

U.S. Outlook

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Date	Indicator	For	Estimate	Consensus*	Previous Period
15-Dec-2015	Empire Manufacturing	Dec	-6.0	-5.5	-10.7
15-Dec-2015	CPI MoM	Nov	0.1%	0.0%	0.2%
15-Dec-2015	CPI Ex Food and Energy MoM	Nov	0.2%	0.2%	0.2%
15-Dec-2015	NAHB Housing Market Index	Dec	63	63	62
15-Dec-2015	Net Long-term TIC Flows	Oct	NA	NA	\$33.6b
16-Dec-2015	Housing Starts	Nov	1150k	1130k	1060k
16-Dec-2015	Building Permits	Nov	1170k	1150k	1161k
16-Dec-2015	Industrial Production MoM	Nov	-0.1%	-0.1%	-0.2%
16-Dec-2015	Capacity Utilization	Nov	77.5%	77.5%	77.5%
16-Dec-2015	Markit US Manufacturing PMI	Dec P	52.6	NA	52.8
16-Dec-2015	FOMC Rate Decision (Upper Bound)	16-Dec	0.50%	0.50%	0.25%
16-Dec-2015	FOMC Rate Decision (Lower Bound)	16-Dec	0.25%	0.25%	0.00%
17-Dec-2015	Current Account Balance	3Q	-\$123.0b	-\$122.0b	-\$109.7b
17-Dec-2015	Philadelphia Fed Business Outlook	Dec	1.0	2.3	1.9
17-Dec-2015	Initial Jobless Claims	12-Dec	276K	NA	282K
17-Dec-2015	Leading Index	Nov	0.2%	0.1%	0.6%
18-Dec-2015	Markit US Services PMI	Dec P	NA	NA	56.1
18-Dec-2015	Markit US Composite PMI	Dec P	NA	NA	55.9
18-Dec-2015	Kansas City Fed Manf. Activity	Dec	NA	NA	1

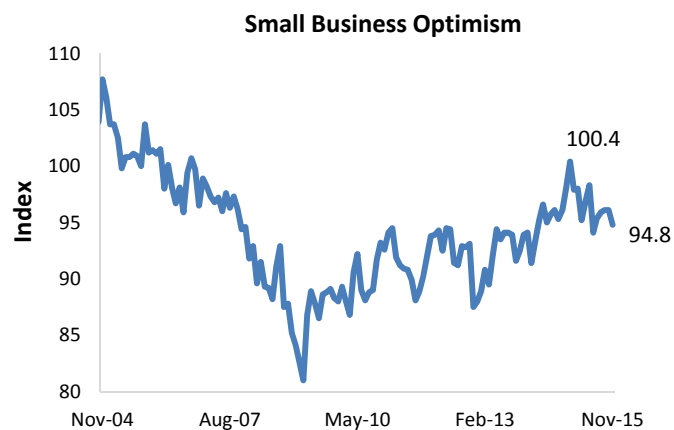
*Consensus from Bloomberg

A Few Modest Misses Won't Deter a Fed Hike

The last full week of U.S. economic releases, before what arguably is the biggest FOMC meeting in nine years, came in on the underwhelming side. Labor market indicators from the Labor Market Conditions Index (LMCI) for November, Job openings for October, and initial jobless claims for last week all missed analyst consensus expectations.

Another disappointment came from the NFIB small business index, which sank in November to 94.8 from 96.1 in October. While this is just a sentiment index and not hard economic data, it does probably accurately reflect the souring mood of small business owners about the outlook for the U.S. economy. On the other hand, with the first Fed interest rate hike in nearly a decade looming, some trepidation in small business confidence is to be expected.

A Chill in Confidence- Small Business Optimism Dims

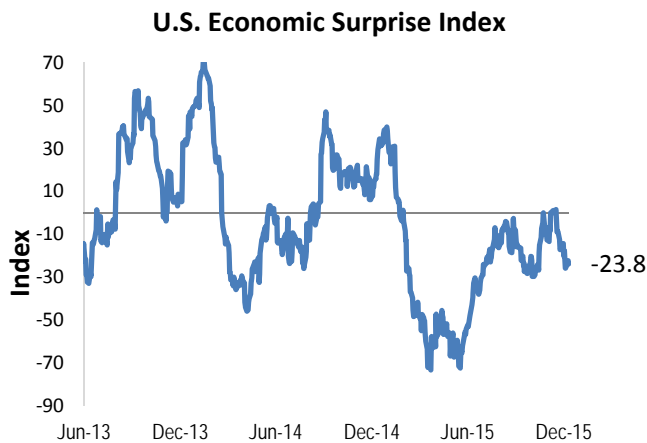


Source: National Federation of Independent Business

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Lastly, wholesale sales were flat in October and wholesale inventories fell 0.1% on the month. Not necessarily a bad thing for the economic outlook since bloated inventories need some trimming, but it could mean a little more inventory subtraction in Q4 GDP than previously forecast. This creates a bit of a downside risk to our 2.1% real GDP forecast for the fourth quarter, but has no impact on our economic and interest rate outlook for 2016.

U.S. Economic Surprises Remain On the Negative Side



Source: Citigroup Global Markets

However, on the eve of next week’s December FOMC meeting, it probably won’t fundamentally alter FOMC members’ forecasts for the U.S. economy in 2016 and beyond, and will have little bearing on their decision on whether or not to raise U.S. interest rates. Markets have nearly fully priced in a December rate hike from the Fed at this point. The Fed Funds Futures implied probability of the December rate hike from the Fed is now at 76%. The 2-Yr Treasury yield is holding near its highest level in this expansion at 0.91%.

Two-Year Treasury Note Yield Near Expansion Highs

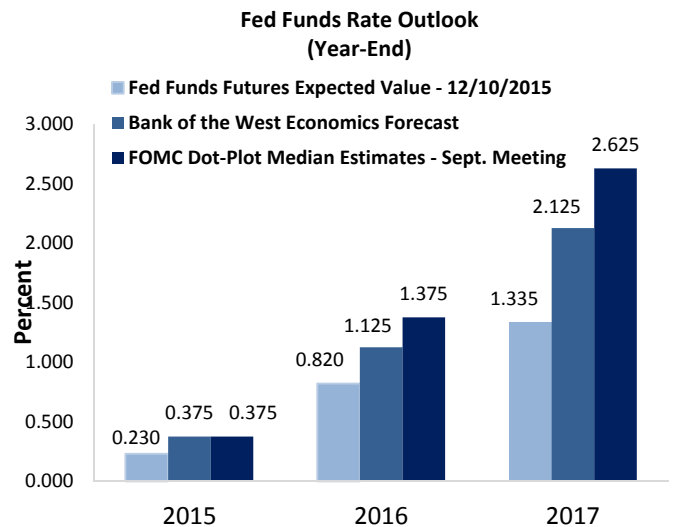


Source: Federal Reserve System

Perhaps more important than the FOMC’s momentous decision of whether to start normalizing short-term interest rates next week will be the way they communicate the path of the Fed funds target rate going forward. I expect them to retain the gradual language and even emphasize that the pace of additional interest rate hikes will remain data dependent. This will give the FOMC the flexibility to scale-up or scale-back their rate hike pace next year depending how the labor market or inflation evolves.

Besides dissecting every word in the FOMC statement next week, analysts will be poring over the latest summary of economic projections and dot-plot to gauge not only the median expected pace of monetary tightening and economic growth, but also the direction of change. Have the median dot-plot expectations been scaled-back since September, which was the latest time the FOMC released its economic forecasts and expectations surrounding policy rates.

Widely Differing Views On Likely Rate Hike Path Remain



Source: Chicago Board of Trade; Federal Reserve; Bank of the West Economics

I expect the FOMC has scaled back a bit on their expectations of where the Fed funds target rate will be at the end of 2016 and 2017 since September’s meeting, given the on-going weakness of the global economy and the likely influence this will have on the U.S. dollar and core-inflation in 2016. The divergence between Fed monetary normalization and further easing by many other major central banks, from the ECB to PBOC, could put further upward pressure on the U.S. dollar and dampen emerging inflationary pressures created by the tightening labor market. Next week’s FOMC meeting will true up market interest rate expectations and set the investment themes for 2016.

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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*	-0.9	4.6	4.3	2.1	0.6	3.9	2.1	2.1	2.3	2.3	2.4	2.5	1.5	2.4	2.5	2.4
Personal Consumption Expenditures*	1.3	3.8	3.5	4.3	1.7	3.6	3.0	2.5	3.0	3.0	2.9	2.8	1.7	2.7	3.1	2.9
Non-residential Fixed Investment*	8.3	4.4	9.0	0.7	1.6	4.1	2.4	2.4	2.9	2.9	3.3	3.5	3.0	6.2	3.1	2.9
Private Housing Starts (000s units)	934	984	1,029	1,055	978	1,158	1,153	1,160	1,190	1,225	1,230	1,250	928	1,001	1,112	1,224
Vehicle Sales (mill. Units, annualized)	15.7	16.5	16.7	16.8	16.6	17.1	17.8	18.0	17.9	17.8	17.6	17.6	15.5	16.4	17.4	17.7
Industrial Production*	3.6	5.7	3.9	4.7	-0.3	-2.4	1.9	-0.1	1.8	1.9	1.9	1.8	1.9	3.7	1.4	1.2
Nonfarm Payroll Employment (mil.)	137.8	138.6	139.4	140.2	141.0	141.6	142.2	142.8	143.4	144.0	144.5	145.1	136.4	139.0	141.9	144.2
Unemployment rate	6.6	6.2	6.1	5.7	5.6	5.4	5.2	4.9	4.8	4.7	4.7	4.6	7.4	6.2	5.3	4.7
Consumer Price Index* (percent)	2.1	2.4	1.2	-0.9	-3.1	3.0	1.6	1.8	2.0	2.0	2.0	2.1	1.5	1.6	0.2	2.0
"Core" CPI* (percent)	1.8	2.2	1.4	1.5	1.7	2.5	1.7	1.5	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	-11.2	3.6	0.8	-4.0	1.7	1.7	1.8	1.8	1.2	1.9	-3.1	0.6
Trade Weighted Dollar (Fed BOG, major)	76.9	76.4	77.5	82.5	89.3	90.0	91.7	93.0	95.2	96.4	97.5	98.7	75.9	78.4	91.0	97.0
Crude Oil Prices -WTI (\$ per barrel)	99	103	98	73	48	58	47	45	47	49	51	51	98	93	50	50

*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	2009	2,064	2102	2027						1,644	1,930		
Dow Jones Industrial Average	16,177	16,604	16,954	17345	17,808	18,004	17,077						15,010	16,770		
Federal Funds Rate (effective)	0.07	0.09	0.09	0.10	0.11	0.12	0.13	0.13	0.38	0.63	0.71	0.96	0.11	0.09	0.13	0.67
Treasury-3 Month Bills (yield)	0.05	0.03	0.03	0.02	0.02	0.02	0.09	0.09	0.32	0.57	0.65	0.90	0.06	0.03	0.06	0.61
Treasury-2 Year Notes (yield)	0.37	0.42	0.52	0.54	0.60	0.61	0.68	0.75	1.07	1.36	1.47	1.73	0.31	0.46	0.66	1.41
Treasury-5 Year Notes (yield)	1.60	1.66	1.70	1.60	1.46	1.53	1.55	1.55	1.82	2.02	2.17	2.30	1.17	1.64	1.52	2.08
Treasury-10 Year Notes (yield)	2.77	2.62	2.50	2.28	1.97	2.16	2.21	2.17	2.42	2.55	2.60	2.82	2.35	2.54	2.13	2.60
Treasury-30 Year Notes (yield)	3.68	3.44	3.27	2.97	2.55	2.88	2.96	2.95	3.08	3.14	3.23	3.36	3.44	3.34	2.84	3.20
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.50	3.75	3.83	4.08	3.25	3.25	3.25	3.79
Libor 3-Mo. U.S. Dollar	0.26	0.25	0.24	0.25	0.30	0.30	0.31	0.36	0.57	0.82	0.90	1.15	0.28	0.25	0.32	0.86
Mortgage-30 Year (yield)	4.36	4.23	4.14	3.96	3.72	3.82	3.95	3.86	4.11	4.24	4.31	4.54	3.98	4.17	3.84	4.30
BAA Corporate (yield)	5.12	4.82	4.74	4.73	4.50	4.83	5.24	5.40	5.54	5.69	5.79	6.03	5.10	4.86	4.99	5.76

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