THE PROBANK AUSTIN ADVISOR

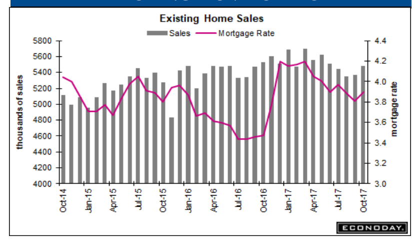
December 18, 2017

Markets	11-Dec	12-Dec	13-Dec	14-Dec	15-Dec	YTD%	30-Dec-16
DJIA	24,386.03	24,504.80	24,585.43	24,508.66	24,651.74	24.74%	19,762.60
S&P 500	2,659.99	2,664.11	2,662.85	2,652.01	2,675.81	19.52%	2,238.83
NASDAQ	6,875.08	6,862.32	6,875.80	6,856.53	6,936.58	28.86%	5,383.12
SNL Bank Index	611.92	618.95	611.32	606.24	614.81	15.42%	532.65
Fed Funds Rate	1.16%	1.17%	1.17%	1.41%	1.41%		0.55%
1 Month LIBOR	1.46%	1.47%	1.48%	1.49%	1.50%		0.77%
3 Month LIBOR	1.56%	1.57%	1.59%	1.60%	1.61%		1.00%
3 Month T-Bill	1.33%	1.34%	1.30%	1.32%	1.31%		0.51%
1 Year Treasury	1.69%	1.70%	1.68%	1.70%	1.71%		0.85%
2 Year Treasury	1.82%	1.83%	1.79%	1.82%	1.84%		1.20%
3 Year Treasury	1.95%	1.95%	1.90%	1.92%	1.95%		1.47%
5 Year Treasury	2.16%	2.18%	2.12%	2.14%	2.16%		1.93%
10 Year Treasury	2.39%	2.40%	2.36%	2.35%	2.35%		2.45%
30 Year Treasury	2.77%	2.79%	2.74%	2.71%	2.68%		3.06%

WEEKLY HIGHLIGHT

The FOMC did raise rates, but did not change its guidence for 2018

EXISTING HOME SALES



(click to enlarge)

ON THIS DAY IN HISTORY

1787 - New Jersey becomes 3rd state to ratify the US Constitution

1799 - George Washington's body interred at Mount Vernon

1892 - Tchaikovsky's 'Nutcracker Suite' premieres

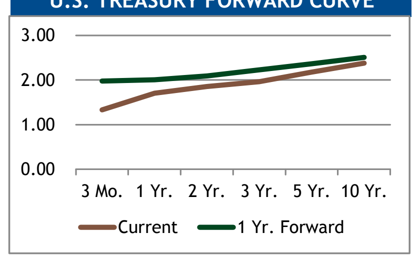
1932 - Chicago Bears beat Portsmouth Spartans 9-0 in 1st NFL playoff game

1966 - Dr. Suess' 'How the Grinch Stole Christmas' airs for 1st time on CBS

Economy		Week of December 11, 2017
JOLTS	5.996 Million	Unfilled job openings fell 2.0% as strong job growth filled some of the open positions, still reflecting a tight labor market
Producer Price Index	0.4%	The higher than expected increase was driven by a spike in gasoline prices, but even the core rate was up 0.3%
Consumer Price Index	0.4%	Again, it was gas prices driving the above average increase, with the core rate up only 0.1%
FOMC Meeting Statement		The FOMC did raise managed rates another 25 basis points, bringing the total increase to +1.25% since December, 2015
Revised FOMC Forecasts		The Fed did revise upward their forecast for economic growth in 2018 from 2.1% to 2.4%, but no change in guidence
Fed Chair Press Conference		No real news from the press conference, with the FOMC still on course to raise three times next year
Retail Sales	0.8%	Consumer spending has surged in the fourth quarter, with this strong data from November and October revised upward to 0.5%
Industrial Production	0.2%	A drop in utility output offset the rise in mining, leaving growth to the rise in manufacturing
Capacity Utilization	77.1%	Up from the 77.0% level of October, but still no inflation pressures from supply constraints

Calendar	Release	Covering	Week of December 18, 2017
Housing Starts	Tuesday	November	Starts had been flat until October when they jumped by 13.7% to 1.290 M; we expect a slight downturn to 1.240 M
Existing Home Sales	Wednesday	November	Existing home sales had been improving at a steady pace and we expect another increase to 5.520 M from 5.480 M
Real GDP - Final	Thursday	3rd Qtr	No change from the 3.3% growth reported last month, which is the best quarterly growth in the last year
Durable Goods Orders	Friday	November	Aircraft orders are expected to return orders on the growth path before the drop of 1.2% in October, with November at +2.0%
Personal Income	Friday	November	Another strong month of 0.4% growth in incomes, as a tight labor market begins to affect wages

U.S. TREASURY FORWARD CURVE



THE PROBANK AUSTIN ADVISOR

Personal Spending	Friday	November	November was a strong rebound in final demand, with the consensus forecast at +0.5% in spending expected
Core PCE Price Index	Friday	November	Even with the solid economic growth and tight labor market, inflation shows no sign of rising with only 0.1% for the month
New Home Sales	Friday	November	After the surge in sales in October at 685,000, the consensus expects them to settle back to 650,000 for November

THE PROBANK AUSTIN ADVISOR

Commentary

As widely expected, **the Fed** did raise managed rates by 25 basis points last week. This now takes the target rate for Fed Funds up 125 basis points since the Fed began its effort to normalize monetary policy in December 2015. One hundred of these increases have been executed in the last twelve months. This last increase was fully priced in the bond market as market interest rates were little changed after the FOMC meeting. The Fed did not change its guidence of three more increases in 2018, but did extend their time period to include two increases in both 2019 and 2020. Should they follow through with these moves it would take the Funds rate up to 3.25% and the Prime rate up to 6.25% over the next three years. The Fed did increase their **Real GDP** forecast for 2018 to 2.5% from the previous 2.1% expectation in the September release. The mystery of why no **inflation** in an environment of low **unemployment** and strong **consumer final demand** data remains unanswered by the Fed. They continue to say the forces keeping inflation low are transitory. They do believe inflation will reach their target of 2% by the end of 2018, and therefore, continued increases in managed rates is appropriate. The inflation data from last week was slightly higher than has been the case over the past two years. Most of the rise in the headline numbers for the **PPI** and **CPI** was due to the spike in gasoline prices in November. The core rate for the PPI was elevated, but that was not the case for the CPI. The core PCE Price Index is due out this week and is expected to be up only 0.1%. That would leave the year-over-year increase at 1.7%.

The other data from last week was uniformly strong. **Retail sales** were up 0.8% for the month of November, which means **PCE** for the fourth quarter will be better than the 2.3% increase reported for the third quarter. This would make our forecast for **Real GDP** for the fourth quarter of 2.9% light. Consensus expectations for fourth quarter growth has been rising as economic data has been better than expected. This week will have the spotlight on the housing market. **Existing and new home sales** spiked in October and are expected to settle back a bit for November, but the trend in housing continues to be steady growth. We believe housing will contribute to better overall economic growth next year. The **yield curve** continues to flatten as short and intermediate yields react to the Fed and long-term yields do not have an inflation risk premium. The shape of the yield curve is causing funding costs for banks to rise while loan yields remain under pressure. The good news for banks was the progress made on the tax reform bill in Congress. It now appears banks tax rates will drop to 21% in 2018. This should allow banks to grow earnings even if net interest income growth is difficult to achieve. The larger positive would be a steeper yield curve. We do not expect to achieve this until the last quarter of 2018.