

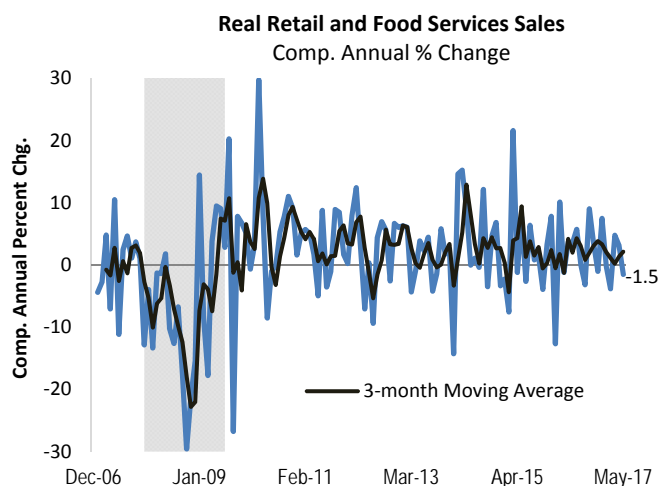
Date	Indicator	For	Estimate	Consensus*	Previous Period
20-Jun-2017	Current Account Balance	1Q	NA	-\$124.9b	-\$112.4b
21-Jun-2017	Existing Home Sales	May	5.53m	5.55m	5.57m
22-Jun-2017	Initial Jobless Claims	17-Jun	242K	NA	237K
22-Jun-2017	FHFA House Price Index MoM	Apr	0.4%	NA	0.6%
22-Jun-2017	Leading Index	May	0.4%	0.4%	0.3%
22-Jun-2017	Kansas City Fed Manufacturing Activity	Jun	10	NA	8
23-Jun-2017	Markit US Manufacturing PMI	Jun P	52.9	NA	52.7
23-Jun-2017	Markit US Services PMI	Jun P	53.5	NA	53.6
23-Jun-2017	Markit US Composite PMI	Jun P	NA	NA	53.6
23-Jun-2017	New Home Sales	May	598k	600k	569k

*Consensus from Bloomberg

Fed Gambles on Inflation's Return

Mixed messages continue to be thrown off by the U.S. economy, and this week we can add retail sales, housing starts and consumer inflation for May to the list of economic indicators that continue to disappoint analysts' expectations.

May Retail Sales Surprisingly Weak

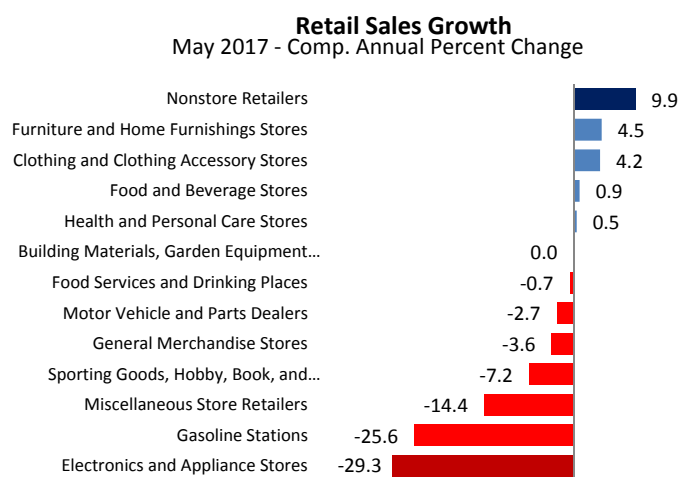


Source: Federal Reserve Bank of St. Louis

Retail sales in May dropped at a 1.5% annualized pace, and the three-month moving average has slumped to a 2.2% annualized rate before inflation. The three-month moving average on retail sales is running at about half the pace seen over the past 12 months. So a noticeable deterioration is evident. Most analysts are hanging their forecasts on a consumer spending rebound of some kind during the remainder of 2017. GDP growth forecasts are still at risk of further downgrades.

Sales were weak across the board last month, outside of monthly gains for non-store, furniture, and clothing retailers. Sales dropped the most for electronics, gasoline, miscellaneous, and sporting goods stores.

Consumers Checking Out?

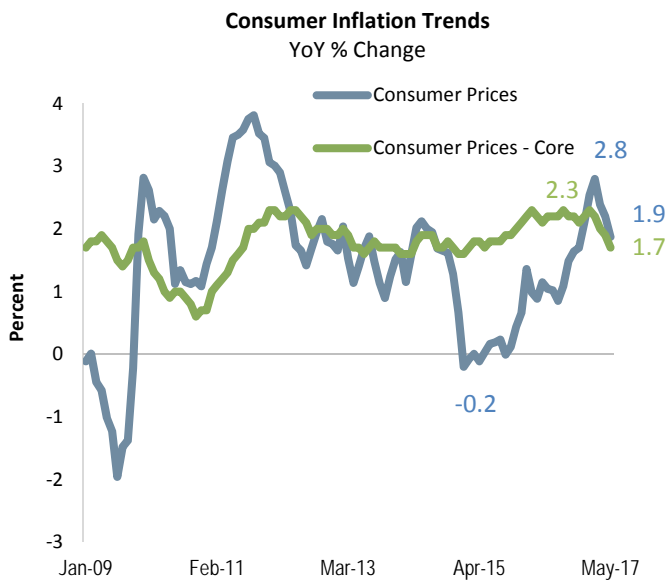


Source: US. Bureau of the Census

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Inflation, too, is showing signs of moderation after a sharp rebound in the first quarter. Core-CPI inflation peaked in January, and all-items consumer inflation peaked in February.

Consumer Inflation Drops Below 2.0% Again



Source: U.S. Bureau of Labor Statistics

Market inflation breakevens, in this case the 10-Year TIPS spread, has plunged by 33 basis points since the end of January and is once again well below 2.0% at 1.75%. This is a measure of bond investor inflation expectations over the next 10 years.

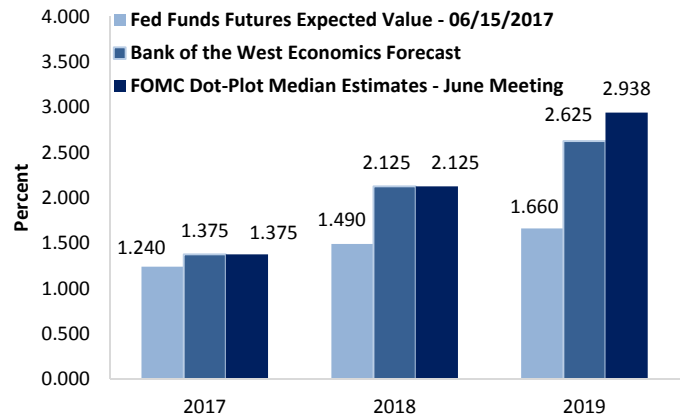
Yet the Fed continues to have confidence that the tightening labor market will push consumer inflation toward its 2.0% target by 2018, as long as trend GDP growth holds near its current rate. This will allow the FOMC to keep on hiking the fed funds rate one more time this year and three more times in 2018 and 2019, respectively.

Investors remain skeptical. The fed funds futures market reduced the probability of another rate hike in September in the wake of the June FOMC statement and weak data to just 16% from around 33.0% prior to the meeting. The probability of the next hike coming in December is below 50% today, at around 33%. For 2018 and 2019 the markets have penciled in only one additional rate hike a year.

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Markets Even More Skeptical of the FOMC's Rate Hike Path

Fed Funds Rate Outlook (Year-End)

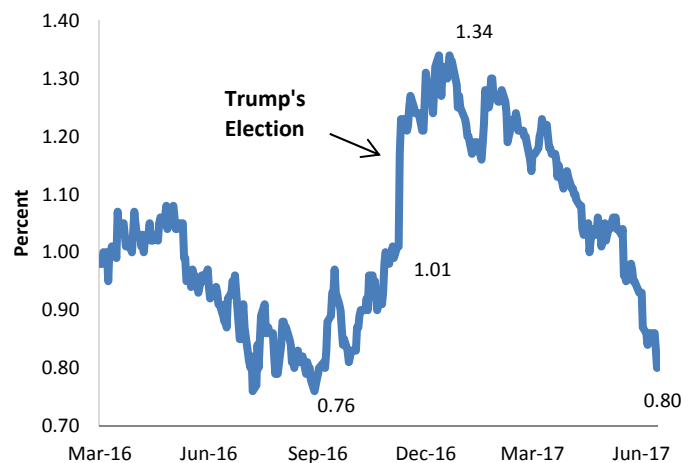


Source: Chicago Board of Trade; Federal Reserve; Bank of the West Economics

This combination of a somewhat less dovish Fed and diminishing growth and inflation expectations is compressing the Treasury yield to an extent that rivals the lows of the expansion.

The 2/10 Treasury Spread Nearing Expansion Lows

10-Year Minus 2-Year Treasury Bond Yield Spread



Source: Bloomberg; Bank of the West Economics

This is putting renewed pressure on the banks as net interest margins compress. Bank credit has already tightened for CRE and auto lending, while loan demand has weakened pretty much across all segments. Bottom line: The market appears to be calling the Fed's inflation bet. Will the Fed's next move be to double down or call?

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	2.1	1.2	2.9	2.3	2.0	1.9	2.1	2.0	2.2	2.6	1.6	2.2	2.1
Personal Consumption Expenditures*	1.6	4.3	3.0	3.5	0.6	3.2	2.7	2.4	2.2	2.2	2.1	2.1	3.2	2.7	2.6	2.4
Non-residential Fixed Investment*	-3.4	1.0	1.4	0.9	11.4	2.4	2.9	2.8	2.7	3.4	3.9	4.4	2.1	-0.5	4.2	3.2
Private Housing Starts (000s units)	1,153	1,158	1,150	1,248	1,242	1,198	1,230	1,256	1,263	1,265	1,275	1,285	1,108	1,177	1,232	1,272
Vehicle Sales (mill. Units, annualized)	17.3	17.1	17.5	18.0	17.2	16.8	17.1	17.0	16.9	16.8	16.8	16.7	17.4	17.5	17.0	16.8
Industrial Production*	-1.3	-0.7	0.8	0.7	1.8	6.0	1.8	1.9	2.2	2.3	2.2	2.2	0.3	-1.2	2.1	2.4
Nonfarm Payroll Employment (mil.)	143.4	144.0	144.7	145.2	145.7	146.2	146.7	147.1	147.6	148.0	148.5	148.9	141.8	144.3	146.4	148.2
Unemployment rate	4.9	4.9	4.9	4.7	4.7	4.3	4.2	4.1	4.1	4.0	4.1	4.2	5.3	4.9	4.3	4.1
Consumer Price Index* (percent)	0.1	2.3	1.8	3.0	3.1	0.5	2.1	2.1	2.1	2.1	2.1	2.1	0.1	1.3	2.2	2.0
"Core" CPI* (percent)	2.5	2.1	2.1	2.0	2.5	1.0	2.0	2.0	2.1	2.1	2.1	2.1	1.8	2.2	1.9	2.0
PPI (finished goods)* (percent)	-3.9	3.0	1.7	3.4	6.3	3.0	2.7	2.5	2.4	2.1	2.0	2.1	-3.3	-1.0	3.7	2.4
Trade Weighted Dollar (Fed BOG, major)	93.2	89.5	90.3	93.3	94.5	94.8	96.0	95.7	96.2	96.8	96.2	96.0	90.9	91.6	95.3	96.3
Crude Oil Prices -WTI (\$ per barrel)	33	45	45	49	52	49	50	50	51	51	52	53	50	43	50	52

*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	2,326								2,061	2,093		
Dow Jones Industrial Average	16,663	17,764	18,372	18,865	20,406								17,591	17,916		
Federal Funds Rate (effective)	0.36	0.37	0.39	0.45	0.70	0.94	1.13	1.21	1.46	1.71	1.96	2.13	0.13	0.39	0.99	1.81
Treasury-3 Month Bills (yield)	0.29	0.26	0.30	0.43	0.61	0.87	1.08	1.16	1.41	1.67	1.92	2.08	0.05	0.32	0.93	1.77
Treasury-2 Year Notes (yield)	0.84	0.77	0.73	1.01	1.24	1.28	1.51	1.70	1.94	2.21	2.45	2.61	0.69	0.84	1.43	2.30
Treasury-5 Year Notes (yield)	1.37	1.24	1.13	1.61	1.95	1.80	2.00	2.20	2.50	2.72	2.92	3.15	1.53	1.34	1.99	2.82
Treasury-10 Year Notes (yield)	1.91	1.75	1.56	2.14	2.45	2.23	2.45	2.65	2.92	3.12	3.36	3.55	2.14	1.84	2.45	3.24
Treasury-30 Year Notes (yield)	2.72	2.57	2.28	2.83	3.05	2.88	3.13	3.33	3.57	3.77	4.01	4.20	2.84	2.60	3.10	3.89
Prime Rate	3.50	3.50	3.50	3.55	3.80	4.06	4.32	4.50	4.60	4.85	5.00	5.25	3.26	3.51	4.17	4.93
Libor 3-Mo. U.S. Dollar	0.62	0.64	0.79	0.92	1.07	1.19	1.39	1.47	1.73	1.97	2.22	2.40	0.34	0.74	1.28	2.08
Mortgage-30 Year (yield)	3.74	3.59	3.45	3.84	4.17	4.07	4.28	4.48	4.75	4.95	5.19	5.40	3.85	3.66	4.25	5.07
BAA Corporate (yield)	5.30	4.66	4.26	4.64	4.66	4.57	4.80	5.10	5.43	5.65	5.88	6.07	5.00	4.71	4.78	5.76

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