

Global Expansion, Central Bank Strategy, the Bond Market and the Dollar

The global expansion remains engaged. The U.S economy, representing about one-fifth of global demand, got off to a sluggish start with 1.4 percent real GDP growth (annualized) in the first quarter. We expect U.S. GDP growth to approximately double for the recently completed second quarter. The Bureau of Economic Analysis will release the first estimate of Q2 GDP on July 28. Europe collectively represents a little more than a fifth of global demand and continues to show positive data with several countries growing faster than the United States. China, also representing about a fifth of global GDP, has recently looked a little better after a softer start to the year. Japan is gaining momentum. Together, these four regions represent about three-quarters of the global economy, and all of them are generating more demand.

A key theme for many central banks this year and next is to take advantage of the synchronized global expansion and begin normalizing monetary policy. This means raising interest rates off of the near zero, or below zero, floor. It also means gradually winding down extraordinary policy such as asset purchase programs, otherwise known as quantitative easing (QE). Finally, it means renormalizing the vastly expanded balance sheets that came as a result of QE.

The U.S. Federal Reserve took the lead amongst major central banks in driving interest rates down to near zero by the end of 2008. It took a leading role in central bank asset purchases, beginning QE1 in December 2008. It is also taking the lead in winding down extraordinary policy. The Fed ended asset purchases with the termination of QE3 in December 2013. It began lifting interest rates in late 2015, and has managed four 25-basis-point increases in the benchmark fed funds rate since then. The Fed has also announced its intention to begin reducing the size of its vastly expanded balance sheet, possibly as early as this October.

Recently, other central banks have begun to hint that they may also start to normalize policy. European Central Bank President Mario Draghi recently made bullish comments about the European economy that suggest he may announce the winding down of the ECB's asset purchase program by the end of this year, to commence sometime in 2018. The euro climbed against the dollar after Draghi's comments. U.S Treasury bond yields increased as expectations for future demand eased.

Bank of England President Mark Carney's recent comments suggest that he may be considering an increase in the BOE's benchmark interest rate soon. The Bank of England will be an interesting case because their economic tailwind may be fading. The UK has enjoyed one of the fastest growing economies in Europe recently, but that changed in 2017Q1 when UK real GDP growth slowed to 0.2 percent (quarter-to-quarter). This was the slowest 2017Q1 GDP growth of all the G7 countries. Canada was the fastest.

Confirmation of policy normalization by the ECB and other central banks will put more downward pressure on the dollar and upward pressure on Treasury bond yields. Downward movement on the value of the dollar would be good news for U.S. exporters, lowering their prices in local currencies. A weaker dollar would also revive import price inflation, giving the Fed a little more justification for its normalization policy. Finally, a weaker dollar would be welcome news for U.S. border regions that have seen trade with Mexico and Canada decline.

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 (<i>Percent Change Annualized</i>)	2.1	1.4	2.6	3.2	2.9	2.7	2.7	2.6	1.6	2.4	2.8
CPI (<i>Percent Change Year-over-Year</i>)	1.8	2.6	2.0	1.8	1.7	1.4	1.9	2.2	1.3	2.0	1.9
Payroll Jobs (<i>Average Monthly Diff., Ths.</i>)	169.9	181.8	164.3	173.9	175.1	170.4	159.5	150.8	194.3	173.8	156.7
Unemployment Rate (<i>Percent</i>)	4.7	4.7	4.4	4.3	4.3	4.2	4.2	4.2	4.9	4.4	4.2
Federal Funds Rate (<i>Effective</i>)	0.45	0.70	0.95	1.13	1.17	1.42	1.63	1.82	0.40	0.99	1.70
10-Yr. Treasury Rate	2.13	2.44	2.26	2.38	2.37	2.59	2.80	3.01	1.84	2.36	2.89

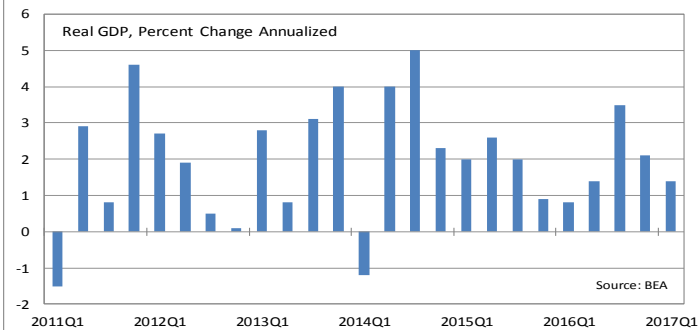
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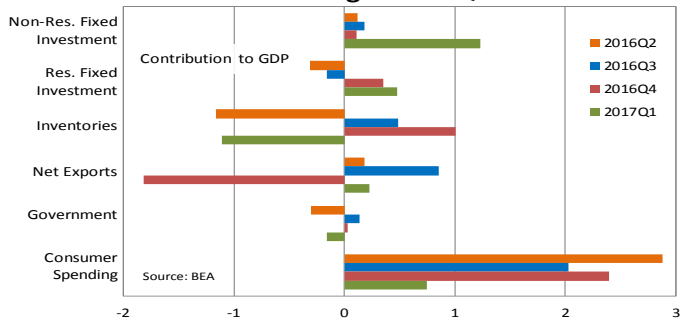
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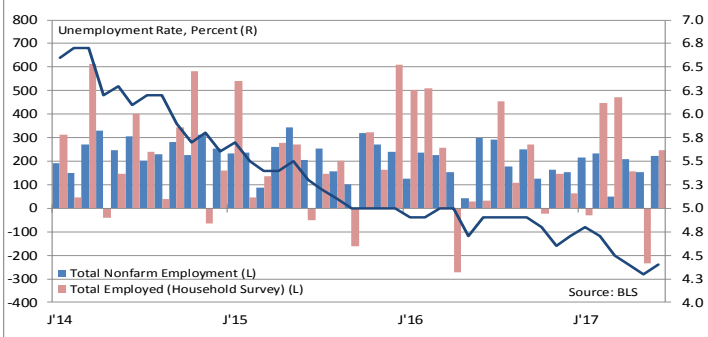
Q1 GDP Growth Revised Up to 1.4%



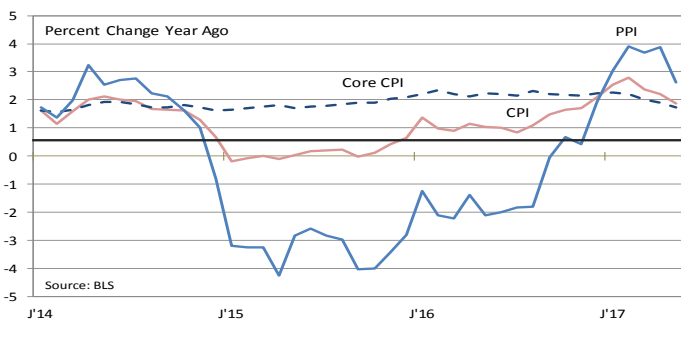
Weak Consumer Spending and Dip in Inventories Weighed on Q1 GDP



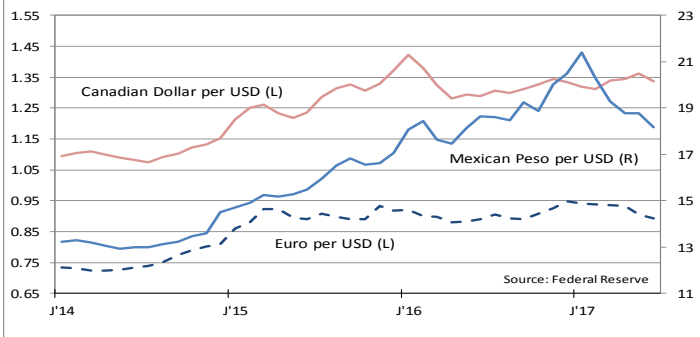
June was Good for Job Growth



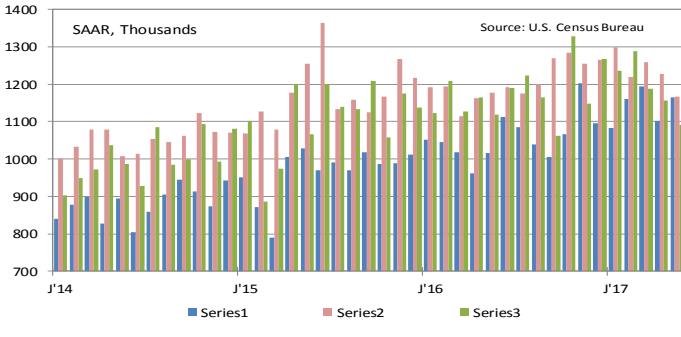
Inflation Eased with Lower Oil Prices in May



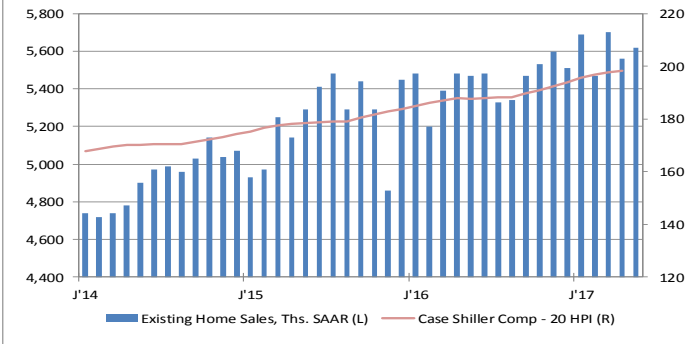
Dollar Declined in June



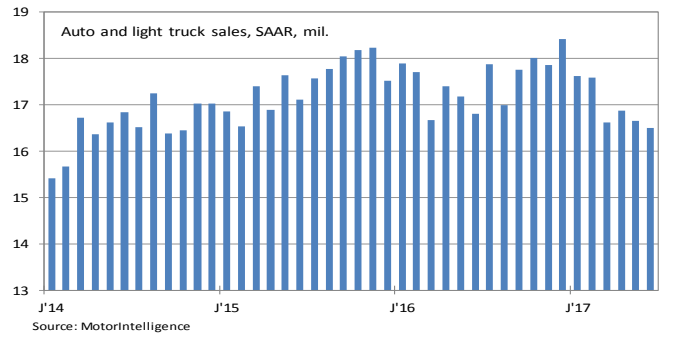
Residential Construction Slowed in May



Existing Home Sales Increased in May



May Auto Sales Decreased to 16.5 mln



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	4Q'16a	1Q'17a	2Q'17f	3Q'17f	4Q'17f	1Q'18f	2Q'18f	3Q'18f	2016a	2017f	2018f
Output											
Nominal GDP (Billions \$)	18869	19027	19239	19479	19715	19946	20178	20403	18569	19365	20288
Percent Change Annualized	4.2	3.4	4.5	5.1	4.9	4.8	4.7	4.5	3.0	4.3	4.8
Real GDP (Chained 2009 Billions \$)	16813	16873	16983	17119	17242	17359	17475	17588	16662	17054	17530
Percent Change Annualized	2.1	1.4	2.6	3.2	2.9	2.7	2.7	2.6	1.6	2.4	2.8
Pers. Consumption Expenditures	11670	11701	11755	11832	11895	11961	12031	12100	11522	11796	12065
Percent Change Annualized	3.5	1.1	1.8	2.7	2.1	2.3	2.3	2.3	2.7	2.4	2.3
Nonresidential Fixed Investment	2197	2252	2279	2304	2332	2358	2384	2408	2189	2292	2395
Percent Change Annualized	0.9	10.4	4.9	4.4	5.0	4.6	4.4	4.1	-0.5	4.7	4.5
Residential Investment	596	614	611	619	630	639	646	652	592	619	649
Percent Change Annualized	9.6	12.9	-2.1	5.5	7.4	5.3	4.6	4.1	4.9	4.5	4.9
Change in Private Inventories	50	3	28	48	59	60	60	60	22	34	60
Net Exports	-605	-596	-601	-610	-613	-613	-613	-613	-563	-605	-613
Government Expenditures	2908	2901	2915	2928	2942	2955	2969	2984	2907	2922	2977
Percent Change Annualized	0.2	-0.9	1.9	1.9	1.8	1.8	1.9	2.0	0.8	0.5	1.9
Industrial Prod. Index (2007=100)	103.3	103.7	105.3	105.5	105.7	106.0	106.3	106.6	103.1	105.0	106.5
Percent Change Annualized	0.7	1.5	6.3	0.7	1.0	1.1	1.2	1.2	-1.2	1.9	1.4
Capacity Utilization (Percent)	75.8	75.8	76.7	76.8	76.9	76.9	77.1	77.2	75.7	76.6	77.1
Prices											
CPI (1982-84=100)	242.2	244.1	244.2	244.8	246.3	247.6	248.9	250.1	240.0	244.9	249.5
Percent Change Annualized	3.0	3.1	0.2	1.0	2.5	2.2	2.0	2.0	1.3	2.0	1.9
PCE Price Index (2009=100)	111.5	112.1	112.2	112.4	113.1	113.8	114.4	114.9	110.7	112.5	114.6
Percent Change Annualized	2.0	2.4	0.1	0.9	2.5	2.3	2.2	2.0	1.1	1.6	1.9
GDP Price Index (2009=100)	112.2	112.8	113.3	113.8	114.4	115.0	115.6	116.1	111.5	113.6	115.8
Percent Change Annualized	2.1	1.9	1.9	1.9	2.0	2.0	2.0	1.9	1.3	1.9	2.0
Producer Price Index, Finished Goods	193.8	196.7	197.3	197.4	198.6	199.6	200.7	201.8	191.9	197.5	201.2
Percent Change Annualized	3.4	6.1	1.1	0.3	2.4	2.0	2.2	2.2	-1.0	2.9	1.9
Crude Oil, WTI (\$/barrel)	49.2	50.0	51.0	48.0	50.0	50.0	50.0	52.5	43.1	49.8	51.3
Labor Markets											
Payroll Jobs (Average Monthly Diff., Ths.)	169.9	181.8	164.3	173.9	175.1	170.4	159.5	150.8	194.3	173.8	156.7
Unemployment Rate (Percent)	4.7	4.7	4.4	4.3	4.3	4.2	4.2	4.2	4.9	4.4	4.2
Average Weekly Hours, Prod. Works.	33.6	33.6	33.7	33.6	33.6	33.6	33.6	33.6	33.6	33.6	33.6
Population (Millions)	324.4	325.1	325.8	326.4	327.1	327.7	328.4	329.0	323.5	326.1	328.7
Percent Change Annualized	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.7	0.8	0.8
Personal Income											
Average Hourly Earnings (\$)	21.75	21.86	21.99	22.13	22.27	22.42	22.58	22.74	21.56	22.06	22.66
Percent Change Annualized	2.3	2.0	2.4	2.5	2.6	2.8	2.8	3.0	2.5	2.4	2.7
Real Disp. Income (2009 Billions \$)	12729	12783	12898	13005	13063	13141	13221	13308	12667	12937	13267
Percent Change Annualized	-0.3	1.7	3.7	3.4	1.8	2.4	2.4	2.7	2.6	2.1	2.5
Personal Saving Rate (Percent)	4.9	5.1	5.3	5.3	5.3	5.3	5.3	5.3	5.7	5.3	5.3
Housing											
Housing Starts (Ths., Ann. Rate)	1248	1238	1167	1215	1233	1250	1261	1270	1177	1213	1265
Ext. SF Home Sales (Ths., Ann Rate)	4920	4993	4983	5036	5093	5133	5171	5213	4828	5026	5191
New SF Home Sales (Ths., Ann Rate)	568	619	610	623	633	640	645	649	561	621	647
Case/Shiller HPI (Jan. 2000=100)	185.3	188.2	190.1	192.2	194.6	197.1	199.5	201.8	181.2	191.3	200.7
Year/Year Percent Change	5.3	5.6	5.9	5.8	5.0	4.8	5.0	5.0	5.1	5.6	4.9
Consumer											
Household Economic Stress Index	1.2	1.7	0.5	0.3	0.9	0.9	1.1	1.3	1.0	0.9	1.2
Auto Sales (Millions)	18.1	17.3	16.7	16.5	16.3	16.1	16.0	15.9	17.5	16.7	15.9
Interest Rates (percent per year)											
Federal Funds Rate (Effective)	0.45	0.70	0.95	1.13	1.17	1.42	1.63	1.82	0.40	0.99	1.70
Prime Rate	3.55	3.79	4.04	4.23	4.27	4.52	4.73	4.92	3.51	4.08	4.80
1-Month LIBOR	0.60	0.83	1.06	1.22	1.29	1.56	1.76	1.95	0.50	1.10	1.83
3-Month LIBOR	0.92	1.07	1.20	1.32	1.39	1.66	1.87	2.05	0.74	1.25	1.93
1-Yr. Treasury Rate	0.76	0.89	1.12	1.22	1.25	1.51	1.72	1.92	0.61	1.12	1.79
5-Yr. Treasury Rate	1.61	1.94	1.81	1.94	1.94	2.16	2.37	2.58	1.34	1.91	2.45
10-Yr. Treasury Rate	2.13	2.44	2.26	2.38	2.37	2.59	2.80	3.01	1.84	2.36	2.89
30-Year Fixed Rate Mortgage	3.81	4.17	3.99	3.97	4.01	4.24	4.48	4.71	3.65	4.03	4.57

a = actual f = forecast

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