

Date	Indicator	For	Estimate	Consensus*	Previous Period
17-Jul-2017	Empire Manufacturing	Jul	13.0	15.0	19.8
18-Jul-2017	Import Price Index MoM	Jun	-0.1%	-0.1%	-0.3%
18-Jul-2017	NAHB Housing Market Index	Jul	65	67	67
18-Jul-2017	Net Long-term TIC Flows	May	NA	NA	\$1.8b
19-Jul-2017	Housing Starts	Jun	1130k	1170k	1092k
19-Jul-2017	Building Permits	Jun	1196k	1210k	1168k
20-Jul-2017	Initial Jobless Claims	15-Jul	249K	NA	247K
20-Jul-2017	Philadelphia Fed Business Outlook	Jul	22.0	20.0	27.6
20-Jul-2017	Leading Index	Jun	0.3%	0.4%	0.3%

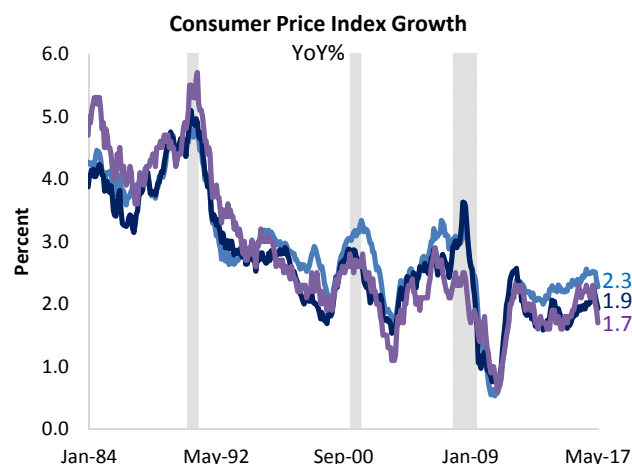
\*Consensus from Bloomberg

## Where Did Inflation Go?

As recently as March, inflation appeared to be heating up. The consumer price index had just completed two consecutive quarters of 3.0% plus annualized growth; and with a tightening labor market to boot, it was starting to feel like the Fed was a bit behind the curve in normalizing interest rates. Indeed, minutes from the March FOMC meeting seemed to suggest the Fed was chomping at the bit to get ahead of inflation with more frequent rate hikes planned for 2017 and 2018. Fast forward to June, and the inflation landscape appears far different and the outlook for inflation far less certain. Consumer inflation has slowed almost in half to 1.6% from a 2.8% pace in February.

Numerous core consumer inflation measures are also dropping, moving further away from the Fed's medium-term target of around 2.0%.

### Core Measures of Consumer Inflation Dropping Too

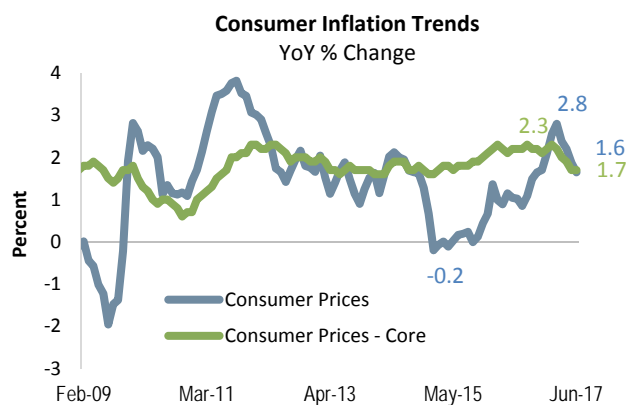


Source: Federal Reserve Bank of Cleveland/FRED

So what has changed over the last several months and why are Janet Yellen and the Fed sounding a bit less confident in their inflation forecasts these days?

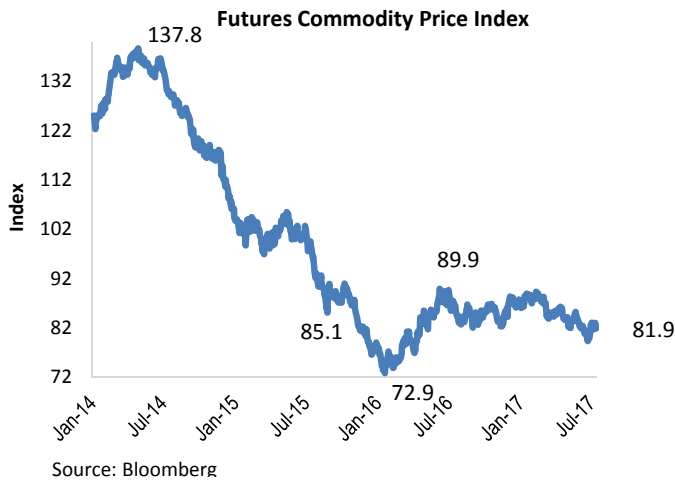
The big reason for the reversal of late comes down to ebbs and flows in energy and commodity prices. Global crude oil and metal prices were vaulting higher last year. This year they have been dropping or holding steady.

### Consumer Price Inflation Subsides



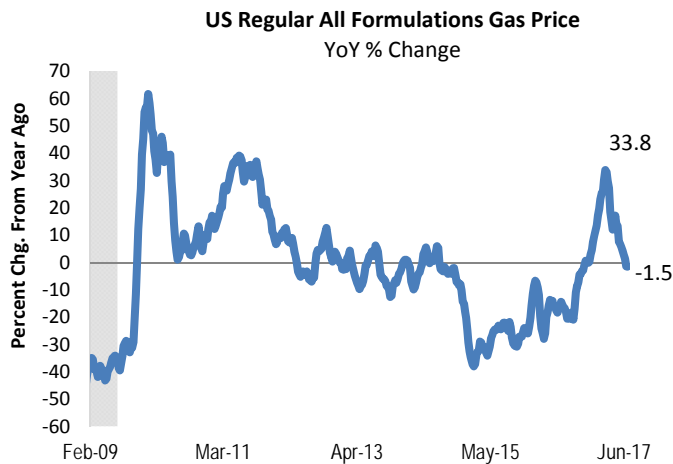
Source: U.S. Bureau of Labor Statistics

Global Commodity Prices Fail to Launch



Take U.S. retail gasoline prices, for instance. In February 2017, gasoline prices were 34% above last year's levels. By June gasoline prices were 1.5% below last year's levels.

Retail Gasoline Prices Treading Water



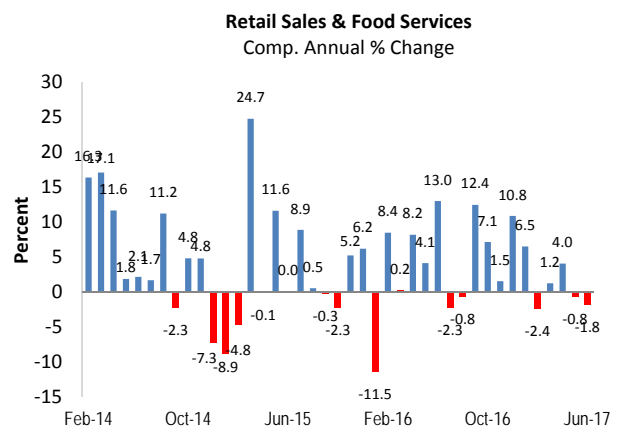
Also, despite the tightening labor market and signs of anecdotal wage pressures in certain regions and job categories, rising wages are not yet sufficient or widespread enough to push overall consumer inflation higher. Yellen pointed to new entrants in the labor force as a possible explanation for why we are not yet seeing stronger nominal wage gains.

Moreover, nominal retail sales growth has been mixed and volatile so far this year, even with generally favorable financial conditions for many consumers. The

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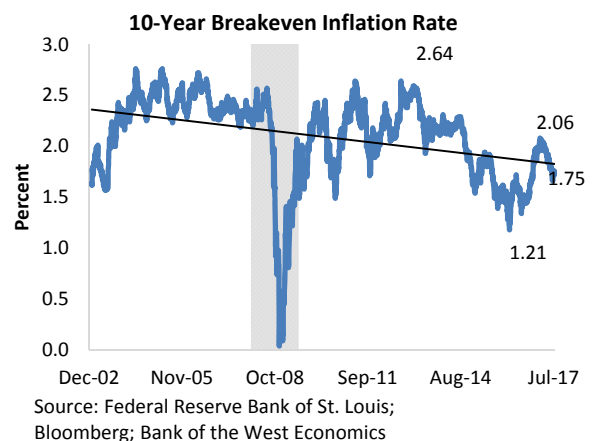
combination of lackluster consumer demand and structural changes occurring between traditional brick-and-mortar retailers and the Amazons of the world appears to be at least temporarily keeping a lid on the traditional link between the labor market and rising prices.

Retail Sales Have Been Hit or Miss This Year



Finally, the bond market isn't buying the Fed's inflation forecasts. The 10-Year TIPS spread, a measure of the market's inflation forecast over the next 10 years, has slumped to just 1.75% from 2.1% in February. We continue to forecast consumer inflation next year at around 2.0%, but that is lower than we forecasted six months ago. The main driver for the change is our evolving view on WTI oil prices, which we now see staying below \$50 per barrel through the end of 2018.

Bond Market Skeptical About a Return of Inflation



### 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	1.4	2.5	2.7	2.0	1.9	2.1	2.1	2.2	2.6	1.6	2.2	2.1
Personal Consumption Expenditures*	1.6	4.3	3.0	3.5	1.1	3.0	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	10.4	2.7	3.4	2.8	2.7	3.4	3.9	4.4	2.1	-0.5	4.1	3.3
Private Housing Starts (000s units)	1,153	1,158	1,150	1,248	1,238	1,124	1,230	1,256	1,263	1,265	1,275	1,285	1,108	1,177	1,212	1,272
Vehicle Sales (mill. Units, annualized)	17.3	17.1	17.5	18.0	17.2	16.6	16.8	16.8	16.7	16.6	16.6	16.5	17.4	17.5	16.8	16.6
Industrial Production*	-1.3	-0.7	0.8	0.7	1.5	6.0	1.8	1.9	2.2	2.3	2.2	2.2	0.3	-1.2	2.0	2.4
Nonfarm Payroll Employment (mil.)	143.4	144.0	144.7	145.2	145.7	146.2	146.7	147.2	147.6	148.1	148.5	149.0	141.8	144.3	146.5	148.3
Unemployment rate	4.9	4.9	4.9	4.7	4.7	4.4	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	6.1	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	93.5	94.5	93.1	92.0	92.7	93.2	93.8	93.2	93.0	90.9	91.6	93.1	93.3
Crude Oil Prices -WTI (\$ per barrel)	33	45	45	49	52	48	45	45	46	46	47	48	50	43	47	47

\*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	2,398							2,061	2,093		
Dow Jones Industrial Average	16,663	17,764	18,372	18,865	20,406	20,994							17,591	17,916		
Federal Funds Rate (effective)	0.36	0.37	0.39	0.45	0.70	0.94	1.16	1.21	1.46	1.71	1.96	2.13	0.13	0.39	1.00	1.81
Treasury-3 Month Bills (yield)	0.29	0.26	0.30	0.43	0.61	0.91	1.08	1.16	1.41	1.67	1.92	2.08	0.05	0.32	0.94	1.77
Treasury-2 Year Notes (yield)	0.84	0.77	0.73	1.01	1.24	1.30	1.48	1.65	1.90	2.16	2.40	2.58	0.69	0.84	1.42	2.26
Treasury-5 Year Notes (yield)	1.37	1.24	1.13	1.61	1.95	1.81	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	2.26	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	2.90	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	4.05	4.32	4.35	4.60	4.85	5.00	5.25	3.26	3.51	4.13	4.93
Libor 3-Mo. U.S. Dollar	0.62	0.64	0.79	0.92	1.07	1.21	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	3.98	4.23	4.43	4.70	4.92	5.16	5.40	3.85	3.66	4.20	5.05
BAA Corporate (yield)	5.30	4.66	4.26	4.64	4.66	4.50	4.70	4.95	5.33	5.55	5.79	5.98	5.00	4.71	4.70	5.66

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