U.S. Outlook

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Date	Indicator	For	Estimate	Consensus*	Previous Period
20-Mar-2017	Chicago Fed Nat Activity Index	Feb	NA	NA	-0.1
21-Mar-2017	Current Account Balance	4Q	-$128.2b	-$129.1b	-$113.0b
22-Mar-2017	FHFA House Price Index MoM	Jan	0.4%	NA	0.4%
22-Mar-2017	Existing Home Sales	Feb	5.54m	5.58m	5.69m
23-Mar-2017	Initial Jobless Claims	18-Mar	240K	NA	241K
23-Mar-2017	New Home Sales	Feb	550k	560k	555k
23-Mar-2017	Kansas City Fed Manufacturing Activity	Mar	15	NA	14
24-Mar-2017	Durable Goods Orders	Feb P	1.0%	1.2%	2.0%
24-Mar-2017	Durables Ex Transportation	Feb P	0.4%	0.5%	0.0%
24-Mar-2017	Markit US Manufacturing PMI	Mar P	54.8	NA	54.2

*Consensus from Bloomberg

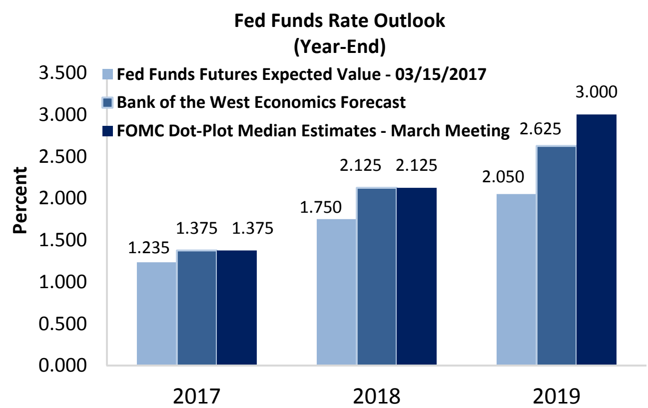
Interest Rate Normalization Is 'Hurry Up and Wait'

"Hurry up and wait" pretty well describes the state of monetary policy today as the Fed goes further down the path of interest-rate normalization. The Fed delivered its first quarter-point rate hike of the year this week, just three months after the last one, as was well-advertised ahead of time from Janet Yellen herself.

Ultimately the move became widely expected by the markets and economic analysts. Yet the full-court press toward a March rate hike was late in coming and not entirely obvious, given the evolution of incoming economic data. Indeed, fed funds futures were only putting about a 35% probability on a March rate hike prior to the strong hints coming from Fed officials in the final weeks before the March FOMC meeting. Instead, the market had penciled in the first rate hike of the year happening at the June FOMC meeting.

Even more strange, the Summary of Economic Projections (SEP) and fed funds dot-plot released along with the March FOMC statement did not make any significant changes to the outlook for economic growth, inflation, or interest-rate hikes since the December meeting. The FOMC median forecast is still anticipating three quarter-point rate hikes in 2017, 2018, and 2019.

FOMC Holds to Three-Rate-Hikes-a-Year Rate Path

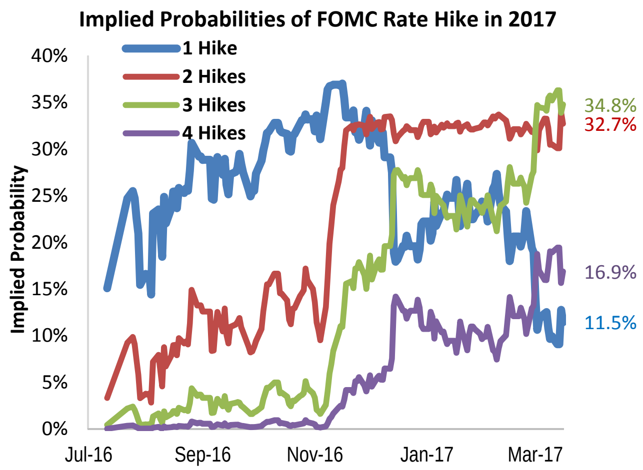


Source: Chicago Board of Trade; Federal Reserve; Bank of the West

So what gives? In my opinion the FOMC took the opportunity to fire a shot across the bow against rapidly tightening labor markets, rising consumer inflation, and stock market gains that some analysts find excessive given the current economic environment. For all those reasons, I understand the Fed's decision to act sooner rather than later.

However, I believe it would be a mistake to read anything beyond the FOMC's decision to hike interest rates this week. Some analysts have been starting to toy with the idea of a more aggressive Fed delivering four rate hikes this year. This remains a low-probability outcome in my opinion. We are sticking with our forecast of three quarter-point rate hikes this year, with the next one coming in September.

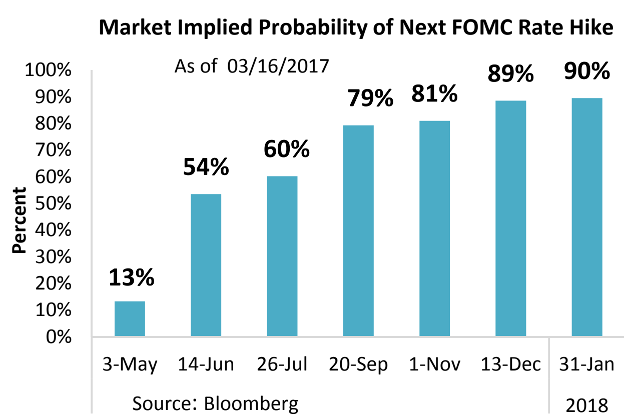
Four Rate Hikes in 2017 Still a Long Shot



Source: Bloomberg

With little upward migration in the dot-plot, inflation, or growth projections, we believe the market may have to wait a bit longer for the next move from the Fed. The fed funds futures markets are now projecting June as a good time for the next rate hike from the Fed, but we can find several reasons why the Fed might need to wait longer than that before taking the next step toward normalization.

When Is the Next Rate Hike? June, July, or September

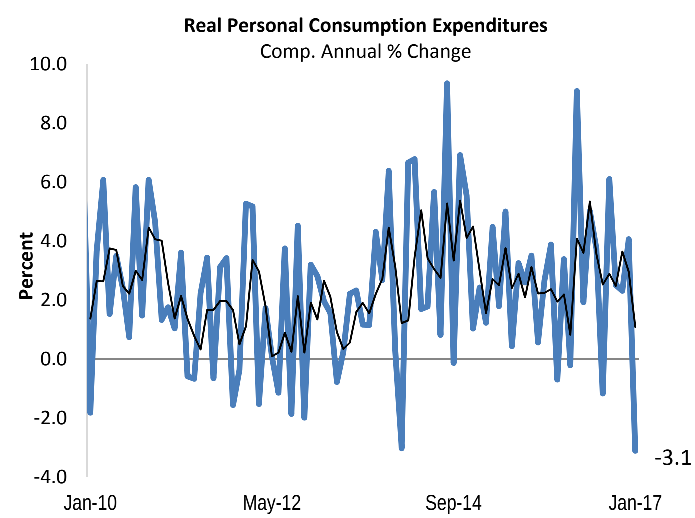


First, despite all the action in the labor market, prices, and sentiment measures, GDP growth in the first quarter is likely to be underwhelming. We are still forecasting GDP growth of 1.6% in the first quarter on an annualized basis, with real consumer spending cooling down to around a 2.0% growth pace. The Atlanta Fed's GDP Now indicator has slipped to an estimate of just 0.9% for Q1 GDP. Why put up more headwinds on growth if the economy is already moderating?

Second, the spike in first quarter inflation could fade in the second quarter. A big driver of the resurgence in consumer inflation has been the sharp increase in oil and energy prices from their 2016 lows. But recently, oil prices have been quietly slipping back below $50 per barrel on rising inventories. This reduces the urgency to head off an overshoot on consumer inflation targets and could give the FOMC more room to pause before the next hike.

Third, the cumulative impact of the three rate hikes the Fed has already delivered could start having a more visible impact on consumer spending and the demand for housing. Consumer spending appears to be slowing significantly in the first quarter, and 30-year mortgage rates have already risen almost a percentage point from their lows last fall. Recent pending home sales and building permits data may be showing the signs of strain already.

Consumer Spending Growth Slips in the First Quarter



Source: U.S. Bureau of Economic Analysis

For all these reasons, I think a go-slow approach to rate hikes is still the best medicine for the U.S. economy. Let the economy adjust to the rate hikes that have already occurred. If GDP growth and inflation reaccelerate over the summer as we expect, the Fed can comfortably move again in September.

Major Economic Indicators

Economic Data	History				Forecast								Yr/Yr % chg or Annual Avg.			
	2016.1	2016.2	2016.3	2016.4	2017.1	2017.2	2017.3	2017.4	2018.1	2018.2	2018.3	2018.4	2015	2016	2017	2018
Real GDP*	0.8	1.4	3.5	1.9	1.6	2.2	2.2	2.2	2.2	2.3	2.4	2.4	2.6	1.6	2.1	2.3
Personal Consumption Expenditures*	1.6	4.3	3.0	3.0	2.1	2.5	2.5	2.4	2.4	2.4	2.4	2.4	3.2	2.7	2.7	2.4
Non-residential Fixed Investment*	-3.4	1.0	1.4	1.3	5.9	4.1	2.9	2.8	2.7	3.4	3.9	4.4	2.1	-0.5	3.3	3.3
Private Housing Starts (000s units)	1,151	1,159	1,145	1,249	1,200	1,210	1,220	1,240	1,252	1,265	1,275	1,285	1,108	1,176	1,218	1,269
Vehicle Sales (mill. Units, annualized)	17.3	17.1	17.5	18.0	17.5	17.5	17.4	17.4	17.3	17.3	17.2	17.2	17.4	17.5	17.5	17.3
Industrial Production*	-1.7	-0.8	1.7	0.4	1.5	1.7	2.4	2.5	2.4	2.3	2.2	2.2	0.3	-0.9	1.4	2.3
Nonfarm Payroll Employment (mil.)	143.4	144.0	144.7	145.2	145.9	146.5	147.0	147.6	148.1	148.6	149.1	149.6	141.8	144.3	146.7	148.9
Unemployment rate	4.9	4.9	4.9	4.7	4.7	4.6	4.5	4.5	4.4	4.3	4.4	4.5	5.3	4.9	4.6	4.4
Consumer Price Index* (percent)	0.1	2.3	1.8	3.0	2.2	2.5	2.3	2.3	2.3	2.2	2.2	2.2	0.1	1.3	2.5	2.3
"Core" CPI* (percent)	2.5	2.1	2.1	2.0	2.5	2.0	2.1	2.1	2.2	2.2	2.2	2.3	1.8	2.2	2.2	2.2
PPI (finished goods)* (percent)	-3.9	3.0	1.7	3.6	0.4	3.0	2.7	2.5	2.4	2.1	2.0	2.1	-3.3	-1.0	2.2	2.4
Trade Weighted Dollar (Fed BOG, major)	93.2	89.5	90.3	93.3	94.5	95.9	97.0	96.7	97.2	97.8	97.2	97.0	90.9	91.6	96.0	97.3
Crude Oil Prices -WTI ($ per barrel)	33	45	45	49	52	51	52	52	53	53	54	55	50	43	52	54

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

Financial Data	History				Forecast								Annual Average			
	2016.1	2016.2	2016.3	2016.4	2017.1	2017.2	2017.3	2017.4	2018.1	2018.2	2018.3	2018.4	2015	2016	2017	2018
S & P 500	1,951	2,075	2,162	2,185									2,061	2,093		
Dow Jones Industrial Average	16,663	17,764	18,372	18,865									17,591	17,916		
Federal Funds Rate (effective)	0.36	0.37	0.39	0.45	0.71	0.88	0.96	1.21	1.46	1.71	1.88	2.13	0.13	0.39	0.94	1.79
Treasury-3 Month Bills (yield)	0.29	0.26	0.30	0.43	0.55	0.72	0.95	1.18	1.47	1.73	1.92	2.17	0.05	0.32	0.85	1.82
Treasury-2 Year Notes (yield)	0.84	0.77	0.73	1.01	1.23	1.36	1.56	1.75	1.99	2.26	2.40	2.66	0.69	0.84	1.48	2.33
Treasury-5 Year Notes (yield)	1.37	1.24	1.13	1.61	1.97	2.17	2.41	2.61	2.86	3.06	3.23	3.49	1.53	1.34	2.29	3.16
Treasury-10 Year Notes (yield)	1.91	1.75	1.56	2.14	2.53	2.64	2.87	3.05	3.30	3.50	3.67	3.93	2.14	1.84	2.77	3.60
Treasury-30 Year Notes (yield)	2.72	2.57	2.28	2.83	3.14	3.27	3.48	3.68	3.90	4.10	4.26	4.53	2.84	2.60	3.39	4.20
Prime Rate	3.50	3.50	3.50	3.55	3.75	3.89	4.10	4.35	4.60	4.85	5.00	5.25	3.26	3.51	4.02	4.93
Libor 3-Mo. U.S. Dollar	0.62	0.64	0.79	0.92	1.05	1.17	1.35	1.56	1.80	1.97	2.17	2.42	0.34	0.74	1.28	2.09
Mortgage-30 Year (yield)	3.74	3.59	3.45	3.84	4.20	4.31	4.50	4.70	4.90	5.10	5.39	5.65	3.85	3.66	4.43	5.26
BAA Corporate (yield)	5.30	4.66	4.26	4.64	4.80	4.94	5.24	5.49	5.85	6.01	6.20	6.45	5.00	4.71	5.12	6.13

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