October 03, 2014

U.S. Outlook

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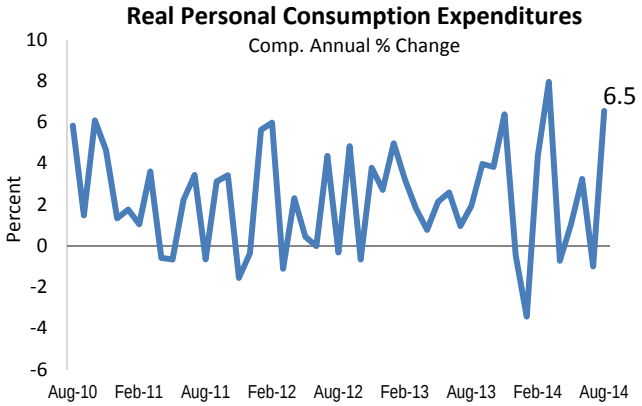
Date	Indicator	For	Estimate	Consensus*	Previous Period
07-October -2014	JOLTS Job Openings	AUG	N/A	4,700K	4,673K
07-October -2014	Consumer Credit	AUG	$22.0B	$21.0B	$26.0
09-October -2014	Initial Jobless Claims	10/04	293K	N/A	287K
09-October -2014	Wholesale Inventories MoM	AUG	0.2%	0.3%	0.1%
10-October -2014	Import Price Index MoM	SEP	-0.6%	-0.6%	-0.9%
10-October -2014	Monthly Budget Statement	SEP	N/A	$72.0B	$75.1B

*Consensus from Bloomberg

Taking the Temperature of the Consumer

Consumer spending was back on track in August, growing 0.5 percent in both nominal and inflation-adjusted terms from zero growth in July that was upwardly revised from -0.1 percent. The August figure was somewhat above consensus expectations of 68 economists surveyed on Bloomberg. Real consumer spending increased 2.6 percent from August 2013, and grew at an impressive 6.5 annualized rate during the back to school season, the second best monthly reading this year.

Inflation-adjusted Spending Rebounds Sharply

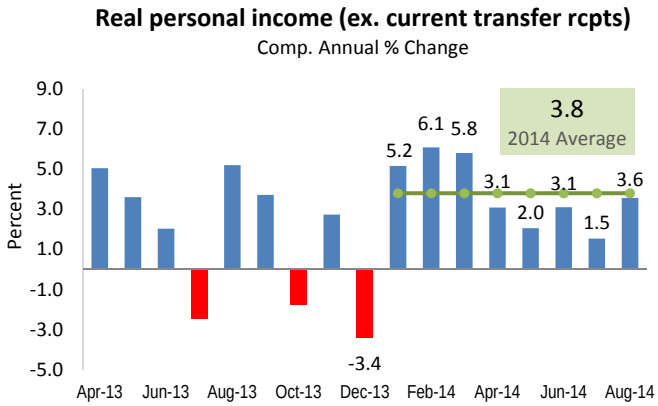


Source: U.S. Bureau of Economic Analysis

Even more encouraging, consumers appear to have enough income to make these purchases without digging into their savings. The personal savings rate remained at a solid 5.4%. This supports our forecast for stronger consumer spending in the fourth quarter.

Personal income picked up some steam as well in August, increasing 0.3 percent last month in real and nominal terms. Real personal income has averaged a healthy 3.8 percent so far in 2014.

Personal Income Growth Running Stronger in 2014

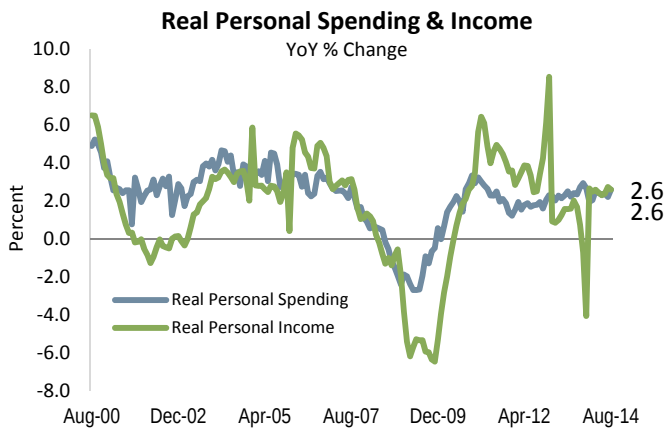


Source: U.S. Bureau of Economic Analysis

On a per capita basis, real personal income growth is less impressive, rising only 1.9 percent from last August. Even so, this is the second best reading since December 2012.

Putting the spending and income pieces together, we notice that income growth has finally caught up with spending gains. Future consumer spending should hold up well and could even accelerate for a time as long as income growth holds up.

Income Growth Has Caught Up to Spending



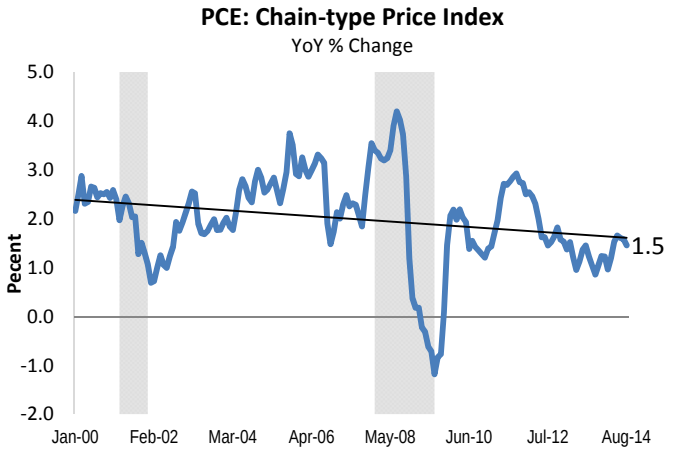
Source: U.S. Bureau of Economic Analysis

However, a sharp drop in September light vehicle sales, a contraction in construction spending in July, and lower non-durable manufacturing inventories has prompted us to lower our tracking estimate of GDP for the third quarter to 3.1 percent.

Keeping Tabs on the Fed's Dual Mandate

So how is the Fed doing on reaching its dual mandate of full-employment and stable 2.0 percent inflation? The 12-month change in the price index for personal consumption expenditures (PCE) was at 1.5 percent in August. The core PCE index that excludes food and energy was also at 1.5 percent, and in both cases, a bit higher than analysts' estimates and closer to the Fed's target of 2.0 percent.

Headline Inflation Still Has Some Room For Improvement



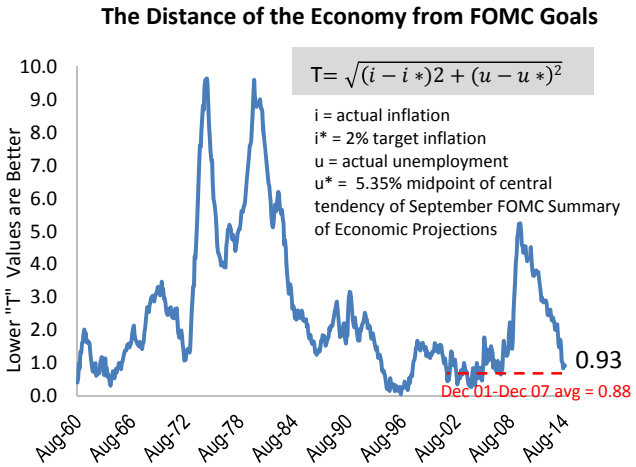
Source: U.S. Bureau of Economic Analysis

The other mandate that the Fed watches in conducting monetary policy is the unemployment rate at which aggregate employment is at a maximum without generating inflation. During the Fed's latest FOMC meeting in September, the midpoint of the central tendency forecast of that unemployment rate was 5.35 percent. So, at 5.35 percent unemployment, the country is said to be at full-employment, according to the Fed.

Following St. Louis Fed President James Bullard's recent speech, we decided to put inflation and unemployment components into a simple objective function to see how far the economy is from the Fed's dual mandate goals. One of the core assumptions here is that both inflation and unemployment are equally weighted.

Bear with me, while I explain my formula/calculation and then I'll reveal the startling implications for monetary policy. During the mathematical integration of inflation and unemployment, we took the square root of the objective function (T) values for better scaling, where ***"i"*** is the actual rate of inflation, "**i***" is the target inflation rate, "**u**" is the unemployment rate, and "**u***" is the long-run average unemployment to get a measure of the distance from the Fed's goals.

Closer and Closer to Fed's Macroeconomic Targets



Source: St. Louis Fed; BOTW Economics Calculations

In other words, the lower the value of function T, the closer the economy is to the FOMC's goals. Currently, the objective function value of 0.93 is extremely close to pre-crisis levels of 0.88, the six year average spanning from December 2001 to December 2007. The take away here is that FOMC is perhaps closer to its macroeconomic targets today than it has been for much of the time since 1960. Analysis like this suggests the Fed might be behind the curve in normalizing interest rates.

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	4.6	3.1	3.1	3.0	3.0	2.9	2.9	2.3	2.2	2.2	3.1
Personal Consumption Expenditures*	3.6	1.8	2.0	3.7	1.2	2.5	2.0	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	9.7	6.9	5.5	4.9	4.9	4.9	4.9	7.2	3.0	6.1	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	16.7	16.8	17.0	17.1	17.2	17.3	14.4	15.5	16.4	17.2
Industrial Production*	4.2	1.9	2.5	4.9	3.9	5.5	2.0	5.0	4.5	4.4	4.4	4.3	3.8	2.9	3.9	4.4
Nonfarm Payroll Employment (mil.)	135.5	136.1	136.6	137.2	137.8	138.5	139.1	139.7	140.4	141.4	141.7	142.3	134.1	136.4	138.8	141.4
Unemployment rate	7.7	7.5	7.2	7.0	6.7	6.2	6.1	5.8	5.7	5.6	5.5	5.5	8.1	7.4	6.2	5.6
Consumer Price Index* (percent)	1.2	0.4	2.2	1.1	1.9	3.0	0.5	1.5	1.8	1.8	1.9	1.9	2.1	1.5	1.7	1.7
"Core" CPI* (percent)	2.0	1.4	1.8	1.6	1.6	2.5	0.9	1.8	1.8	1.8	1.8	1.8	2.1	1.8	1.7	1.7
PPI (finished goods)* (percent)	0.8	-1.0	2.3	1.2	3.9	3.7	-0.3	1.8	1.5	1.4	1.3	1.4	2.0	1.2	2.2	1.4
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	94	97	97	97	96	94	98	99	97

*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	0.03	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	0.62	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	1.87	1.93	2.14	2.35	2.63	0.76	1.17	1.70	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	0.25	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	4.97	5.00	5.18	5.40	5.56	4.94	5.10	4.92	5.29

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