

## An Important Summer is Shaping Up in Washington

They say “Sell in May, and go away.” However, if you do that this year you are likely to miss a lot. The upcoming June 13/14 Federal Open Market Committee meeting is shaping up to be eventful. Also, the Trump Administration is sharpening its pencils and getting to work on tax reform. National Economic Council Director Gary Cohn expects to deliver a detailed plan to Congress by the end of summer. We also look forward to seeing more details of the President’s infrastructure plan in the coming months.

Despite the clunker of a jobs report for May, we expect the Federal Reserve to raise the fed funds rate range by 25 basis points for the second time this year on June 14. Most recent U.S. and global economic data have been positive, and the weaker-than-expected 138,000 jobs increase in May looks like a fluky number. As of June 6, the fed funds futures market views a June 14 rate hike as nearly a sure thing, with an implied probability of 96 percent. In addition to a rate hike on June 14, we expect to learn more about the FOMC’s thinking about future rate hikes, both for the remainder of 2017, and also for 2018. This could come in the form of forward guidance in the monetary policy announcement on June 14, added details from Janet Yellen’s post-FOMC meeting press conference, and from the updated “dot plot.”

In the near term, we expect the Fed to raise the fed funds rate one more time this year after June 14, for a total of three, 25 basis point rate hikes in 2017. The two leading candidates for the dates of the third rate hike this year are September 20 and December 13, which coincide with scheduled press conferences by the FOMC chairwoman Janet Yellen. There is an FOMC meeting over October 31/November 1, but that meeting does not coincide with a press conference. Given the need for the Fed to communicate clearly about interest rate policy and balance sheet reduction, the odds of a significant move coming from the Fed on November 1 appear to be low.

The timing of the third rate hike in 2017 will be coordinated with the Fed’s plans for balance sheet reduction. The Fed will likely take a pause from interest rate hikes to begin balance sheet reduction, which is expected to be equivalent to a marginal tightening of monetary policy. We look for the Fed to provide some more information about balance sheet reduction on June 14. So far, they have said that they would like to start reducing the pace of reinvestment of maturing assets this year (this will begin to reduce the size of the Fed’s balance sheet). They would also like to gradually ramp up caps on reinvestments until they reach their targets, and hold the caps constant until they reach the desired size of their balance sheet. We still need to know the start date of the reinvestment caps, the scale of the caps, the mechanisms of asset roll-off and the desired final size of the Fed’s balance sheet. Right now, we are expecting to see about a \$1.5 to \$2 trillion reduction in assets by the Fed, to occur over about a five-year period. We need further insight into the mechanisms for Treasury bond roll-off and for mortgage-backed-security roll-off in order to understand how new Fed policy will impact financial markets and bank financial flows by the end of this year.

The Trump Administration may begin to fill some of the vacant seats on the Board of Governors this summer. Janet Yellen appears to be heading toward retirement next February. Her replacement may be vetted this fall.

### U.S. Economic Outlook, Summary

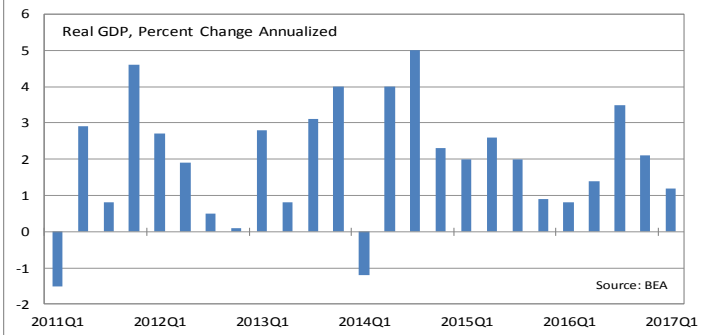
	4Q'16a	1Q'17a	2Q'17f	3Q'17f	4Q'17f	1Q'18f	2Q'18f	3Q'18f	2016a	2017f	2018f
Real GDP (Percent Change Annualized)	2.1	1.2	2.8	2.6	3.0	2.5	2.8	2.5	1.6	2.2	2.7
CPI (Percent Change Year-over-Year)	1.8	2.6	2.4	2.4	2.1	1.7	1.9	1.9	1.3	2.3	1.9
Payroll Jobs (Average Monthly Diff., Ths.)	169.9	181.8	141.7	176.3	171.5	172.9	172.3	167.2	194.3	167.8	169.1
Unemployment Rate (Percent)	4.7	4.7	4.4	4.3	4.3	4.2	4.1	4.1	4.9	4.4	4.1
Federal Funds Rate (Effective)	0.45	0.70	0.94	1.17	1.38	1.42	1.63	1.82	0.40	1.05	1.70
10-Yr. Treasury Rate	2.13	2.44	2.25	2.29	2.59	2.71	2.94	3.15	1.84	2.39	3.02

**a = actual f = forecast**

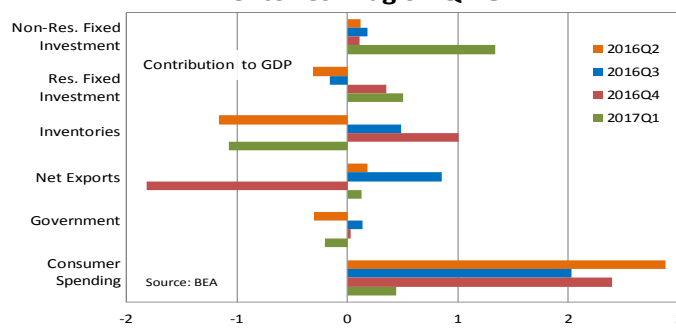
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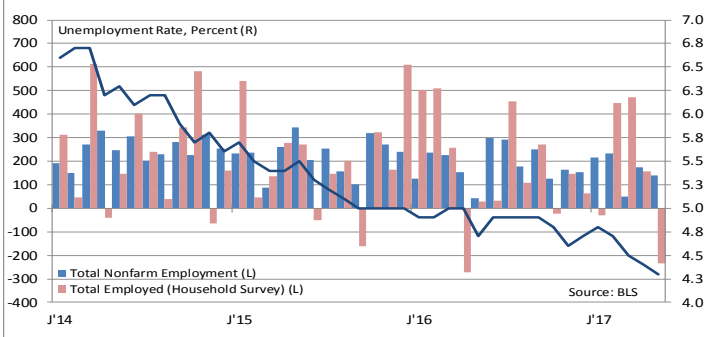
**Q1 GDP Growth Revised Up to 1.2%**



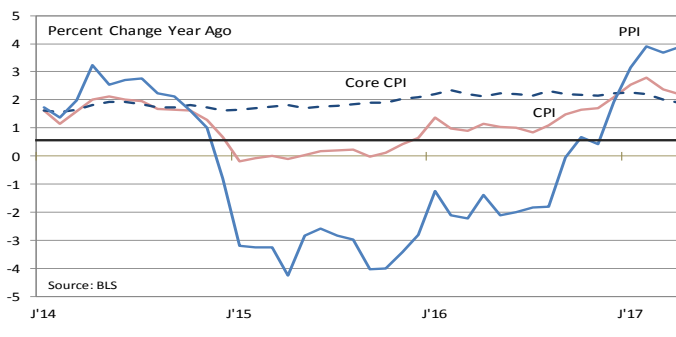
**Weak Consumer Spending and Dip in Inventories Drag on Q1 GDP**



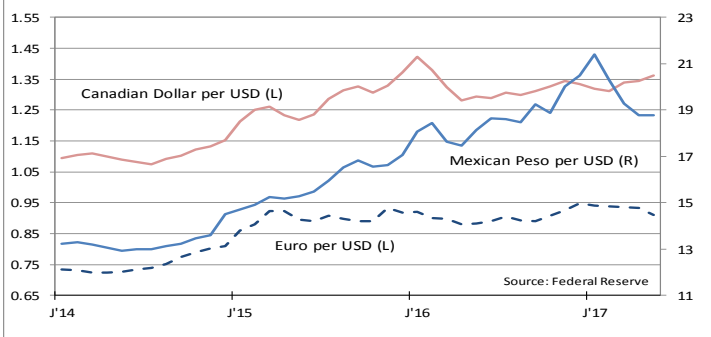
**Unemployment Rate Sinks to 4.3% in May**



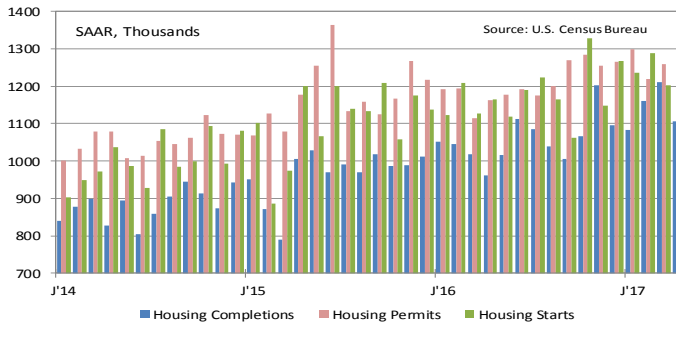
**CPI Eases as PPI Rises**



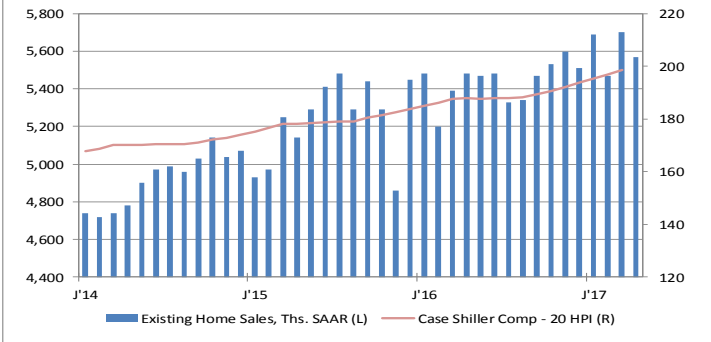
**Dollar Stable in May**



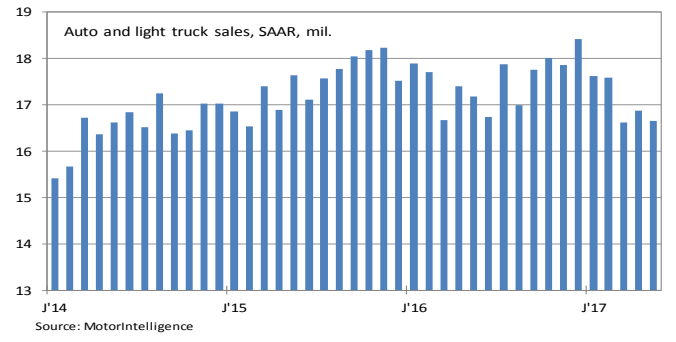
**Residential Construction Slows in April**



**Existing Home Sales Decline in April**



**May Auto Sales Ease to 16.7 mln**



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	4Q'16a	1Q'17a	2Q'17f	3Q'17f	4Q'17f	1Q'18f	2Q'18f	3Q'18f	2016a	2017f	2018f
<b>Output</b>											
Nominal GDP (Billions \$)	18869	19028	19255	19471	19706	19925	20163	20388	18569	19365	20272
<b>Percent Change Annualized</b>	<b>4.2</b>	<b>3.4</b>	<b>4.9</b>	<b>4.6</b>	<b>4.9</b>	<b>4.5</b>	<b>4.9</b>	<b>4.5</b>	<b>3.0</b>	<b>4.3</b>	<b>4.7</b>
Real GDP (Chained 2009 Billions \$)	16813	16862	16980	17090	17215	17323	17444	17553	16662	17036	17495
<b>Percent Change Annualized</b>	<b>2.1</b>	<b>1.2</b>	<b>2.8</b>	<b>2.6</b>	<b>3.0</b>	<b>2.5</b>	<b>2.8</b>	<b>2.5</b>	<b>1.6</b>	<b>2.2</b>	<b>2.7</b>
Pers. Consumption Expenditures	11670	11689	11739	11796	11854	11914	11981	12040	11522	11769	12009
<b>Percent Change Annualized</b>	<b>3.5</b>	<b>0.6</b>	<b>1.7</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>2.3</b>	<b>2.0</b>	<b>2.7</b>	<b>2.1</b>	<b>2.0</b>
Nonresidential Fixed Investment	2197	2257	2286	2315	2346	2374	2402	2430	2189	2301	2416
<b>Percent Change Annualized</b>	<b>0.9</b>	<b>11.4</b>	<b>5.2</b>	<b>5.2</b>	<b>5.4</b>	<b>4.9</b>	<b>4.8</b>	<b>4.7</b>	<b>-0.5</b>	<b>5.1</b>	<b>5.0</b>
Residential Investment	596	616	623	630	638	646	654	662	592	627	658
<b>Percent Change Annualized</b>	<b>9.6</b>	<b>13.7</b>	<b>5.2</b>	<b>4.1</b>	<b>5.4</b>	<b>5.1</b>	<b>5.1</b>	<b>4.9</b>	<b>4.9</b>	<b>5.9</b>	<b>5.0</b>
Change in Private Inventories	50	4	33	48	62	62	62	62	22	37	62
Net Exports	-605	-600	-611	-621	-619	-622	-620	-621	-563	-613	-622
Government Expenditures	2908	2899	2913	2924	2937	2952	2967	2982	2907	2918	2975
<b>Percent Change Annualized</b>	<b>0.2</b>	<b>-1.1</b>	<b>1.9</b>	<b>1.5</b>	<b>1.8</b>	<b>2.1</b>	<b>2.1</b>	<b>2.1</b>	<b>0.8</b>	<b>0.4</b>	<b>1.9</b>
Industrial Prod. Index (2007=100)	103.3	103.8	104.9	105.2	105.2	105.1	105.0	105.0	103.1	104.8	105.0
<b>Percent Change Annualized</b>	<b>0.7</b>	<b>1.8</b>	<b>4.3</b>	<b>1.5</b>	<b>-0.3</b>	<b>-0.4</b>	<b>-0.2</b>	<b>0.1</b>	<b>-1.2</b>	<b>1.6</b>	<b>0.3</b>
Capacity Utilization (Percent)	75.8	75.9	77.0	77.3	77.2	77.0	76.9	76.8	75.7	76.8	76.9
<b>Prices</b>											
CPI (1982-84=100)	242.2	244.1	245.0	246.1	247.3	248.3	249.6	250.8	240.0	245.6	250.2
<b>Percent Change Annualized</b>	<b>3.0</b>	<b>3.1</b>	<b>1.5</b>	<b>1.8</b>	<b>2.0</b>	<b>1.7</b>	<b>2.0</b>	<b>2.0</b>	<b>1.3</b>	<b>2.3</b>	<b>1.9</b>
PCE Price Index (2009=100)	111.5	112.2	112.5	113.0	113.5	114.0	114.6	115.1	110.7	112.8	114.9
<b>Percent Change Annualized</b>	<b>2.0</b>	<b>2.4</b>	<b>1.2</b>	<b>1.8</b>	<b>1.9</b>	<b>1.7</b>	<b>2.0</b>	<b>2.0</b>	<b>1.1</b>	<b>1.9</b>	<b>1.8</b>
GDP Price Index (2009=100)	112.2	112.9	113.4	114.0	114.5	115.1	115.7	116.3	111.5	113.7	116.0
<b>Percent Change Annualized</b>	<b>2.1</b>	<b>2.2</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>	<b>1.3</b>	<b>2.0</b>	<b>2.0</b>
Producer Price Index, Finished Goods	193.8	196.8	197.6	198.5	199.5	200.3	201.3	202.3	191.9	198.1	201.8
<b>Percent Change Annualized</b>	<b>3.4</b>	<b>6.3</b>	<b>1.6</b>	<b>1.8</b>	<b>2.0</b>	<b>1.7</b>	<b>2.0</b>	<b>2.0</b>	<b>-1.0</b>	<b>3.2</b>	<b>1.9</b>
Crude Oil, WTI (\$/barrel)	49.2	50.0	51.0	53.0	55.0	55.0	55.0	55.0	43.1	52.3	55.0
<b>Labor Markets</b>											
Payroll Jobs (Average Monthly Diff., Ths.)	169.9	181.8	141.7	176.3	171.5	172.9	172.3	167.2	194.3	167.8	169.1
Unemployment Rate (Percent)	4.7	4.7	4.4	4.3	4.3	4.2	4.1	4.1	4.9	4.4	4.1
Average Weekly Hours, Prod. Works.	33.6	33.6	33.6	33.6	33.6	33.5	33.5	33.5	33.6	33.6	33.5
Population (Millions)	324.4	325.1	325.8	326.4	327.1	327.7	328.4	329.0	323.5	326.1	328.7
<b>Percent Change Annualized</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.7</b>	<b>0.8</b>	<b>0.8</b>
<b>Personal Income</b>											
Average Hourly Earnings (\$)	21.75	21.86	21.99	22.12	22.26	22.41	22.56	22.73	21.56	22.06	22.65
<b>Percent Change Annualized</b>	<b>2.3</b>	<b>2.0</b>	<b>2.3</b>	<b>2.4</b>	<b>2.5</b>	<b>2.7</b>	<b>2.8</b>	<b>2.9</b>	<b>2.5</b>	<b>2.3</b>	<b>2.7</b>
Real Disp. Income (2009 Billions \$)	12729	12782	12863	12927	13002	13087	13163	13244	12667	12893	13205
<b>Percent Change Annualized</b>	<b>-0.3</b>	<b>1.7</b>	<b>2.5</b>	<b>2.0</b>	<b>2.3</b>	<b>2.6</b>	<b>2.3</b>	<b>2.5</b>	<b>2.6</b>	<b>1.8</b>	<b>2.4</b>
Personal Saving Rate (Percent)	4.9	5.2	5.3	5.3	5.3	5.3	5.3	5.3	5.7	5.3	5.3
<b>Housing</b>											
Housing Starts (Ths., Ann. Rate)	1248	1242	1229	1243	1255	1269	1280	1292	1177	1242	1286
Ext. SF Home Sales (Ths., Ann Rate)	4920	4993	4998	5063	5097	5136	5174	5211	4828	5038	5191
New SF Home Sales (Ths., Ann Rate)	568	616	618	627	632	638	643	647	561	623	645
Case/Shiller HPI (Jan. 2000=100)	185.3	188.3	191.4	194.3	197.3	200.4	203.4	206.4	181.2	192.9	204.9
<b>Year/Year Percent Change</b>	<b>5.3</b>	<b>5.7</b>	<b>6.6</b>	<b>7.0</b>	<b>6.5</b>	<b>6.4</b>	<b>6.3</b>	<b>6.2</b>	<b>5.2</b>	<b>6.5</b>	<b>6.2</b>
<b>Consumer</b>											
Household Economic Stress Index	1.2	1.6	0.2	-0.3	-0.1	-0.5	-0.3	-0.2	1.0	0.3	-0.3
Auto Sales (Millions)	18.1	17.3	16.8	16.8	16.7	16.6	16.5	16.4	17.5	16.9	16.5
<b>Interest Rates (percent per year)</b>											
Federal Funds Rate (Effective)	0.45	0.70	0.94	1.17	1.38	1.42	1.63	1.82	0.40	1.05	1.70
Prime Rate	3.55	3.79	4.04	4.27	4.48	4.52	4.73	4.92	3.51	4.15	4.80
1-Month LIBOR	0.60	0.83	1.03	1.25	1.50	1.56	1.76	1.95	0.50	1.15	1.83
3-Month LIBOR	0.92	1.07	1.19	1.42	1.66	1.72	1.92	2.11	0.74	1.33	1.99
1-Yr. Treasury Rate	0.76	0.89	1.11	1.25	1.46	1.51	1.72	1.92	0.61	1.18	1.79
5-Yr. Treasury Rate	1.61	1.94	1.79	1.84	2.13	2.25	2.49	2.71	1.34	1.93	2.57
10-Yr. Treasury Rate	2.13	2.44	2.25	2.29	2.59	2.71	2.94	3.15	1.84	2.39	3.02
30-Year Fixed Rate Mortgage	3.81	4.17	4.00	4.08	4.35	4.45	4.66	4.86	3.65	4.15	4.74

a = actual f = forecast

June 7, 2017

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