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U.S. Outlook

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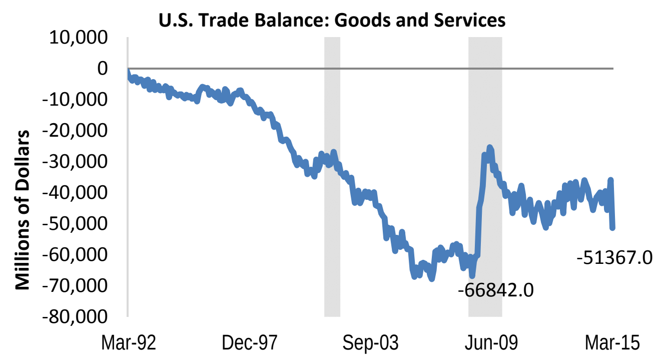
Date	Indicator	For	Estimate	Consensus*	Previous Period
11-MAY-2015	Labor Market Conditions Index Change	Apr	NA	NA	-0.3
12-MAY-2015	NFIB Small Business Optimism	Apr	96.5	NA	95.2
12-MAY-2015	JOLTS Job Openings	Mar	NA	NA	5133
13-MAY-2015	Retail Sales Advance MoM	Apr	0.30%	0.20%	0.90%
13-MAY-2015	Retail Sales Ex Auto MoM	Apr	0.50%	0.40%	0.40%
13-MAY-2015	Import Price Index MoM	Apr	0.30%	0.20%	-0.30%
13-MAY-2015	Business Inventories	Mar	0.20%	0.20%	0.30%
14-MAY-2015	PPI Final Demand MoM	Apr	0.10%	0.10%	0.20%
14-MAY-2015	PPI Ex Food and Energy MoM	Apr	0.10%	0.10%	0.20%
14-MAY-2015	Initial Jobless Claims	09-May	270K	NA	265K
15-MAY-2015	Empire Manufacturing	May	3.0	5.0	-1.19
15-MAY-2015	Industrial Production MoM	Apr	0.1%	0.0%	-0.6%
15-MAY-2015	Capacity Utilization	Apr	78.4%	78.4%	78.4%
15-MAY-2015	U. of Mich. Sentiment	May P	96.9	96.5	95.9
15-MAY-2015	Net Long-term TIC Flows	Mar	NA	NA	$9.8B

*Consensus from Bloomberg

Uneven Growth with Whiffs of Higher Prices

This week's U.S. Trade report for March revealed an even more lopsided trade performance than was estimated in the Q1 Advance Real GDP report released last week. Continued weakness in U.S. exports and a surprisingly strong rebound in imports, as delays under the West Coast port slowdown eased, helped push the U.S. monthly trade deficit to its highest level since October of 2008; the trade deficit widened by a whopping $15.5 billion from February alone. Factoring in these March trade numbers, our current estimate of Q1 Real GDP dropped below stagnation into contraction territory at -0.3 percent annualized. Export growth should catch-up a bit in Q2, while import growth will slow, but even so, the trade deficit deterioration is expected to leave a visible mark on U.S. real GDP growth this year.

Ballooning Trade Deficit Turns Q1 GDP Estimate Negative

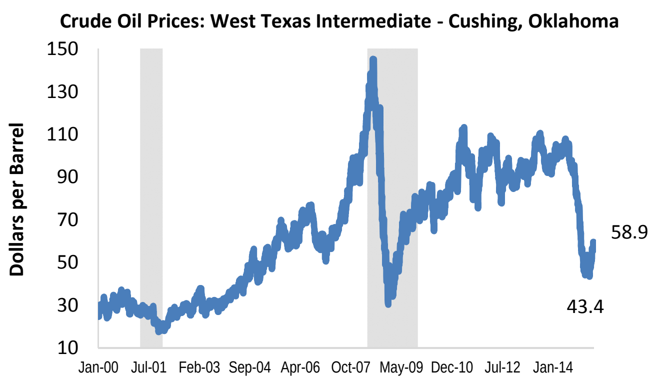


Source: Bureau of Economic Analysis, Census Bureau

A rebound in real consumer spending growth and to some extent residential construction should help push growth back toward 2.4 percent annualized in Q2, but business investment is likely to remain weak at least for another quarter, while the U.S. trade deficit will be an even bigger drag on growth this year. The rapid U.S. dollar appreciation from a year ago is expected to largely hold over the forecast horizon, limiting U.S. export growth, while higher oil prices ahead and a stronger consumer will mean more import growth.

At the same time, the market's view on U.S. inflation prospects appears to be evolving rapidly toward a more normal environment after several months of handwringing over deflation concerns. The solid bounce in global crude oil prices is likely helping to feed expectations in global bond markets that deflation will prove temporary.

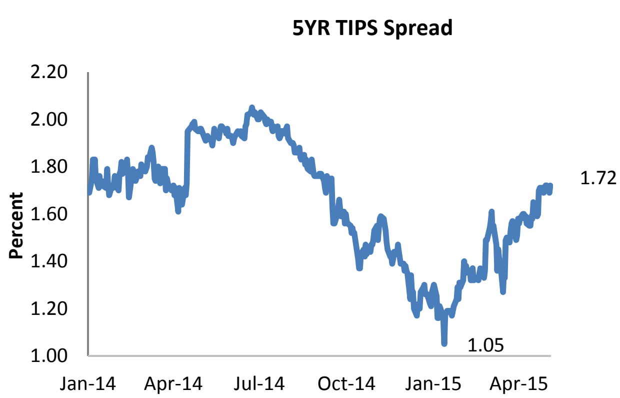
Oil Prices Turn The Corner, Higher Inflation Not Far Behind



Source: U.S. Energy Information Administration

Inflation break-evens, like the 5-Year TIPS Spread, a proxy for bond investors' medium-term inflation expectations, have moved dramatically higher in recent weeks, back to historical norms. This normalization of inflation expectations is a big part of the explanation of why we are seeing increasing long-term nominal interest rates in the U.S.

Market Inflation Expectations Rebounding Swiftly



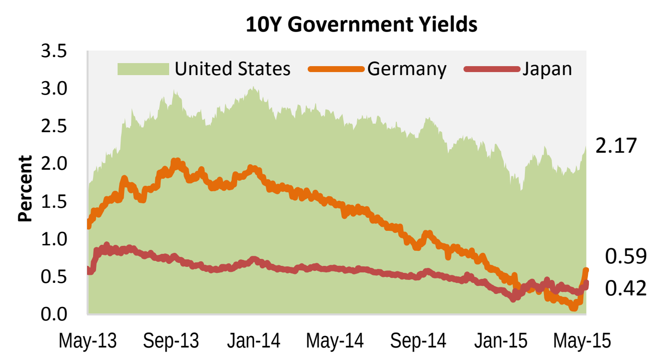
Source: Federal Reserve System

Indeed, more signs are popping-up in the real economy too that U.S. core inflation is likely to rise from here. The latest indicators from the Labor Department's Employee Cost Index and sharp rise in Unit Labor Costs suggest rising wage pressures could soon find their way into higher consumer prices.

Companies will need to face these rising labor costs by either boosting sale prices and revenues, or taking a hit on profits. If consumer demand continues to strengthen, as we expect, the hit to corporate profits should prove temporary as higher costs start to get passed along as higher prices.

Moreover, the unrelenting downward pressure on long-term U.S. bond yields from abroad, especially from Europe, appears to be easing. Dropping interest rates in Europe in anticipation of European deflation, the launch of the ECB's QE program, and more recently, fears of a Greek exit, seem to have largely run their course in European bond markets. Global bond investors look at relative interest rates and expectations for currency movements as a big factor in making their asset allocation decisions. This has kept global capital flowing into U.S. bonds despite signs that the Federal Reserve is preparing to lift short-term interest rates, keeping a lid on U.S. long-term rates. Recent currency moves suggest these capital flows could be waning, providing another source of lift for U.S. interest rates.

European Rates Putting Less Downward Pressure On U.S



Source: Bloomberg

So, like last year, the economy probably contracted a bit in the first quarter, as a downturn in the U.S. trade balance and business investment overwhelmed a modestly expanding consumer sector. Looking ahead, this growth imbalance is likely to remain in place at least in the current quarter, resulting in only a moderate bounce in GDP growth to around 2.4 percent. By the second half, growth will resume its nearly 3.0 percent pace. Markets appear to be responding early to the pick-up in forecasted growth with rising oil prices, increased inflation expectations and higher long-term interest rates. Market and Fed expectations around future inflation appear to be aligning nicely, keeping a September rate hike in sight.

Major Economic Indicators

Economic Data	History 2014.1	2014.2	2014.3	2014.4	Forecast 2015.1	2015.2	2015.3	2015.4	2016.1	2016.2	2016.3	2016.4	Yr/Yr % chg or Annual Avg. 2013	2014	2015	2016
Real GDP*	-2.1	4.6	5.0	2.2	-0.3	2.4	2.9	2.9	2.7	2.8	2.7	2.7	2.2	2.4	2.2	2.8
Personal Consumption Expenditures*	1.2	2.5	3.2	4.4	2.0	3.7	3.5	3.4	3.1	3.1	2.9	2.8	2.4	2.5	3.3	3.2
Non-residential Fixed Investment*	1.6	9.7	8.9	4.7	-3.4	-0.2	5.0	5.0	4.7	4.6	4.6	4.2	3.0	6.3	2.9	4.5
Private Housing Starts (000s units)	925	985	1,030	1,063	969	1,040	1,101	1,133	1,145	1,170	1,230	1,250	930	1,001	1,061	1,199
Vehicle Sales (mill. Units, annualized)	15.7	16.5	16.7	16.8	16.6	16.8	17.0	17.1	17.2	17.2	17.3	17.3	15.5	16.4	16.9	17.2
Industrial Production*	3.9	5.7	4.1	4.6	-1.0	2.0	3.3	3.2	3.4	3.4	3.4	3.4	2.9	4.2	2.4	3.3
Nonfarm Payroll Employment (mil.)	137.8	138.6	139.4	140.2	141.0	141.8	142.7	143.5	144.3	145.1	145.9	146.6	136.4	139.0	142.3	145.5
Unemployment rate	6.6	6.2	6.1	5.7	5.6	5.4	5.2	5.1	5.0	4.9	4.9	4.9	7.4	6.2	5.3	4.9
Consumer Price Index* (percent)	2.1	2.4	1.2	-0.9	-3.0	1.7	1.9	1.9	1.9	1.9	2.0	2.1	1.5	1.6	0.1	1.9
"Core" CPI* (percent)	1.8	2.2	1.4	1.5	1.9	1.8	1.8	1.9	1.9	1.9	2.0	2.0	1.8	1.7	1.8	1.9
PPI (finished goods)* (percent)	4.1	3.5	0.4	-5.1	-11.5	0.3	1.0	1.1	1.3	1.3	1.4	1.4	1.2	1.3	0.3	1.8
Trade Weighted Dollar (Fed BOG, major)	76.9	76.4	77.5	82.2	89.3	91.0	91.4	91.7	91.0	91.8	92.5	92.4	76.1	78.3	90.9	91.9
Crude Oil Prices -WTI ($ per barrel)	99	103	98	73	49	57	58	59	62	63	64	65	98	94	56	64

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

Financial Data	History 2014.1	2014.2	2014.3	2014.4	2015.1	Forecast 2015.2	2015.3	2015.4	2016.1	2016.2	2016.3	2016.4	Annual Average 2013	2014	2015	2016
S & P 500	1,835	1,900	1,976	2,009	2,064								1,644			
Dow Jones Industrial Average	16,177	16,604	16,954	17,345	17,808								15,010			
Federal Funds Rate (effective)	0.07	0.09	0.09	0.10	0.11	0.13	0.21	0.46	0.88	1.13	1.38	1.71	0.11	0.08	0.23	1.27
Treasury-3 Month Bills (yield)	0.05	0.03	0.03	0.02	0.02	0.03	0.11	0.36	0.78	1.03	1.28	1.61	0.06	0.03	0.13	1.18
Treasury-2 Year Notes (yield)	0.37	0.42	0.52	0.54	0.60	0.65	0.88	1.08	1.55	1.85	2.10	2.43	0.31	0.45	0.80	1.98
Treasury-5 Year Notes (yield)	1.60	1.66	1.70	1.60	1.46	1.55	1.72	2.00	2.44	2.64	2.89	3.02	1.17	1.63	1.68	2.75
Treasury-10 Year Notes (yield)	2.77	2.62	2.50	2.28	1.97	2.17	2.35	2.51	2.71	2.84	2.95	3.18	2.35	2.54	2.25	2.92
Treasury-30 Year Notes (yield)	3.68	3.44	3.27	2.97	2.55	2.77	2.95	3.05	3.16	3.27	3.40	3.53	3.44	3.34	2.83	3.34
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.33	3.58	4.00	4.25	4.50	4.83	3.25	3.25	3.35	4.40
Libor 3-Mo. U.S. Dollar	0.26	0.25	0.24	0.25	0.30	0.30	0.33	0.58	1.00	1.25	1.50	1.83	0.28	0.25	0.38	1.40
Mortgage-30 Year (yield)	4.36	4.23	4.14	3.96	3.72	3.92	4.16	4.30	4.52	4.65	4.76	4.99	3.98	4.19	4.02	4.73
BAA Corporate (yield)	5.12	4.82	4.74	4.73	4.50	4.65	4.78	4.87	5.05	5.20	5.32	5.55	5.10	4.86	4.70	5.28

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