FED RELEASE/SECOND QUARTER 2017 GDP ADVANCE ESTIMATES

Good day everyone. Thank you for joining us once again here at Seifried & Brew for our weekly briefing. I am Jamie Sumner, chief analyst here at Seifried & Brew. For this week's webcast we wanted to go over the ***Fed release*** last week as well as the advanced estimate of the ***second quarter 2017 GDP*** in here.

So first, let's look at the statement that the Fed put out (Slide 2). Overall, they're indicating that the labor market has continued to strengthen in here. We see that in the job situations report that came out. That's a positive and that economic activity has been rising moderately and that's what we have been seeing in here. When we look at the GDP release, we can see that come through the actual numbers. Overall household spending, they say, and business fixed investment, have continued to expand and that is in fact the case when we look at the overall numbers. However, overall inflation and the measures excluding food and energy prices have declined. So we are stuck in this area where we're seeing some good job growth. We're also seeing now in the second quarter some good economic growth, however, that inflation just is not there. In fact, it's been coming down. We see that in the PCE (Personal Consumption Expenditures). We see that in the CPI (Consumer Price Index) and also in the different producer price indexes (PPI) that are out there. So, overall they're suggesting that it's a relatively moderate type of economy and economic activity out there.

When we look further into their release (Side3), overall they kept the target rate the same, falling between that 1-1¼ in here. That was a unanimous vote. They expect that conditions will continue to evolve that will only warrant gradual increases. And they have had this in here for a number of quarters here or a number of releases. That is gradual increases in the federal funds rate. And they anticipate it to be "below levels that are expected to prevail in the longer run". So, that's at that 3% level. So even though they went through this, increasing that federal funds rate (in fact they're up 100 basis points [bps] from where we were back in 2015), they still say we're not going to reach that 3% for a significant amount of time. In fact, if you look at the implied curve out there and the next rate increase, the probability, is at about 53% for January of 2018. So, it looks like we're going to be staying in here as far as the markets, kind of pricing in, staying at this level for the remainder of the year. The committee, they're continuing the reinvestment of the principle payments and interest payments inside of their portfolio. However, in the last meeting they released their process that they're going to go through when they begin this balance sheet normalization program. This quarter, or this month, when they came out, they said it's going to happen relatively soon. With that stronger GDP that came out on Friday, we would anticipate that that balance sheet normalization process will begin most likely in September unless something happens between now and then. So that's something to look forward to when we do our quarterly briefing with Dr. Ed in September. We'll talk a little bit about that.

Overall 2Q 2017 GDP came in at a 2.6% (Slide 3), stronger than anticipated in here and that's a positive. When we start to break that down and we look at quarter to quarter, we can see (Slide 4) how much of an increase it is over where we were in the first quarter, at 1.4%. During the second quarter release, they do a number of look backs and adjustments to prior quarters and prior year's GDP. So, some of the numbers are slightly different but nothing to be too concerned about. For instance, the last quarter they had it at 1.4% and it came in at 1.2%. So, we saw a little bit of a decline in here. But overall similar to what we've been seeing, so this 2.6% is very strong in here.

We break it down (on Slide 5) into the different components. We see ***Consumer*** segments producing that 193 bps of that 2.6% (a big component in here, very strong). We compare that the last quarter at 1.32% or 132 bps, so we saw a pretty big pickup in here. In that number, durable goods increased significantly this quarter and that was

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almost led primarily by recreational goods and vehicles. That kind of led that durable goods number. Also with inside of services, services picked up a little bit and just promoted that consumer spending, so that is very positive. On the ***Investment*** side adding 34 bps; this is a number that we're kind of excited about because when you break it down a little further you'll see that the equipment number, business equipment investment, really picked up. In fact, it contributed 44 bps to the overall GDP. However, we had to back out some for investments on inventories. That came down a little bit, not as much we saw last quarter, but just a couple of basis points. But residential fixed investment kind of took a backseat, slid down. In fact, when we look in here it contracted, it took away 27 bps from GDP with inside the investments portion. So, we saw this big pullback in that residential investment. And we saw that in some of the residential numbers that came out with the housing starts, permits, and existing home sales. We saw in the second quarter, the first two months in the second quarter, that trailed off a little bit, picked up in June. So, we anticipate, hopefully next quarter, will see that residential real estate come back and show a positive number. ***Government Spending*** here adding 12 bps there. Led almost fully by national defense spending; very strong number in there. In fact, national defense was the only positive in the government number. We had negative changes in the state and local in non-defense numbers and for the government that's led by that national defense budget. ***Exports-Imports*** adding 18 bps to GDP here, or contributing 18 bps. That is just a continual outpacing of exports versus imports and that is a positive inside of the number and the overall economy.

So that's what we have, overall fairly strong GDP number coming out here at that 2.6% growth rate. The Fed looks like they're going to be normalizing their balance sheet coming in the next quarter and we'll see how that impacts the long end of the curve. We will see a pick up on the long end the curve in that 10-year mark and beyond. It looks like we're going to see a little stabilization in the short end of the curve so hopefully we don't continue to see the narrowing of the yield curve producing difficult time for banks in that net interest margin. That's what we have for you this week. We hope to see you back here next week when we look at a variety of different ***interest rate forecasts*** as well, as we should have some numbers coming out on the banking industry in terms of performance for the second quarter. Have a great week everyone.

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