

Economic Analysis

Inflationary Pressures Subdued, Headline CPI Falls 0.2% in August

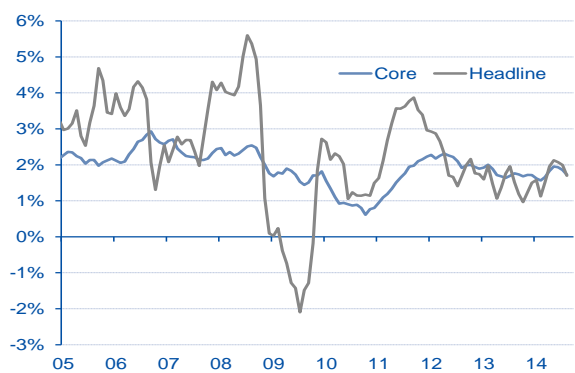
Kim Fraser Chase

The headline consumer price index declined 0.2% in August, marking the first monthly drop since April 2013. As expected, energy prices put significant downward pressure on the CPI, down 2.6% following a 0.3% decline in July and driven largely by a significant drop in gasoline prices. Food inflation remained steady at 0.2% for the month, with pressures balanced between prices for food at home and food away from home. Excluding food and energy, core CPI was unchanged after holding at positive monthly growth for more than four years. Both headline and core CPI decelerated to 1.7% YoY in August. These trends are certainly in line with our expectations for below-average inflation throughout the coming years. Our baseline scenario assumes that headline inflation will average 1.9% YoY in 2014 and then accelerate to 2.2% in 2015. Core CPI is expected to remain below the Fed's target at least through 2015 and possibly into 2016.

Industrial Production Disappoints in August as Manufacturing Drops 0.4%

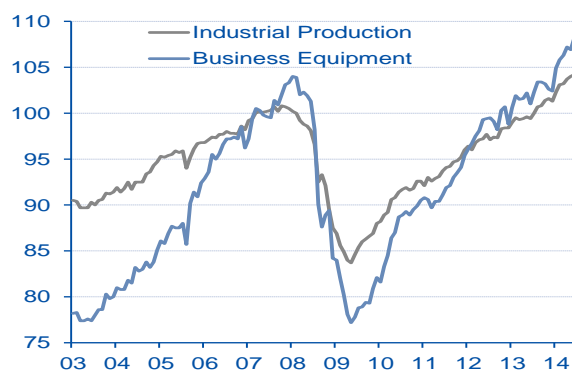
Manufacturing output surprised to the downside in August, contributing to a 0.1% monthly decline in the industrial production index. Despite various surveys of strengthening manufacturing activity throughout the month, the sector's subcomponent of the industrial production index dropped 0.4% for the first time since January. Furthermore, July's data were revised downward for both manufacturing (from 1.0% to 0.7%) and total output (0.4% to 0.2%). For 3Q14 thus far, the average monthly change in total industrial production is at the slowest pace since 2Q13, an underwhelming trend when it comes to GDP growth expectations for the quarter. However, it is very rare to see two consecutive months of decline in manufacturing output, and as such we expect that the component will increase again throughout the rest of the year. When it comes to mining and utilities, both increased in August and should continue to do so in the coming months. Looking at annual growth, total industrial output accelerated significantly between January and July of this year (from 2.95% to 4.83% YoY) and held above the pre-crisis average in August at 4.1%. Overall, we expect that industrial production growth will stabilize and average close to 4.0% YoY growth in both 2014 and 2015.

Graph 1
Headline and Core CPI (YoY % Change)



Source: Bureau of Labor Statistics & BBVA Research

Graph 2
Industrial Production Index (SA, 2007=100)



Source: FRB & BBVA Research

Week Ahead

Existing Home Sales (August, Monday 10:00 ET)

Forecast: 5.175M

Consensus: 5.200M

Previous: 5.150M

Existing home sales have shown a strong recovery throughout the past six months following a weak end to 2013. In August, we expect that existing home sales will continue its upward trend but remain below the peak seen in July 2013. Pending home sales, which are a leading indicator for the existing market, increased 3.3% in July, pointing to future gains in final sales. Furthermore, an increase in supply and slower home price appreciation are helping to encourage potential homebuyers. For the next year, we expect to see more strength in existing sales compared to the new home market.

New Home Sales (August, Wednesday 10:00 ET)

Forecast: 430K

Consensus: 430K

Previous: 412K

New home sales are expected to increase in August after declining in both June and July. Homebuilder confidence has been on the rise following a brief dip earlier in 2014, suggesting that new home construction may be gaining momentum yet again. The new home market has certainly shown the weakest performance when it comes to the housing recovery, with limited affordability and constrained supply holding down demand. While we do expect to see a modest increase in August, our expectations are not overly optimistic for the rest of this year. At least in the near term, it is unlikely that we will see significant acceleration in new home sales above 500K.

Durable Goods Orders, Ex Transportation (August, Thursday 8:30 ET)

Forecast: -3.1%, 0.7%

Consensus: -17.9%, 0.6%

Previous: 22.6%, -0.7%

Durable goods new orders are always extremely volatile on a month-to-month basis, and as such, we expect to see another sizable monthly shift in August. July's gain was historically high as aircraft orders increased more than 200% for the month, though we do not expect to see a repeat of this in the coming months. For August, we are likely to see a modest decline in total durable goods orders as the series adjusts for the abnormal spike in the prior month. Excluding transportation, the data are more stable yet we do expect to see a deceleration in the coming months. Capital goods orders excluding aircraft remain an important indicator to watch when it comes to business investment, though August is likely to be less encouraging in this regard.

GDP, Final (2Q14, Friday 8:30 ET)

Forecast: 4.3%

Consensus: 4.6%

Previous: 4.2%

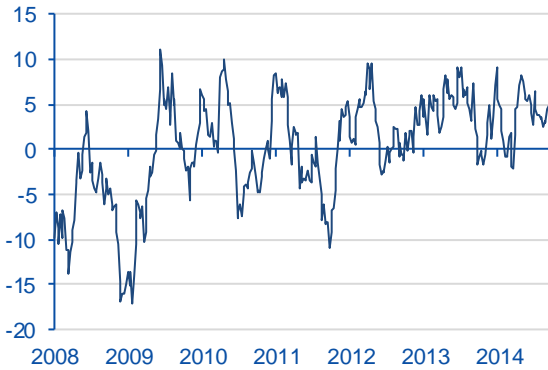
The final estimate for 2Q real GDP growth is not expected to deviate much from the preliminary report. Most of the relevant data has already been incorporated into the BEA's estimates, although the final figure will reflect any contributing data that has been revised since the previous GDP release. The trade balance had the most notable revision, showing better-than-expected improvement for June. Also, construction spending was much less negative in June than was previously estimated, so this could help lift the residential and nonresidential investment components. Other major contributors to GDP, such as inventories and personal consumption expenditures, were unrevised for June. Therefore, we expect the minor upward revisions to trade and construction spending to influence a slight positive change in real GDP growth for the final estimate.

Market Impact

The underwhelming FOMC statement has left markets even more unsure of how to interpret incoming economic data. Not much on the calendar this week will distract markets from digging deeper into ongoing Fed speeches.

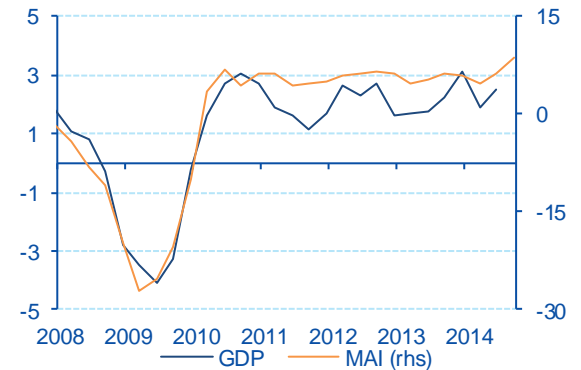
Economic Trends

Graph 3
BBVA US Weekly Activity Index (3 month % change)



Source: BBVA Research

Graph 4
BBVA US Monthly Activity Index & Real GDP (4Q % change)



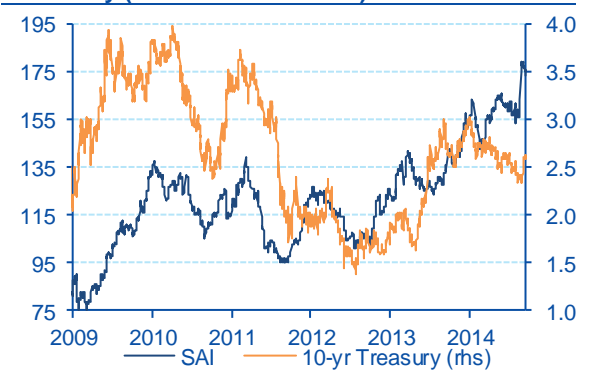
Source: BBVA Research & BEA

Graph 5
BBVA US Surprise Inflation Index (Index 2009=100)



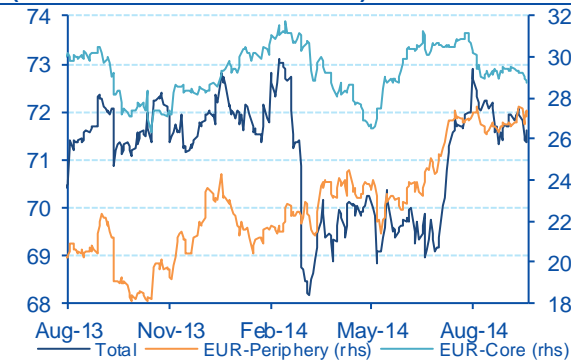
Source: BBVA Research

Graph 6
BBVA US Surprise Activity Index & 10-yr Treasury (Index 2009=100 & %)



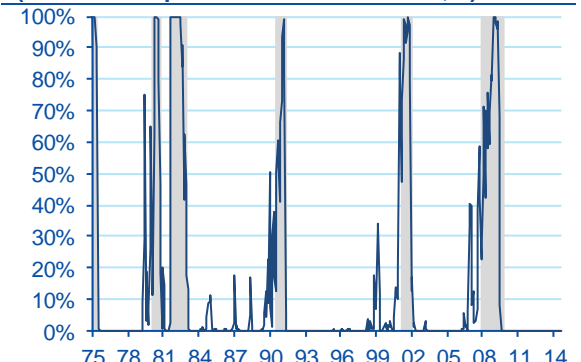
Source: Bloomberg & BBVA Research

Graph 7
Equity Spillover Impact on US (% Real Return Co-Movements)



Source: BBVA Research

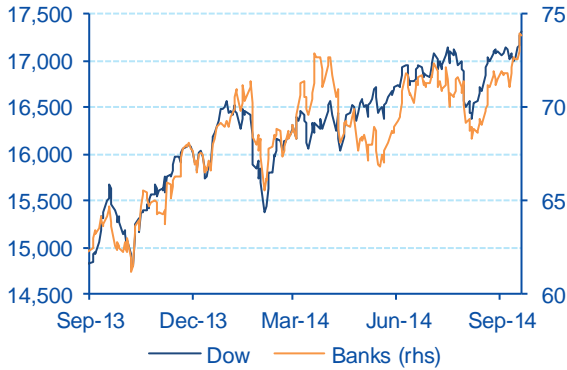
Graph 8
BBVA US Recession Probability Model (Recession episodes in shaded areas, %)



Source: BBVA Research

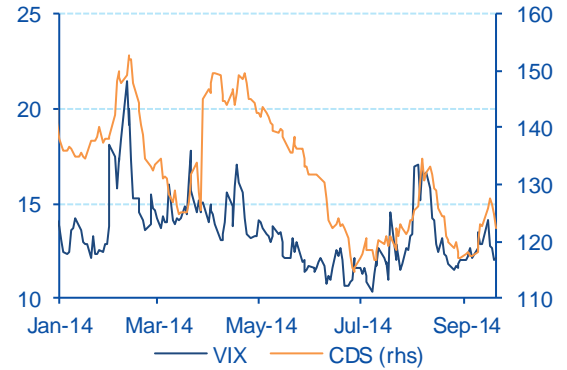
Financial Markets

Graph 9
Stocks
(Index, KBW)



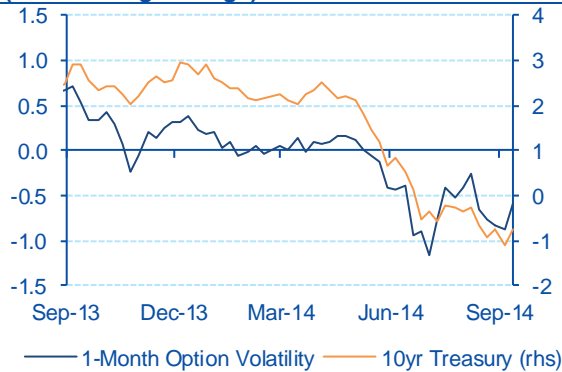
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS
(Indices)



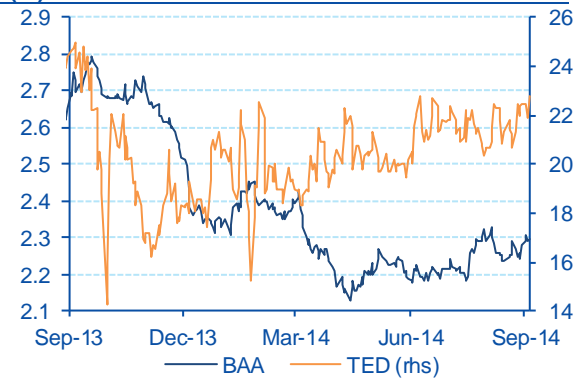
Source: Bloomberg & BBVA Research

Graph 11
Option Volatility & Real Treasury
(52-week avg. change)



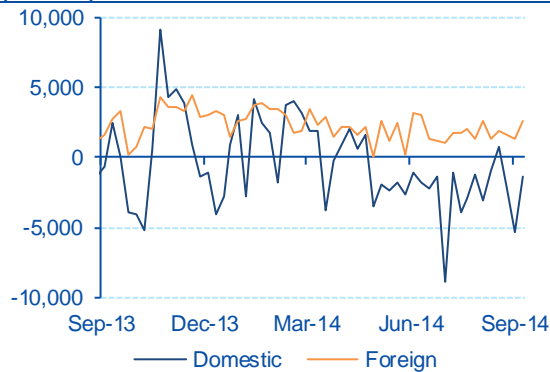
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads
(%)



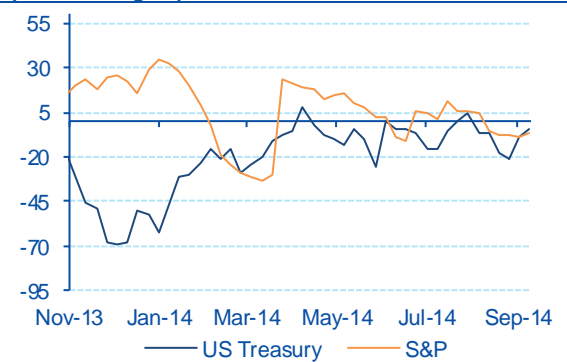
Source: Bloomberg & BBVA Research

Graph 13
Long-Term Mutual Fund Flows
(US\$Mn)



Source: Haver Analytics & BBVA Research

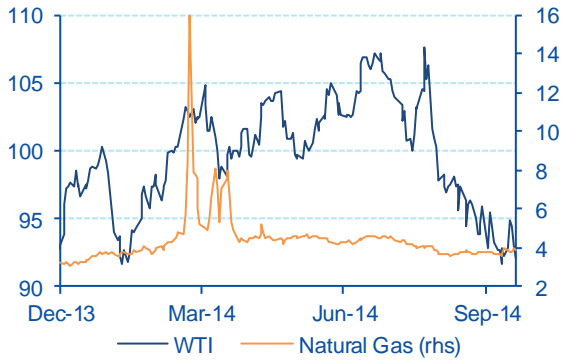
Graph 14
Total Reportable Short & Long Positions
(Short-Long, K)



Source: Haver Analytics & BBVA Research

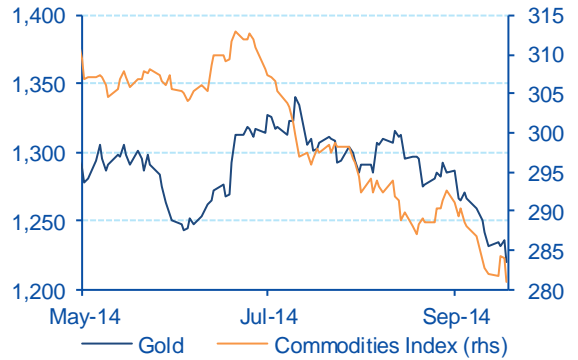
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



Source: Bloomberg & BBVA Research

Graph 16
Gold & Commodities
(US\$ & Index)



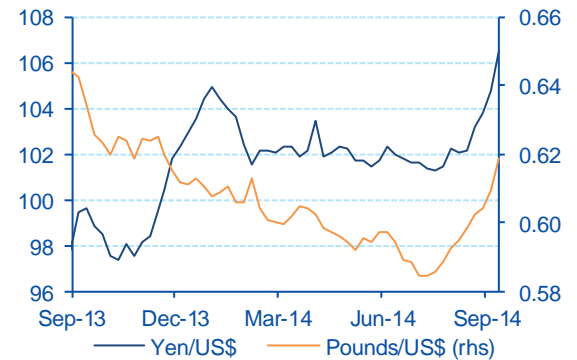
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



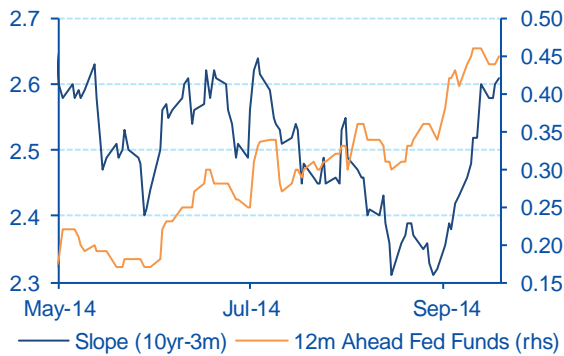
Source: Bloomberg & BBVA Research

Graph 18
6-Month Forward Exchange Rates
(Yen & Pound / US\$)



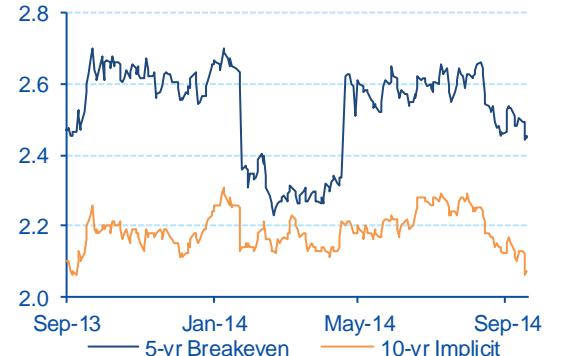
Source: Haver Analytics & BBVA Research

Graph 19
Fed Futures & Yield Curve Slope
(% & 10year-3month)



Source: Haver Analytics & BBVA Research

Graph 20
Inflation Expectations
(%)



Source: Bloomberg & BBVA Research

Interest Rates

Table 1
Key Interest Rates (%)

	Last	Week ago	4-Weeks ago	Year ago
Prime Rate	3.25	3.25	3.25	3.25
Credit Card (variable)	14.86	14.86	14.86	14.10
New Auto (36-months)	2.93	2.93	2.92	2.51
Heloc Loan 30K	4.81	4.81	4.97	5.22
5/1 ARM *	3.06	2.99	2.95	2.90
15-year Fixed Mortgage *	3.37	3.26	3.23	3.23
30-year Fixed Mortgage *	4.23	4.12	4.10	3.99
Money Market	0.42	0.40	0.39	0.41
2-year CD	0.87	0.87	0.85	0.77

*Freddie Mac National Mortgage Homeowner Commitment US
Source: Bloomberg & BBVA Research

Table 2
Key Interest Rates (%)

	Last	Week ago	4-Weeks ago	Year ago
1M Fed	0.09	0.09	0.09	0.08
3M Libor	0.23	0.23	0.23	0.25
6M Libor	0.33	0.33	0.32	0.37
12M Libor	0.59	0.57	0.55	0.64
2yr Sw ap	0.81	0.80	0.71	0.48
5yr Sw ap	1.99	1.97	1.81	1.60
10Yr Sw ap	2.72	2.75	2.55	2.81
30yr Sw ap	3.29	3.34	3.14	3.65
30day CP	0.10	0.12	0.11	0.12
60day CP	0.12	0.11	0.11	0.15
90day CP	0.13	0.13	0.13	0.14

Source: Bloomberg & BBVA Research

Quote of the Week

Janet Yellen, Federal Reserve Board Chair
FOMC Press Conference
17 September 2014

"I want to emphasize that there is no mechanical interpretation of what the term 'considerable time' means. And, as I've said repeatedly, the decisions that the Committee makes about what is the appropriate time to begin to raise its target for the federal funds rate will be data dependent... I know 'considerable time' sounds like it's a calendar concept, but it is highly conditional and it's linked to the Committee's assessment of the economy."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
22-Sep	Chicago Fed National Activity Index	AUG	0.37	0.33	0.39
22-Sep	US Existing Homes Sales SAAR	AUG	5.18	5.20	5.15
22-Sep	US Existing Homes Sales MoMSA	AUG	0.49	0.97	2.39
24-Sep	US New One Family Houses Sold Annual Total SAAR	AUG	430.00	430.00	412.00
24-Sep	US New One Family Houses Sold Annual Total MoMSA	AUG	4.37	4.37	-2.40
25-Sep	US Initial Jobless Claims SA	SEP 20	300.00	298.00	280.00
25-Sep	US Continuing Jobless Claims SA	SEP 13	2450.00	2445.00	2429.00
25-Sep	US Durable Goods New Orders Industries MoMSA	AUG	-3.10	-17.90	22.60
25-Sep	US Durable Goods New Orders Total ex Transportation MoMSA	AUG	0.70	0.60	-0.70
26-Sep	GDP US Chained 2009 Dollars QoQ SAAR	2Q T	4.30	4.60	4.20
26-Sep	GDP US Personal Consumption Chained 2009 Dlr % Change from Previous Period SAAR	2Q T	2.50	3.00	2.50
26-Sep	US GDP Price Index QoQ SAAR	2Q T	2.10	2.10	2.10
26-Sep	US GDP Personal Consumption Core Price Index QoQ % SAAR	2Q T	2.00	2.00	2.00
26-Sep	University of Michigan Survey of Consumer Confidence Sentiment	SEP F	85.00	84.70	84.60

Forecasts

	2011	2012	2013	2014	2015	2016	2017
Real GDP (% SAAR)	1.8	2.8	1.9	2.0	2.5	2.8	2.8
CPI (YoY %)	3.1	2.1	1.5	1.9	2.2	2.3	2.4
CPI Core (YoY %)	1.7	2.1	1.8	2.0	2.1	2.3	2.4
Unemployment Rate (%)	8.9	8.1	7.4	6.3	5.9	5.8	5.5
Fed Target Rate (eop, %)	0.25	0.25	0.25	0.25	0.50	1.50	2.50
10Yr Treasury (eop, % Yield)	1.98	1.72	2.90	3.00	3.50	3.75	4.00
US Dollar/ Euro (eop)	1.31	1.31	1.37	1.31	1.29	1.36	1.36

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