THE PROBANK AUSTIN ADVISOR

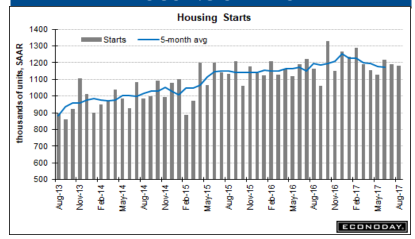
October 16, 2017

Markets	9-Oct	10-Oct	11-Oct	12-Oct	13-Oct	YTD%	30-Dec-16
DJIA	22,761.07	22,830.68	22,872.89	22,841.01	22,871.72	15.73%	19,762.60
S&P 500	2,544.73	2,550.64	2,555.24	2,550.93	2,553.17	14.04%	2,238.83
NASDAQ	6,579.73	6,587.25	6,603.55	6,591.51	6,605.80	22.71%	5,383.12
SNL Bank Index	579.49	583.08	581.29	574.63	572.25	7.43%	532.65
Fed Funds Rate	N / A	1.16%	1.16%	1.16%	1.16%		0.55%
1 Month LIBOR	1.24%	1.24%	1.24%	1.24%	1.24%		0.77%
3 Month LIBOR	1.36%	1.36%	1.36%	1.36%	1.35%		1.00%
3 Month T-Bill	1.07%	1.08%	1.10%	1.09%	1.09%		0.51%
1 Year Treasury	1.35%	1.42%	1.40%	1.41%	1.39%		0.85%
2 Year Treasury	1.54%	1.51%	1.51%	1.51%	1.51%		1.20%
3 Year Treasury	1.66%	1.64%	1.66%	1.66%	1.64%		1.47%
5 Year Treasury	1.97%	1.95%	1.95%	1.95%	1.91%		1.93%
10 Year Treasury	2.37%	2.35%	2.35%	2.33%	2.28%		2.45%
30 Year Treasury	2.91%	2.88%	2.88%	2.86%	2.81%		3.06%

WEEKLY HIGHLIGHT

Inflation remains well contained, while the surge in retail sales was largely affected by the storms

HOUSING STARTS



(click to enlarge)

Economy	Week of October 9, 2017	
JOLTS Index	6.082 Million	Down from 6.140M for July as the gap between openings and hirings continue to point to a tight labor market
Producer Price Index	0.4%	The rise in both the headline and the core rate was a function of services and hurricane related energy prices
Consumer Price Index	0.5%	The jump was driven by weather affected sectors, including energy, while the core rate was only up 0.1%
Retail Sales	1.6%	The huge monthly number was inflated by replacement demand in Texas and Florida, but excluding cars, sales were up 0.5%

ON THIS DAY IN HISTORY

1781 - Washington takes Yorktown

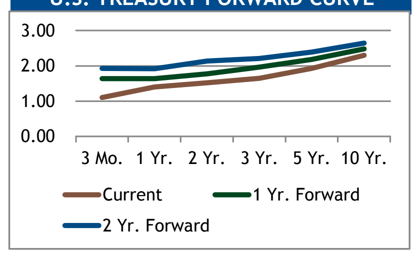
1859 - John Brown raids Harper's Ferry

1923 - Disney Brothers cartoon studio founded

1962 - Cuban missile crisis begins

Calendar	Release	Covering	Week of October 16, 2017
Industrial Production	Tuesday	September	After dropping by 0.9% in August due to the weather, only a small rebound of 0.1% is expected with a lag yet to be experienced
Capacity Utilization	Tuesday	September	A small increase to 76.2% is expected, as the operating rate continues a slow but steady growth
Housing Starts	Wednesday	September	Housing was affected in both August and September by the hurricanes with expectations for 1.17 million, after 1.18 M
Leading Indicators	Thursday	September	A small increase of 0.1% is expected for this index that has been strong over the past 18 months
Existing Home Sales	Friday	September	Again, the weather held down sales in August and is expected to be a modest 5.3M for September

U.S. TREASURY FORWARD CURVE



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Commentary

The hurricanes in late August and September are still affecting the economic data being released. Last week it was the **inflation** data, this week it will be the housing data. The **Producer Price index** was up 0.4% for the month of September. This increase was driven by higher energy prices as ports were closed and refining was reduced due to the storms. However, the core rate which excludes food and energy was also up 0.4% and is up 2.2% on a year-over-year basis through September. This was viewed as some indication inflation is beginning to surface. The **Consumer Price Index** was up 0.5% for the month, but the core rate was only up 0.1%. The YOY increase for the core rate now stands at 1.7%, which is still below the Fed's target of 2%. The **retail sales** data for September (the last month of the quarter) was strong, but that was largely a function of **auto sales**. Auto sales jumped in September due to replacement demand from cars lost in the storms. However, excluding auto sales and higher gas prices, retail sales posted a strong gain of 0.5% for the month. This is better than we had been expecting and means **Real GDP growth** for the third quarter will come in above our current forecast of 2.3%.

The question remains as to whether **the Fed** will raise managed rates at their December **FOMC meeting** without clear evidence inflation has risen. The Fed Funds Futures are pricing in a 75% probability of another 25 basis point move at that meeting. The two-year treasury, which is the most sensitive to possible Fed action, has moved up from 1.3% in yield to 1.5% over the last month. The market expects the Fed to act even without solid evidence of higher inflation pressures. We continue to forecast no change in December. Our view is the Fed will not have reliable data due to the impact of the storms in the third quarter and rebound of activity in the fourth quarter. The small increase in the core rate of the CPI indicates inflation remains well below the 2% target rate, and until it begins to rise we expect the Fed to wait. The **yield curve** remains flat with the spread between the two-year and the ten-year treasury at 77 basis points, the lower end of its trading range over the past year. We do not expect any meaningful change in either term level of interest rates or the shape of the yield curve until the second half of next year. The better than average growth in the economy we are forecasting is not expected to drive pricing up over the next nine months. The data due out this week for the housing sector is another case of unreliable data affected by the storms causing the Fed to wait for the data to normalize. This flat curve is beginning to impact bank's net interest income. Earning asset yields are not moving higher while funding costs are. More of our clients are reporting rising rates for public funds, large corporate and retail deposits as those customers demand yields closer to those available in national markets. There is some indication **disintermediation** is beginning at some banks, as customers move balances from low cost non-maturity deposit products and into special time deposits being offered at much higher yields. We expect this trend will intensify over the last three months of this year. Loan pricing must improve if revenue growth is to be maintained.

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