U.S. Outlook

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Date	Indicator	For	Estimate	Consensus*	Previous Period
6-Mar-2017	Factory Orders	Jan	1.0%	0.9%	1.3%
7-Mar-2017	Trade Balance	Jan	-$46.7b	-$45.7b	-$44.3b
7-Mar-2017	Consumer Credit	Jan	$16.000b	$20.000b	$14.160b
8-Mar-2017	ADP Employment Change	Feb	190k	185k	246k
8-Mar-2017	Nonfarm Productivity	4Q F	1.4%	1.5%	1.3%
8-Mar-2017	Unit Labor Costs	4Q F	1.6%	1.5%	1.7%
8-Mar-2017	Wholesale Inventories MoM	Jan F	NA	NA	-0.1%
9-Mar-2017	Import Price Index MoM	Feb	0.3%	0.1%	0.4%
9-Mar-2017	Initial Jobless Claims	04-Mar	238K	NA	223K
9-Mar-2017	Household Change in Net Worth	4Q	NA	NA	$1593b
10-Mar-2017	Change in Nonfarm Payrolls	Feb	186k	180k	227k
10-Mar-2017	Change in Manufacturing Payrolls	Feb	10k	8k	5k
10-Mar-2017	Unemployment Rate	Feb	4.7%	4.7%	4.8%
10-Mar-2017	Average Hourly Earnings MoM	Feb	0.2%	0.2%	0.1%
10-Mar-2017	Average Weekly Hours All Employees	Feb	34.4	34.4	34.4

*Consensus from Bloomberg

Two Steps Forward, One Step Back

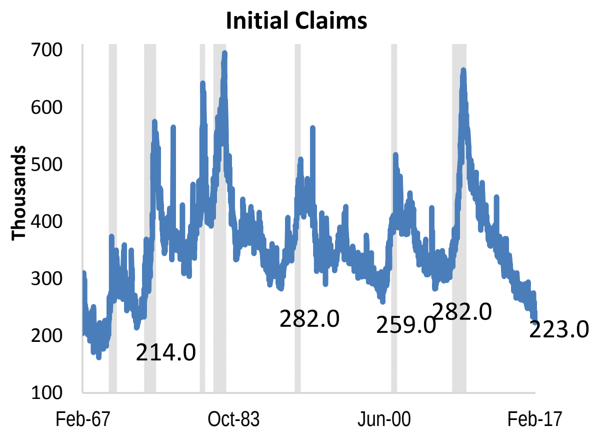
The chorus of calls from Fed officials that a rate hike is coming soon got a lot louder this week. Two dovish-leaning voting members William Dudley, New York Fed President, and Lael Brainard, Governor, both sounded an optimistic note on the economic outlook and a growing comfort in raising interest rates again soon. Brainard is widely considered one of the most dovish current voting members on the FOMC. She noted that another interest rate hike was "likely appropriate soon" and that the economy appears to be in transition. William Dudley said the case for tightening had become "a lot more compelling" and the "risks to the outlook are now starting to tilt to the upside."

John William, San Francisco Fed President and traditionally not much of a hawk or a dove on monetary policy, also mentioned in a speech this week that "an interest rate increase will receive serious consideration at the March FOMC meeting." Williams isn't currently a voting member of the FOMC, but his views probably reflect quite closely the evolving median view of the FOMC. Governor Powell, a centrist, followed up with an interview on Thursday that "the case for a rate increase for March has come together". This consistent and urgent messaging by FOMC voting members points pretty strongly toward a March rate increase.

What is prompting this newfound urgency to hike interest rates again? 1) Sharper-than-expected progress on the Fed's dual mandate of full employment and 2.0% inflation over the medium term. 2) Strong stock market gains that raise regulatory concerns about financial instability risks from accommodative monetary policy.

The labor market has tightened faster than many doves thought likely just a few months ago. Non-farm payrolls increased a strong +227K jobs in January, and we are forecasting another +186K job increase when the February payroll numbers are released next Friday. There is probably more upside risk in this forecast of February job growth than downside risk at the moment. Just looking at the more timely weekly initial jobless claims data, the claims dropped to an ultra-low 223K last week, near a 44-year low! No, that isn't a typo; weekly jobless claims haven't been this low since March 1973, and the labor market was a lot smaller in the 70s than it is now.

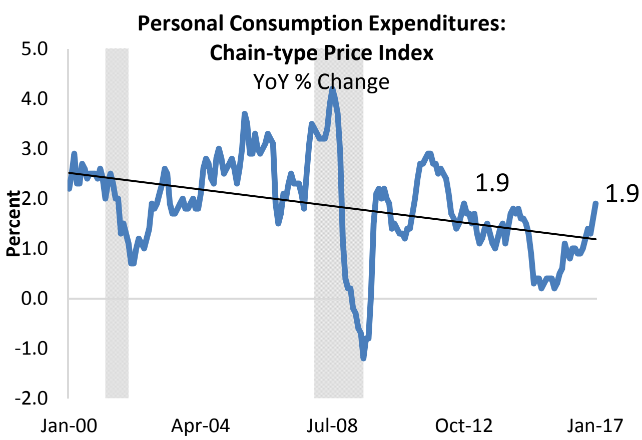
Best Labor Market in 50 Years?



Source: U.S. Employment and Training Administration

At the same time consumer inflation is taking off. The latest evidence: The PCE deflator, the Fed's favorite measure of consumer inflation, increased 1.9% from a year ago in January. It's the fastest 12-month increase in this consumer inflation measure since October 2012.

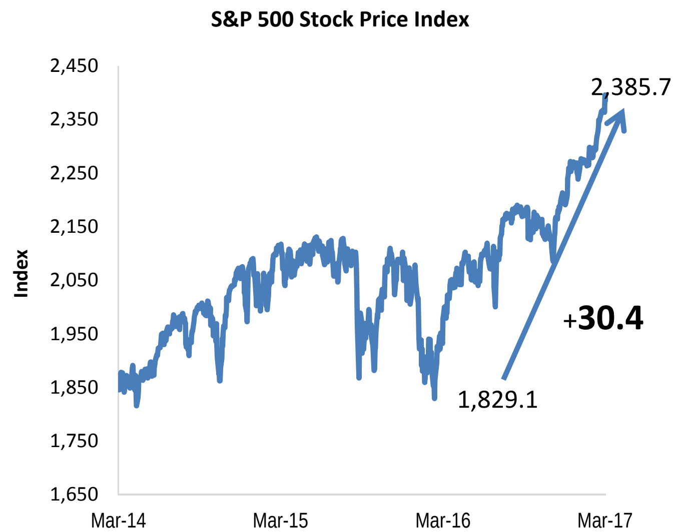
More Evidence of Emerging Consumer Inflation



Source: US. Bureau of Economic Analysis/FRED

Finally, stock returns since last March have been stellar. The S&P 500 has gained more than 30% in less than 12 months on GDP growth of less than 2%. While some of the gains are likely being driven by expectations of major corporate tax cuts and stronger economic growth ahead, there is also reason to assume ultra-low interest rates could be contributing to the equity market rally's vigor. Concern is growing this rapid increase in equity prices over such a short period of time could set the market up for another nasty correction down the road. For all these reasons, the FOMC doves are getting a lot more serious about a more regular cadence of quarter-point rate hikes this year.

Animal Spirits Carry Away the Stock Market



Source: Standard and Poor's

But will it be March? The market thinks so. Fed funds futures now place the probability of a March rate increase at around 90%. This jump in rate hike probabilities is due largely to the hawkish shift in FOMC member language. More is expected to be revealed around evolving FOMC thinking today as Fed Chair Yellen and Stanley Fischer share their thoughts on the economy. Market expectations for a rate hike in March could change on a dime if Yellen throws cold water on the idea of such a near-term rate increase.

Overall, I understand the more hawkish tilt in FOMC language of late, given the progress on the Fed's dual mandate and the ebullience in the stock market. Given recent comments from Fed officials, I put the probability of a March rate hike at around 70% today. However, when I look at the overall economy's performance, I don't see the urgency in acting in March versus May. There was actually a disappointing decline in real income and real consumer spending for January that caused us to significantly mark down our forecast for Q1 2017 GDP growth to 1.6% from 2.1%. If the Fed does choose to move in March, we would not expect another rate increase until 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	145.7	146.2	146.7	147.2	147.7	148.2	148.8	149.3	141.8	144.3	146.4	148.5
Unemployment rate	4.9	4.9	4.9	4.7	4.7	4.6	4.5	4.5	4.4	4.5	4.5	4.5	5.3	4.9	4.6	4.5
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	53	54	54	54	55	55	55	56	50	43	54	55

*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	0.63	0.79	0.96	1.21	1.46	1.71	1.88	2.13	0.13	0.39	0.90	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 .