

# THE PROBANK AUSTIN ADVISOR

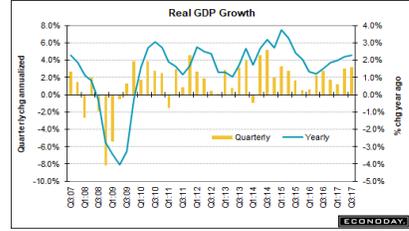
January 22, 2018

Markets	15-Jan	16-Jan	17-Jan	18-Jan	19-Jan	YTD%	29-Dec-17
DJIA	N / A	25,792.86	26,115.65	26,017.81	26,071.72	5.47%	24,719.22
S&P 500	N / A	2,776.42	2,802.56	2,798.03	2,810.30	5.11%	2,673.61
NASDAQ	N / A	7,223.68	7,298.28	7,296.05	7,336.38	6.27%	6,903.39
SNL Bank Index	N / A	648.39	652.36	651.30	657.08	6.38%	617.68
Fed Funds Rate	N / A	1.42%	1.42%	1.42%	N / A		1.42%
1 Month LIBOR	1.56%	1.56%	1.56%	1.56%	1.56%		1.56%
3 Month LIBOR	1.73%	1.73%	1.74%	1.74%	1.74%		1.69%
3 Month T-Bill	1.43%	1.45%	1.44%	1.45%	1.44%		1.39%
1 Year Treasury	1.78%	1.79%	1.79%	1.79%	1.79%		1.76%
2 Year Treasury	1.99%	2.03%	2.05%	2.05%	2.06%		1.89%
3 Year Treasury	2.12%	2.12%	2.15%	2.17%	2.20%		1.98%
5 Year Treasury	2.35%	2.36%	2.39%	2.43%	2.45%		2.20%
10 Year Treasury	2.55%	2.54%	2.57%	2.62%	2.64%		2.40%
30 Year Treasury	2.85%	2.83%	2.84%	2.90%	2.91%		2.74%

## WEEKLY HIGHLIGHT

Market rates moved higher last week as economic conditions continue to strengthen

## REAL GDP-ADVANCE



(click to enlarge)

## ON THIS DAY IN HISTORY

1673 - Postal service between New York & Boston begins

1857 - National Association of Baseball Players founded in NY

1930 - -35 degrees (F) in Mount Carroll, IL

1946 - President Truman establishes the CIA

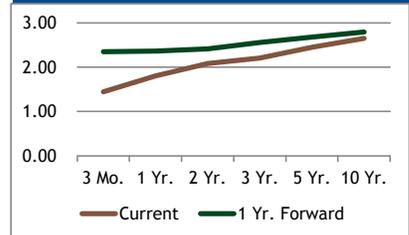
## Economy Week of January 15, 2018

Industrial Production	0.9%	
Capacity Utilization	77.9%	Solid improvement in the operating rate continues and does not square with the output data
Housing Starts	1.192 Million	A surprise on the downside, with permits remaining very strong, indicating this may be a one month slowdown

## Calendar Week of January 22, 2018

Calendar	Release	Covering	Week of January 22, 2018
Existing Home Sales	Wednesday	December	Existing home sales have lagged new homes as the inventory of homes on the market is low, expect 5.750M
New Home Sales	Thursday	December	Following a spike to 733K for November, expectations call for a solid 680K as this sector remains at an elevated level
Leading Indicators	Thursday	January	The stock market gains and improved orders should continue to drive this index up, with consensus at +0.5% for the month
Durable Goods Orders	Friday	December	Orders are very volatile on a monthly basis but have been trending higher, with +0.6% expected as compared to +1.3% for Nov.
Real GDP-Advance	Friday	4th Qtr.	The Advance Report is subject to large revisions, but the 2.9% expected is consistent with a 3% growth in the economy

## U.S. TREASURY FORWARD CURVE



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## Commentary

Investors continued to drive stock prices higher and bond prices lower last week. The pricing action in financial markets reflects the expectation corporate profits will be very strong in 2018, while the Fed continues to move managed interest rates higher. The anticipated Fed action will be possible because the economy will be much stronger this year than any year in the past eight. The Advance report for fourth quarter Real GDP is due on Friday, with the consensus forecast calling for growth of 2.9%. This would be in comparison to the 3.0% of the second quarter and 3.2% of the third. This growth is well above the average annual growth of 2.1% in the last eight years. Economic growth is expected to be led by a surge in consumer final demand as compared to the prior two quarters. Personal consumption expenditures are expected to be reported as having increased by 3.6% for the quarter as compared to only 2.2% in the third quarter. There will be some drag on the economy from low inventory builds and the trade deficit. Capital spending is expected to be higher in the fourth quarter than the third, but growth will be below that expected in 2018. There is a lag between the decline in the dollar and a narrowing trade deficit.

We are forecasting a much lower trade deficit for this year as the tax reform act causes our products to be more competitively priced from a lower dollar, and capital is brought back from overseas due to the lower corporate tax structure. Economic growth should be much stronger in 2018 than estimated prior to the tax reform act being passed. None of the models used to estimate the impact of the tax reform included companies using a portion of their tax savings to be shared with employees. Companies continue to announce raising wages and paying special bonuses to employees using part of the lower costs of taxes. This will produce a surge in personal income not anticipated when the tax act was passed. We believe this surge in personal income will fuel faster growth in consumer final demand than the assumptions used in scoring the tax reform act by the CBO. The question is whether this economic environment will begin to produce higher inflation pressures.

The action in the bond market would suggest investors are beginning to price in higher inflation in current market rates. The ten-year treasury has moved up 20 basis points in yield in the last month, the same increase in the two-year. The spread between short and longer term market rates is holding at just below 60 basis points. This is still a historically narrow spread, but it has not narrowed any further as the term structure of market rates moved up the last month. Our forecast calls for the core rate of the PCE price index to move above 2% in the fourth quarter of the year. The Fed will have the room to continue its process of normalizing monetary policy as long as economic growth is accelerating, even if inflation does not increase as much as the Fed fears. Should inflation data begin to move more and sooner than we expect, the Fed could move managed rates up faster than the current guidance of three rate moves in 2018. We do not expect the curve to steepen until the fourth quarter, but the term structure of rates should move higher as we move through this year.

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