VINING SPARKS

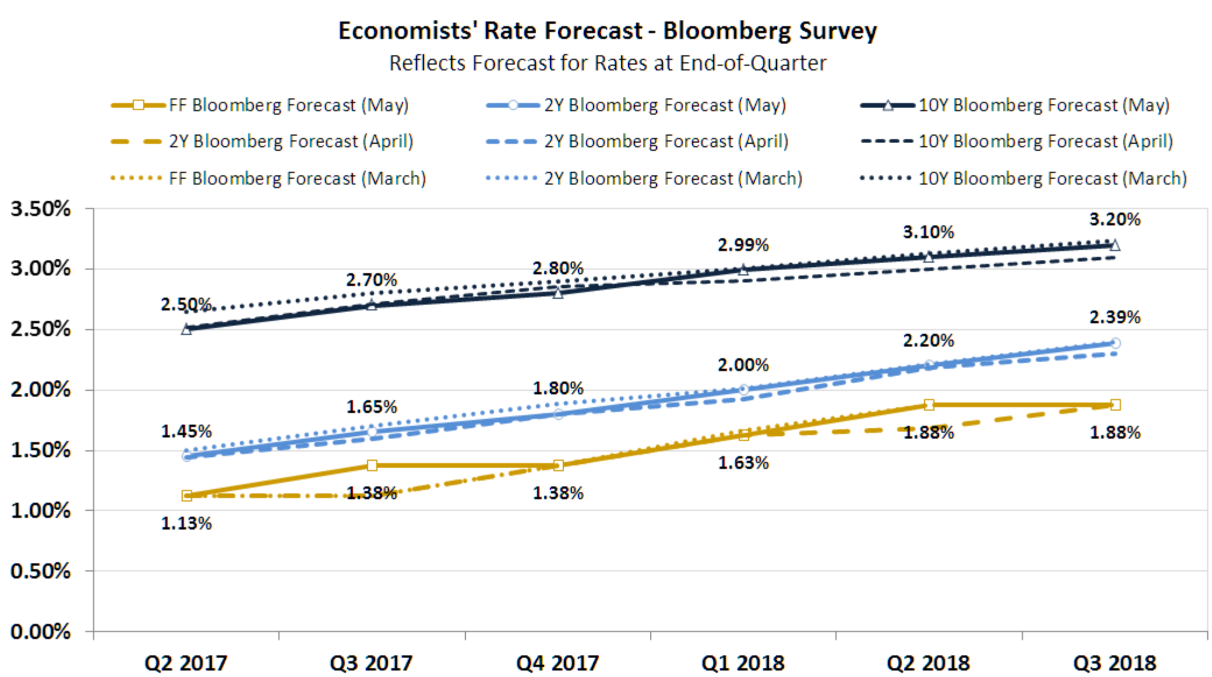
May 2017

Economists Expect Tamer Inflation, Tighter Labor Market, Quicker Rate Hikes

The May 2017 Bloomberg Survey of Economists shows that economists expect economic growth to rebound 3.0% in 2Q , up from April's projection of 2.6% growth, after a disappointing 1Q report. The economy expanded just 0.7% in 1Q (SAAR) according to the initial estimate from the BEA as personal consumption dropped to its lowest rate of growth since 2009. While the weak consumption results were expected, the magnitude of the drop was a bit of a surprise. The rebound in economic growth in 2Q is expected to come from stronger private investment and personal consumption rebounding to an above-trend 2.8% rate. Stronger private investment is expected primarily from a rebuilding of inventories, but also accompanied by recent strength in both housing and business investment.

Additionally, economists expect headline inflation to run at a slower rate of growth in 2H17 despite expectations that the labor market will be even tighter. Headline inflation is projected to increase 2.3% YoY by the end of 2Q, down from April's projection of a 2.5% rate. Inflation for both 3Q and 4Q were also revised fractionally lower bringing the full-year 2017 inflation projection down from 2.5% to 2.4%. Ironically, inflation is expected to be slower despite economists revising their projections lower for the unemployment rate. The unemployment rate is now projected to stick at 4.4% through the end of the year, down from February's projection of 4.6% and April's projection of 4.5%. This looser-than-historical relationship between the strength of the labor market and inflation continues to be a source of uncertainty for interest rate projections. An unemployment rate of 4.4% would be historically consistent with more rapid inflation and, thus, tighter monetary policy than is currently expected. However, this economic cycle has proven to be unique in the amount of existing wage slack that has remained.

Likely the result of the unemployment rate dropping to 4.4% in the April report, economists still expect a rate hike at the June FOMC meeting but have pulled forward their expectations for a 4Q hike into 3Q. However, expectations for the year-end target range of 1.25%-1.50% was unchanged. Economists also expect two additional hikes in 1H18, up from one hike in the April survey, bringing the target range to 1.75%-2.00% by June 2018. With this forecast as a backdrop, economists expect the short-end of the Treasury curve to move up more quickly with the 2-year Treasury yield ending 3Q17 at 1.65% (up 5 bps from the April survey) and 4Q17 at 1.80% (unchanged from the April survey). As for longer yields, economists expect them to be slightly lower in the short term with the 10-year ending 2017 at 2.80% (2.85% in the April survey), but rising more quickly in 2018. The 10-year Treasury yield is now expected to end June 2018 at 3.10% (up from 3.00% in the April survey). Based on the interest rate forecasts, economists have clearly become more confident that the strength in the labor market will be convincing enough for the FOMC to continue its gradual path of rate hikes.



Craig Dismuke, Chief Economist Dudley Carter, Economist

BLOOMBERG SURVEY OF ECONOMISTS (Economic Projections)

May 2017 Survey Results

	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Avg. 2017	Avg. 2018
GDP						
Bloomberg Forecast (May)	**3.0%**	**2.4%**	**2.3%**	**2.3%**	**2.2%**	**2.3%**
Vining Forecast (May)	*2.6%*	*2.4%*	*2.6%*	*1.9%*	*2.2%*	*N/A*
Bloomberg Forecast (April)	2.6%	2.4%	2.3%	2.2%	2.2%	2.3%
Bloomberg Forecast (March)	2.5%	2.4%	2.4%	2.3%	2.3%	2.3%
Bloomberg Forecast (February)	2.3%	2.5%	2.4%	2.3%	2.3%	2.3%
CPI YoY%						
Bloomberg Forecast (May)	**2.3%**	**2.4%**	**2.3%**	**2.2%**	**2.4%**	**2.3%**
Vining Forecast (May)	*2.3%*	*2.6%*	*2.4%*	*2.0%*	*2.3%*	*N/A*
Bloomberg Forecast (April)	2.5%	2.5%	2.4%	2.2%	2.5%	2.3%
Bloomberg Forecast (March)	2.4%	2.6%	2.4%	2.3%	2.5%	2.4%
Bloomberg Forecast (February)	2.4%	2.6%	2.3%	2.4%	2.4%	2.4%
Unemployment Rate						
Bloomberg Forecast (May)	**4.5%**	**4.4%**	**4.4%**	**4.4%**	**4.5%**	**4.4%**
Vining Forecast (May)	*4.5%*	*4.5%*	*4.5%*	*4.5%*	*4.6%*	*N/A*
Bloomberg Forecast (April)	4.6%	4.5%	4.5%	4.5%	4.6%	4.4%
Bloomberg Forecast (March)	4.6%	4.6%	4.5%	4.5%	4.6%	4.5%
Bloomberg Forecast (February)	4.6%	4.6%	4.6%	4.5%	4.6%	4.5%
Average Monthly Payrolls (000s)						
Bloomberg Forecast (May)	**178**	**170**	**165**	**152**	**172**	**154**
Vining Forecast (May)	*175*	*170*	*160*	*160*	*170*	*N/A*
Bloomberg Forecast (April)	173	169	165	154	176	155
Bloomberg Forecast (March)	175	169	160	151	181	150
Bloomberg Forecast (February)	171	165	165	158	171	150

BLOOMBERG SURVEY OF ECONOMISTS (Interest Rate Projections)

May 2017 Survey Results

	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018
Federal Funds Target Rate (Median of Upper and Lower Bounds)*						
Bloomberg Forecast (May)	**1.125%**	**1.375%**	**1.375%**	**1.625%**	**1.875%**	**1.875%**
Vining Forecast (May)	*1.125%*	*1.125%*	*1.125%*	*1.375%*	*1.625%*	*1.625%*
Bloomberg Forecast (April)	1.125%	1.125%	1.375%	1.625%	1.688%	1.875%
Bloomberg Forecast (March)	1.125%	1.125%	1.375%	1.665%	1.875%	1.875%
Bloomberg Forecast (February)	0.875%	0.875%	1.125%	1.375%	1.625%	1.625%
2-Year Treasury Rate						
Bloomberg Forecast (May)	**1.45%**	**1.65%**	**1.80%**	**2.00%**	**2.20%**	**2.39%**
Vining Forecast (May)	*1.35%*	*1.40%*	*1.45%*	*1.50%*	*1.60%*	*1.70%*
Bloomberg Forecast (April)	1.44%	1.60%	1.80%	1.92%	2.18%	2.30%
Bloomberg Forecast (March)	1.50%	1.70%	1.89%	2.01%	2.21%	2.40%
Bloomberg Forecast (February)	1.40%	1.50%	1.70%	1.82%	2.08%	2.20%
10-Year Treasury Rate						
Bloomberg Forecast (May)	**2.50%**	**2.70%**	**2.80%**	**2.99%**	**3.10%**	**3.20%**
Vining Forecast (May)	*2.45%*	*2.50%*	*2.55%*	*2.60%*	*2.60%*	*2.60%*
Bloomberg Forecast (April)	2.52%	2.71%	2.85%	2.90%	3.00%	3.10%
Bloomberg Forecast (March)	2.65%	2.80%	2.90%	3.00%	3.13%	3.24%
Bloomberg Forecast (February)	2.57%	2.70%	2.80%	2.90%	3.00%	3.16%

Source: Bloomberg; All figures are quarter-end. GDP and CPI are annualized.

*In the January 2014 Survey, Bloomberg began reporting economists' projections for the upper and lower bound for the Fed Funds Target Rate.