

# U.S. Outlook

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Date	Indicator	For	Estimate	Consensus*	Previous Period
14-Jul-2015	Retail Sales Advance MoM	Jun	0.3%	0.3%	1.2%
14-Jul-2015	Retail Sales Ex Auto MoM	Jun	0.5%	0.6%	1.0%
14-Jul-2015	Import Price Index MoM	Jun	0.1%	0.2%	1.3%
14-Jul-2015	NFIB Small Business Optimism	Jun	98.6	98.5	98.3
14-Jul-2015	Business Inventories	May	0.2%	0.2%	0.4%
15-Jul-2015	PPI Final Demand MoM	Jun	0.2%	0.2%	0.5%
15-Jul-2015	PPI Ex Food and Energy MoM	Jun	0.1%	0.1%	0.1%
15-Jul-2015	Empire Manufacturing	Jul	4.0	3.0	-2.0
15-Jul-2015	Industrial Production MoM	Jun	0.1%	0.2%	-0.2%
15-Jul-2015	Capacity Utilization	Jun	78.1%	78.1%	78.1%
16-Jul-2015	Initial Jobless Claims	11-Jul	280K	NA	297K
16-Jul-2015	Philadelphia Fed Business Outlook	Jul	12.0	11.5	15.2
16-Jul-2015	NAHB Housing Market Index	Jul	59	59	59
17-Jul-2015	Housing Starts	Jun	1085K	1100K	1036K
17-Jul-2015	Building Permits	Jun	1130K	1103K	1250K
17-Jul-2015	CPI MoM	Jun	0.3%	0.3%	0.4%
17-Jul-2015	CPI Ex Food and Energy MoM	Jun	0.2%	0.2%	0.1%
17-Jul-2015	U. of Mich. Sentiment	Jul P	95.5	96.4	96.1

\*Consensus from Bloomberg

## Financial Volatility Takes Center Stage

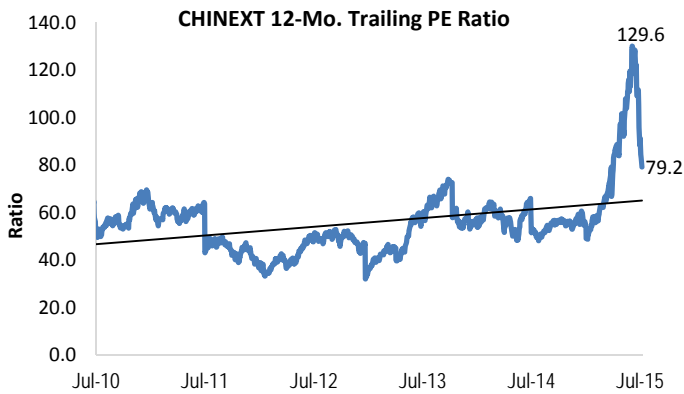
The economic and financial drama unfolding in Greece and China is dominating the headlines and has relegated the discussion of Fed liftoff to the back pages of the newspaper. While we don't dismiss the downside economic risks to China and the Eurozone economies from what has occurred, especially if financial conditions continue to worsen, we do think, however, it is important to keep things in perspective when financial volatility runs amok and irrational panic sets in.

First, we are holding our fire on baseline GDP growth downgrades in both China and the Eurozone until we see more evidence of economic damage. We have not yet altered our GDP growth forecasts for either China or Europe for 2015. Our forecast for Chinese GDP growth this year is 6.8%, a bit below the economic consensus and official targets of 7.0% growth this year.

China is currently grappling with a stock market bubble collapse built on a shaky foundation of margin debt. Price/earnings ratios in China's stock markets reached nose-bleed and unsustainable levels over a very short period of time. The Chinese stock rally began in earnest in March of this year, and reached ridiculous proportions in May.

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**China Stock Index P/E Ratios Got Out of Hand**

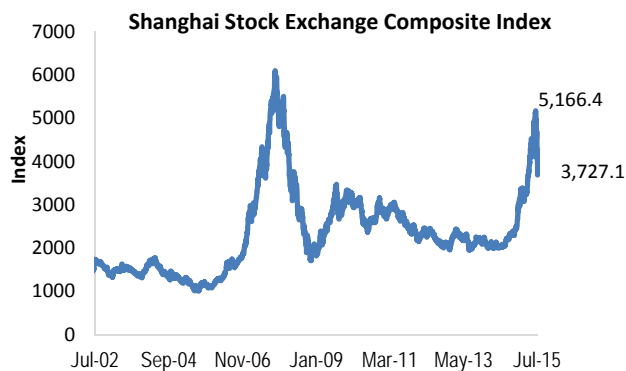


Source: Bloomberg

The chart above illustrates the dramatic fall in Chinese stock prices and p/e ratios in recent days, but it's probably too early to say this is a disaster for the Chinese economic outlook. Indeed, one can conjure up images of our own dot-com bubble collapse in 2001 that did a lot of damage to the Bay Area economy, but only led to a mild nine month recession in the United States where Real GDP didn't even decline year-on-year. In China, the impact should be even smaller, since stocks aren't as widely held by Chinese households as they are in the United States. Only 10-12% of Chinese households own shares compared to nearly 50% of households in the U.S. that either own shares outright or indirectly through stock mutual funds and 401K's.

Moreover, China has seen stock price bubbles and collapses like this before and survived largely intact. The last one was in the lead-up to the "Great Recession". Granted China also launched a huge fiscal stimulus package to support economic growth at the time, a path the China government would not want to necessarily go down this time.

**China Mainland Stocks Have Blown Bubbles Before**

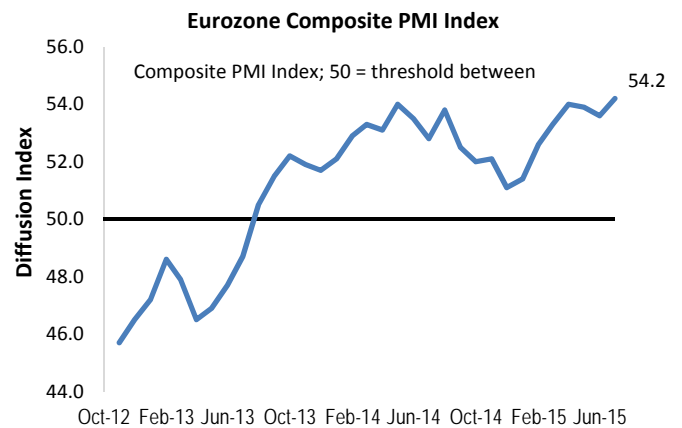


Source: Bloomberg

Finally, it is important to note that Chinese stock prices are still higher than where they started the year, the Shanghai Composite index is 90% above year ago levels today. The drop, so far, hasn't even brought valuations back down to Earth yet. During the Great Recession, U.S. household wealth dropped by about \$13 trillion dollars wiping out three years' worth of gains, in China stocks have lost about \$3 trillion dollars so far, only wiping out their wealth gains over the last three months.

Our growth outlook for the Eurozone remains at 1.5% for 2015. Despite the damning headlines out of Greece, recent economic indicators from the Eurozone suggest economic activity actually improved in the second quarter. In fact, the Eurozone composite PMI index hit an expansion high in June. This should give Europe a little bit of space to sort out Greece without materially damaging the overall European economy. Financial contagion from Greece into the Eurozone appears fairly well contained so far, though I don't think a full Grexit has been priced in by the markets either.

**Eurozone Expansion Accelerates in the 2<sup>nd</sup> Quarter**



Source: Markit

Most importantly for this audience, we do not expect a measurable negative impact on the U.S. economic outlook from the financial events that have occurred in Europe and China so far. I don't suspect the Federal Reserve does is either, but it could get them to raise the caution flag again, keeping the first rate hike in the FOMC's back pocket instead of on the table in September. Since we have not altered our forecast for the U.S. economy, we are sticking to our one and done September liftoff forecast for the FOMC, but admit the probably the Fed could hold off until December is close to 50/50 at this point.

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## Major Economic Indicators

Economic Data	History				Forecast								Yr/Yr % chg or Annual Avg.			
	2014.1	2014.2	2014.3	2014.4	2015.1	2015.2	2015.3	2015.4	2016.1	2016.2	2016.3	2016.4	2013	2014	2015	2016
Real GDP*	-2.1	4.6	5.0	2.2	-0.2	2.7	3.0	2.9	2.7	2.8	2.7	2.7	2.2	2.4	2.3	2.8
Personal Consumption Expenditures*	1.2	2.5	3.2	4.4	2.1	3.0	3.5	3.4	3.1	3.1	2.9	2.8	2.4	2.5	3.1	3.2
Non-residential Fixed Investment*	1.6	9.7	8.9	4.7	-2.0	1.6	5.0	5.0	4.7	4.6	4.6	4.2	3.0	6.3	3.3	4.6
Private Housing Starts (000s units)	934	984	1,029	1,055	978	1,093	1,121	1,143	1,155	1,170	1,230	1,250	928	1,001	1,084	1,201
Vehicle Sales (mill. Units, annualized)	15.7	16.5	16.7	16.8	16.6	17.1	17.2	17.1	17.2	17.2	17.3	17.3	15.5	16.4	17.0	17.3
Industrial Production*	3.9	5.7	4.1	4.6	-0.3	-1.9	3.3	3.2	3.4	3.4	3.4	3.4	2.9	4.2	1.9	3.1
Nonfarm Payroll Employment (mil.)	137.8	138.6	139.4	140.2	141.0	141.6	142.3	143.0	143.6	144.3	145.0	145.7	136.4	139.0	142.0	144.7
Unemployment rate	6.6	6.2	6.1	5.7	5.6	5.4	5.2	5.1	5.0	4.9	4.9	4.8	7.4	6.2	5.3	4.9
Consumer Price Index* (percent)	2.1	2.4	1.2	-0.9	-3.1	2.2	2.0	2.0	2.0	2.0	2.0	2.1	1.5	1.6	0.1	2.0
"Core" CPI* (percent)	1.8	2.2	1.4	1.5	1.7	2.3	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	-11.3	0.3	1.8	1.7	1.7	1.7	1.8	1.8	1.2	1.3	0.4	1.9
Trade Weighted Dollar (Fed BOG, major)	76.9	76.4	77.5	82.2	89.3	90.0	91.4	91.7	91.0	91.8	92.5	92.4	76.1	78.3	90.6	91.9
Crude Oil Prices -WTI (\$ per barrel)	99	103	98	73	49	58	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				Forecast								Annual Average			
	2014.1	2014.2	2014.3	2014.4	2015.1	2015.2	2015.3	2015.4	2016.1	2016.2	2016.3	2016.4	2013	2014	2015	2016
S & P 500	1,835	1,900	1,976	2,009	2,064	2,102							1,644			
Dow Jones Industrial Average	16,177	16,604	16,954	17,345	17,808	18,004							15,010			
Federal Funds Rate (effective)	0.07	0.09	0.09	0.10	0.11	0.12	0.21	0.38	0.63	0.88	1.13	1.38	0.11	0.08	0.21	1.00
Treasury-3 Month Bills (yield)	0.05	0.03	0.03	0.02	0.02	0.02	0.07	0.24	0.53	0.78	1.03	1.28	0.06	0.03	0.09	0.91
Treasury-2 Year Notes (yield)	0.37	0.42	0.52	0.54	0.60	0.61	0.74	0.98	1.35	1.65	1.90	2.23	0.31	0.45	0.73	1.78
Treasury-5 Year Notes (yield)	1.60	1.66	1.70	1.60	1.46	1.53	1.70	1.93	2.34	2.54	2.79	2.92	1.17	1.63	1.66	2.65
Treasury-10 Year Notes (yield)	2.77	2.62	2.50	2.28	1.97	2.16	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	2.88	3.14	3.27	3.31	3.37	3.50	3.63	3.44	3.34	2.96	3.44
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.33	3.50	3.75	4.00	4.25	4.50	3.25	3.25	3.33	4.13
Libor 3-Mo. U.S. Dollar	0.26	0.25	0.24	0.25	0.30	0.30	0.33	0.50	0.75	1.00	1.25	1.50	0.28	0.25	0.36	1.13
Mortgage-30 Year (yield)	4.36	4.23	4.14	3.96	3.72	3.82	4.16	4.30	4.52	4.65	4.76	4.99	3.98	4.19	4.00	4.73
BAA Corporate (yield)	5.12	4.82	4.74	4.73	4.50	4.83	5.10	5.20	5.45	5.60	5.72	5.95	5.10	4.86	4.90	5.68

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