

## Economic Analysis

## FOMC Stresses Importance of Data-Dependent Policy in October Minutes

Kim Fraser Chase

The minutes from October's FOMC meeting revealed some further discussion on forward guidance and post-QE3 strategies, but nothing stood out as a major surprise (see [Fed Watch](#)). There was very little debate on actually ending the asset purchase program, as most participants had already come around to the idea of announcing the end of QE3 at this meeting. Committee members agreed that the program had achieved its goals outlined back in September 2012 and that there was "sufficient underlying strength in the broader economy to support ongoing progress toward maximum employment in a context of price stability." Leading up to the October meeting, there was talk that the FOMC would remove the "considerable time" language from their forward guidance communication. While the statement ultimately left the wording unchanged, the meeting minutes did hint at more divergent views within the Committee. All participants were in agreement that the timing of the first rate hike would remain data-dependent, yet some felt that the "considerable time" piece contradicted plans to increase rates based on incoming economic data. Others argued that removing "considerable time" from the forward guidance language would signal a "significant shift" in the FOMC's policy stance and have unwanted financial market reaction or hint at an earlier hike than would seem appropriate by the Committee. This debate suggests that a change to the Committee's forward guidance is likely once they reach some level of consensus on the new wording, which in turn is tied to how much market expectations may or may not diverge from the FOMC's outlook. The FOMC meeting discussion also touched on the "post-liftoff policy" and the Committee's plans regarding the pace of interest rate hikes. Many members suggested that it would be helpful to begin incorporating language related to their strategy, but the group concluded that this would "pose challenges given the inherent uncertainty of the economic and financial outlook and the Committee's desire to retain flexibility to adjust policy in response to the incoming data."

### Headline Inflation Flat in October, but Core Figures Stable

The Consumer Price Index was unchanged in October following a slight upward movement in September. To no surprise, energy prices continue to weigh on the headline figure, down 1.9% in October and marking the fourth consecutive monthly decline. Food prices increased a modest 0.15% for the month to help partially offset the energy declines, but most of the upward pressure stemmed from core CPI components. Excluding food and energy, inflation increased a steady 0.2%. The usual drivers were at play in this report: shelter (0.24%) and medical care services (0.21%). Transportation services increased a massive 0.8% for the month, mostly due to a 2.4% gain in airline fares. Apparel continued its deflationary trend, down 0.2% for the third straight month, while prices for used cars and trucks also dropped. On a YoY basis, headline and core inflation hit 1.65% and 1.82%, respectively. If prices continue to increase at this gradual pace, we should see a more confident Fed when it comes to the first rate hike. Even if energy prices remain low, we do not expect that this will have a major impact on the Fed's decision (unless a negative impact arises and intensifies). Overall, our expectations remain unchanged for stable but low inflation over the forecast horizon, hovering around 2.0% annually for the next few years.

## Week Ahead

### GDP, Preliminary (3Q14, Tuesday 8:30 ET)

Forecast: 3.0%

Consensus: 3.3%

Previous: 3.5%

The second estimate for 3Q14 real GDP growth is expected to show a slight downward revision from the initial report last month. Most of the data released for September was worse than expected, and some reports even noted minor downward revisions to August's data. Real personal consumption and construction spending both declined in September and will likely weigh on GDP. The international trade balance worsened for the month as real exports declined significantly, and this should reduce the overall contribution from net exports during the quarter. Finally, business inventory growth was in line with consensus expectations for September, but we did see a minor revision for August.

### S&P Case-Shiller HPI (September, Tuesday 9:00 ET)

Forecast: 4.77%

Consensus: 4.60%

Previous: 5.57%

The S&P Case-Shiller Home Price Index is expected to remain mostly unchanged in September as housing demand remains subdued. According to other indicators, home prices were mostly unchanged as YoY growth rates continue to decline. Despite the fact that affordability is on the rise, credit conditions remain tight and many potential homebuyers are kept out of the market. Consequently, housing demand has been relatively low throughout the past year, driving down home prices. We expect that home prices will continue to decelerate at a gradual pace throughout the coming year as both supply and demand adjust to changing economic conditions.

### Personal Income and Outlays (October, Wednesday 8:30 ET)

Forecast: 0.2%, 0.3%

Consensus: 0.4%, 0.3%

Previous: 0.2%, -0.2%

Personal income and outlays are both expected to increase in October after coming in below expectations in September. Consumption was the biggest disappointment in September, down 0.2% for the month despite the boost in consumer purchasing power from falling gasoline prices. In October, we expect that spending will rebound as consumers shift into holiday-related habits. On the income side, we expect to see another steady monthly gain in October that coincides with ongoing labor market improvements but also holds in line with our expectations for low inflation throughout the coming year.

### New Home Sales (October, Wednesday 10:00 ET)

Forecast: 470K

Consensus: 470K

Previous: 467K

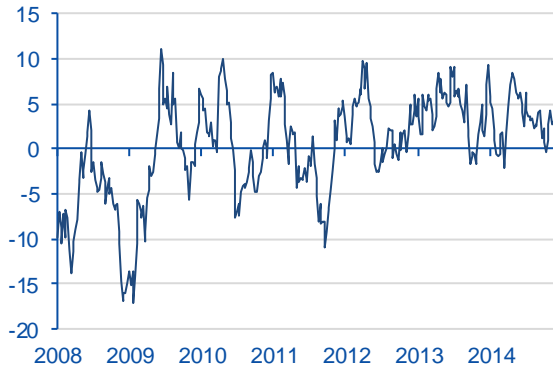
New home sales have been on the rise throughout the past few months, fueled by a significant 15.4% boost in August and another more modest gain in September. New home construction has been incredibly volatile since mid-2014, with housing starts jumping nearly 20% in July but then dropping 13.0% in August. As such, it is hard to get a clear read on the supply of new homes on the market and how this may be impacting sales. In October, we expect new home sales to decline slightly, mostly as an adjustment to the previous month's aggregate gains. Regardless, the new home market still has a long way to go to make up for what was lost during the crisis.

### Market Impact

Markets should be mostly calm this week as we head into the Thanksgiving holiday. Still, there will be a fair amount of economic reports crammed into the early part of this short week. We'll get the final wrap-up on housing data for October, and a significant revision to 3Q GDP growth could sway markets if the figure suggests a major change in the 2014 outlook.

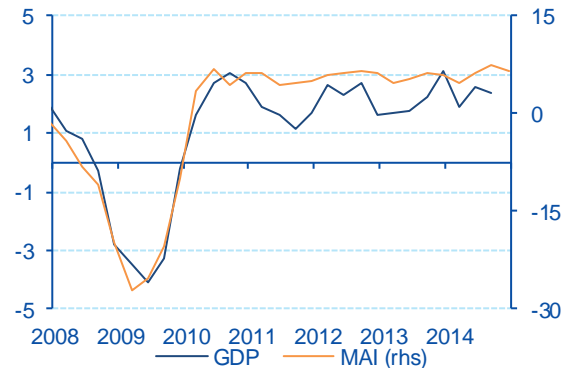
## Economic Trends

**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)



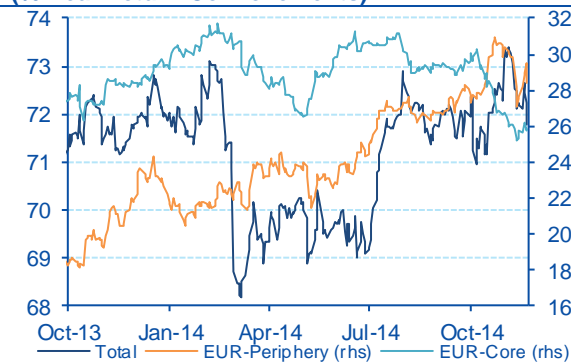
Source: BBVA Research

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



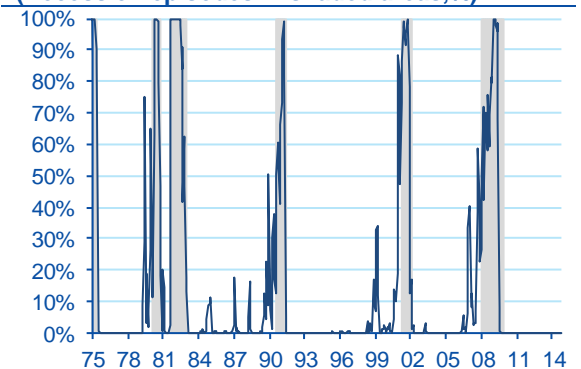
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

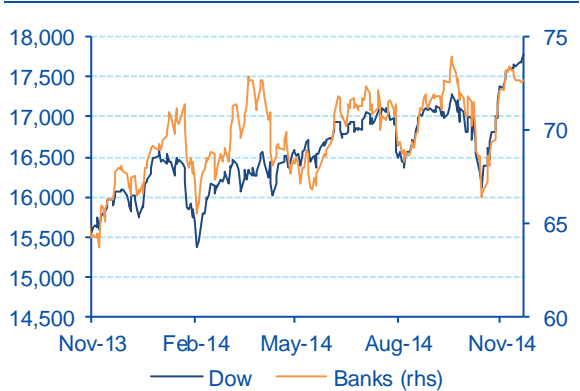
**Graph 8**  
**BBVA US Recession Probability Model**  
(Recession episodes in shaded areas,%)



Source: BBVA Research

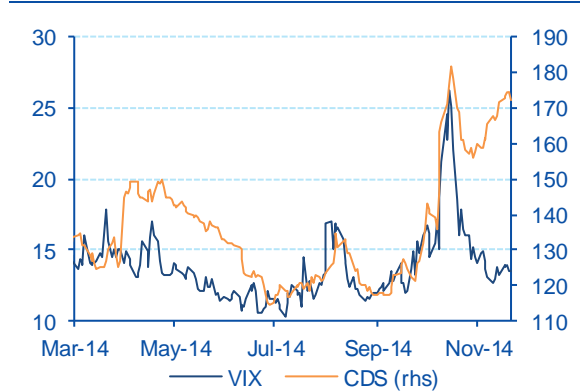
**Financial Markets**

Graph 9  
**Stocks (Index, KBW)**



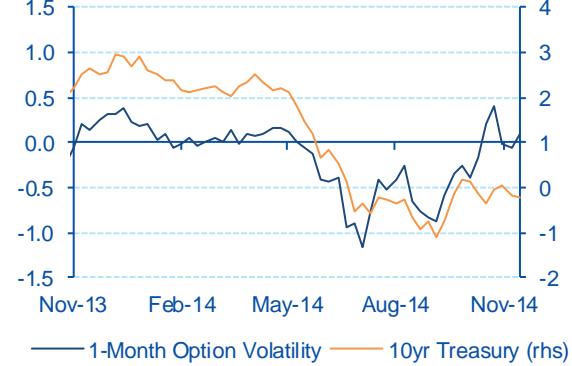
Source: Bloomberg & BBVA Research

Graph 10  
**Volatility & High-Volatility CDS (Indices)**



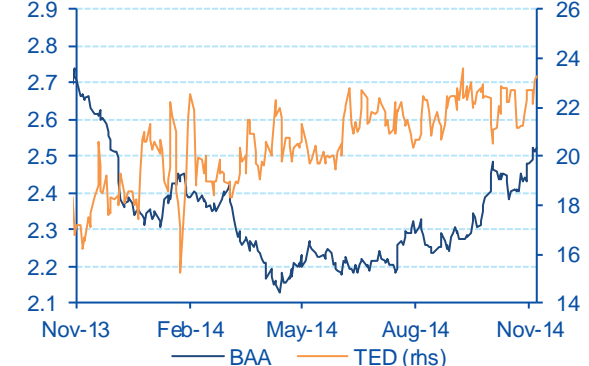
Source: Bloomberg & BBVA Research

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



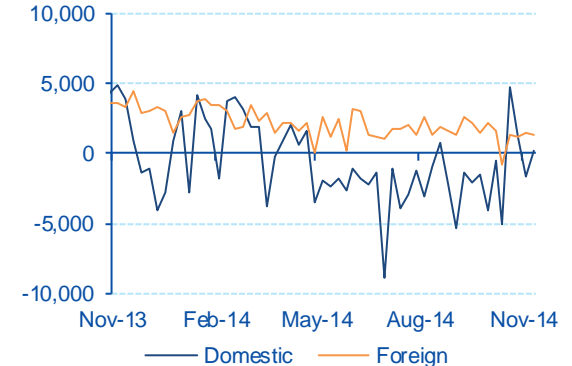
Source: Haver Analytics & BBVA Research

Graph 12  
**TED & BAA Spreads (%)**



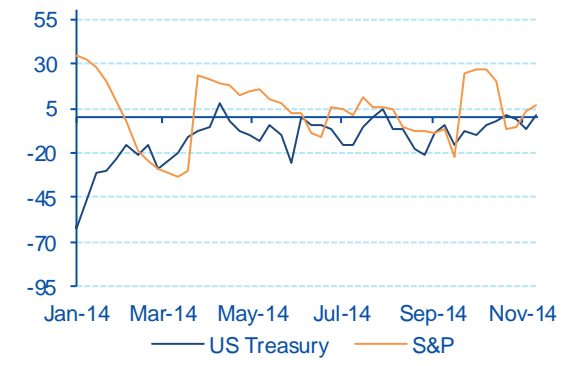
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

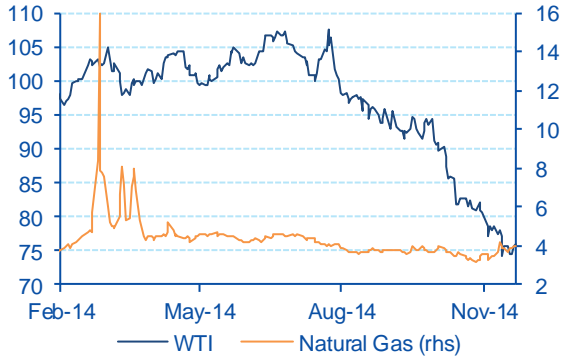
Graph 14  
**Total Reportable Short & Long Positions (Short-Long, K)**



Source: Haver Analytics & BBVA Research

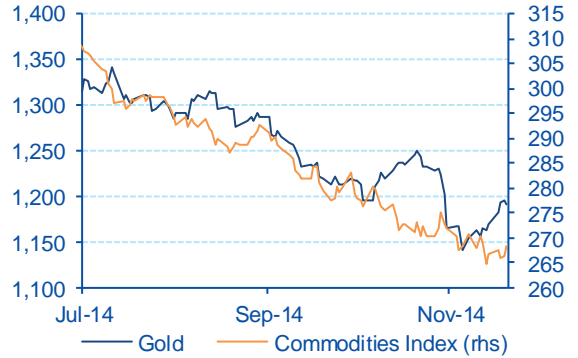
**Financial Markets**

Graph 15  
**Commodities**  
(Dpb & DpMMBtu)



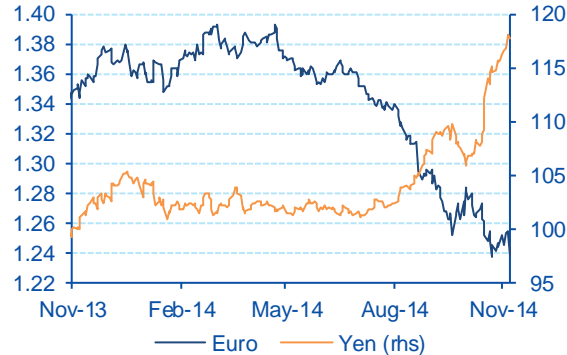
Source: Bloomberg & BBVA Research

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



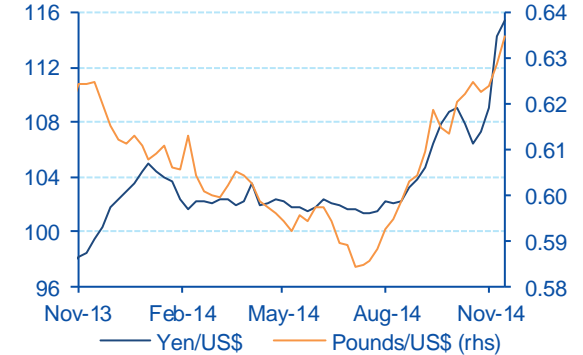
Source: Haver Analytics & BBVA Research

Graph 17  
**Currencies**  
(Dpe & Ypd)



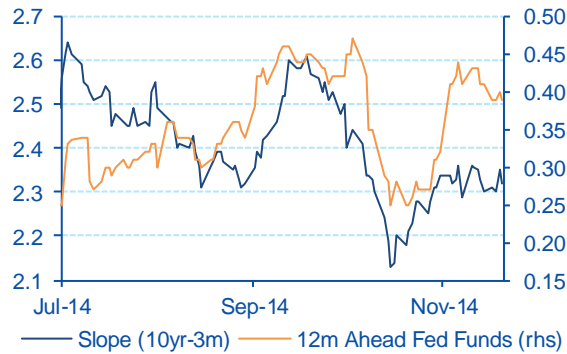
Source: Bloomberg & BBVA Research

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)	2.94	2.96	2.94	2.68
Heloc Loan 30K	4.82	4.74	4.84	5.18
5/1 ARM *	3.01	3.02	2.91	2.90
15-year Fixed Mortgage *	3.17	3.20	3.08	3.23
30-year Fixed Mortgage *	3.99	4.01	3.92	3.99
Money Market	0.43	0.43	0.42	0.42
2-year CD	0.87	0.87	0.89	0.83

\*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	0.10	0.09	0.09	0.09
3M Libor	0.23	0.23	0.23	0.24
6M Libor	0.33	0.33	0.32	0.34
12M Libor	0.56	0.57	0.55	0.58
2yr Sw ap	0.72	0.73	0.64	0.38
5yr Sw ap	1.74	1.74	1.67	1.43
10Yr Sw ap	2.44	2.45	2.41	2.78
30yr Sw ap	2.99	3.02	3.03	3.72
30day CP	0.11	0.12	0.11	0.12
60day CP	0.12	0.11	0.11	0.15
90day CP	0.14	0.13	0.13	0.12

Source: Bloomberg & BBVA Research

## Quote of the Week

President Barack Obama

Remarks by the President in Address to the Nation on Immigration

20 November 2014

*“And to those members of Congress who question my authority to make our immigration system work better, or question the wisdom of me acting where Congress has failed, I have one answer: Pass a bill.”*

## Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
24-Nov	Chicago Fed National Activity Index	OCT	0.20	0.40	0.47
24-Nov	Dallas Fed Manufacturing Outlook Level Of General Business Activity	NOV	11.70	8.00	10.50
25-Nov	GDP US Chained 2009 Dollars QoQ SAAR	3Q S	3.00	3.30	3.50
25-Nov	GDP US Personal Consumption Chained 2009 Dirs % Change from Previous Period SAAR	3Q S	1.80	1.90	1.80
25-Nov	US GDP Price Index QoQ SAAR	3Q S	1.20	1.30	1.30
25-Nov	US GDP Personal Consumption Core Price Index QoQ % SAAR	3Q S	1.40	1.40	1.40
25-Nov	S&P/Case-Shiller Composite-20 City Home Price Index SA MOM % Change	SEP	0.30	0.20	-0.15
25-Nov	S&P/Case-Shiller Composite-20 City Home Price Index YoY	SEP	4.77	4.60	5.57
25-Nov	Conference Board Consumer Confidence SA 1985=100	NOV	95.70	96.00	94.48
26-Nov	US Initial Jobless Claims SA	NOV 22	290.00	287.00	291.00
26-Nov	US Continuing Jobless Claims SA	NOV 15	2345.00	2360.00	2330.00
26-Nov	US Durable Goods New Orders Industries MoM SA	OCT	0.90	-0.60	-1.10
26-Nov	US Durable Goods New Orders Total ex Transportation MoM SA	OCT	0.50	0.50	-0.10
26-Nov	US Personal Income MoM SA	OCT	0.20	0.40	0.20
26-Nov	US Personal Consumption Expenditures Nominal Dollars MoM SA	OCT	0.30	0.30	-0.20
26-Nov	MNI Chicago Business Barometer (sa)	NOV	61.90	63.00	66.20
26-Nov	University of Michigan Consumer Sentiment Index	NOV F	90.10	90.00	89.40
26-Nov	US Pending Home Sales Index MoM SA	OCT	0.20	1.00	0.29
26-Nov	US New One Family Houses Sold Annual Total SAAR	OCT	470.00	470.25	467.00
26-Nov	US New One Family Houses Sold Annual Total MoM SA	OCT	0.64	0.70	0.20

## 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	1.9	2.1	2.3	2.4
Unemployment Rate (%)	8.9	8.1	7.4	6.2	5.8	5.5	5.0
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	2.65	3.36	3.75	3.98
US Dollar/ Euro (eop)	1.31	1.31	1.37	1.23	1.20	1.24	1.26

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