

Economic Analysis

# Headline CPI Falls 0.4% in December, Closing out 2014 at a Modest 1.6% YoY

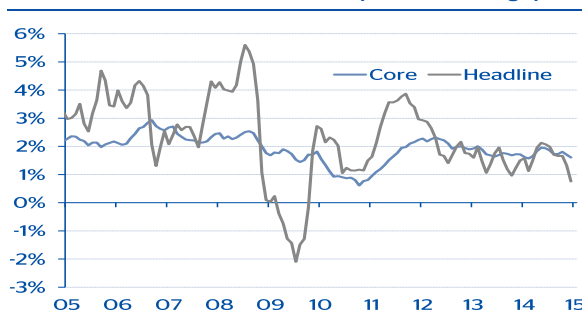
Kim Fraser Chase

It is no surprise that sharp declines in oil prices are having a major impact on the consumer price index, with the energy price index in decline throughout the past six months. In December, energy prices dropped 4.7% mostly due to the commodities side as gasoline prices fell 9.4% for the month. Headline CPI declined for the second consecutive month (the first back-to-back declines since early 2013), with the 0.4% drop marking the largest since the midst of the crisis. However, falling energy prices were not the only factor to weigh on inflation in December. Transportation prices declined 0.45% for the first time since August, while vehicle prices (both new and used) also declined for the month. Apparel prices dropped a shocking 1.2% following a similar decline in November, although this is likely due to the holiday-related discounts and promotions rather than a pass through from headline inflation. Upward pressures stemmed from the usual suspects, with medical care services and commodities increasing 0.3% and 1.0%, respectively. Shelter prices also increased, though at a softer pace than in previous months. All in all, inflation ended the year much lower than expected, with headline and core averaging just 1.6% and 1.75%, respectively. For 2015, we expect that oil prices will continue to weigh on inflation, and we will likely see a more direct pass through to core prices as well.

## Retail Sales Surprise to the Downside in December

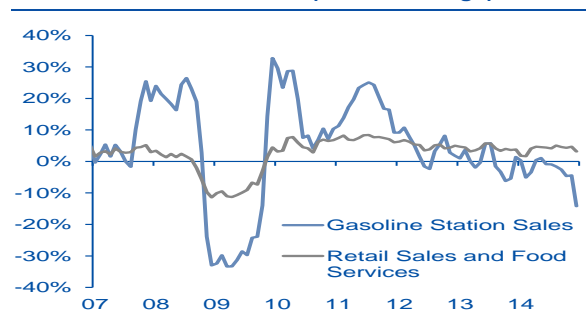
December's retail sales report was disappointing, to say the least, down 0.94% (-0.57% in real terms) from November to mark the largest monthly drop since January. Holiday discounts and a little extra savings from the gas pump were not enough to offset the significant decline in gasoline station sales, down 6.5% in December for the seventh consecutive monthly drop. Auto sales also declined for the first time in three months, weighing on the headline figure. Excluding autos and gas, retail sales dropped a disappointing 0.26%. Most core components declined for the month, including building materials (-1.9%), electronics and appliances (-1.6%), miscellaneous store retailers (-1.9%), and general merchandise stores (-0.9%). On the bright side, sales for food services and drinking places increased a healthy 0.8% in December, suggesting that consumers may actually be spending at least part of what they are saving from lower gas prices. In general, we expect that the ongoing decline in oil prices will have a positive impact on personal consumption throughout 2015.

Graph 1  
**Headline and Core CPI Inflation (YoY % Change)**



Source: BLS & BBVA Research

Graph 2  
**Retail and Gasoline Sales (YoY % Change)**



Source: U.S. Census & BBVA Research

## Week Ahead

### Housing Starts and Building Permits (December, Wednesday 8:30 ET)

Forecast: 1020K, 1045K

Consensus: 1040K, 1058K

Previous: 1028K, 1052K

Housing starts and building permits are both expected to decline slightly for the second consecutive month as the year-end brings with it a slower trend in housing activity. December's housing data have not shown much improvement over November, and the extreme winter weather hitting most of the country is not so favorable for new home construction. Building permits tend to lead housing starts by a few months; however, throughout the second half of 2014 we saw the two series moving hand in hand on a monthly basis. Given the usual seasonal distortions this time of year, we do not expect to see a big shift in either direction for housing starts or permits.

### Jobless Claims (January, Thursday 8:30 ET)

Forecast: 303K

Consensus: 300K

Previous: 316K

Initial jobless claims are expected to hover near the 300K mark in January, though the reports should not cause much market anxiety. Claims have been slowly trending upward after reaching a recovery low of 266K in mid-October, crossing back over the threshold to 316K during the second week in January. Despite the fact that jobless claims have increased, we have seen significant strength in other employment data that more than offsets the modest rise in claims. Furthermore, there may be some holiday-related volatility at play, with long weekends and vacations throughout the past few weeks distorting the data trends.

### Existing Home Sales (December, Friday 10:00 ET)

Forecast: 4990K

Consensus: 5080K

Previous: 4930K

Existing home sales started off 2014 near two-year lows, and it is unlikely that the end-of-year data will show much improvement. For December, we expect that existing home sales will increase slightly but not quite enough to make up for November's 6.1% decline. In fact, levels are likely to hold below the recent peak of 5380K in July 2013. Pending home sales, which tend to be a leading indicator of existing sales, rebounded in November after a relatively weak showing throughout the prior months, hinting at a positive lift for home sales in December and/or January. Nevertheless, it is unlikely that the existing home market saw a significant boost in demand to close out the year.

### Leading Indicators Index (December, Friday 9:55 ET)

Forecast: 0.3%

Consensus: 0.4%

Previous: 0.6%

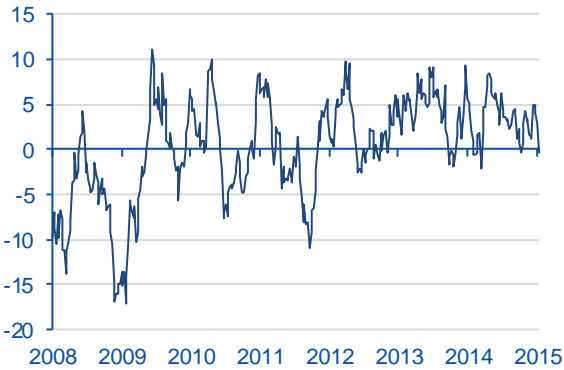
The leading indicators index has been driven by accommodative financial conditions throughout the recovery period, with the interest rate spread and credit factors being the strongest contributors. In level terms, the overall index is just a few notches away from the pre-recession peak. For December, we expect that the index will increase for the eleventh consecutive month but at a slightly slower pace compared to the previous months. The 10-year Treasury yield declined in December, hinting at a smaller positive contribution from the interest rate spread. Furthermore, data on manufacturing new orders and jobless claims were more negative in December.

### Market Impact

The holiday-shortened week should be a quiet one for financial markets, with few economic indicators warranting any potential reaction. Housing data will be important to watch for, although expectations are already very low so a modest decline won't cause any concern. Therefore, falling oil prices and increased demand for U.S. treasuries will most likely be the primary focus this week.

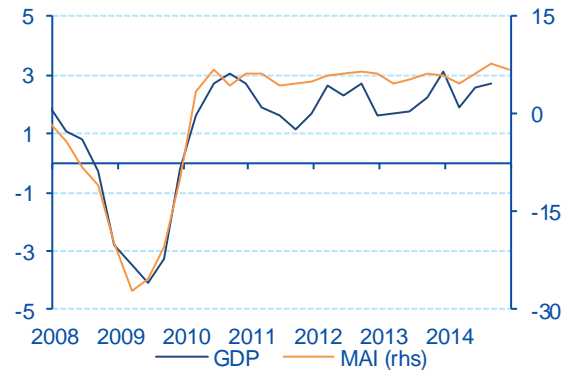
## Economic Trends

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



Source: BBVA Research

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



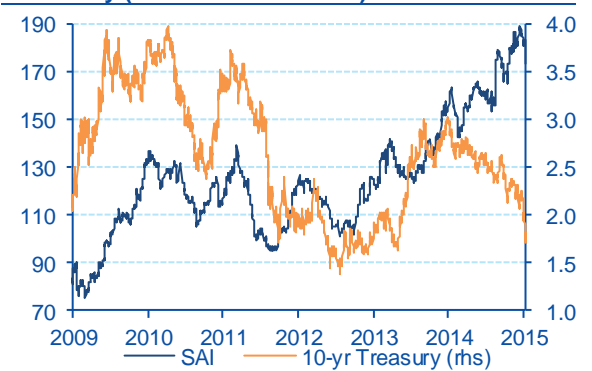
Source: BBVA Research & BEA

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



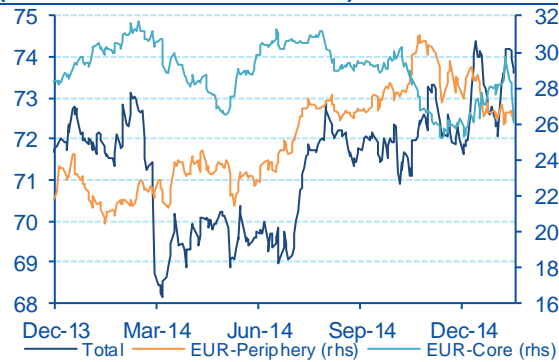
Source: BBVA Research

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



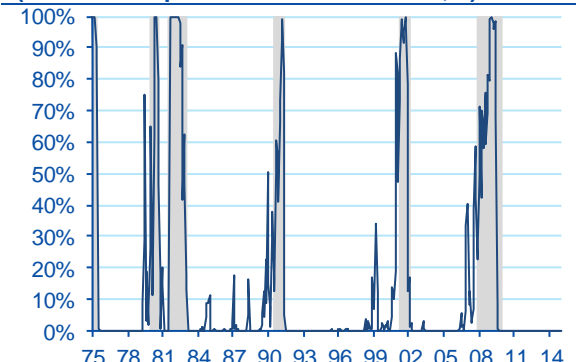
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

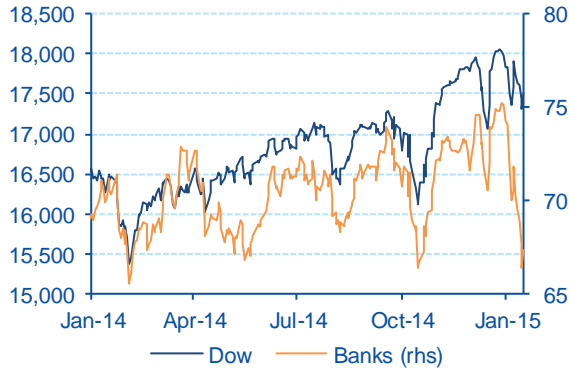
Graph 8  
**BBVA US Recession Probability Model (Recession episodes in shaded areas, %)**



Source: BBVA Research

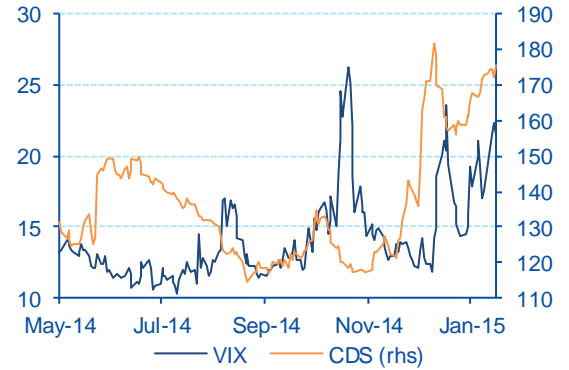
**Financial Markets**

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



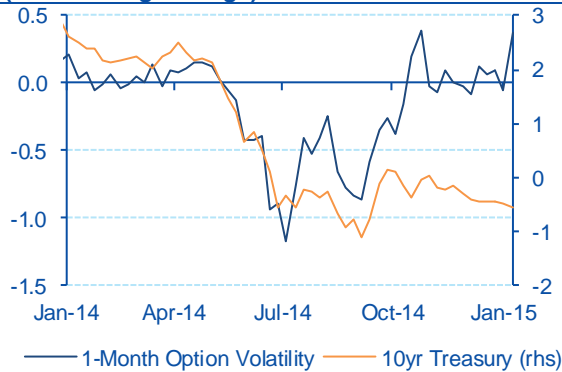
Source: Bloomberg & BBVA Research

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



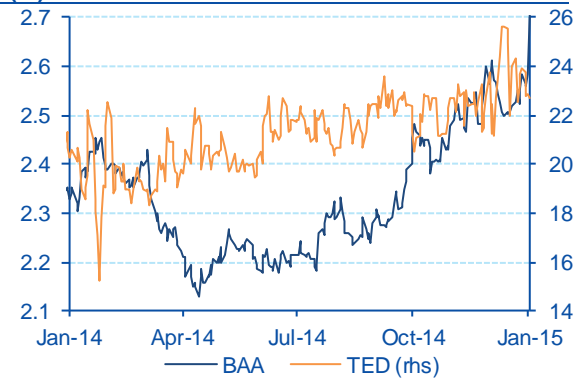
Source: Bloomberg & BBVA Research

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



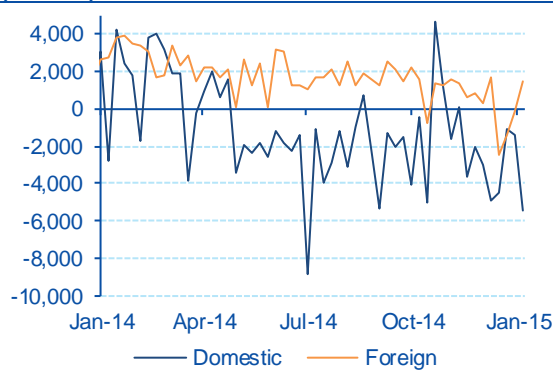
Source: Haver Analytics & BBVA Research

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



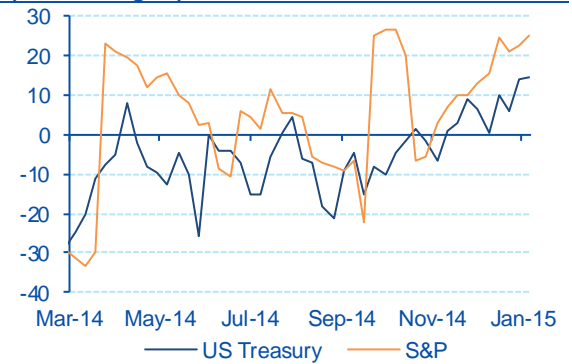
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

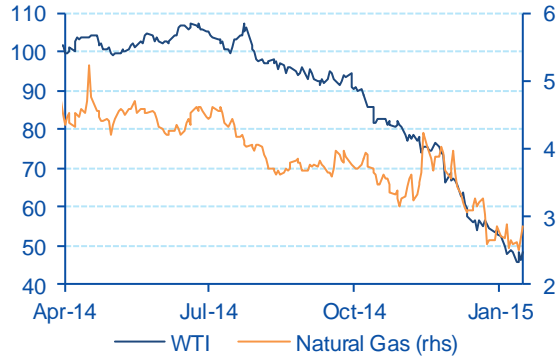
**Graph 14**  
**Total Reportable Short & Long Positions**  
**(Short-Long, K)**



Source: Haver Analytics & BBVA Research

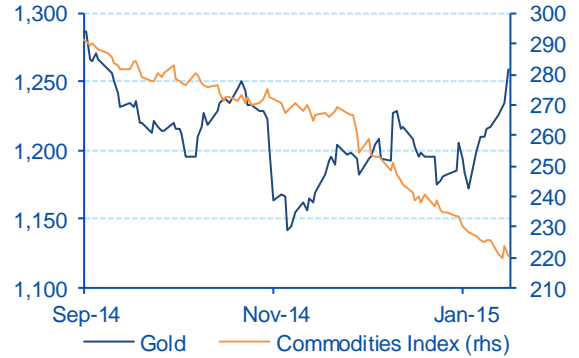
**Financial Markets**

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



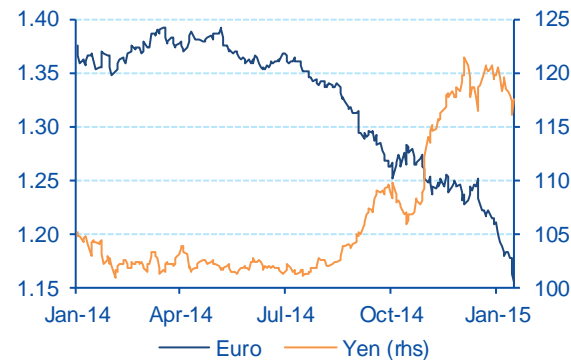
Source: Bloomberg & BBVA Research

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



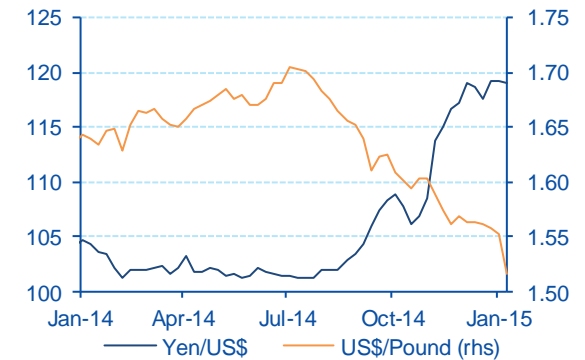
Source: Haver Analytics & BBVA Research

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



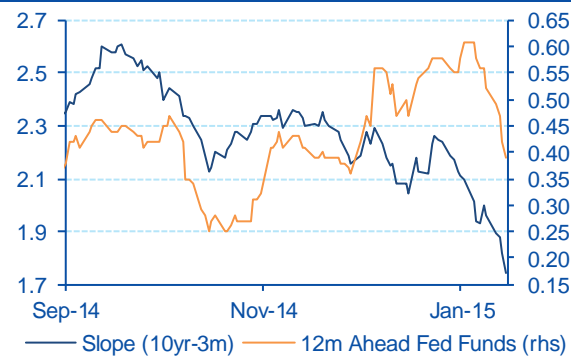
Source: Bloomberg & BBVA Research

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



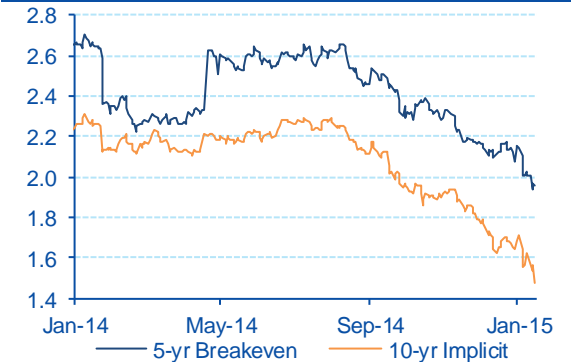
Source: Haver Analytics & BBVA Research

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)	2.63	2.61	2.70	2.35
Heloc Loan 30K	4.99	4.95	4.93	5.36
5/1 ARM *	2.90	2.98	2.95	2.90
15-year Fixed Mortgage *	2.98	3.05	3.09	3.23
30-year Fixed Mortgage *	3.66	3.73	3.80	3.99
Money Market	0.42	0.42	0.43	0.42
2-year CD	0.85	0.85	0.87	0.82

\*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	0.12	0.12	0.13	0.07
3M Libor	0.25	0.25	0.23	0.24
6M Libor	0.36	0.36	0.32	0.33
12M Libor	0.61	0.63	0.55	0.57
2yr Sw ap	0.72	0.79	0.87	0.51
5yr Sw ap	1.44	1.57	1.78	1.75
10Yr Sw ap	1.95	2.07	2.29	2.93
30yr Sw ap	2.37	2.47	2.71	3.73
30day CP	0.11	0.12	0.11	0.12
60day CP	0.14	0.11	0.11	0.15
90day CP	0.17	0.13	0.13	0.13

Source: Bloomberg & BBVA Research

## Quote of the Week

Charles Plosser, President and CEO of the Federal Reserve Bank of Philadelphia  
A Perspective on the Economy and Monetary Policy  
14 January 2015

*“In my view, this dual mandate has contributed to a view that monetary policy can accomplish far more than perhaps it is capable of achieving. I believe that assigning multiple objectives for the central bank has opened the door to highly discretionary policies, which can be justified by shifting the focus or rationale for action from goal to goal. That is why I have argued that Congress ought to redefine the Fed's monetary policy goals to focus solely, or at least primarily, on price stability.”*

## Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
20-Jan	National Association of Home Builders Market Index SA	JAN	57.00	58.00	57.00
21-Jan	US New Privately Owned Housing Units Started by Structure Total SAAR	DEC	1020.00	1040.00	1028.00
21-Jan	Private Housing Units Started by Structure Total Monthly % Change SA	DEC	-0.78	1.17	-1.60
21-Jan	Private Housing Authorized by Bldg Permits by Type Total SAAR	DEC	1045.00	1057.50	1052.00
21-Jan	Private Total Housing Authorized by Building Permits MoM SA	DEC	-0.67	0.53	-3.70
22-Jan	US Initial Jobless Claims SA	JAN 17	303.00	300.00	316.00
22-Jan	US Continuing Jobless Claims SA	JAN 10	2420.00	2400.00	2424.00
23-Jan	Chicago Fed National Activity Index	DEC	0.55	0.60	0.73
23-Jan	US Existing Homes Sales SAAR	DEC	4.99	5.08	4.93
23-Jan	US Existing Homes Sales MoM SA	DEC	1.22	3.04	-6.10
23-Jan	Conference Board US Leading Index MoM	DEC	0.30	0.40	0.60

## Forecasts

	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP (% SAAR)	1.8	2.8	1.9	2.0	2.5	2.8	2.8	2.9
CPI (YoY %)	3.1	2.1	1.5	1.6	2.0	2.3	2.4	2.4
CPI Core (YoY %)	1.7	2.1	1.8	1.8	2.1	2.3	2.4	2.4
Unemployment Rate (%)	8.9	8.1	7.4	6.2	5.8	5.5	5.0	5.0
Fed Target Rate (eop, %)	0.25	0.25	0.25	0.25	0.50	1.50	2.50	3.25
10Yr Treasury (eop, % Yield)	1.98	1.72	2.90	2.21	2.80	3.32	3.70	3.76
US Dollar/ Euro (eop)	1.31	1.31	1.37	1.23	1.20	1.24	1.28	1.32

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