

# OUTLOOK UNITED STATES

1<sup>st</sup> QUARTER 2017



# Unprecedented mix of optimism and uncertainty

The Fed in recognizing the underlying strength of the economy is all but certain raise rates in March and embark on a more aggressive tightening schedule in 2017

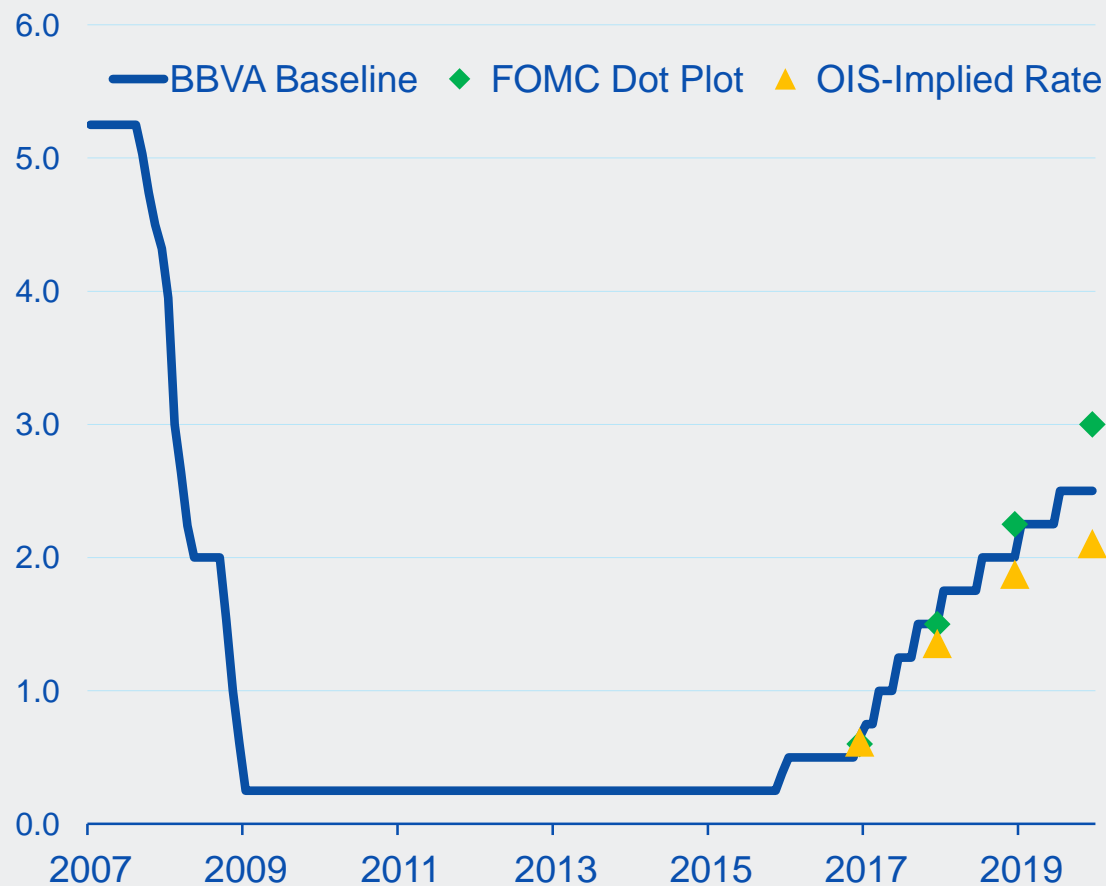
Full employment on horizon, as the unemployment rate trends at 4.8%. If improvements in labor market continue at current pace the approximately 1 million left out of the labor force should be absorbed by 2018.

Although business and consumer confidence are trending towards record highs, incoming data suggests U.S. to continue on a moderate growth path. Fiscal policy and deregulation tilt risk balance to the upside

# Monetary Policy

- **FOMC speeches align expectations around March increase**
- **Committees now views economy as “in transition” and the labor market as having “essentially met the employment portion” of the mandate**
- **In light of the communication, we are revising our baseline scenario**
  - i. Next 25bp increase in Mar ‘17
  - ii. From 2 to 3 hikes in ‘17
  - iii. Upward bias for ‘18
- **Abrupt shift in tone suggests probability of expedited tightening cycle has grown**

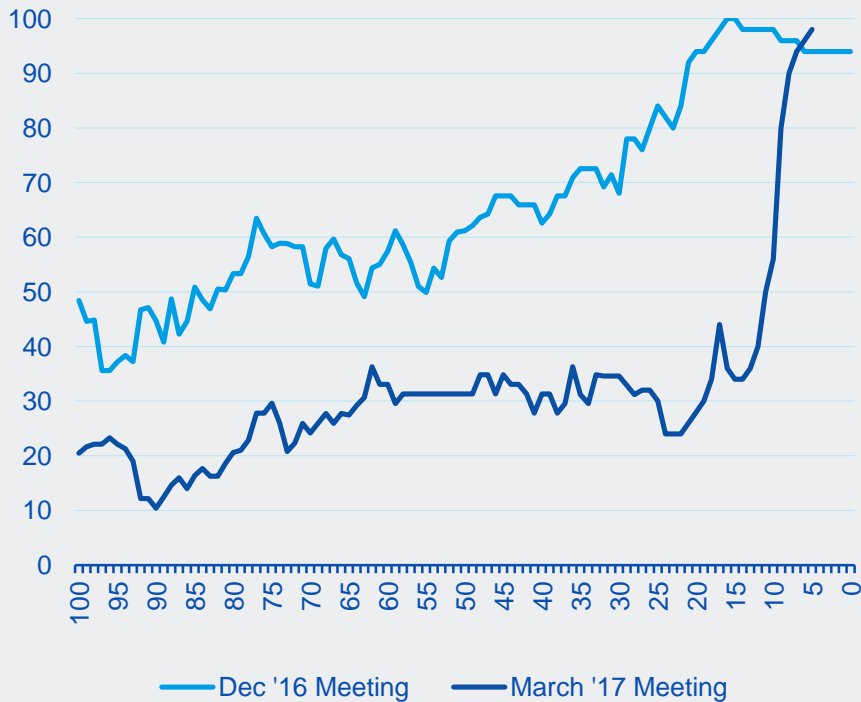
**Fed Funds Rate**  
%, upper limit



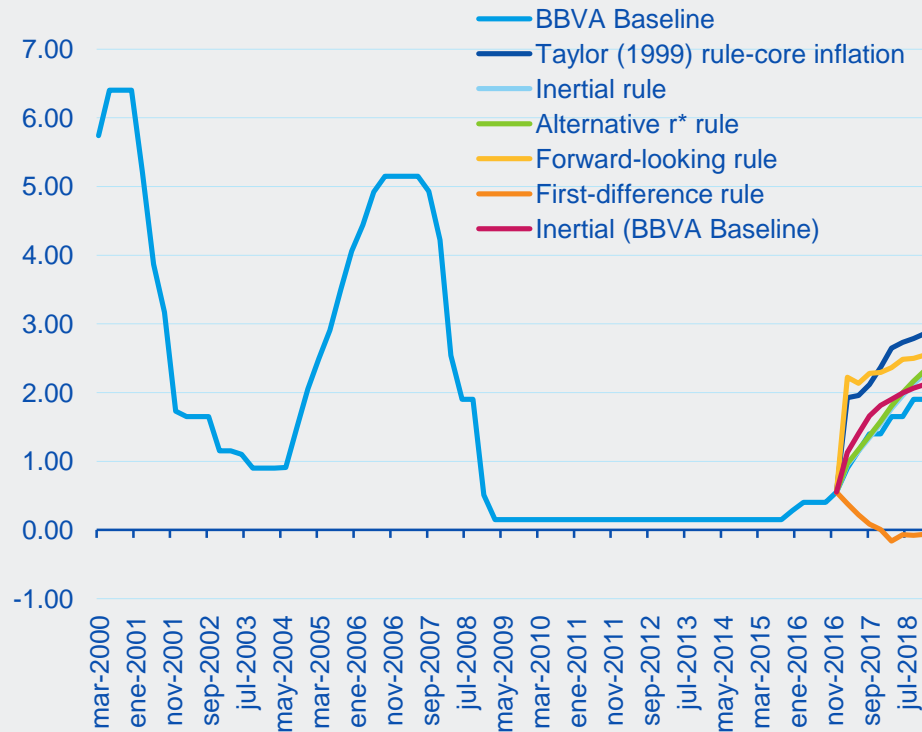
# Monetary policy: testing limits of guidance

## FOMC closer to rules-based strategy after cajoling markets

**Implied market probability of 25bp rate increase**  
%, days until meeting



**Fed Funds Rate Projections**  
%

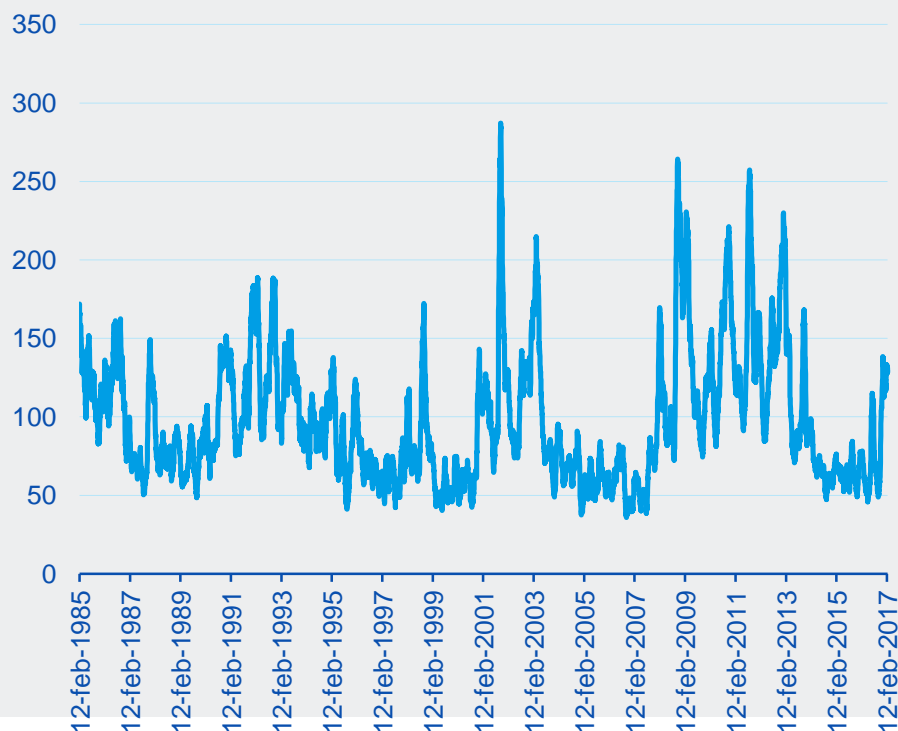


# Monetary policy: challenges and tradeoffs

Committee balancing policy uncertainty and progress towards objectives

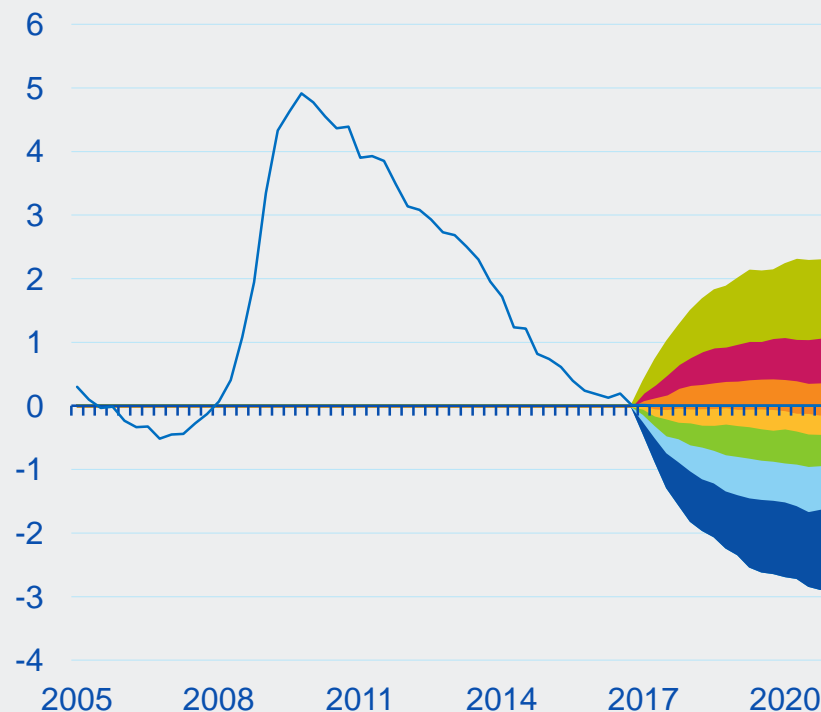
**Daily Policy Uncertainty**

100=average, 30-day moving average



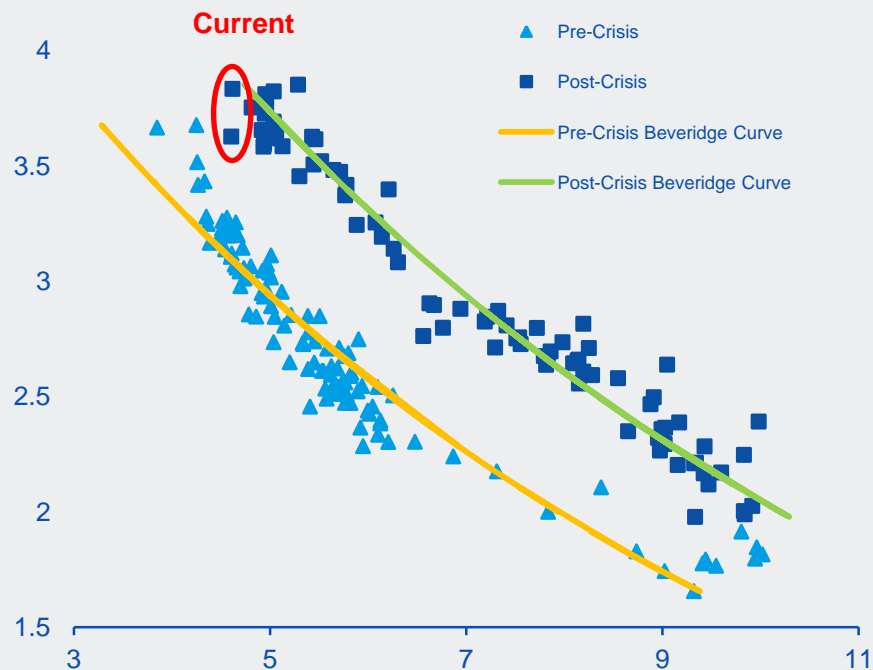
**Unemployment Rate Gap**

PP

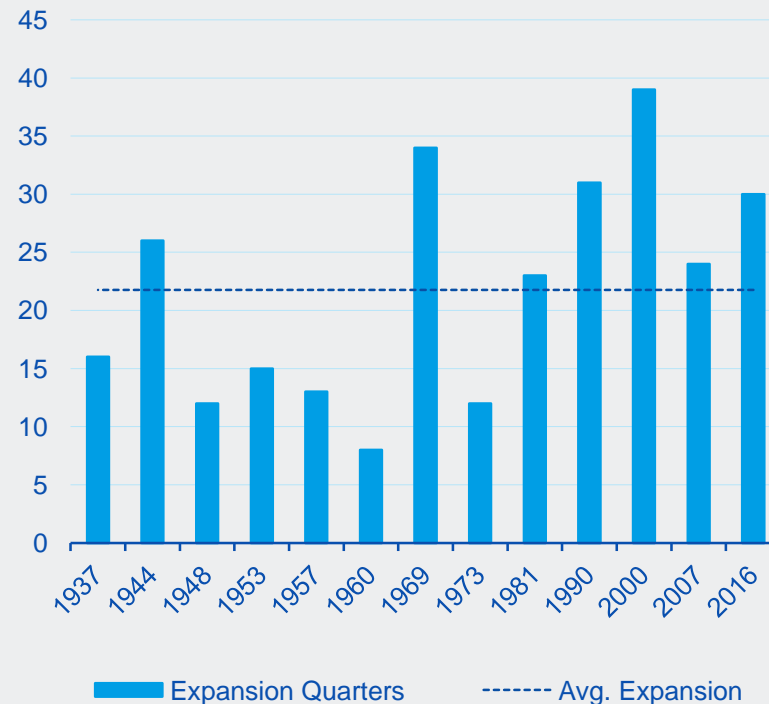


# Monetary policy: risks to delaying FOMC acknowledging strength of U.S. economy and age of cycle

**Beveridge Curve**  
%



**Age of Economic Cycles in U.S.**  
# Quarters



# FOMC: true believers

## February Statement & Minutes

- FOMC leaves rate unchanged at (0.5-0.75%)
- Minutes highlights committees apathy towards the current administrations policy proposals
- Committee prepared to respond to higher inflation, but continue to expect inflation to trend below 2% in medium-run
- February 22nd minutes: "Participants again **emphasized their considerable uncertainty about the prospects for changes in fiscal and other government policies as well as about the timing and magnitude of the net effects of such changes on economic activity.**"
- **Brainard Speech March 1, 2017:** "The **economy appears to be at a transition.** We are **closing in on full employment**, inflation is moving gradually toward our target, **foreign growth is on more solid footing**, and **risks to the outlook are as close to balanced** as they have been in some time."
- **Yellen Speech March 3, 2017:** "we realize that **waiting too long to scale back** some of our support could potentially **require us to raise rates rapidly** sometime down the road."

## What do we expect?

- 25bp increase at March meeting (implied market probability 98%)
- Upcoming meeting to set the stage for pace of tightening cycle, as committee could begin to move away from "gradual" pace towards a steeper path
- Fed to confront possibility of major undershooting of "longer-term normal" unemployment rate
- Committee to continue communication of reacting to fiscal stimulus, rather than preempting
- Discussion on natural real interest rates and expectations going forward
- FOMC to intensify discussion on balance sheet normalization strategy

## Projections

**Three rate hikes in 2017**

**Two additional hikes in 2018 (upward bias)**

**Elevated policy uncertainty**

**Fed Funds Rate:**

**Dec 17: 1.5**

**Dec 18: 2.0**

Fed

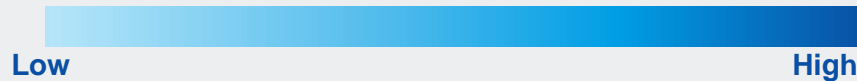
**Timeline Exit Strategy**



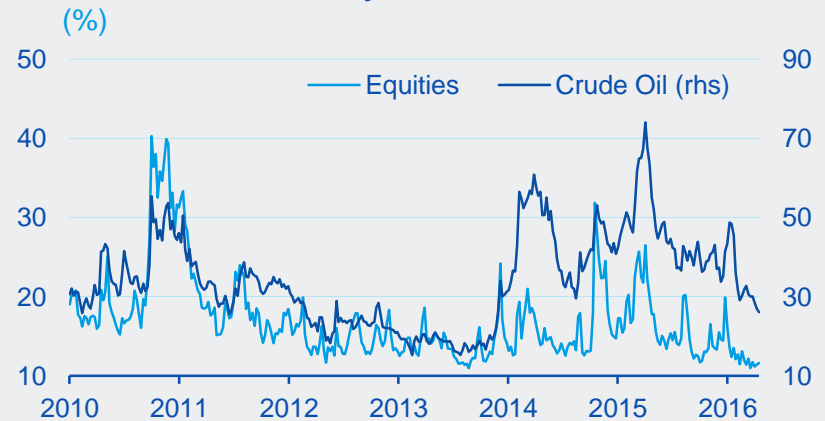
# Financial markets: risk-on sentiment

## Market Risk Indicators

		Current	1-month ago	3-months ago	6-months ago	1-year ago
Equities	S&P 500	[Light Blue]				
	Energy	[Dark Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
	Construction	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
	Consumer	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
	Banks	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
Bonds	3-Month Yield	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
	10-Year Yield	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Dark Blue]
	Corporate Spreads-AAA	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
	Corporate Spreads-BBB	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
Volatility	Market Volatility Index	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
	Crude Oil Volatility Index	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
Credit	C&I Loans	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
	Real Estate Loans	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
	CRE Loans	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
	Credit Card Loans	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
Sovereigns (CDS)	Brazil	[Light Blue]	[Light Blue]	[Dark Blue]	[Dark Blue]	[Dark Blue]
	Italy	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
	Turkey	[Light Blue]	[Dark Blue]	[Dark Blue]	[Dark Blue]	[Dark Blue]
	Venezuela	[Dark Blue]	[Dark Blue]	[Dark Blue]	[Dark Blue]	[Dark Blue]
	Argentina	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
Misc.	Financial Stress	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
	Busines Conditions Index	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]
	Exchange Rate	[Light Blue]	[Light Blue]	[Light Blue]	[Light Blue]	[Dark Blue]

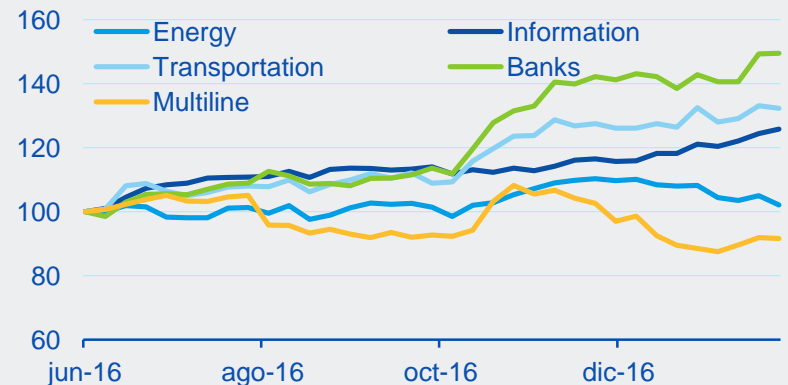


## CBOE Market Volatility



## SP Equity Indexes

(July-2016=100)

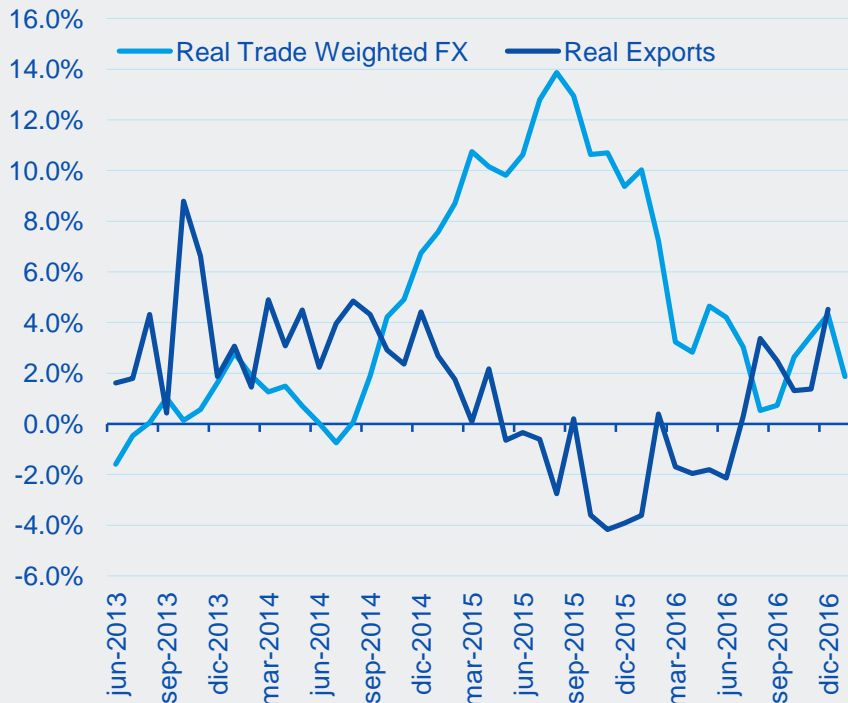




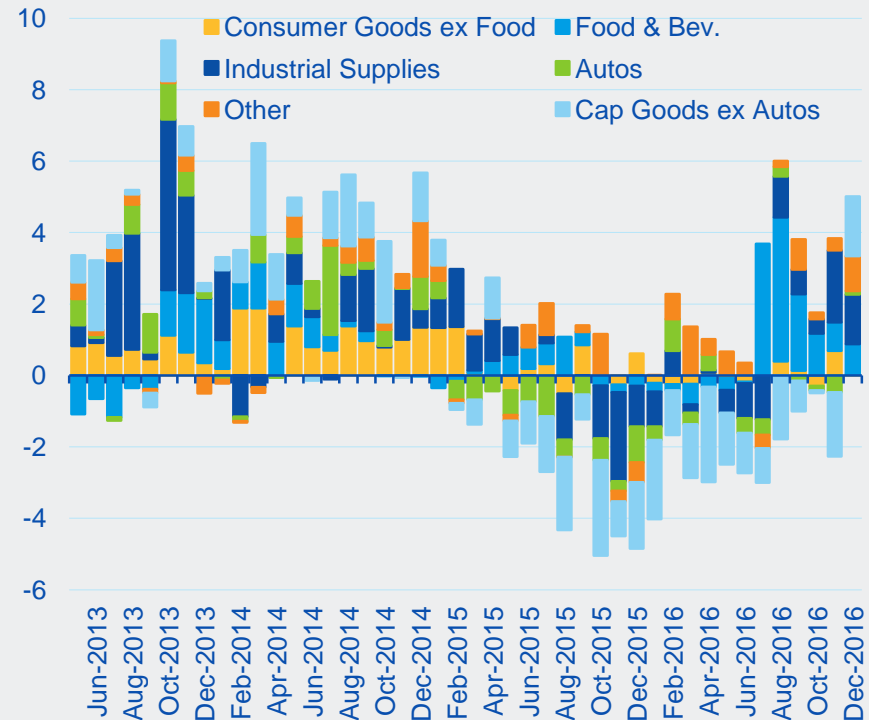
# Exchange rate pressures easing

Modest appreciation in dollar has not derailed recovery in exports

**Real Exchange Rates & Real Exports**  
(YoY % change)



**Real Exports**  
(contribution to YoY % change)



# U.S. economic dashboard

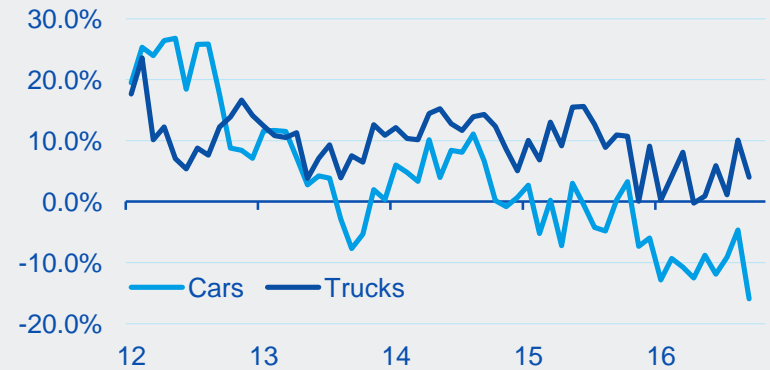
## U.S. Economic Heat Map

	Current	1-month ago	3-months ago	6-months ago	1-year ago
ISM Manufacturing	Dark Blue	Blue	Light Blue	Very Light Blue	White
ISM Nonmanufacturing	Dark Blue	Blue	Light Blue	Very Light Blue	White
Small Business Optimism	Dark Blue	Blue	Light Blue	Very Light Blue	White
Capacity Utilization	Dark Blue	Blue	Light Blue	Very Light Blue	White
Industrial Production	Dark Blue	Blue	Light Blue	Very Light Blue	White
Capital Goods New Orders	Dark Blue	Blue	Light Blue	Very Light Blue	White
Nondurable Goods Orders	Dark Blue	Blue	Light Blue	Very Light Blue	White
Retail Sales	Dark Blue	Blue	Light Blue	Very Light Blue	White
Unemployment Rate	Light Blue	Blue	Dark Blue	Very Dark Blue	Black
Private Nonfarm Payrolls	Dark Blue	Blue	Light Blue	Very Light Blue	White
Employment to Population	Dark Blue	Blue	Light Blue	Very Light Blue	White
Average Hourly Earnings	Dark Blue	Blue	Light Blue	Very Light Blue	White
Auto Sales	Dark Blue	Blue	Light Blue	Very Light Blue	White
Real Disposable Income	Dark Blue	Blue	Light Blue	Very Light Blue	White
Personal Savings Rate	Dark Blue	Blue	Light Blue	Very Light Blue	White
Retail Sales ex auto & gas	Dark Blue	Blue	Light Blue	Very Light Blue	White
Consumer Confidence	Dark Blue	Blue	Light Blue	Very Light Blue	White
Total Private Construction	Dark Blue	Blue	Light Blue	Very Light Blue	White
Month's Supply	Dark Blue	Blue	Light Blue	Very Light Blue	White
Housing Starts	Dark Blue	Blue	Light Blue	Very Light Blue	White
Home Prices	Dark Blue	Blue	Light Blue	Very Light Blue	White
New Home Sales	Dark Blue	Blue	Light Blue	Very Light Blue	White
Exports	Dark Blue	Blue	Light Blue	Very Light Blue	White
Policy Uncertainty	Dark Blue	Blue	Light Blue	Very Light Blue	White

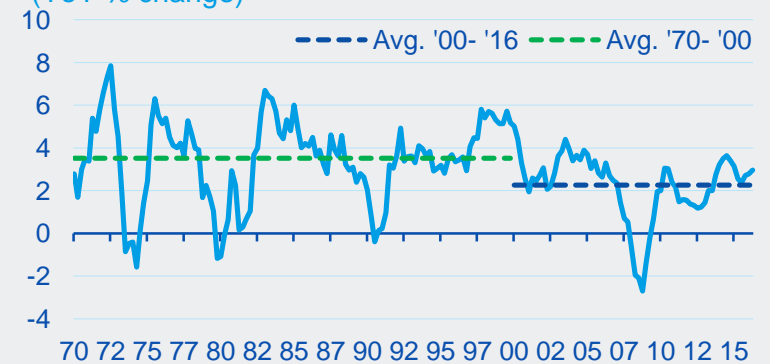
Deteriorating

Improving

## Domestic Auto Sales (YoY % change)



## Real PCE (YoY % change)



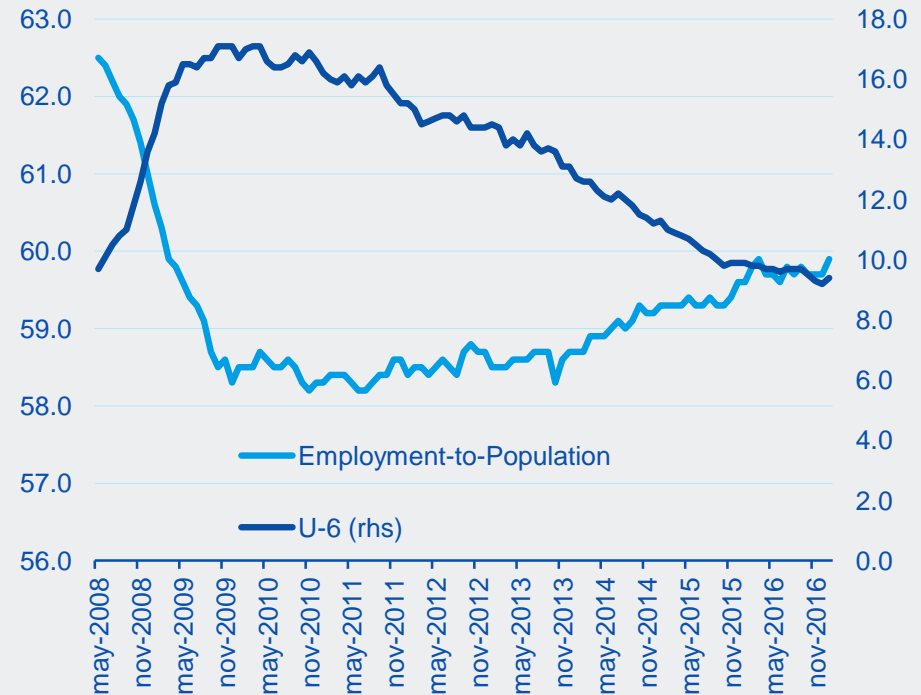
# Labor market overview

Gains in services continue to drive labor market improvements.

Industry Nonfarm Payrolls (%)



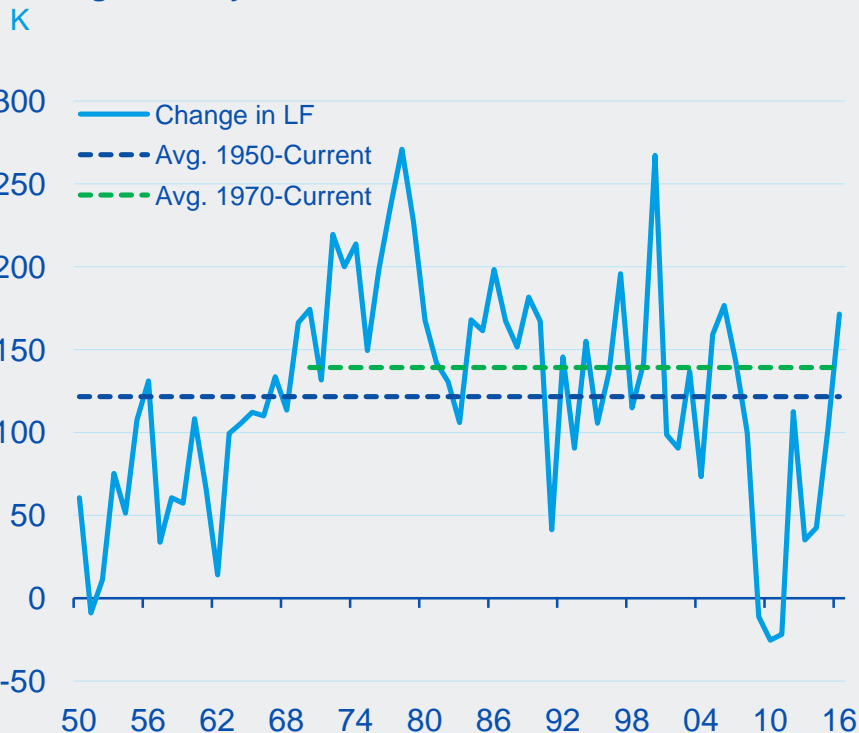
Labor Utilization & Employment-to-population (%)



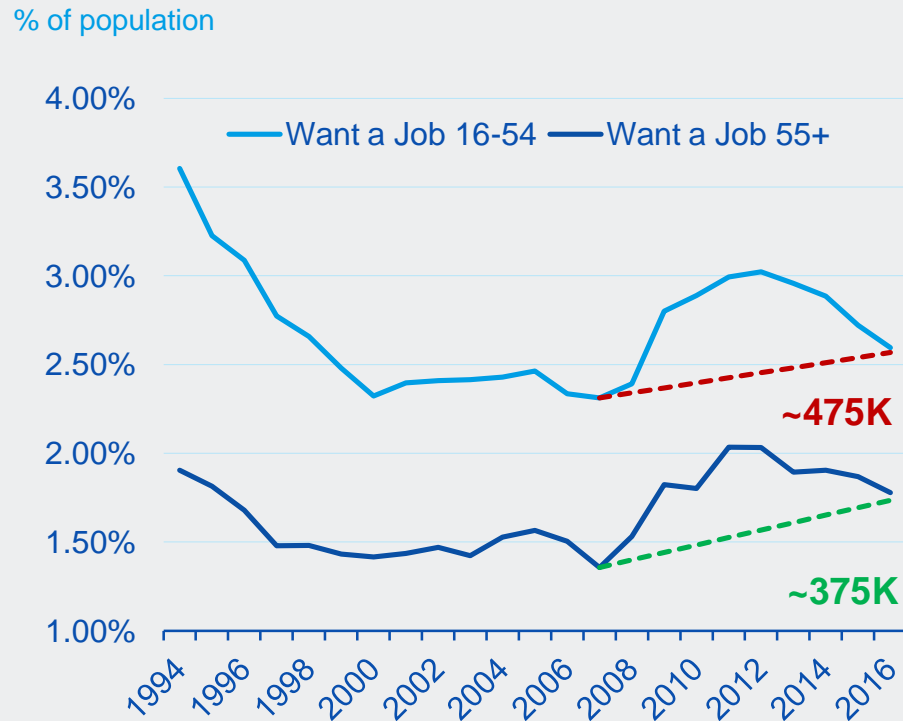
# Slack in labor market withdrawing

2 million people re-entered labor force in 2016. Remaining 750K-1.2m potential reentrants will likely be absorbed by 2018.

Average Monthly Labor Force Growth



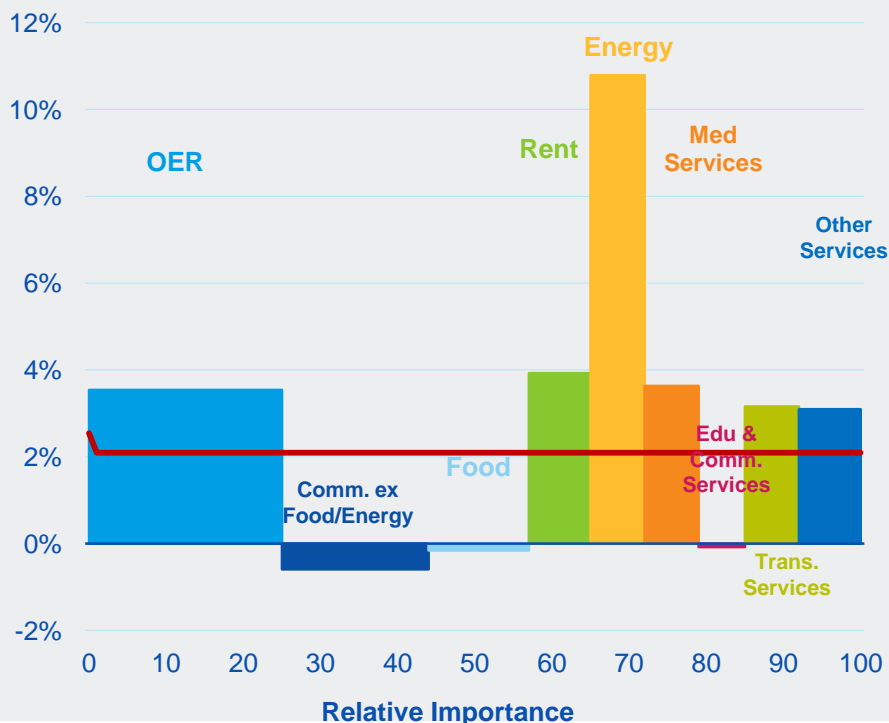
Persons Not In Labor Force, Want a Job



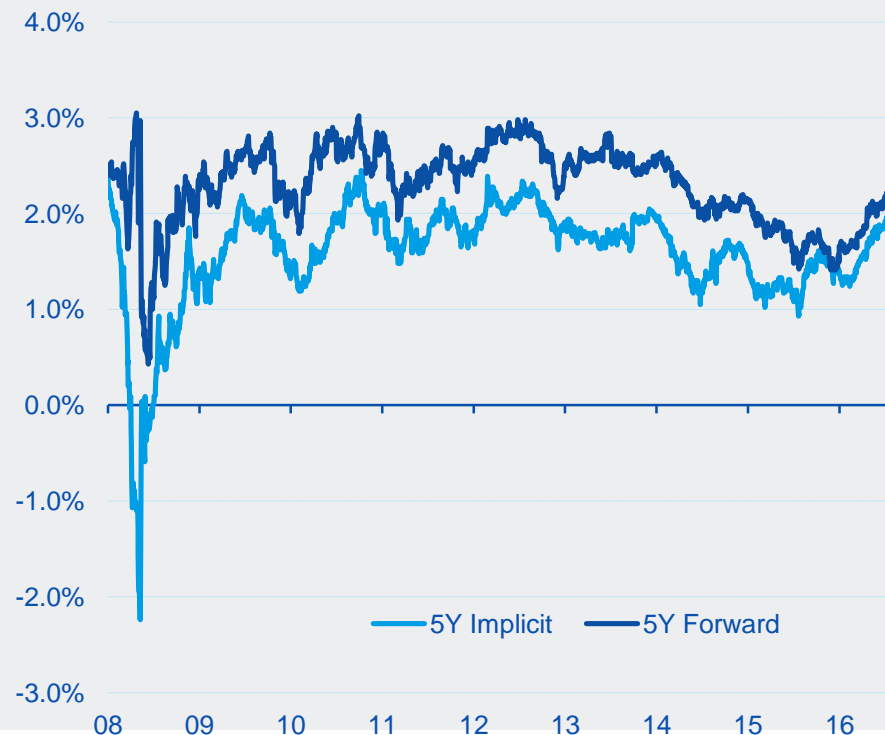
# Inflation: whites of eyes in crosshairs

Rising commodity prices, continued gains in core services and home prices, and possibility of higher deficits lift inflation expectations.

**Inflation Contributions**  
YoY %



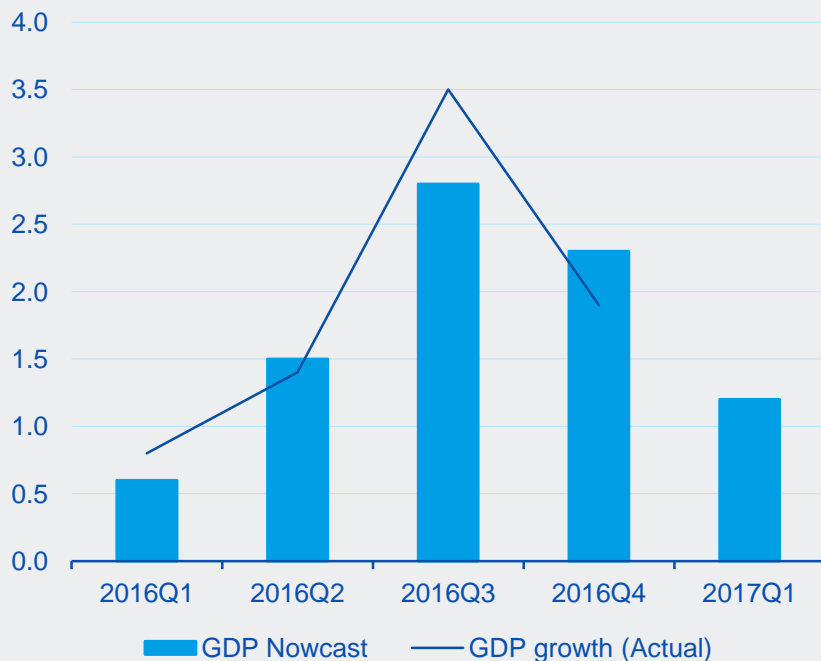
**Inflation Expectations**  
YoY %



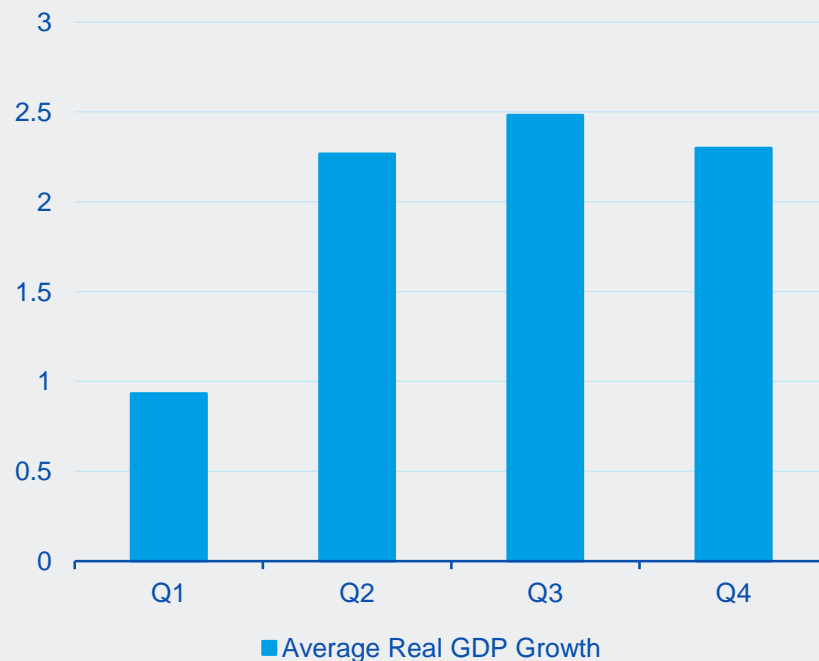
# GDP: seasonality & first quarter growth

Seasonal idiosyncrasies and incoming data suggests moderate growth in 1Q17.

**Real GDP Nowcast**  
QoQa %



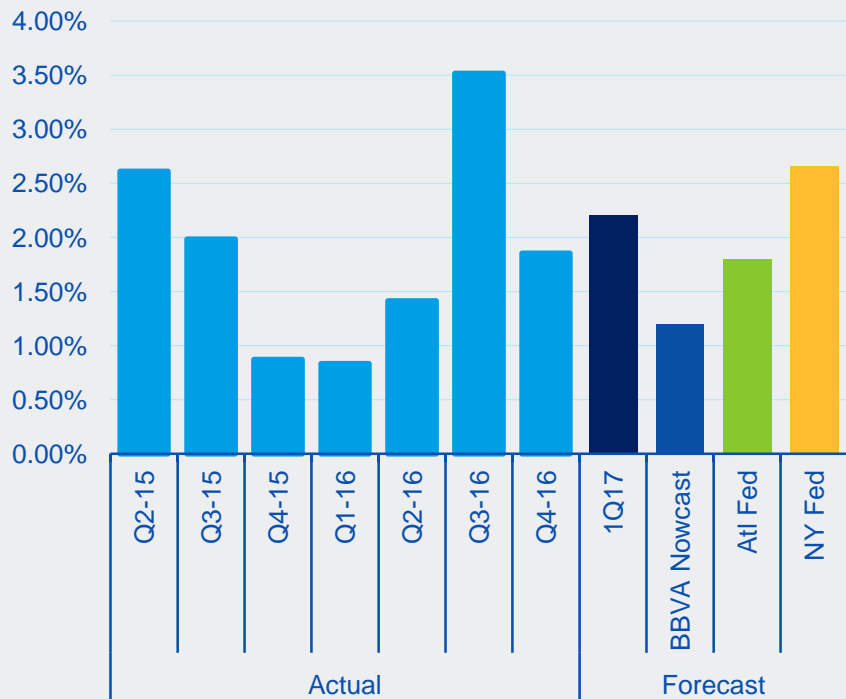
**Average Real GDP growth 2011-2016**  
QoQa %



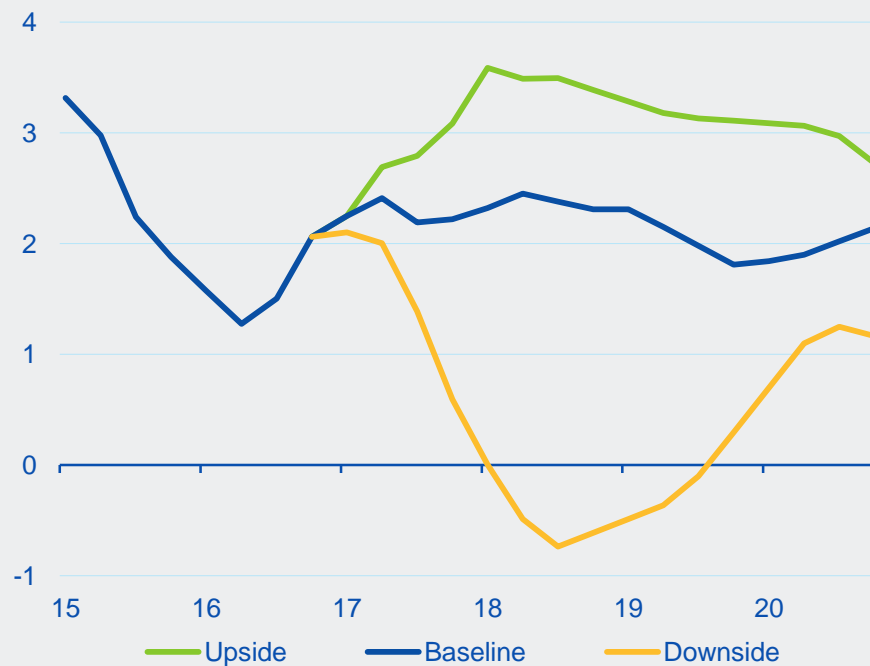
# Outlook & forecasts

Consumer and business optimism will buoy growth in short-run. Policy mix and timing will determine medium-run.

**U.S. Short-term Real GDP Forecast (SAAR %)**

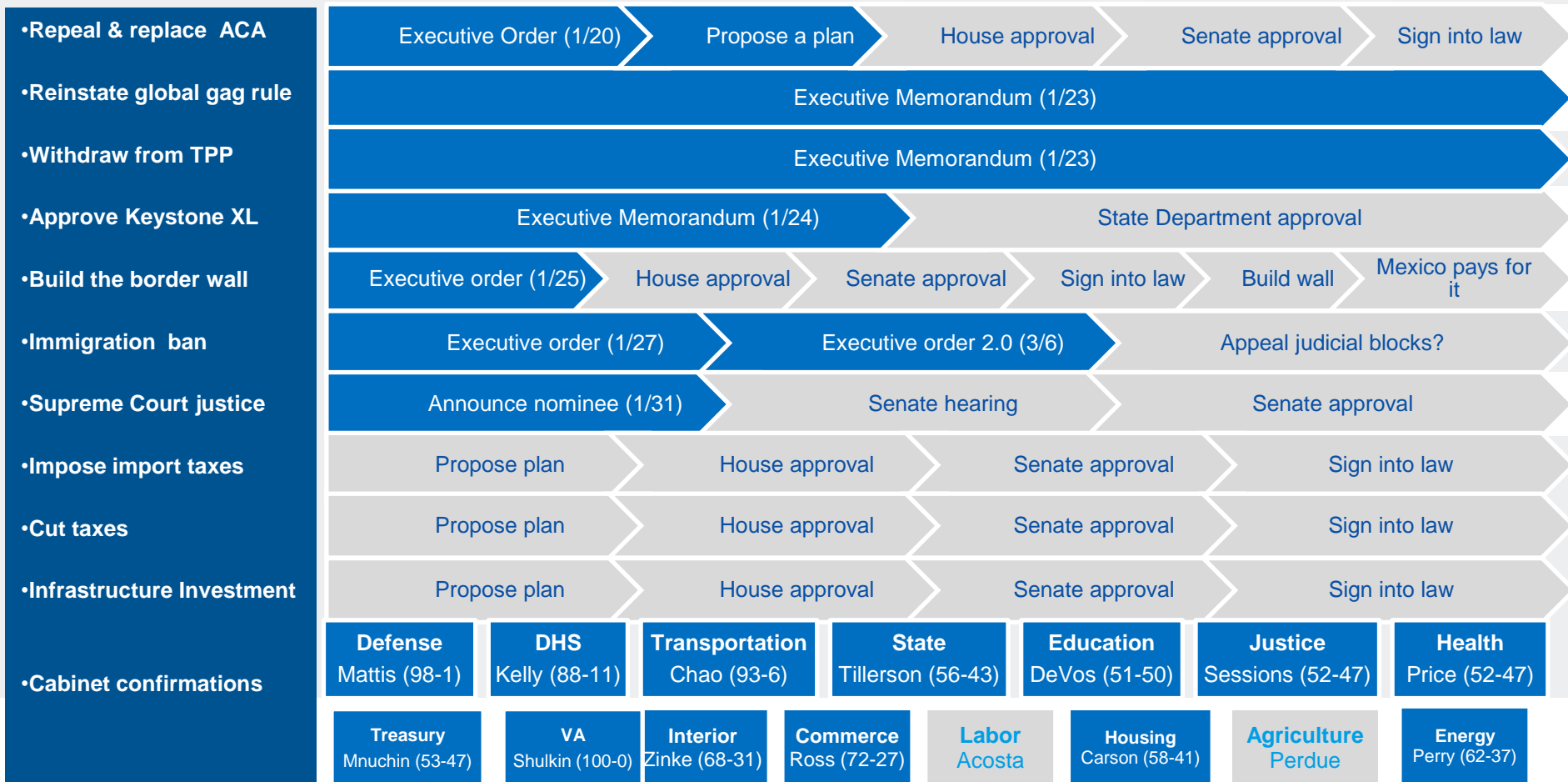


**U.S. Real GDP Growth Scenarios (% change)**



# New administration's agenda

Trump has made moves, but several proposals could face obstacles in Congress and judicial review





# Macro scenarios: risk balance leaning to upside

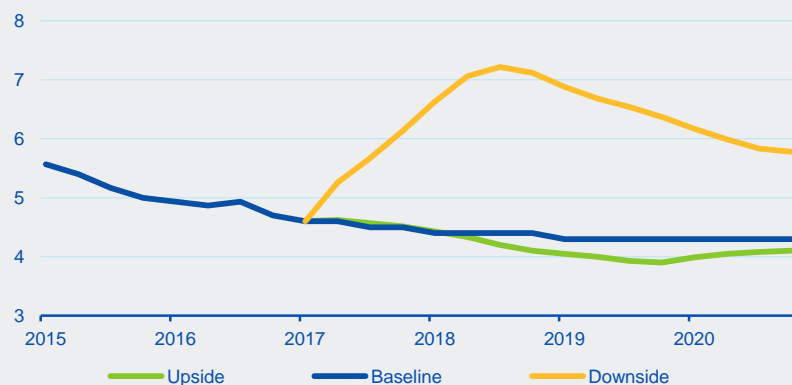
**10-year Yields**  
%, average



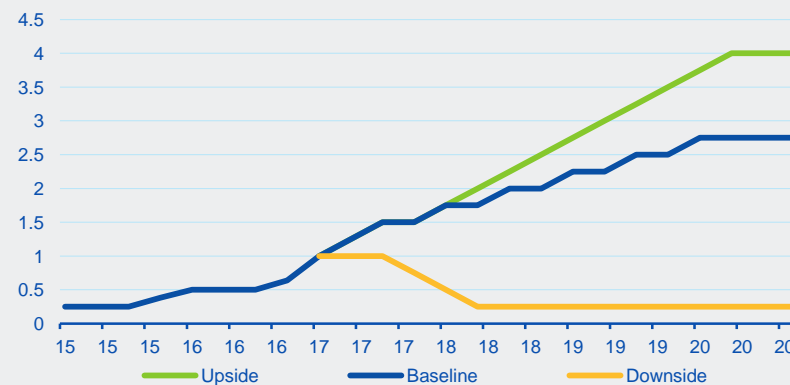
**Consumer Price Index**  
% change



**Unemployment Rate**  
%



**Fed Funds Target Rate**  
%



# Key macroeconomic indicators

Accelerating growth with slight overshooting of inflation target

## U.S. Macroeconomic Indicators

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Real GDP (% SAAR)	1.6	2.2	1.7	2.4	2.6	1.6	<b>2.3</b>	<b>2.4</b>	<b>2.1</b>	<b>2.0</b>
Real GDP (Contribution, pp)										
PCE	1.6	1.0	1.0	2.0	2.2	1.8	<b>1.8</b>	<b>1.5</b>	<b>1.4</b>	<b>1.5</b>
Gross Investment	0.7	1.5	1.0	0.7	0.8	-0.3	<b>0.5</b>	<b>1.0</b>	<b>0.9</b>	<b>0.7</b>
Non Residential	0.9	1.1	0.4	0.8	0.3	-0.1	<b>0.5</b>	<b>0.8</b>	<b>0.7</b>	<b>0.5</b>
Residential	0.0	0.3	0.3	0.1	0.4	0.2	<b>0.2</b>	<b>0.2</b>	<b>0.2</b>	<b>0.2</b>
Exports	0.9	0.5	0.5	0.6	0.0	0.0	<b>0.2</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>
Imports	-0.9	-0.4	-0.2	-0.7	-0.7	-0.2	<b>-0.4</b>	<b>-0.4</b>	<b>-0.5</b>	<b>-0.6</b>
Government	-0.7	-0.4	-0.6	-0.2	0.3	0.2	<b>0.1</b>	<b>0.1</b>	<b>0.1</b>	<b>0.0</b>
Unemployment Rate (% average)	8.9	8.1	7.4	6.2	5.3	4.9	<b>4.5</b>	<b>4.4</b>	<b>4.3</b>	<b>4.3</b>
Average Monthly Nonfarm Payroll (K)	132	186	184	213	241	207	<b>180</b>	<b>174</b>	<b>181</b>	<b>201</b>
CPI (YoY %)	3.1	2.1	1.5	1.6	0.1	1.3	<b>2.3</b>	<b>2.0</b>	<b>2.2</b>	<b>2.2</b>
Core CPI (YoY %)	1.7	2.1	1.8	1.7	1.8	2.2	<b>1.8</b>	<b>2.0</b>	<b>2.2</b>	<b>2.3</b>
Fiscal Balance (% GDP)	-8.4	-6.7	-4.1	-2.8	-2.4	<b>-3.2</b>	<b>-2.9</b>	<b>-2.4</b>	<b>-2.8</b>	<b>-3.1</b>
Current Account (bop, % GDP)	-3.0	-2.8	-2.2	-2.8	-2.4	<b>-2.8</b>	<b>-3.0</b>	<b>-3.1</b>	<b>-3.1</b>	<b>-3.2</b>
Fed Target Rate (% eop)	0.25	0.25	0.25	0.25	0.38	0.64	<b>1.5</b>	<b>2.0</b>	<b>2.5</b>	<b>2.75</b>
Core Logic National HPI (YoY %)	-2.9	4.0	9.8	6.9	5.4	5.6	<b>6.7</b>	<b>6.0</b>	<b>6.1</b>	<b>5.2</b>
10-Yr Treasury (% Yield, eop)	1.98	1.72	2.90	2.21	2.24	2.49	<b>2.68</b>	<b>2.96</b>	<b>3.25</b>	<b>3.35</b>
Brent Oil Prices (dps, average)	111.3	111.7	108.7	99.0	52.9	45.2	<b>57.0</b>	<b>58.7</b>	<b>59.6</b>	<b>59.6</b>

# OUTLOOK UNITED STATES

1<sup>st</sup> QUARTER 2017

