

Economic Outlook

United States

First Quarter 2012
Economic Analysis

- Economic growth will accelerate in 2012
- Energy producing states are seeing an influx of labor and capital
- California's potential growth is under pressure
- Productivity gains are essential to raise U.S. potential growth
- Real estate related debt continues to weigh on bank balance sheets

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Art & Lay out:
Fernando Tamayo and Juan Pablo Arreola

Closing Date: February 10, 2012

1. Editorial

In 2011, for the first time in 62 years, the U.S. became a net exporter of oil products. In addition, crude oil production increased for the third year in a row –unseen since the mid-80s– and reached the highest level in eight years

The transformation of the U.S. into a net exporter arises from three driving forces. First, domestic demand for refined products is projected to grow slowly. Second, robust growth in emerging markets and a burgeoning middle class are creating new sources of demand for refined petroleum products. Third, the U.S. energy sector is a global leader and has exhibited a rapid ability to harness technological change.

As a result of the severe recession, domestic demand for refined fuels dropped sharply. Although demand has recovered, its growth rate is moderating as the pace of economic expansion remains below its pre-crisis average. Furthermore, for certain products such as gasoline, demand has shifted permanently downward due to higher ethanol content in auto fuel, improvements in vehicle fuel-efficiency, alternative sources of energy and a change in consumer preferences toward more energy-efficient and green transportation options.

Across the globe, the rapid expansion of the middle class in emerging markets is boosting demand for autos, gasoline and air travel; this relatively stronger growth will support U.S. exports of oil products to meet both final and intermediate demand. For example, gasoline and low-sulfur diesel exports satisfy final consumption, and products such as petroleum coke are used as intermediate goods. Emerging markets are the primary destination for gasoline. In 2011, Mexico accounted for nearly 60% of total gasoline exports, and another 15% went to Brazil, Ecuador and Guatemala combined. Exports of petroleum coke (used in steel production) are destined for the world's manufacturing centers: in 2011, China and Japan accounted for almost 24% of total petroleum coke exports, and Italy and Spain combined consumed around 13%.

Many industries would not be able to transform themselves into a global powerhouse in the face of ailing demand and lower growth prospects at home; however, the U.S. energy sector has exhibited a remarkable ability to adapt to changing conditions. High energy prices make new drilling technologies cost-effective and are thus boosting domestic production. These new technologies guarantee a more stable source of crude oil and lower the risks of supply disruption from global turmoil. Meanwhile, with strong cash flows and profit growth, energy companies are improving the efficiency of existing facilities and building new ones. This cycle generates a positive feedback loop that is increasing refining flexibility, capacity utilization and the bottom line. Thus, the industry maintains a competitive edge over foreign counterparts.

As a consequence of these trends, job creation and investment in the energy sector remains healthy. Oil and gas extraction and operational support activities together account for only 0.3% of total non-farm employment; however, these sectors generated more than 13% of total jobs between 2009 and 2011. Moreover, between 2001 and 2011, payroll in these two sectors increased 72% compared to a 0.5% decline in the rest of the economy. Capital is flowing to the industry: at the end of 2011, real fixed investment in mining, shafts and wells, has almost reached its pre-crisis level, but it was nearly 40% down for the remaining industries. Job creation across all skill levels and second-round effects across other sectors magnify the overall impact of this boom.

Nevertheless, this seemingly endless prosperity may not come without costs. Environmental concerns have intensified. The U.S. is the second highest greenhouse gas emitter behind China and pollution began increasing with the economic recovery. Additionally, some studies have concluded that new drilling technologies like hydraulic fracturing cause groundwater pollution. Therefore, it is imperative that the government act quickly to implement a long-term energy policy that reduces regulatory uncertainty and creates a stable environment for traditional and alternative energy development. This policy must carefully balance the benefits of greater domestic production and world leadership with environmental concerns. Allowing the industry to leverage its innovation, productivity, clean technologies and exports will help the U.S. move closer to energy independence and ensure that it stays at the forefront of global competitiveness.

Sincerely,

Nathaniel Karp

BBVA U.S. Chief Economist

2. Global Outlook

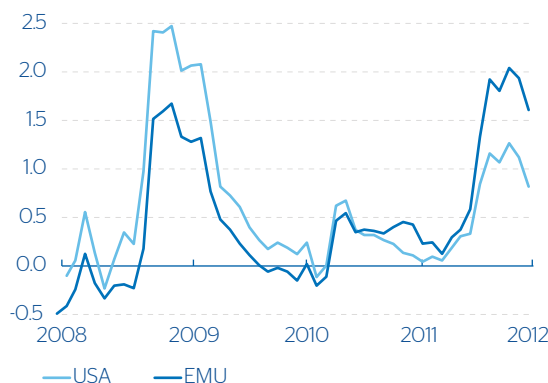
The global economy slowed at the end of 2011, but emerging economies will lead the rebound in the second half of 2012

The global economy decelerated markedly in the last quarters of 2011. This was the result of weaker growth in Europe (which experienced negative growth in Q4) and the deceleration in emerging economies. They grew around 1% quarter-on-quarter at the end of 2011 – the lowest growth rates since the 2008 crisis. However, the drivers of this deceleration are dramatically different. Europe is starting to feel the effects of stubbornly high financial tensions since September (see Chart 1) due to the lack of major advances to solve the sovereign and financial crisis. On the other hand, in addition to headwinds from developed economies, the slowdown in emerging economies is partly the result of deliberate policy tightening through the first half of 2011 to avoid overheating.

Going forward, we expect emerging economies to lead a global rebound in the second half of 2012 as their policies turn to supporting growth. At the same time, even though the US will grow less than in previous recoveries, it will decouple from the financial tension induced recession in Europe. These tensions will remain elevated for a significant part of 2012 because of the delay in solving the crisis. Thus, relative to our previous Global Economic Outlook published in November, we are revising down our forecasts for global growth by 0.6pp in 2012 and 0.3pp in 2013, to 3.5% and 4.1%, respectively (Chart 2)

Chart 1

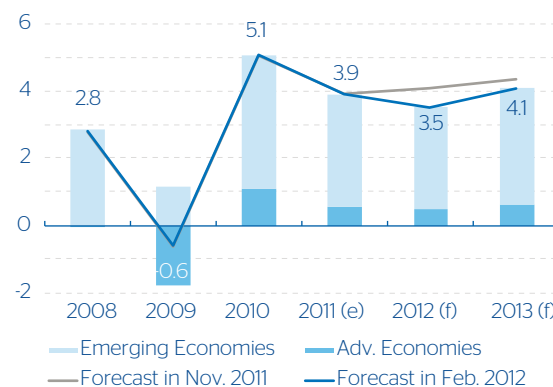
BBVA Financial Stress Index



Source: BBVA Research

Chart 2

Global GDP Growth (%)



Source: BBVA Research and IMF

No major advances have taken place in the resolution of the European crisis. This is still the main risk to the global outlook

Even with the downward revision of growth rates in Europe and emerging countries, we still see risks to the global growth outlook tilted markedly to the downside. These risks continue to hinge on the evolution of the unabated sovereign debt and financial crisis in Europe. Without a resolution, output could contract sharply in Europe and spillover to the rest of the world through trade links, financial exposures and an increase in risk aversion.

Although there have been some advances since October such as the provision of long-term liquidity by the ECB and some agreement to greater fiscal discipline, more decisive action in three main areas are necessary to solve the crisis in Europe. First, to allay concerns about sovereign debt defaults, policymakers must finish the deal with private sector bondholders to ensure Greece's solvency. At the same time, policymakers should erect sizable and credible firewalls around European nations to avoid contagion to illiquid countries. Second, administrations should push key macroeconomic reforms to increase growth. Reforms aimed at repairing financial institutions' balance sheets are necessary, but these measures must take care to avoid sudden deleveraging and a reduction in credit to the private sector. Finally, further advances in euro area governance such as a clear roadmap to a fiscal union are necessary to reinforce the monetary union, prevent future crises and ease the implementation of sovereign firewalls.

In line with those three points, Europe's prospects would improve if all countries approve and implement the agreed upon fiscal compact along with proposed economic reforms for peripheral countries. Subsequently, the discussion should pivot to (i) erecting a sovereign firewall around Greece (or allowing the ECB to act more decisively in bond markets), and (ii) revisiting the deficit reduction targets of most European countries in light of a new recession

Sustained financial tensions have pushed Europe into recession. The growth gap with the US will widen in the next two years

Financial tensions in Europe remain higher than after the fall of Lehman Brothers in 2008 (Chart 1). Thus, we have revised down our growth projections for Europe, and we are now expecting growth of -0.5% for the year. Growth may turn positive in 2H12, but we expect only a slow rebound in 2013. These projections may be optimistic, as they depend on a fast resolution of the crisis and a notable reduction of financial stress to avoid a sharper contraction. Contrary to Europe, the US will exhibit resilience in 2012, as in the last quarters of 2011, but the risks from Europe and high uncertainty about domestic policy will weigh on performance. Nevertheless, the U.S. will outperform Europe and the gap between their respective growth rates will amplify

Strong domestic demand buttresses a soft landing in emerging economies. Going forward, policies will shift to supporting economic growth

In contrast with the fall of Lehman Brothers in 2008, consumer confidence in emerging economies has held up in spite of the ongoing European crisis. One possible explanation for this resilience surrounds the speed at which these crises unfolded: the surprise of Lehman's fall is sharply different from the slow evolution of Europe's quagmire. Thus, in spite of lower capital inflows, reduced asset prices and lower exchange rates due to elevated global risk aversion in the financial sector, domestic demand in emerging economies has held up well.

Economic policies will turn to promoting economic growth in 2012 in contrast to the tightening policies observed in 2011. Thus, domestic demand will continue to drive growth in these markets and buffer the external headwinds from developed economies. Growth rates in emerging economies are expected to approach 2% quarter-on-quarter by the end of 2012 (up from 1% at the end of 2011), and thus result in an annual expansion of 6.2% this year.

3. US Outlook

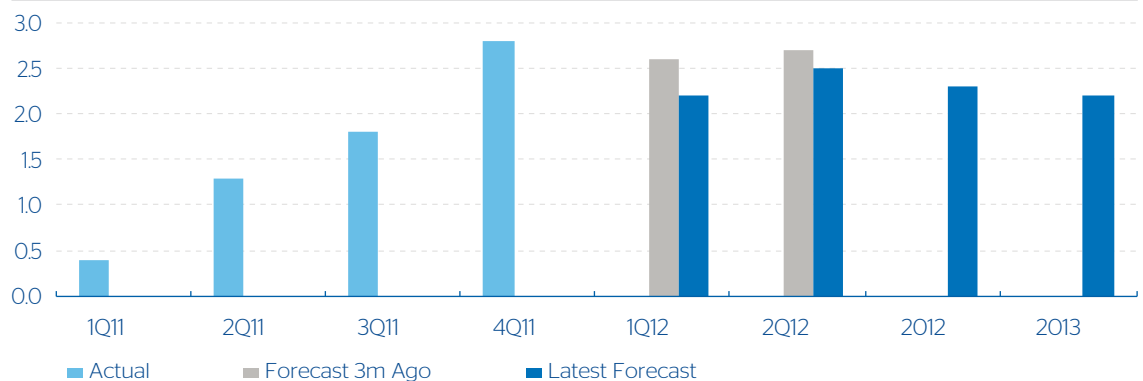
No clear signs of a significant boost in 1Q12

Economic activity has improved since the low point in mid-2011, with consumer and business expectations on the rise. Even still, recent data have been less-than-exciting, with employment and housing data still far below pre-recession peaks. In fact, we expect that the pace of expansion is likely to slow for 1Q12.

Growth in 4Q11 was the strongest of 2011, at 2.8% QoQ annualized, and this momentum should partially carry over into 2012. In particular, personal consumption expenditures should remain similar, with continued strength in durable goods. Although recent declines in consumer confidence levels suggest some hesitation moving forward, improvement in labor market conditions should balance concerns. While the crisis in Europe has not affected all aspects of domestic activity, we expect that the downward pressure on exports will persist. Our baseline scenario for economic growth is the same as in the previous outlook.

Chart 3

Real GDP Growth (Quarterly % Change at an Annual Rate)



Source: BBVA Research

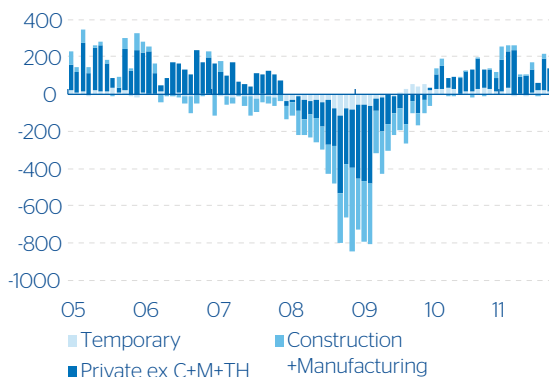
The employment situation has been improving gradually, with relatively stable growth in nonfarm payrolls and a decline in the unemployment rate to 8.3% in January. However, total nonfarm payroll levels have rebounded only 36% in the past two years compared to the pre-recession peak. Jobless claims data has been mostly positive, yet there has been no clear indication that business hiring plans will become less conservative in the near future. Many have argued that the sub-400k level of initial jobless claims combined with a sudden drop in the unemployment rate suggests a more robust than anticipated labor market in 2012; however, our outlook is more conservative. A lack of structural reforms, the effect of changing demographics on labor force participation, political uncertainty, and a higher non-accelerating inflation rate of unemployment (NAIRU) are issues entwined with the role of potential growth. A smaller labor force or higher levels of structural unemployment affect the size of potential growth in the US. The labor market's persistent difficulties also affect the chance of achieving political consensus necessary for deep reforms.

Even with January's boost in nonfarm payrolls, employment gains remain weaker than in 1Q11 and give only some hope for the future of job growth. Hiring has only increased 12% since the end of the recession in June 2009, and structural unemployment remains a significant concern. The current Beveridge Curve is still suggestive of an uptick in structural unemployment, indicating inefficiency in the labor market due to a mismatch between available jobs and the unemployed. The unemployment rate today could embody more structural unemployment than in recent decades, but growth in measures of labor compensation suggest considerable excess resource slack. Our long-held view is that the NAIRU is currently higher than the Federal Reserve's published forecasts

and we expect it to nudge upwards over several quarters. Furthermore, we expect that the growth in average hourly earnings is more reflective of inflation expectations. Overall, we expect that nonfarm payrolls will grow modestly in 1Q12 but not enough to cause significant declines in the unemployment rate. Although we expect job creation to remain weak, it will improve upon 2010-11 job creation and will coincide with moderate economic growth.

Chart 4

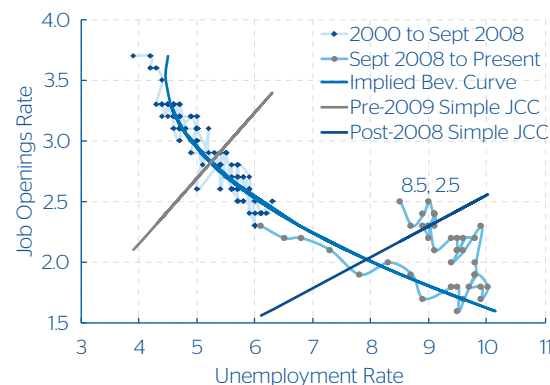
**Private Nonfarm Payrolls
(Monthly Change in Thousands)**



Source: BBVA Research and BLS

Chart 5

National Beveridge Curve

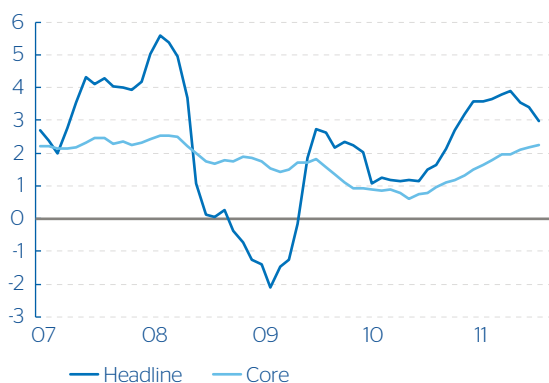


Source: BBVA Research and BLS

Our baseline forecast for inflation remains mostly similar to the previous projections. Headline inflation will continue to decline in 1Q12. Despite high rent costs and the recent bounce back in gas prices, we continue to expect that inflation will decelerate in the coming months given the projected economic environment with downside risks and large economic slack. Although core consumer price inflation has been increasing, core prices will remain within the Fed's comfort zone. We expect that commodity prices will decline throughout 1Q12, particularly with the slowdown and uncertainty in global economies. However, high gas prices could linger and put upward pressure on headline inflation for longer than expected. Employment costs have increased in recent quarters, but growth rates remain low compared to historical trends. The distribution of prices in the consumer price index shows a recent upward trend, but inflation expectations suggest low inflation in the medium and long term.

Chart 6

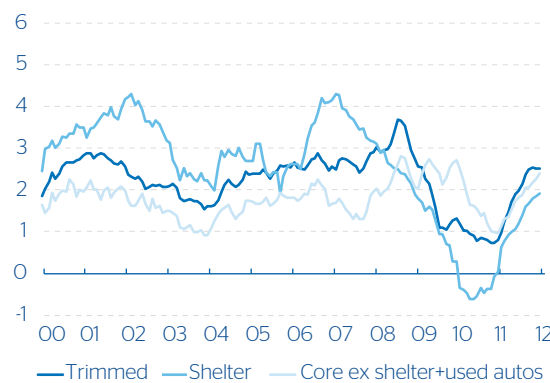
**Consumer Price Index
(YoY % Change)**



Source: BBVA Research and BLS

Chart 7

**Trimmed Mean, Shelter Prices and Core CPI
(YoY % Change)**



Source: BBVA Research and BLS

The lower-than-expected estimate for real GDP growth in 4Q11 is in line with Bernanke's view that the growth outlook is mixed and the recovery not "self-sustaining", prompting the Fed to revise down its growth projections for 2012 and 2013. We still regard the FOMC's projections of US GDP growth as too optimistic, especially given the fiscal drag from expected future austerity measures in 2013. Bernanke regards the housing sector as partially responsible for the damaged link between monetary policy and economic activity. Effects of additional quantitative easing measures will be muted without dealing with the challenges in the housing market. The Fed has implemented several measures to hold down both short and long-term interest rates to incentivize home purchases. The Fed also bought 1.25 trillion dollars of Mortgage Backed Securities between 2009 and 2010 to increase liquidity and keep mortgage financing available. Certainly, while these measures have led to lower mortgage rates, the Fed knows that the effect on mortgage rates of any additional stimulus measures will be limited and insufficient to restore equilibrium in the housing market, given the current oversupply. Therefore, the Fed is waiting for more fiscal stimulus directed specifically to the real estate sector.

In the latest meeting, the Fed also released FOMC members' projections for the Fed Funds target rate for the first time, showing that the rate will remain at or below 1% until the end of 2014. As implied by futures prices, the market had expected a first rate increase around 1Q14 and the statement shifted expectations for interest rates considerably farther into the future. FOMC developments suggest that the probability of another round of large-scale asset purchases has increased but the Fed is not yet ready to embark on these purchases until either a tail risk event emerges or the data clearly suggests a significant slowdown in US growth. We expect that the Fed will be on hold until the beginning of 4Q14. Moreover, Fed interventions and global uncertainties will keep long-term rates low, though we do expect a very moderate upward trend in yields. In the risk scenario, we expect 10-year yields to drop just below 1.5%.

Chart 8

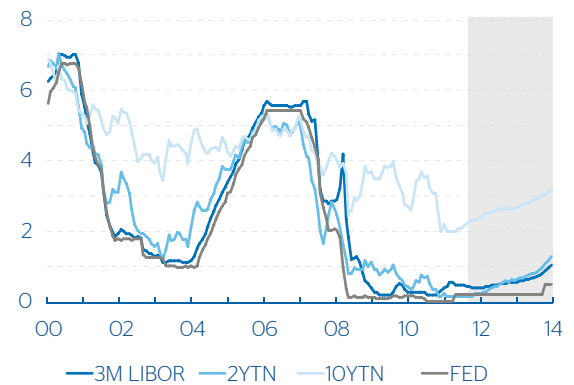
Fed Futures and 10-year Treasuries (%)



Source: BBVA Research and Haver Analytics

Chart 9

Selected Interest Rate Forecasts (%)



Source: BBVA Research

The FOMC has clearly outlined their long-term goals for policy. In particular, they view a 2% YoY growth rate of PCE inflation as most consistent with their inflation mandate. While both inflation and maximum unemployment are equally-weighted, the FOMC will always apply flexibility to the concept based on whatever initial conditions policy faces at the time. The announcement of long-term goals for monetary policy also implies that the FOMC will not tie their efforts to a specific unemployment rate because the Fed acknowledges that unemployment in the short-term may be determined by factors other than monetary policy. As such, the FOMC will focus on the natural rate of unemployment as a loose benchmark for employment maximization. Deviation from one target or the other is tolerable and the response of monetary policy to a deviation will depend on the speed of convergence of the particular goal. Given the Fed's concern with unemployment, we do expect that they will continue to favor loose monetary policy even if inflation surpasses the target.

The Fed has also emphasized that monetary policy is not intended to address the nation's fiscal situation. Unfortunately, political brinkmanship continues to incite fiscal uncertainty, and we do not expect significant reforms until after the presidential election in November 2012. Congress will most likely agree to extend unemployment benefits and the temporary payroll tax-cut for the remainder of the year. We estimate that these measures will add 0.2 to 0.6 percentage points to real GDP growth in 2012.

Housing activity will continue to be a drag on the recovery through 2012. Despite recent sparks in housing demand, levels remain near historical lows and are far from a recovery compared to pre-recession peaks. High excess inventories, tight credit conditions and an inefficient foreclosure process weigh on housing prices. Attractive prices, in combination with low mortgage rates, have not yet boosted demand enough to stimulate the market. Following the Fed's advice, the Obama Administration announced an expansion of the Home Affordable Modification Program (HAMP) to help debt-laden and underwater borrowers. This announcement is the Administration's first move in 2012 to support the housing market, prevent foreclosures and help homeowners repair their balance sheets. The initial HAMP program has been proceeding slowly. It was expected to reach 4 million homeowners, but it has seen only about 900,000 successful modifications, and thus, this new plan is an attempt to reach more borrowers and entice lenders to participate.

Previous attempts related to the Home Affordable Refinance Program (HARP) had limited impact on housing activity. While the elimination of certain fees and limitations might have encouraged borrowers to refinance, the changes ultimately ignored those households with negative equity or without government-backed loans. Thus, many homeowners remain underwater. Beyond extending the filing deadline by an additional year to the end of 2013, the new rules to HAMP will greatly expand eligibility for the program to include underwater borrowers, homeowners with high debt payment to income ratios, and investors who own rental properties, and will also triple the payment to banks (and Fannie Mae and Freddie Mac) for reducing principal (from \$0.21 per dollar forgiven to \$0.63). Certainly, the higher payment provides an incentive for lenders to modify the mortgages of underwater borrowers and those with high debt service ratios. If the program includes large-scale rental conversion programs for real-estate-owned properties and it could support home prices and housing activity.

The commercial real estate sector appears to be faring slightly better than residential, though weaknesses still persist. The steady increase in commercial mortgage-backed-security delinquencies in the office segment is related to job losses in financial services, particularly in finance and real estate. Weak job creation in these sectors will keep office vacancy rates elevated throughout 2012, however, performance differs significantly across regional markets.

Overall, our growth outlook for 2012 is stronger compared to 2011. We maintain our 2012 real GDP growth forecast at 2.3%. However, economic activity will be limited by downside risks, including slow job creation, housing stress, and continued global uncertainties. Furthermore, the rise in political uncertainty is likely to continue as the 2012 presidential campaign heats up. While risks remain tilted to the downside for 2012, another Lehman-type crisis is unlikely.

4. Regional Outlook: A Dissection of Employment Trends

Over the past year, the unemployment rate made step-wise drops in January 2011 to just above 9% and in January 2012 to just above 8%

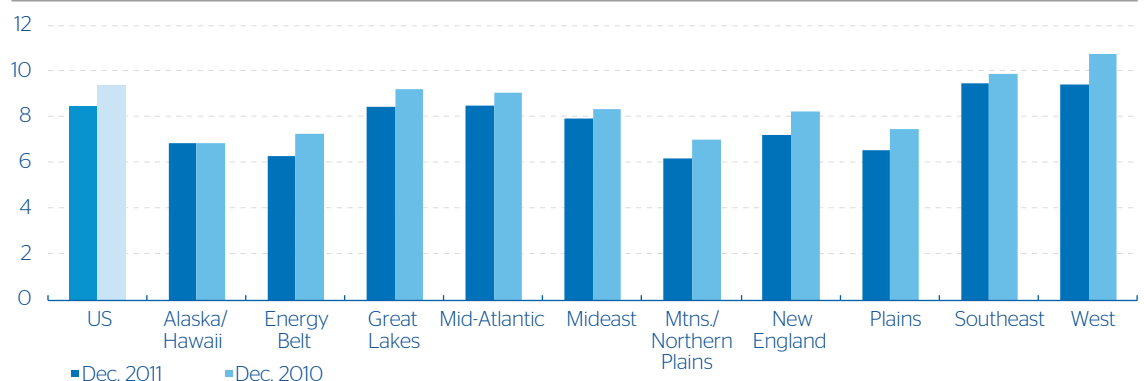
This rapid decline, however, masks underlying weakness in the economy as many job seekers have dropped out of the labor force and the labor force participation rate continues to decline below 64%. Furthermore, the employment to population ratio has remained low and essentially flat since late 2009 at around 59% - well below its pre-recession peak of over 63%.

This statistic is shaping the debate around whether structural unemployment is restraining growth. Certainly, fewer people in the workforce reduce the productive capacity of the U.S. economy, and the longer that a worker remains unemployed, the faster his or her skills depreciate. Looking across employment by occupation and industries, it is evident that the bulk of jobs have been lost in construction and office support activities, and further job losses in construction and financial and real estate services certainly do not help the picture. Nevertheless, job gains are occurring regionally in construction, healthcare, software design, and energy extraction, among other industries, and many people will need to transition into these industries to fill labor demand.

Looking across regions in the U.S. offers us a glimpse as to which industries are driving employment gains and where we can expect growth to continue this year. We have categorized the 50 U.S. states into 10 regions, and the states are grouped both geographically and thematically. For example, the Energy Belt consists of the key energy-rich states of Texas, Colorado, New Mexico, Louisiana, Wyoming, Utah and Oklahoma. At the end of 2011, the regions with the lowest unemployment rates well below 6.5% were the Mountain/Northern Plains region and this Energy Belt. In the former region, the explosive growth of North Dakota due to energy production contributes to the region's average. The Plains region's unemployment remains below 7%, as high commodity prices have boosted demand for farmland and agricultural output. The regions that are struggling with high unemployment above 9% are the West (led by California and Nevada) and the Southeast (led by Florida, Georgia and Mississippi).

Chart 10

Regional Unemployment Rates, SA,(%)



Source: BBVA Research

Several key sectors are contributing to an elevated unemployment rate. First, construction activity remains weak on a year-over-year basis: elevated inventories of unsold homes weigh on the rebound in this market. Furthermore, high vacancy rates in the commercial real-estate office and retail segments compounds the problem, as there is minimal need for new shopping centers and office buildings when domestic demand remains low. A turnaround in these areas will depend on job creation in key office-using sectors such as financial services and other professional services. Nevertheless, construction employment made modest gains across some regions last year. We estimate that for every 1% increase in annual construction employment, a state's growth rate increases by approximately 9 basis points.

The region with the highest growth rate in construction employment is the mountains/northern plains area, primarily because construction employment in North Dakota is up over 20% as the influx of new residents need places to live, work and shop. This growth alone would add nearly two percentage points (pp) to the state's growth rate. The Southeast region remains the most depressed, as home prices continue to fall in that area, and office vacancy rates are among the highest in the nation. Home prices began falling in Georgia and Alabama later than other states; thus, they are projected to continue to fall throughout 2012. In Florida, elevated foreclosures are adding to the housing inventory, and therefore construction employment will remain muted in this region throughout 2012. The decline in construction employment has reduced the region's GDP expansion by 0.3 pp in 2011, and we anticipate that it will be a net drag in 2012 also.

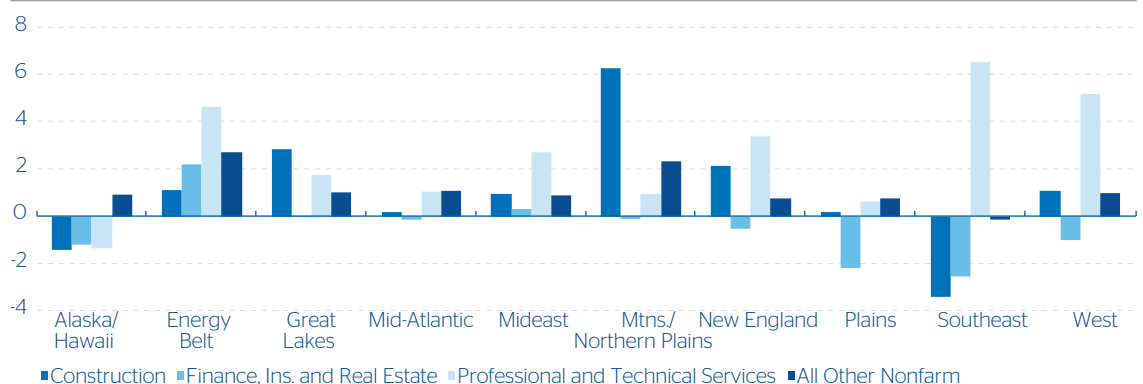
Unfortunately, as the contribution of financial services and real estate to GDP is declining, job reductions in these sectors may continue throughout 2012. Our estimates indicate that for every 1% expansion in financial and real estate services increases state-level GDP growth by 7 and 3 basis points, respectively. The following chart illustrates that the growth in finance, insurance and real-estate related employment only grew appreciably in the Energy Belt region in 2011 (adding approximately 0.2 pp to growth), and it continues to struggle in the Southeast and West regions.

Aside from mining employment gains related to the energy boom, a bright spot for employment has been the growth in professional and technical services – particularly in engineering-related and computer software design services. A 1% expansion in this sector's employment contributes between 7 and 10 basis points to the GDP growth rate. The strongest growth in these professional sectors has actually in the weakest performing region: the southeast. Georgia, and primarily Atlanta, has added about 19,000 jobs in these sectors alone. Florida, too, has seen sizeable job creation in the professional and technical services; however, a large contributor has been legal services undoubtedly due to the slow foreclosure process and the substantial number of delinquent loans. Thus, in spite of other sector employment declines, the rapid growth here has added around 0.5 pp to the region's growth rate last year.

In the West, strong job creation in professional and technical services is also boosting employment across other sectors. These high-wage jobs in fields such as computer programming, scientific R&D and engineering services are directly contributing to a strengthening of demand in California, Oregon and Washington, and boosting the region's GDP growth rate by nearly half a percentage point.

Chart 11

Regional Employment Growth, Selected Sectors, (YoY % Change)



Source: BBVA Research

In summary, widespread employment creation is not occurring across every sector in each region. The Energy Belt is the only area in which the year-over-year employment growth is positive in construction, finance, real-estate and professional and technical services. Nevertheless, region-specific industrial concentrations are bolstering economic growth, and indeed, our state monthly activity indexes indicate expansion is continuing in 49 states and strengthening in nearly 2/3 of states in early 2012. While the nationwide average pace of economic expansion is expected to remain just above 2 percent in 2012, regions within the United States are poised to grow at diverging rates as fervent demand for industry-specific output drives expansion during the coming year.

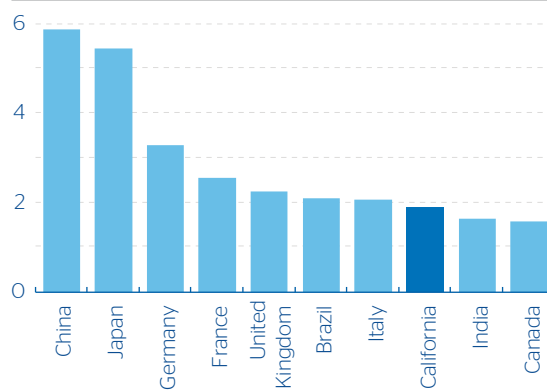
5. California Pulls Ahead, but Tech Alone Won't Be Enough

California Outlook

Despite the severity of the recession, California remains one of the most important economies worldwide. The state's GDP alone is the 9th largest in the world (almost \$2 trillion in 2010), with the 8th largest income per capita worldwide (\$51,000 in 2010). California's competitive advantages relative to other states are helping the economy to transcend the recession's impact and position itself for growth.

Chart 12

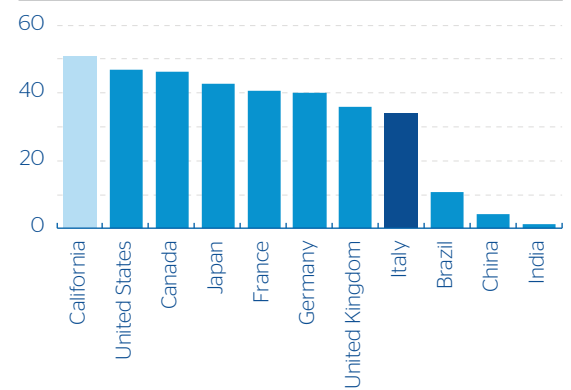
2010 GDP, (Billions of USD, Ordered by World Rank, US (#1) 14.5 Trillion)



Source: BBVA Research

Chart 13

GDP Per Capita 2010 (Thousands of USD)



Source: World Bank and BBVA Research

Good news for 2012

In our baseline scenario, California is expected to expand above the U.S. average. Last year, California showed the first signs of a sustained economic recovery. The economy added 263,000 jobs in the year, the largest net increase among all 50 states. Compared to the approximately 1.3 million jobs lost during the recession, 2011's additions suggest a positive but modest improvement. Thus, the unemployment rate has eased but remains high at 11.1%. The employment situation varies across industries. On the one hand, professional and business services, retail and wholesale trade, leisure and hospitality and education and healthcare account for 60% of job gains in 2011. The government was responsible for 20% of net job creation during the year due to a rebound in local government employment. On the other hand, employment in the manufacturing, construction and finance, insurance and real-estate sectors remains subdued. For example, only 21,300 new jobs were created in construction, a significantly small amount relative to the 388,000 jobs lost since 2006

Chart 14

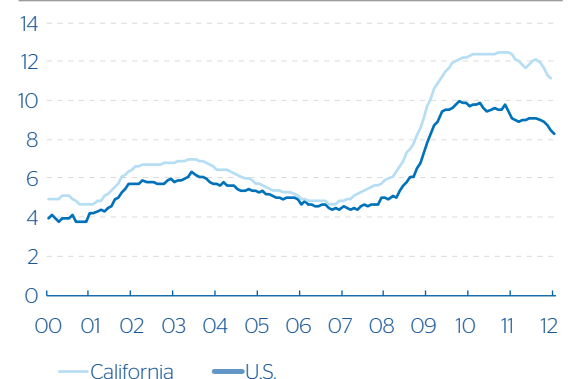
Nonfarm Payroll in 2011 vs. Av. 2007-2004 (Annual Change, Thousands)



Source: Bureau of Labor Statistics

Chart 15

Unemployment Rate California vs. U.S. (% , SA)

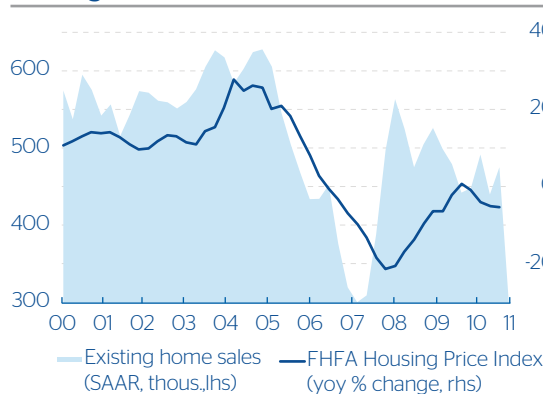


Source: Bureau of Labor Statistics

The weakness in the construction sector is due to still fragile conditions in the housing market. Both building permits and existing home sales have moderately improved; however, home prices continue to decline on a year-to-year basis as foreclosures add to inventory. In fact, the foreclosure rate is declining along with delinquencies. According to the S&P Case-Shiller Home Price Index, prices are falling slightly more than 5% for the metropolitan areas of Los Angeles, San Diego and San Francisco. Statewide, home prices are expected to drop by around 5% year-over-year in 2012. Declining delinquencies signal improvement in the housing market; however, tighter credit conditions limit its pace.

Chart 16

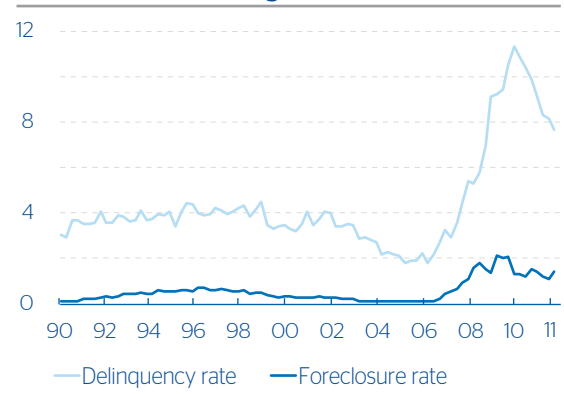
Building Permits and Existing Home Sales



Source: National Association of Realtors & FHFA

Chart 17

Mortgage Delinquency and New Foreclosures (% of total outstanding loans)



Source: Mortgage Bankers Association

Critical to California's exports, demand for high-tech products is expected to remain strong as domestic demand strengthens and emerging markets continue to expand at a 6.2% projected rate. Nevertheless, exports of high-tech goods appear to have decelerated, perhaps due partly to dollar appreciation and the slowdown in Europe that is weighing on aggregate exports.

Chart 18

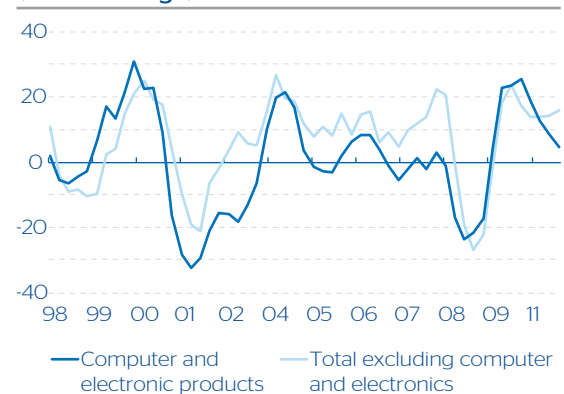
Shipments and Orders of Computer and Electronic Products (YoY % change)



Source: Census Bureau

Chart 19

Exports (YoY % change)



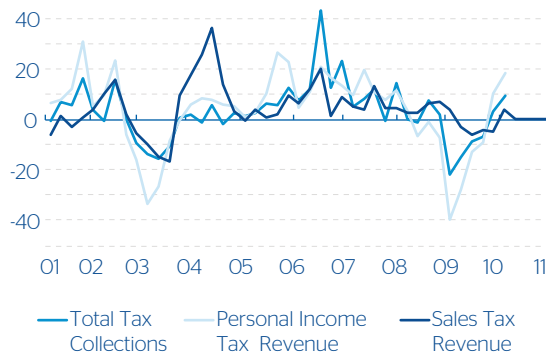
Source: Wiser Trade

In the fiscal arena, more jobs and higher consumer spending led to an increase in tax collections; however, there is still an expected \$9.2 to \$12.8 billion gap in the general fund that needs to be addressed between now and the start of the 2013 fiscal year. To reduce this shortfall, the government is proposing a series of tax increases: a temporary personal income tax increase to wealthiest Californians plus a permanent increase to sales and use taxes. Additionally, the proposal includes spending cuts to social assistance programs. If voters reject these proposals in November, \$5.3 billion in automatic cuts will be triggered that disproportionately affect schools and community colleges.

Although the government is taking necessary steps to alleviate the shortfall, spending cuts in key areas such as education and social assistance may have negative implications in the long-run. In particular, spending cuts in education could affect human capital formation, productivity and growth. Furthermore, cuts to university budgets may leave them less competitive and with a reduced ability to recruit top talent. To avoid draconian spending cuts in strategic areas, the government must increase revenue; however, the political system does not allow a rapid and efficient solution. California's direct democracy requires residents to vote for any attempts to increase revenues through tax increases, and getting a majority of residents to vote for higher taxes could prove difficult, particularly in times of economic distress.

Chart 20

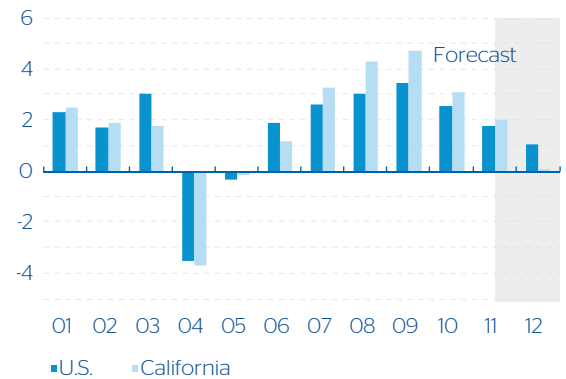
Tax Revenues (YoY % change)



Source: Haver Analytics

Chart 21

GDP (YoY % change)



Source: BBVA Research & Haver Analytics

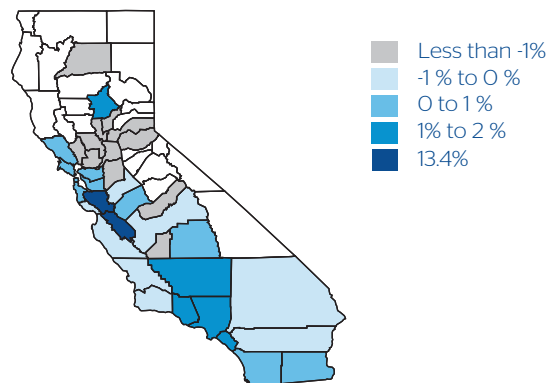
California in the long-run

Our estimates point to a 2.6% potential GDP growth over the next decade. This is higher than our expectations for the U.S., currently at 2.2%. There are three main factors that account for this difference: demographics, concentration of high-value added industries, and international trade.

California continues to be a magnet for investors and workers specialized in high-tech industries. Approximately 40% venture capital investments (\$8.4 billion in 2010) go to Silicon Valley. According to TechAmerica Foundation, in 2010 there were 42,000 establishments and 931,000 workers in California's high-tech industry. Average wage was \$110,600 per year, 119% more than the average wage in the private sector. The total payroll in California's high-tech industry was \$102.9 billion, the largest in the nation. California's high-tech firms employ approximately 78 out of 1000 workers in the private sector, ranking 7th in the nation. The San Jose-Sunnyvale-Santa Clara metropolitan area contributed 1.2 pp of the state's 1.9% GDP growth in 2010. The high-tech industry is expected to contribute strongly to California's economic activity as domestic capital expenditures and international growth support growth.

Map 1

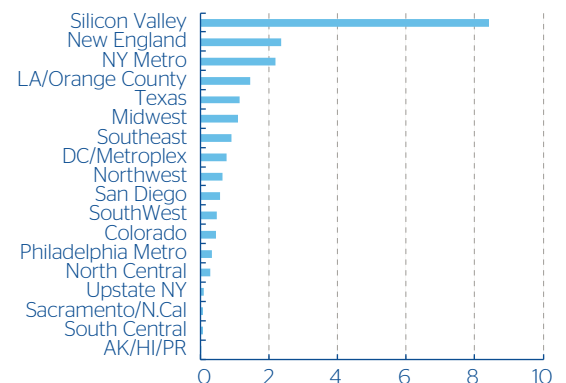
GDP Growth Rate 2009-2010 Annual % Growth of GDP, by MSA (shaded by counties, white=no data)



Source: BBVA Research

Chart 22

Venture Capital Investments in 2011 (\$ billions)

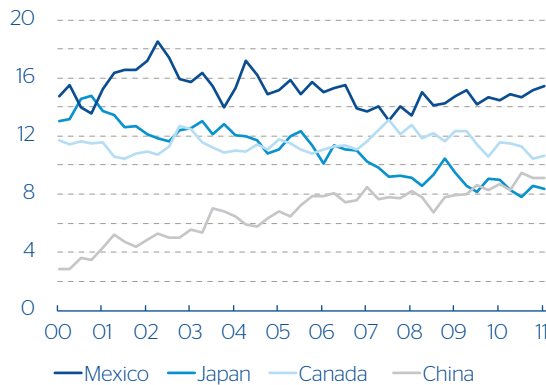


Source: National Venture Capital Association

Other successful industries located in California include agriculture and the food and beverage manufacturing industry. In 2010, California's agriculture industry generated almost \$38 billion in revenue, nearly 12% of total farm revenues in the U.S. Agriculture and processed food is the second largest export commodity after computer and electronics. California also has a competitive advantage in media and entertainment. Hollywood accounts for almost half of domestic film production in the United States, and this industry is expected to generate \$30.9 billion revenues by 2016.

Chart 23

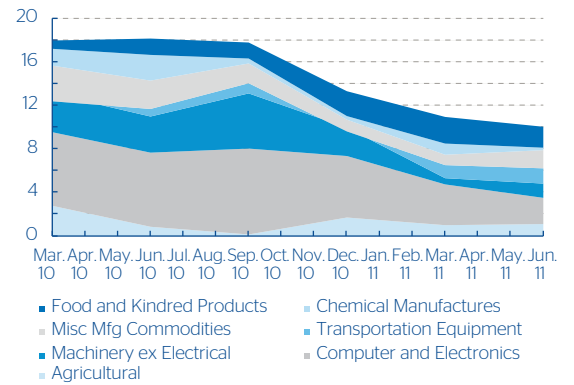
Share of Exports, by Destination (%)



Source: BBVA Research

Chart 24

Contribution to Export Growth (percentage points of YoY % change)

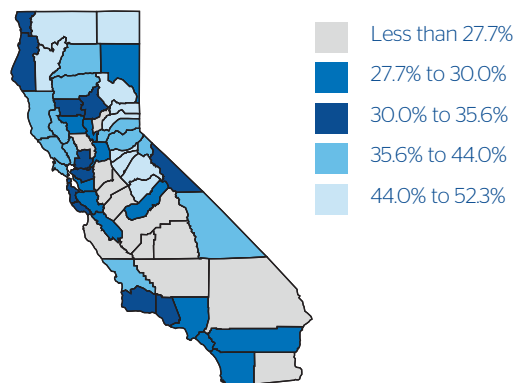


Source: BBVA Research

International trade will continue to support California's economic growth for several years due to solid global demand and a privileged geographical position that provides direct access to Asian markets and NAFTA partners. In 2010, the state exported \$143.3 billion in goods, 11% of total U.S. exports. Computer and electronic products account for one third of total state exports, followed by agricultural products. These sectors will benefit from global demand for food and technology, which has been propelled by rapid economic growth in emerging markets and a burgeoning middle class. For example, exports to countries such as Mexico and China continue to gain momentum.

Map 2

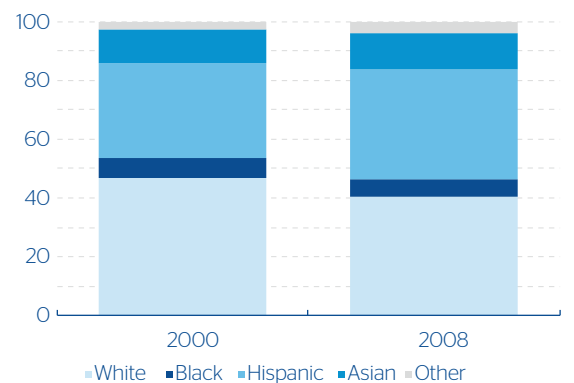
Share of Population Age 50+ (2010 by quintiles)



Source: U.S. Census/Haver and BBVA Research

Chart 25

Composition of Population (Share of Population by Race)



Source: BBVA Research

California will continue to benefit from population growth that is expected to reach 0.94% by 2030; this rate is higher than the 0.64% expected for the U.S. Nevertheless, the demographic landscape is changing and imposes some challenges. As in the rest of the nation, California's population is aging. The median share of the 50 and older population across counties increased from 27% to 32% in ten years. In 2010, 14 counties had slightly more than 40% of their population age 50 and older. The largest change has occurred in the north. An aging population will boost the demand for

medical services but it will also put substantial pressures on the fiscal budget. Secondly, hispanics are increasing their share of total population. Over the past decade, Hispanics accounted for nearly 80% of the natural increase in total population. According to the American Community Survey, Hispanics have a larger share of young individuals in the labor force, which supports tax collections and the supply of workers in labor-intensive industries; however, their average educational attainment falls below the national average, resulting in lower income prospects. Net foreign immigration has remained steady, which allowed agriculture, construction and manufacturing to benefit from a constant supply of cheap labor; however, stricter security in the border, tougher immigration policies at the state level and the lack of comprehensive immigration reform at the national scales, could significantly increase the cost of hiring.

From 2000 to 2008, an average of 54,000 white- and 7,337 African-Americans have left the state every year. Although the motivations are not specified, there is reason to believe that outward migration is the result of adverse economic events that started with the dotcom burst and were followed by the housing crisis and the subsequent recession. On the contrary, net migration of Hispanics has been positive during the same period with an average of 145,000 individuals moving to the state every year. The housing meltdown reduced this flow to an average of 105,000 between 2007 and 2008; however, it is likely to have improved in the following years. If these trends continue, by 2012 Hispanics will comprise 40% of the state's total population -becoming a "minority-majority" group with the largest share.

Bottom Line

California's internal strengths are gradually helping the economy expand. Companies are hiring again and exports are growing robustly. Nevertheless, risks are still tilted to the downside. The housing market is still weak and it could take several years to recover. Meanwhile, although the state's budget gap has declined significantly, current shortfalls will require additional spending cuts and tax increases that could hurt the state's competitiveness in the global economy. In the long-run, prospects for California are positive due to three main factors: first, the concentration of high-value added industries; second, higher population growth than the national average, and a constant supply of labor that will cushion the impact of an aging population; and third, a strong reliance on international trade that will benefit greatly from sustained growth in emerging markets. The combination of these factors result in a higher potential GDP growth rate than the U.S. average.

6. Is Productivity the Answer to Boost US Economic Growth?

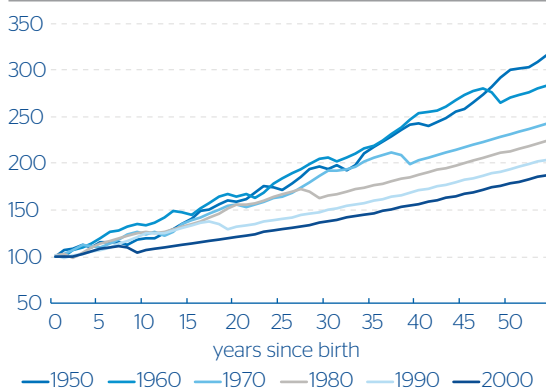
Younger generations will experience a less favorable increase in their standard of living

The US economy gradually accelerated throughout 2011, to 2.8% GDP growth in 4Q, but it only registered 1.7% for the year. Our models indicate that the economy will expand at a faster rate in 2012 but the path to sustainable and robust long run growth is not readily apparent. In the long run, current trends point to a lower growth rate than US households experienced before the 21st century. This fact raises many questions: what will be the main drivers of economic growth in the US, and how fast will the economy grow in the future? Will the US remain the world's superpower? These are just a few of the many potential questions we could ask, and to assess them, we will briefly discuss the main determinants of long-term growth and focus on the productivity of the US economy.

With the current dynamics, younger generations will experience a less favorable increase in their standard of living. The recent financial crisis swept away a significant portion of households' financial wealth and decreased potential US growth by increasing structural unemployment and decreasing the labor participation rate. In addition, baby boomers are beginning to retire and there are fewer college educated workers to replace them. Strict immigration policy and rising job opportunities for educated and highly skilled workers abroad means that much foreign talent will not flock to the US. These changes would decrease US potential growth and therefore, gains in the standard of living will be less compared to previous generations. Chart 26 displays how the standard of living (measured in terms of GDP per capita) of US households has evolved among different generations over 55 years. Just a quick calculation indicates that a person who was born in 1950 experienced an increase of 223% in her standard of living when she turned 55, whereas a person born in 2000 will likely experience only a 90% increase in his standard of living by 2055. This fact is clearly present in historical real GDP growth (see Chart 27). The US economy grew, on average, only 1.6% per year between 2001 and 2011. Even excluding the financial crisis, the average growth rate is significantly lower than the historical average.

Chart 26

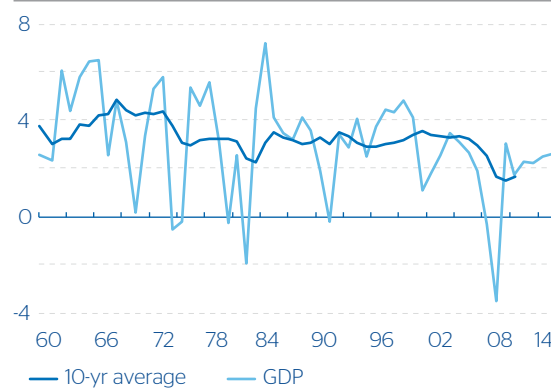
Evolution of Real GDP Per-Capita, by Birth Year (Birth Year = 100)



Source: BBVA Research and BEA

Chart 27

Real GDP (YoY % change)



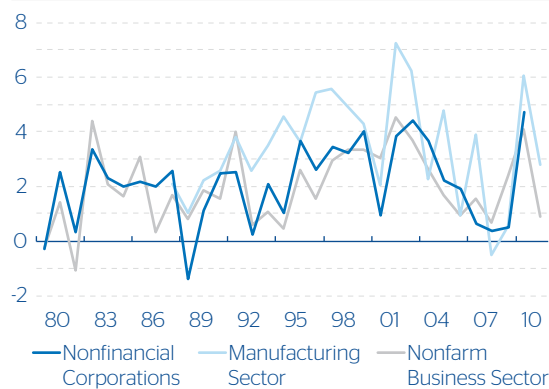
Source: BBVA Research and BEA

The only solution for the U.S. to ramp up growth is to see surges in productivity. Potential growth depends on labor, technology (or productivity) and capital but productivity is one of the most important factors that determine the standard of living of households. An increase in productivity increases economic growth without the need for additional capital or labor. Therefore, an increase in productivity leads to an increase in output per person, or a country's standard of living.

Productivity can be broadly defined as how much output is obtained from a given set of factors of production and it is usually measured in two different ways. Single-factor productivity measures the amount of output produced per unit of a particular factor of production. Labor productivity is one of the most cited measures of single-factor productivity, and the most commonly used measure is real output per hour worked. Chart 28 shows that US labor productivity has increased 4.1% on average from the start of the recovery in 3Q09 to 4Q11, significantly higher than the historical average of 2.2%. This trend is more obvious in the manufacturing industry where the labor productivity increased 6.0% in 2010. Labor productivity has gained momentum during the recovery as many businesses were able to maintain or increase production even while they were shedding employees. Over the same period, average hours worked returned to pre-recession levels, thus current employees were working more intensively. This trend is likely to end as the businesses start to hire and therefore, the contribution of labor productivity to economic growth will diminish.

Chart 28

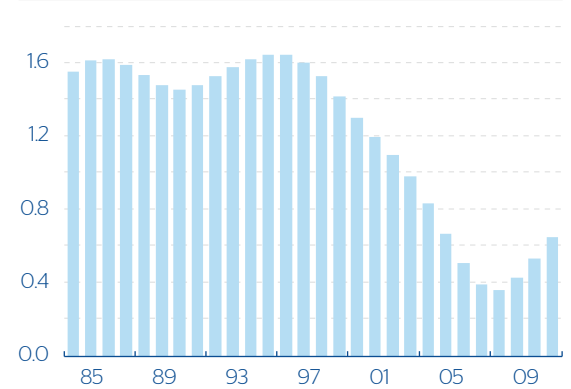
Real Output Per Hour, All Employees (SA, 2005=100, YoY % Change)



Source: BBVA Research and BLS

Chart 29

TFP Contribution to Real GDP Growth (%)



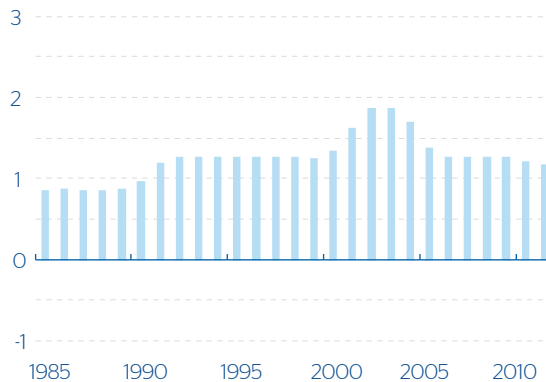
Source: BBVA Research

Although it is widely used, the measure of labor productivity is affected by the intensity of capital usage in production. Two countries may have same production technology, but one may have more capital and thus higher measured labor productivity. Therefore, the measure of labor productivity might be misleading in some cases. Many countries publish multifactor productivity (or total factor productivity (TFP)) which is invariant to the intensity of a particular factor of production. We measure the TFP by employing a general production function that is widely used in economic literature.

$$Y_t = A_t F(K_t, L_t)$$

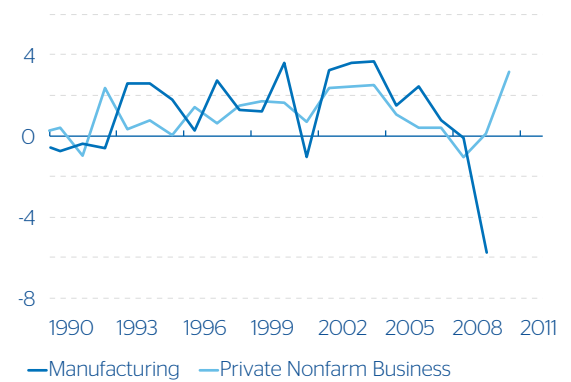
Where Y_t is output, L_t is labor and K_t capital stock and they are all observable. Any change in output that can not be explained by either capital or labor will be measured as technology, A_t (i.e. TFP) which is a residual in the equation above. Our calculations indicate that TFP contributed 1.1 percentage points on average to economic growth per year in the US over the last 45 years. However, its contribution declined to 0.4 pp in the last 5 years. The Congressional Budget Office (CBO) publishes TFP calculations following a similar methodology. According to the CBO, TFP increased 1.27% per year on average in the last 27 years. Moreover, in the last 5 years, TFP growth held steady at 1.25% per year indicating that productivity advances kept the US economy from falling into a deep recession – economic growth in the same period was 0.6% per year on average.

Chart 30
**Total Factor Productivity
(YoY % Change)**



Source: CBO

Chart 31
**Multifactor Productivity (2005=100)
(YoY % Change)**



Source: BBVA Research and BLS

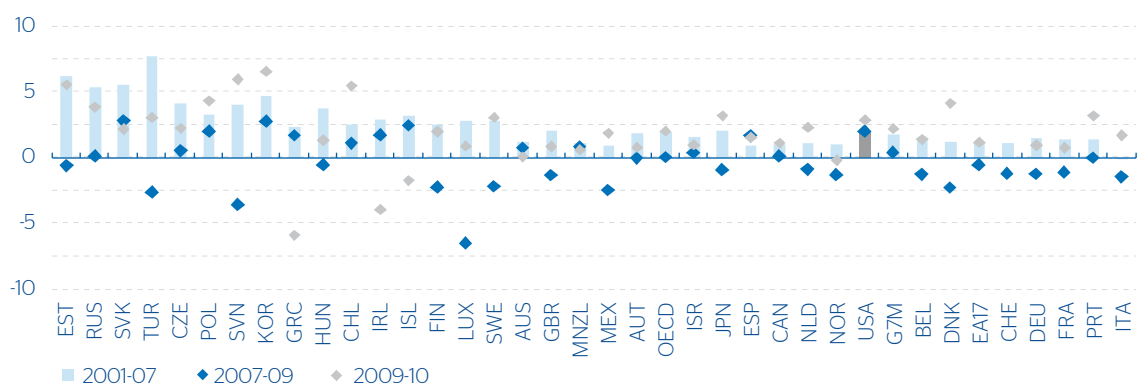
The Bureau of Economic Analysis (BEA) also measures multifactor productivity but with a longer time lag. The BEA's multifactor productivity measure goes back to 1948 and it is available through 2010. The data reveals that productivity in the manufacturing sector has trended downward; however, the nonfarm business and total private business sectors have seen a surge in productivity. Our estimations indicate that multifactor productivity will remain one of the main contributors to economic growth in the US. However, it will not be enough to boost long term growth to pre-2000 growth rates given the current trends in the labor market and changing demographics. To increase productivity significantly, the US must address its structural weaknesses.

The US has to find its new IT revolution

The U.S. economy has benefited from the surge in information technology (IT) in the 1990s. However, the boost from IT cannot solely drive the entire economy. Therefore, the U.S. has to find new ways to advance progress in IT and find revolutions in other sectors that will stimulate widespread economic growth for the long-term.

The most important element of multifactor productivity is human capital which includes workers' stock of education, training and experience. Currently, the US has some of the most productive workers in the world – largely due to their wealth of knowledge – but the gap between the US and other countries is narrowing. Chart 32 shows labor productivity and growth in GDP per capita for selected countries.

Chart 32
**Contribution of Labor Productivity to GDP per Capita
(YoY % Change)**



Source: OECD

One reason for this narrowing gap stems from relatively faster growth abroad. Emerging markets such as Brazil, Russia, and China are competing with the US to attract educated and talented workers as they build their own stock of human capital. In the last two decades, these countries suffered from the proverbial brain drain issue as talented workers flocked to the U.S.; however, during the past couple of years, educated workers are flowing back to these countries after receiving a U.S. university education. U.S. immigration policy is closely related with the issue since strict visa rules prevent well-educated people from being able to work in the U.S. and thus they choose to return to their countries.

In addition to considering immigration policy, the U.S. government can support policies that clarify regulations, incentivize new investment and support research and development (R&D) spending. For the future, R&D spending is crucial to achieve future advancements in productivity and thus raise a country's standard of living. The U.S. spent 2.7% of its GDP in 2007 on R&D, ranking eighth in the world behind Israel, Sweden, South Korea, Finland, Japan, Switzerland and Iceland. In many countries, the public sector provides dollars for R&D, and this funding is crucial for the private sector to make new discoveries. Government spending on R&D grew around 1.5% annually through 2008. However, due to austerity measures, resources devoted to R&D have been limited. Given that the U.S. still faces sizeable public deficits for the foreseeable future, pressure will mount to make additional cuts.

The source of a significant increase in productivity has been associated with progress in information technology (IT) along with advancements in management styles, inventory management, competition, deregulation and flexible markets. In all these areas, the US economy ranks near the top globally. However, continued advancements in these fields will improve competitiveness and efficiency.

In summary, the U.S. economy is facing a challenging task. Given current trends in the labor participation rate, structural unemployment, decelerating productivity growth and changing demographics, younger generations may experience a less favorable increase in their standard of living relative to their parents. We estimate that the US economy's potential growth is 2.2-2.3% per year on average during the next 10 years. This rate is significantly lower than its historical average. An increase in productivity could be the answer to raise GDP per capita but the U.S. should address its structural challenges such as immigration policy and large fiscal deficits and focus on enhancing innovation and improving infrastructure to boost productivity.

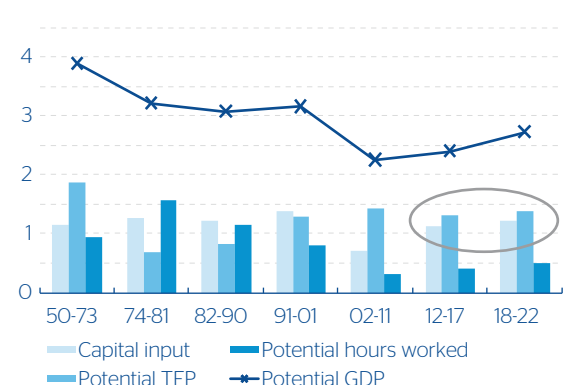
Based on our calculations, if the U.S. succeeds in tackling these issues, potential growth could accelerate. Charts 33 and 34 outline this scenario. In this case, productivity growth accelerates to 1.4% per year over the next decade, and the contribution of capital to potential GDP increases above 1% per year due to higher investment. In total, potential growth reaches 2.6% per year over the next decade and would result in a faster rise in the standard of living for younger generations.

Chart 33
**Potential GDP and Productivity
(YoY % Change)**



Source: CBO and BBVA Research

Chart 34
**Contributions Under Alternative Scenario
(%)**



Source: CBO and BBVA Research

7. Banking Outlook 2012

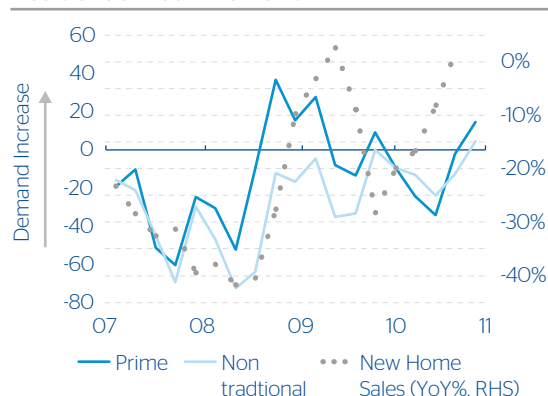
We generally divide our commercial banking key trend indicators into two buckets: forward-looking indicators and backward-looking indicators. Our three major forward-looking indicators are our monthly loan forecasts, the Senior Loan Officer Survey, and our estimates of household deleveraging. The Senior Loan Officer Survey is forward looking in the sense that the tightening stance implied by the survey affects future lending. Deleveraging is an indicator of the circumstances we are in – a balance sheet recession – that play heavily in consumer behavior. Our backward-looking indicators are derived from asset quality indicators from commercial banks, which provide a measure of how banks are progressing in the cleansing of their balance sheets from the crisis.

Loan Standards and Survey-Based Loan Demand Indicators

The latest Federal Reserve's Senior Loan Officer Survey (SLOS) provides a glimpse of the future in the sense that today's tightening stance tends to affect future loan growth since looser standards typically precede higher loan growth. The survey also offers us a perspective on demand for loans. In this regard, demand for residential loans is diverging from demand for commercial real estate (CRE) loans. Demand for CRE is at its strongest point since the late 1990's. Our view of this predicament is that it reflects opportunistic investment at a time of great vulnerability in the CRE market rather than an indication of fundamental demand. Part of this opportunistic investment is mirrored in a rapid snap-back in returns on CRE investments as speculators circle CRE projects for abnormal long-term gains. However, the CRE market faces weak fundamentals for a few years as regards service sector employment growth and excess inventory. From the perspective of the residential market, a certain portion of the issue at hand relates to consumers' behavioral response to the decision today to purchase a home. Given that price appreciation expectations are unhinged, the concept of home ownership is challenged, and the social norm of safety in real estate investments broken, these factors unglue the behavioral reference points that normally keep the housing market chugging along. Although we cannot learn all of this from the SLOS, we can see that standards on prime residential loans and home equity lines of credit remain tight. Banks have also reported a mixed record of waning and rising demand for prime residential loans.

Chart 35

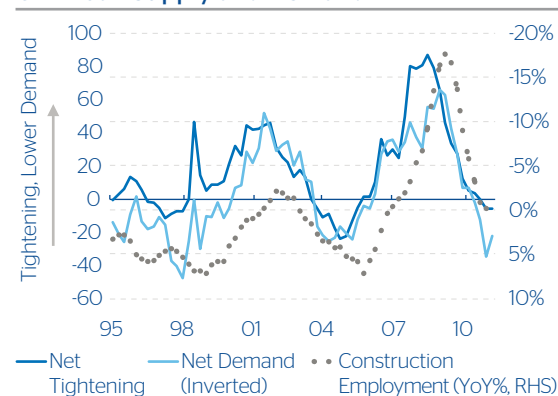
Residential Loan Demand



Source: Federal Reserve and BBVA Research

Chart 36

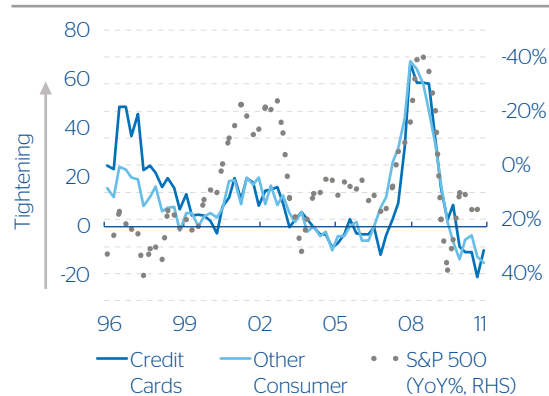
CRE Loan Supply and Demand



Source: Federal Reserve and BBVA Research

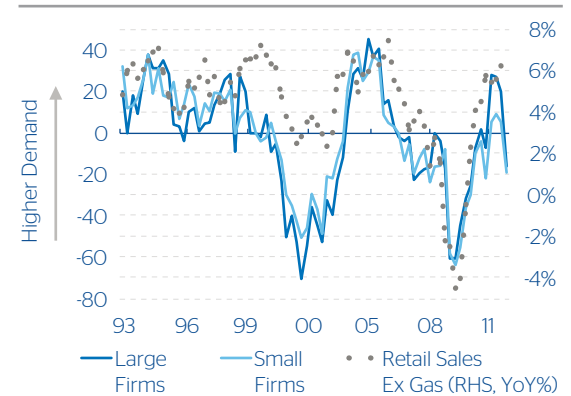
Despite considerable tightness in real estate, “modest fractions of banks” reported easing standards on some consumer lending. Overall, demand for consumer loans was unchanged, with some increases in credit card and auto loan demand offsetting declines for other types of consumer loans. While personal consumption expenditures have fared better than expected in recent months, we continue to expect reluctance among consumers to take on more debt until uncertainties regarding the future outlook have declined. Direct mailings of credit card offerings are reaching elevated levels, meaning competition for consumers is increasing despite the relative sluggishness of actual consumer financing activity. Demand for C&I loans was weaker than in the previous quarter, mostly due to an increase in internally generated funds among customers. In general, most banks acknowledged a “less favorable or more uncertain economic outlook” as the primary determinant of activity in the third quarter. The slight tightening of standards and decrease in demand for commercial and industrial loans is consistent with our supposition that C&I lending is likely to slow over the next several months. C&I lending is currently growing at a 10% YoY rate, which is potentially faster than warranted by expected future economic growth.

Chart 37

Consumer Credit Demand

Source: Federal Reserve and BBVA Research

Chart 38

C&I Credit Demand

Source: Federal Reserve and BBVA Research

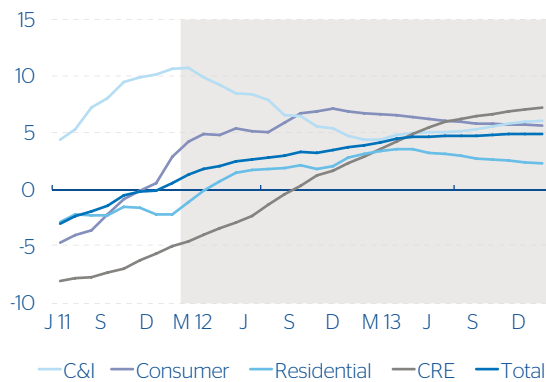
Loan and Deposit Growth

Results from the SLOS are directly relevant to the evolution of credit growth. As discussed previously, we believe that C&I loans have been growing at a faster rate than the equilibrium level predicted by our models. However, the rate of change appears to be slowing as YoY growth approaches its peak. Despite improvements in economic activity, businesses continue to report conservative hiring and capital expansion plans, which puts a limit on the ability of C&I loans to outperform. CRE loan growth continues to decline on a YoY basis. Although distressed properties continue to weigh on the market, investment opportunities are mounting. Given these trends, we continue to expect a return to positive YoY growth by 3Q12. Residential activity has shown significant improvements in recent months, yet data remain well below pre-recession levels. While affordable prices and low mortgage rates have made residential investment more attractive, the threat of further delinquencies has limited bank lending. Another round of Fed interventions in the mortgage market could accelerate residential lending, yet our forecasts suggest negative YoY growth trends at least until mid-2012.

Consumer credit has finally broken through into positive YoY growth territory for the first time since 4Q09. In general, we expect YoY rates to accelerate through 2012 as consumers loosen their spending habits. However, much of this is contingent upon whether recent improvements in employment and other consumer-related data are indicative of more permanent strength in the economy. Additionally, this growth in consumer credit will be notably lower than the pre-crisis trend growth rate of consumer credit. Part of the trepidation of consumers may be seen in deposit trends, which have been relatively stable around a 6.5% YoY growth rate over the past few months.

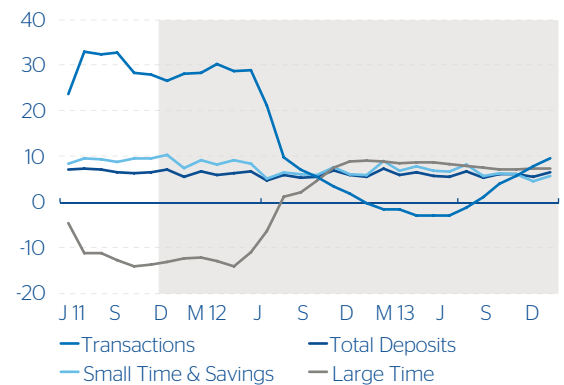
Demand deposits represent the main driver, though we expect figures to level off by mid-2012 as the motivation to hold cash will eventually subside if financial conditions normalize. Savings deposits, which historically have grown in line with population, continue to accelerate as financial uncertainties loom. Small and large time deposit growth faces considerable headwinds from a very flat yield curve.

Chart 39

**Loan Forecasts
(YoY % Change)**


Source: BBVA Research

Chart 40

**Deposit Forecasts
(YoY % Change)**


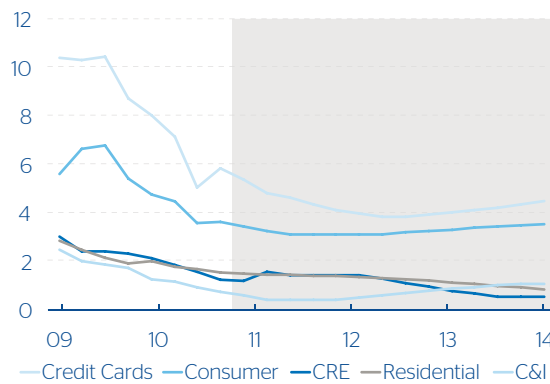
Source: BBVA Research

Asset Quality and Deleveraging

Credit growth is not only dependent not only on activity, but also on existing asset quality. We start from the broad perspective of the debt-to-income ratio for households. Most household debt is related to real estate, but regular consumer credit and “other debt” also play a role. We forecast all three components of debt and also the level of disposable personal income, the ratio of which determines the overall debt-to-income ratio for households. The most recent data from the Federal Reserve’s Flow of Funds Statistics suggests that a debt-to-income ratio of 1.10 for 2011Q3. We expect the debt-to-income ratio to hit 1.0 around late 2014 or early 2015. Given the large weight of mortgages in total household debt, the decline is mostly the result of mortgages. This is especially the case considering that consumer credit by some major holders is increasing. Looking back over the past two years, deleveraging has been the strongest during 2010Q1 to 2011Q1, but appears to be slowing down and progressing at an orderly pace.

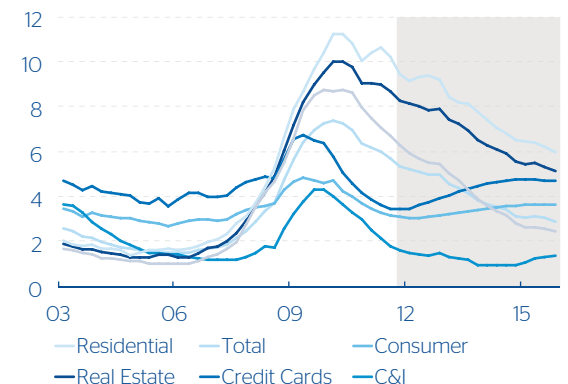
While consumers deleverage their balance sheets, commercial banks are very slowly cleansing their real estate portfolios. However, advancements in real estate asset quality at commercial banks have been far slower than that of other loan categories. According to the Federal Deposit Insurance Corporation (FDIC) Quarterly Banking Profile for 2011Q3, the delinquency rates for both CRE and residential loans remains elevated. Both types of loans take considerable amounts of time to process after the nonaccrual stage. Residential loans must endure a lengthy foreclosure process within the legal system. On the positive side, the charge-off rate on CRE and residential loans is improving moderately. Although prices may be falling, the bulk of the shock to both incomes and prices is behind us and allows for more orderly processing of seriously delinquent loans. Additionally, investors are returning to selected markets, which also enhance banks’ ability to divest underperforming loans. Our forecasts for the charge-off on CRE and residential loans suggest both will continue to improve through 2012 and 2013. Improvement in banks’ asset quality is truly dependent on real estate at this point since consumer and C&I charge-offs and delinquencies are closer to normal ranges.

Chart 41
Chargeoff Forecasts (%)



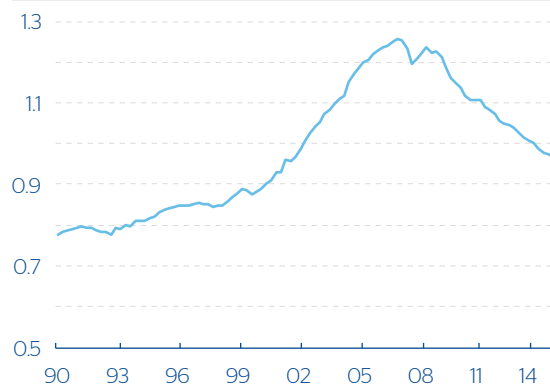
Source: BBVA Research

Chart 42
Delinquency Forecasts (%)



Source: BBVA Research

Chart 43
Debt-to-income ratio



Source: BBVA Research

Chart 44
Financial obligations ratio



Source: BBVA Research and Federal Reserve

Bottom line

Over the past few weeks, the Federal Reserve has emphasized the need to enact housing initiatives to lessen the burden of existing mortgage debt on consumers and to alleviate excess supply in the housing market. From the perspective of the banking system, real estate-related debt continues to weight on bank balance sheets. The burden on consumers and banks both represent reasons why the transmission mechanism from monetary policy to economic activity is damaged. The key asset quality and loan growth indicators summarized above suggest, given the information we have today, that these conditions will not disappear over the next year.

8. Factsheet

Chart 45

Economic Conditions and Presidential Election Outcomes

	1968	1972	1976	1980	1984	1988	1992	1996	2000	2004	2008
Presidential Vote-Share											
Democrat	43%	38%	50%	41%	41%	46%	43%	49%	47%	48%	53%
Republican	43%	61%	48%	51%	59%	53%	37%	41%	48%	51%	46%
Production											
GDP Growth	4.8%	5.3%	5.4%	-0.3%	7.2%	4.1%	3.4%	3.7%	4.1%	3.5%	-0.3%
Manufacturing Output (ISM)	55.1	62.8	56.8	44.5	55.8	56.2	52.6	50.1	51.7	59.1	45.5
Industrial Production	5.5%	9.6%	7.8%	-2.5%	8.9%	5.2%	2.8%	4.5%	4.0%	2.3%	-3.7%
Employment											
Employment Growth (YoY)	3.2%	3.4%	3.2%	0.7%	4.7%	3.2%	0.3%	2.0%	2.2%	1.1%	-0.6%
Private Employment Growth (YoY)	3.0%	3.4%	3.6%	0.4%	5.5%	3.4%	0.1%	2.3%	2.1%	1.3%	-0.9%
Unemployment Rate(%)	3.6	5.6	7.7	7.2	7.5	5.5	7.5	5.4	4.0	5.5	5.8
Market											
Dow Jones (YoY%)	3.1%	7.5%	21.5%	5.6%	-1.0%	-9.5%	12.1%	27.8%	2.6%	14.7%	-14.6%
VIX	13.9	16.5	21.2	17.0	21.6	19.4	21.6	13.5	23.2	28.0	13.8
Consumer Confidence											
Present Situation	167	89	75	69	92	128	31	121	181	95	70
Expectations	115	111	107	77	109	107	82	94	111	97	50

Source: BBVA Research, Federal Reserve, Census, BLS, University of Michigan

Chart 46

U.S. Global Competitiveness Ranking

TWELVE PILLARS		Global Rank	
	2011	2010	Change
Institutions	39	40	↑
Infrastructure	16	15	↓
Macro Environment	90	87	↓
Health and Primary Education	42	42	↔
Higher Education and Training	13	9	↓
Goods Market Efficiency	24	26	↑
Labor Market Efficiency	4	4	↔
Financial Market Development	22	31	↑
Technological Readiness	20	17	↓
Market Size	1	1	↔
Business Sophistication	10	8	↓
Innovation	5	1	↓

Source: World Economic Forum

Chart 47

Global Competitiveness Index (GCI) and Political Subcomponents

Country	GCI 2011-2012	GCI 2010-2011	GCI 2009-2010	Trend	Trust in Politicians	Political Bribes	Cronyism	Wastefulness	Transparency
Switzerland	1	1	1	↔	13	10	11	8	3
Singapore	2	3	3	↑	1	3	3	1	1
Sweden	3	2	4	↔	4	4	1	10	7
Finland	4	7	6	↓	14	5	9	11	6
United States	5	4	2	↓	50	42	50	66	50
Germany	6	5	7	↔	37	22	19	40	28
Netherlands	7	8	10	↑	12	13	7	14	16
Denmark	8	9	5	↓	9	2	4	18	8
Japan	9	6	8	↔	55	9	10	78	38
United Kingdom	10	12	13	↑	44	20	20	53	18

Source: World Economic Forum

9. Economic Forecasts (YoY % Change)

Chart 48

Monthly macroeconomic indicators

	2011	1Q12	2Q12	3Q12	4Q12	2012	2013		2011	1Q12	2Q12	3Q12	4Q12	2012	2013
U.S.								Alabama							
Real GDP	1.7	2.0	2.3	2.5	2.4	2.3	2.2	Real GDP	1.4	1.6	1.6	1.7	1.6	1.7	1.8
Nonfarm Employment	1.2	1.4	1.4	1.5	1.5	1.5	1.4	Nonfarm Employment	0.0	0.2	0.0	0.2	0.3	0.2	0.5
Norm. Personal Income	4.7	2.8	2.9	3.9	4.3	3.4	4.3	Real Personal Income	1.0	1.0	1.2	1.3	1.1	1.2	1.5
Home Price Index	-4.4	-2.1	-2.4	-1.2	-0.8	-1.6	-0.5	Home Price Index	-5.7	-1.7	-1.8	-2.3	-1.8	-1.9	-0.6
Home Sales	2.0	4.1	8.5	8.8	4.4	6.4	4.8	Existing Home Sales	-1.9	11.9	16.9	5.8	3.5	9.2	4.7
Arizona								California							
Real GDP	1.8	2.3	2.3	2.2	2.0	2.2	2.3	Real GDP	1.9	2.5	2.6	2.6	2.4	2.5	2.3
Nonfarm Employment	1.0	2.1	1.9	1.9	1.8	2.0	2.0	Nonfarm Employment	1.3	1.0	1.0	1.0	0.8	1.0	1.4
Real Personal Income	2.3	2.2	1.8	1.7	1.6	1.8	1.8	Real Personal Income	2.9	2.3	1.8	1.9	1.9	2.0	2.3
Home Price Index	-5.7	-1.7	-1.8	-2.3	-1.8	-1.9	-0.6	Home Price Index	-7.3	-5.5	-5.3	-4.6	-4.0	-4.9	-0.5
Existing Home Sales	13.9	7.9	12.0	17.8	18.4	14.0	5.1	Existing Home Sales	1.2	-0.7	11.5	3.7	2.1	3.9	2.3
Colorado								Florida							
Real GDP	1.7	3.0	3.1	2.7	2.4	2.8	2.2	Real GDP	1.8	2.6	2.5	2.4	2.1	2.4	2.3
Nonfarm Employment	0.8	1.0	0.8	0.5	0.5	0.7	1.3	Nonfarm Employment	0.8	1.6	1.1	1.4	1.2	1.3	1.7
Real Personal Income	3.0	2.5	2.0	2.0	1.8	2.1	2.6	Real Personal Income	2.1	1.9	1.5	1.2	1.1	1.4	1.5
Home Price Index	-2.8	0.2	-0.6	-1.5	-0.8	-0.7	1.3	Home Price Index	-6.2	0.1	-1.1	-4.7	-3.5	-2.3	-1.8
Existing Home Sales	0.1	-2.0	5.6	2.3	8.7	3.7	3.2	Existing Home Sales	6.8	-2.4	11.0	6.3	28.9	10.2	2.5
New Mexico								Texas							
Real GDP	1.3	2.3	2.5	2.4	2.3	2.4	2.3	Real GDP	2.8	3.5	3.4	2.9	2.6	3.1	2.7
Nonfarm Employment	0.3	0.6	0.4	0.3	0.4	0.4	0.6	Nonfarm Employment	2.2	2.0	1.6	1.5	1.8	1.8	1.6
Real Personal Income	2.1	2.0	2.1	1.6	1.6	1.8	2.3	Real Personal Income	4.0	3.6	3.2	2.8	2.5	3.0	3.6
Home Price Index	-6.1	-2.2	-2.3	-2.0	0.0	-1.6	0.6	Home Price Index	-1.8	-1.4	-1.0	0.0	1.6	-0.2	1.0
Existing Home Sales	-0.7	-6.9	-0.4	11.0	7.7	2.5	4.0	Existing Home Sales	1.8	4.7	-1.0	2.2	3.8	2.4	3.4

Note: Forecasts in bold

Source: BBVA Research, BEA, BLS, NAR, Census Bureau and FHFA

Chart 49

Economic Structure

	U.S.	AL	AZ	CA	CO	FL	NM	TX
GDP (2010 \$ Billions)	14,527	173	254	1,901	258	748	80	1,207
Population (2010 Thousands)	311,592	4,803	6,483	37,692	5,117	19,058	2,082	25,675
Labor Force (Dec '11 Thousands)	153,887	2,138	3,159	18,219	2,727	9,233	940	12,379
NonFarm Payroll (Dec '11 Thousands)	131,602	1,873	2,413	14,199	2,245	7,292	804	10,649
Unemployment Rate (Dec '11)	8.5	8.1	8.7	11.1	7.9	9.9	6.6	7.8
Total Building Permits, (YTD Dec 2011)	430,157	8,109	10,499	23,288	9,724	33,640	3,505	65,617
Change in Building Permits (YTD Dec YoY (%))	-6.9	-2.8	-2.7	-11.4	3.7	6.2	-13.5	-1.9
Home Ownership Rate (4Q11)	66.0	72.8	66.2	54.8	64.9	68.3	67.3	64.9
Housing Prices (3Q11 YoY Change (%))	-3.7	-5.0	-12.0	-7.0	-0.2	-3.5	-5.5	-1.6
Exports of Goods (3Q11 \$ Billions)	374.3	4.5	4.2	40.5	1.9	16.9	0.6	63.3
Change in Exports (3Q11 YoY Change (%))	17.5	14.3	11.4	12.4	7.4	22.6	40.6	22.0

Source: BEA, BLS, Census, WiserTrade and FHFA

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