U.S. Outlook

SCOTT ANDERSON, Ph.D | Chief Economist | 415.765.8020
www.bankofthewest.com

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Date	Indicator	For	Estimate	Consensus*	Previous Period
21-Dec-2015	Chicago Fed Nat Activity Index	Nov	NA	NA	-0.04
22-Dec-2015	GDP Annualized QoQ	3Q T	1.8%	1.8%	2.1%
22-Dec-2015	GDP Price Index	3Q T	1.3%	1.3%	1.3%
22-Dec-2015	FHFA House Price Index MoM	Oct	0.4%	NA	0.8%
22-Dec-2015	Existing Home Sales	Nov	5.38m	5.36m	5.36m
22-Dec-2015	Richmond Fed Manufacturing Index	Dec	1	NA	-3
23-Dec-2015	Personal Income	Nov	0.3%	0.2%	0.4%
23-Dec-2015	Personal Spending	Nov	0.3%	0.3%	0.1%
23-Dec-2015	Durable Goods Orders	Nov P	-1.0%	-0.4%	2.9%
23-Dec-2015	Durables Ex Transportation	Nov P	-0.2%	0.0%	0.5%
23-Dec-2015	PCE Deflator MoM	Nov	0.1%	0.1%	0.1%
23-Dec-2015	PCE Core MoM	Nov	0.2%	0.1%	0.0%
23-Dec-2015	New Home Sales	Nov	505k	500k	495k
23-Dec-2015	U. of Mich. Sentiment	Dec F	92.0	92.0	91.8
24-Dec-2015	Initial Jobless Claims	19-Dec	273K	NA	271K
28-Dec-2015	Dallas Fed Manf. Activity	Dec	-6.0	NA	-4.9
29-Dec-2015	S&P/CS 20 City MoM SA	Oct	0.4%	NA	0.6%
29-Dec-2015	Consumer Confidence Index	Dec	93.6	NA	90.4
30-Dec-2015	Pending Home Sales MoM	Nov	0.5%	NA	0.2%
31-Dec-2015	Initial Jobless Claims	26-Dec	270K	NA	NA
31-Dec-2015	Chicago Purchasing Manager	Dec	50.4	NA	48.7

*Consensus from Bloomberg

FOMC Signals a Return to Normalcy

Citing considerable improvement in labor market conditions – specifically job gains, declining unemployment, and diminished underutilization of labor resources – the FOMC went ahead with its first interest rate hike in more than nine years. The move raises the Fed funds target rate to 25 to 50 basis points from 0 to 25 basis points.

Given the mechanics of Fed liftoff were quite different this time than during past monetary policy moves, we thought an early-hours review of how things are going was in order. Despite some money market uncertainty and trepidation that the Fed would be able to really manage to lift the Fed funds rate with a 3.0 trillion plus balance sheet, the early evidence seems to sweep those fears aside.

The theory of Fed liftoff has now become a reality. Indeed, so far at least, the mechanics of the liftoff appear to have come off better than the Fed could have even imagined.

Tacked on to the end of the FOMC statement was an implementation note that spelled out how the Fed planned to move the Fed funds effective rate into its new higher target rate range of 25 to 50 basis points.

On Dec. 17th, the FOMC raised the interest rate it pays on bank excess reserves by a quarter percentage point from 0.25 percent to 0.50 percent. This puts an effective ceiling on the Fed fund rate or overnight lending rate in the market.

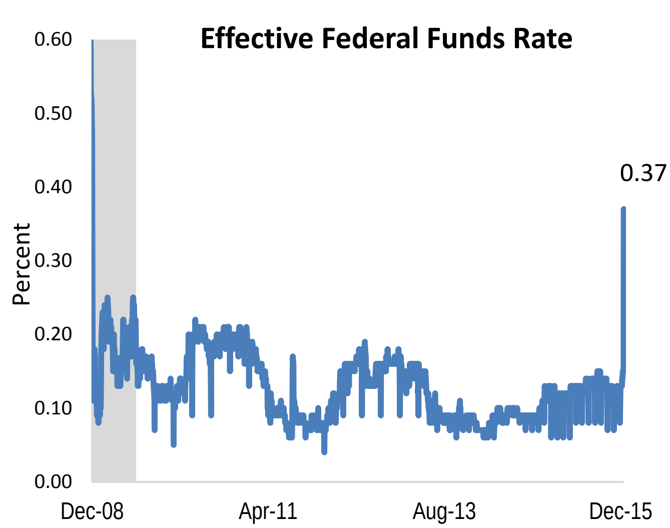
At the same time the FOMC directed the trading desk in New York to conduct open market operations to help maintain the Fed funds rate within the FOMC's target of 25 to 50 basis points. Specifically, reverse- repo operations priced at an offering rate of 0.25 percent and term reverse-repo operations.

"…including: (1) overnight reverse repurchase operations (and reverse repurchase operations with maturities of more than one day when necessary to accommodate weekend, holiday, or similar trading conventions) at an offering rate of 0.25 percent, in amounts limited only by the value of Treasury securities held outright in the System Open Market Account that are available for such operations and by a per-counterparty limit of $30 billion per day; and (2) term reverse repurchase operations to the extent approved in the resolution on term RRP operations approved by the Committee at its March 17-18, 2015, meeting…."

These reverse repo-operations are expected to set an effective floor on the Fed funds rates, keeping it within the FOMC's targeted range.

Early evidence suggests the theory is working smoothly in practice. The Effective Fed funds rate was 0.35 percent at 8AM Eastern Time on Thursday and traded somewhat above that rate to 0.38 percent during the trading day.

Fed Funds Effective Rate Moves Into FOMC's Target Zone



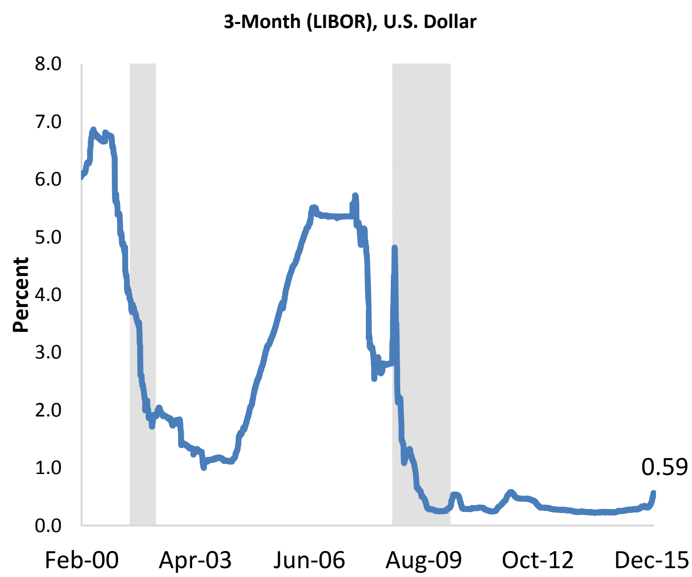
Source: Federal Reserve System

Importantly, the FOMC directed the Fed's trading desk in New York to keep rolling over maturing debt on the Fed's balance sheet, and the FOMC statement mentioned that the Fed will maintain the size of its securities portfolio "until normalization of the level of the federal funds rate is well under way". This probably means for at least another year- sometime in 2017.

Lastly, the FOMC voted to increase the discount rate by a quarter of a percentage point to 1.0 percent as requested by the Boards of Directors of the Federal Reserve Banks of Boston, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Kansas City, Dallas, and San Francisco.

Borrowing costs are already going up for business loans and credit cards. The three month Libor rate is trading around 59 basis points today, about 25 basis points higher than a month ago. The Prime Rate also increased on Wednesday to 3.50 percent from 3.25 percent. Many business loans are priced off of Libor and/or the bank Prime Rate.

Business Borrowing Costs On The Rise Due to Fed Action



Source: ICE Benchmark Administration Limited (IBA)/FRED

Wednesday's action is only the beginning of a Fed tightening cycle that will slowly lift U.S. borrowing costs and eventually consumer deposit rates, over the next several years. However, this process is expected to remain glacial by historical standards, and we expect only three additional quarter point interest rate moves in 2016. Probably two additional rate hikes before next year's Presidential election, and one at the December FOMC meeting just following the November election. Just as the U.S. economic recovery has been a slog, the Fed's return to interest rate normalcy will be a marathon.

Major Economic Indicators

	History								Forecast				Yr/Yr % chg or Annual Avg.			
Economic Data	**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.

	History								Forecast				Annual Average			
Financial Data	**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