

# THE PROBANK AUSTIN ADVISOR

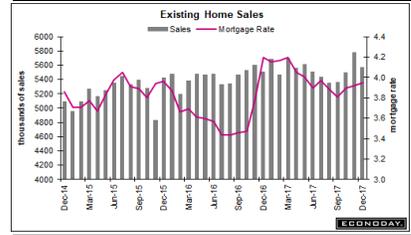
February 19, 2018

Markets	5-Feb	6-Feb	7-Feb	8-Feb	9-Feb	YTD%	29-Dec-17
DJIA	24,601.27	24,640.45	24,893.49	25,200.37	25,219.38	2.02%	24,719.22
S&P 500	2,656.00	2,662.94	2,698.63	2,731.20	2,732.22	2.19%	2,673.61
NASDAQ	6,981.96	7,013.51	7,143.61	7,256.43	7,239.46	4.87%	6,903.39
SNL Bank Index	625.95	630.32	646.05	649.15	648.84	5.04%	617.68
Fed Funds Rate	1.42%	1.42%	1.42%	1.42%	1.42%		1.42%
1 Month LIBOR	1.59%	1.59%	1.59%	1.59%	1.59%		1.56%
3 Month LIBOR	1.83%	1.84%	1.85%	1.87%	1.88%		1.69%
3 Month T-Bill	1.62%	1.59%	1.58%	1.58%	1.62%		1.39%
1 Year Treasury	1.93%	1.95%	1.98%	1.99%	2.00%		1.76%
2 Year Treasury	2.09%	2.10%	2.17%	2.19%	2.21%		1.89%
3 Year Treasury	2.30%	2.30%	2.40%	2.40%	2.38%		1.98%
5 Year Treasury	2.56%	2.54%	2.65%	2.65%	2.63%		2.20%
10 Year Treasury	2.86%	2.83%	2.91%	2.90%	2.87%		2.40%
30 Year Treasury	3.14%	3.11%	3.18%	3.15%	3.13%		2.74%

## WEEKLY HIGHLIGHT

Inflation data released last week confirmed the markets view of rising risk

## EXISTING HOME SALES



(click to enlarge)

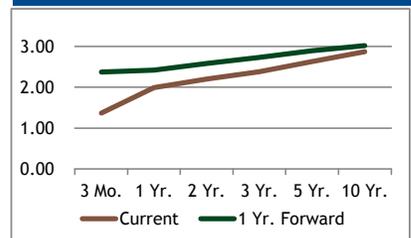
## ON THIS DAY IN HISTORY

- 1878 - Thomas Edison patents the phonograph
- 1945 - U.S. troops land on the Japanese island of Iwo Jima
- 1986 - The "Mir" Space Station is launched, this Soviet vehicle was the world's first modular space station
- 2008 - Fidel Castro steps down as Cuba's president

Economy	Week of February 12, 2018	
Consumer Price Index	0.5%	Inflation data is continuing to reflect rising prices with the core rate up 0.3% and December's data revised upward
Retail Sales	-0.3%	This weak number and the downward revision to December is either a change in spending or a seasonal adjustment problem
Producer Price Index	0.4%	This inflation data is much stronger than prior months, with the core rate up 0.4% and YOY core rate up 2.5%
Industrial Production	-0.1%	This Federal Reserve generated data has not been consistent with other measures of manufacturing activity with a drop in January
Capacity Utilization	77.5%	This is a decline from the downward revised data of December which came in at 77.7% and is still not inflationary
Housing Starts	1.326 Million	A very strong number and strong permits data indicates housing construction will be very strong in the first half of this year

Calendar	Release	Covering	Week of February 19, 2018
Existing Home Sales	Wednesday	January	The lack of homes on the market in many price ranges has kept sales down and we expect 5.650M will be reported
Leading Indicators	Thursday	January	Another strong month at 0.6% is expected to be reported with this index continuing to signal a strong economy in 2018

## U.S. TREASURY FORWARD CURVE



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## Commentary

The data released last week provided further evidence of upward pressure on inflation. The **CPI** increased 0.5% in January after rising a revised 0.2% in December. The core rate rose 0.3% which takes the **YOY** increase up to 1.8%. The **PPI** increased by 0.4% for the month, up from no change in December. The core rate was also up 0.4% and the **YOY** change for the core stands at 2.2%. These higher numbers are the contributing factor to rising **inflation risk** being priced in the bond market. They also will drive the **Fed** to raise managed rates at the March **FOMC** meeting in spite of the volatility in the equity market. The weak data included both retail sales and **industrial production**. We question the validity of these results. **Retail sales** were reported as having declined by 0.3% in January and the December result was revised down to no change from the 0.4% gain first reported. The decline was led by a drop in auto sales which were reported as having declined by 1.3% in January. Part of this was the end of the surge in auto sales from replacement demand created by the hurricanes late in the third quarter. **Auto sales** for January were reported earlier this month at 17.2 million, which is down from 17.9 million reported for December, but is still a strong month relative to the less than 17 million monthly average prior to the hurricanes. We also believe the seasonal adjustment factors used in this report fail to capture the changing nature of the retailing sector as e-commerce continues to grow at the expense of **brick and mortar retailers**. The decline reported for industrial production is at odds with other data for the manufacturing sector. The **ISM index** is near record highs since the recession. **Durable Goods** orders are accelerating and manufacturing employee is increasing. These are indications of rising industrial production not the small decline reported. Additionally, the lower dollar will boost industrial activity with imports becoming more expensive and exports more competitively priced against those imports.

Finally, **business confidence** is high and companies are beginning to increase capital spending using part of the tax savings from the **tax reform act**. This other data leads us to expect strong industrial production growth in the next year. It will take time for these conditions to be reflected in output as companies ramp up production in a **strong demand environment**. The solid economic conditions will continue to put pressure on prices and the weaker dollar does give producers the pricing room to pass on rising labor costs in the form of higher prices. We do expect the core **PCE price index** to be above the Fed's target of 2% beginning in the second quarter. This should drive intermediate and long-term market interest rates higher at a faster pace than the Fed raises short-term rates. The steepening **yield curve** we have been forecasting is already started to develop. The fundamentals suggest this process will continue as **higher inflation** data is released. The Fed will find they are behind the curve and will raise rates four times in 2018.

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