THE PROBANK AUSTIN ADVISOR

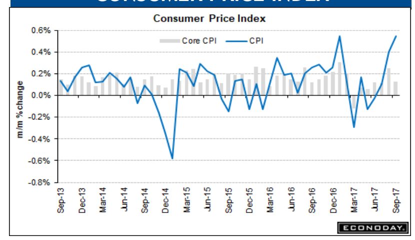
November 14, 2017

Markets	6-Nov	7-Nov	8-Nov	9-Nov	10-Nov	YTD%	30-Dec-16
DJIA	23,548.42	23,557.23	23,563.36	23,461.94	23,422.21	18.52%	19,762.60
S&P 500	2,591.13	2,590.64	2,594.38	2,584.62	2,582.30	15.34%	2,238.83
NASDAQ	6,786.44	6,767.78	6,789.12	6,750.05	6,750.94	25.41%	5,383.12
SNL Bank Index	590.90	577.80	572.13	568.45	567.23	6.49%	532.65
Fed Funds Rate	1.16%	1.16%	1.16%	1.16%	1.16%		0.55%
1 Month LIBOR	1.24%	1.24%	1.25%	1.24%	1.25%		0.77%
3 Month LIBOR	1.40%	1.40%	1.41%	1.41%	1.41%		1.00%
3 Month T-Bill	1.19%	1.22%	1.23%	1.24%	1.23%		0.51%
1 Year Treasury	1.50%	1.49%	1.53%	1.53%	1.54%		0.85%
2 Year Treasury	1.61%	1.63%	1.65%	1.63%	1.67%		1.20%
3 Year Treasury	1.73%	1.75%	1.77%	1.75%	1.79%		1.47%
5 Year Treasury	1.99%	1.99%	2.01%	2.01%	2.06%		1.93%
10 Year Treasury	2.32%	2.32%	2.32%	2.33%	2.40%		2.45%
30 Year Treasury	2.80%	2.77%	2.79%	2.81%	2.88%		3.06%

WEEKLY HIGHLIGHT

Inflation data due out this week is not expected to reflect any pressures on pricing

CONSUMER PRICE INDEX



(click to enlarge)

Economy	Week of November 6, 2017	
JOLTS Index	6.093 Million	The high number of unfilled job openings should keep job growth strong over the next year
Consumer Credit	$20.8 Billion	Credit grew more than expected in September, with $6.4 of the growth in credit card balances

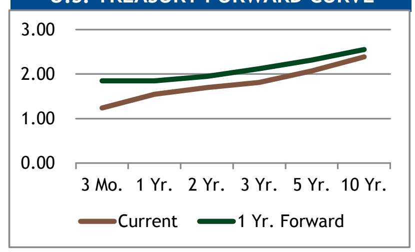
ON THIS DAY IN HISTORY

1908 - Einstein presents his quantum theory of light

1964 - Gordie Howe sets NHL record with 627th career goal

Calendar	Release	Covering	Week of November 13, 2017
Producer Price Index	Tuesday	October	Still no inflation pressures evident, with only a 0.1% expected for the month, after the 0.4% released for September
Consumer Price Index	Wednesday	October	Again, no pricing pressure is expected at only 0.1% forecast following the hurricane impacted 0.5% reported for September
Retail Sales	Wednesday	October	Sales jumped 1.6% in September due to the hurricanes, but is forecast to have only grown by 0.1% for October
Industrial Production	Thursday	October	Strong ISM index numbers and durable goods orders should drive output up 0.5% for the month as manufacturing recovers
Capacity Utilization	Thursday	October	Stronger output should drive the operating rate up, but only to 76.4% which is well below inflationary levels
Housing Starts	Friday	October	Home construction dropped to 1.127M SAAR due to the hurricanes, with a small recovery to 1.190 expected

U.S. TREASURY FORWARD CURVE



THE PROBANK AUSTIN ADVISOR

Commentary

The **yield curve** continues to flatten. Short term market interest rates are moving higher, while long term rates are little changed. This condition is a function of investors expecting **the Fed** to raise managed rates, while the data does not indicate any increase in **inflation**. There is no risk premium being demanded for higher inflation in long term interest rates. The spread between the yield on the two-year treasury and the ten-year has narrowed to just 71 basis points. This compares to the spread of 120 basis points at year-end 2016, and a more normal 200 basis points historically. This spread could narrow further as the Fed moves rates higher in 2018 and inflation remains below the 2% target. Our forecast had called for inflation to move above the target due to rising labor costs in a tight labor market. We have experienced a tightening labor market, with the **unemployment rate** down to 4.1%, the U6 rate under 8% and the **JOLTS index** reporting more than 6 million unfilled job openings in an environment which has just over 11 million listed as unemployed. This condition has not, however, generated accelerating rates of wage growth or higher labor costs as we expected. The bond market does not expect it to occur in the next year. The Fed is concerned it will and wants to continue to **normalize monetary policy** to keep a lid on inflation.

The trailing twelve month increases for **core PPI**, **CPI** and **PCE** price indices are all below 1.5% and not increasing. This week will see the release of the October PPI and CPI. They are expected to come in at a 0.1% increase after the big increases of better than 0.5% for September. September was driven by price increases in the energy and building supply sectors both of which were driven by the impact of the hurricanes in Texas and Florida. The October data is expected lower, as the September jump was a one time event. Without higher inflation pressures, long-term interest rates will not rise as much as increases in short-term rates as the Fed executes its strategy. This environment is the worst condition for banks. We are finally beginning to experience rising deposit rates for non-maturity deposit accounts and higher special CD rates in many markets. This rising cost of funds is being led by the larger banks as they try to buy market share in core retail deposits. These large banks have been successful in cutting non-interest expenses by closing branches and reducing service levels as they increased fees for deposit products. This strategy has allowed community banks and credit unions to continue to enjoy growth in deposits. The larger banks are now trying to grow deposits to fund loan growth and are raising deposits to do so. The new, higher deposit rates are still well below the national market funding costs that have moved higher with the short-term market rates. We believe these higher deposit costs are not fully reflected in the budgets being considered for 2018. Growing net interest income will be much more difficult in 2018 than it was in 2017.