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	0.60	1.00	1.06	1.29	1.59	0.28	0.31	0.46	1.24
Treasury-5 Year Notes (yield)	0.82	0.91	1.50	1.44	1.60	1.63	1.68	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	2.50	2.70	3.00	3.17	3.41	3.56	1.80	2.35	2.67	3.29
Treasury-30 Year Notes (yield)	3.13	3.14	3.71	3.79	3.68	3.55	3.30	3.45	3.76	3.96	4.06	4.16	2.92	3.44	3.50	3.99
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	4.23	4.12	4.30	4.50	4.69	4.93	5.07	3.66	3.98	4.25	4.80
BAA Corporate (yield)	4.81	4.82	5.40	5.36	5.12	4.85	4.72	4.87	5.00	5.18	5.40	5.56	4.94	5.10	4.89	5.29

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