Fed Watch

US

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Economic Analysis

US

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QE Dashboard

Are global headwinds counteracting QE?

- Even though domestic market-based risk indicators such as the VIX and corporate bond spread (13.4 & 289bp) sit at pre-recession lows, there are shadow risks that remain partially responsible for the lackluster growth.
- A continuation of February's private employment gains—246K—would cause the UR to converge to the Fed's quantitative target (6.5%) sooner than anticipated, which could induce the Fed to slow the rate of asset purchases.
- Further housing market improvements and stronger household balance sheets correlated with an uptick in lending activity. Continued emphasis on the housing market by the Fed should continue to support this trend.
- Weak global growth, dovish central bank monetary policy and Euro Area currency risks are causing the dollar to appreciate against a broad basket of currencies.

Table 1
Large Scale Asset Purchases (LSAP) Scorecard

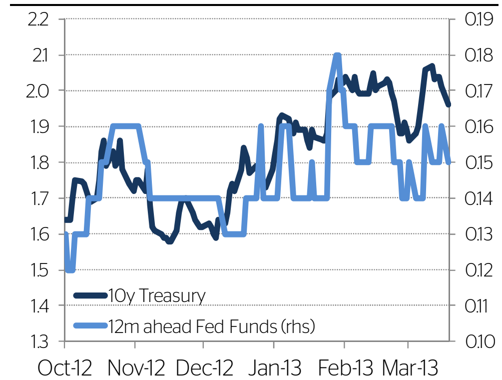
	QE3 (Hybrid)	Sterilized Purchases	Post QE2	Recovery	Crisis	Pre-Crisis
	Latest available	10/11-12/12	11/10-10/11	7/09-10/10	12/07-6/09	3/03-11/07
Inflation Indicators						
Slope (bp)	189	204	284	321	243	139
10yr Treasury (%)	2.0	2.1	2.9	3.3	3.5	4.4
10yr Inflation Indexed (%)	-0.6	-0.1	0.8	1.3	1.8	2.1
5yr breakeven inflation expectations (%)	2.3	1.9	1.8	1.6	1.3	2.3
5yr forward inflation expectations (%)	2.9	2.5	2.5	2.4	2.1	2.4
CRB Spot Commodity Prices(Index,1967=100)	481	506	519	421	392	316
West Texas Intermidiate Spot Price($)	93.7	94.7	89.2	75.8	82.9	53.2
Consumer Prices (12m %)	1.2	2.4	3.0	1.4	2.0	3.6
Core Consumer Prices (12m %)	1.3	2.2	1.5	1.5	2.0	2.4
Risk Indicators						
VIX (Index)	13.4	22.5	22.3	23.7	33.6	15.8
S&P500 (Index)	1552	1310	1226	1093	1109	1219
FTSE Emerging Markets	732	706	773	682	599	868
US Dollar (Effective, broad Index)	100.4	98.8	98.2	102.3	102.8	111.2
US Dollar (Effective, emerging markets)	126.4	127.5	126.6	131.8	130.7	138.4
Corporate Spreads (BAA bp)	289	313	288	287	106	302
3M Libor-Treasury (bp)	21	36	22	22	243	139
Growth Indicators						
Intial Claims (4wk avg)	347	378	418	493	479	332
Unemployment rate (%)	7.7	8.3	9.1	9.7	6.8	4.7
Private Payrolls (K monthly)	246	155	167	-7	-396	75
Consumer confidence (Index)	70	63	58	53	53	88
Housing Starts	917	710	572	588	781	1818
Core Logic Home Prices (yoy%)	9.7	0.1	-4.4	-2.4	-14.1	9.0
Retail sales ex bldg, autos & gas (yoy %)	3.8	5.2	5.8	0.9	-0.6	5.3
Industrial production (yoy %)	2.5	4.1	4.4	0.2	-7.0	2.3
ISM Survey (Index)	54.2	52.2	55.9	55.9	43.9	54.1
Credit Markets						
Monetary aggregate M1 (yoy %)	11.6	9.0	6.0	3.9	7.6	5.5
Bank Credit ($bn)	6195	6013	5870	5967	6081	4520
Bank Mortgage loans ($bn)	2122	2103	2073	2107	2057	2011
Commercial Paper issuance ($bn)	78	80	86	88	134	174
30yr Mortgage sprd (bp)	40	84	39	57	155	115
CP 3m spread (bp)	3	14	14	15	95	24

BBVA Research & Haver Analytics. * Pre-Crisis = Nov 2007

Chart 1
S &P 500 & Slope (Index,bp)

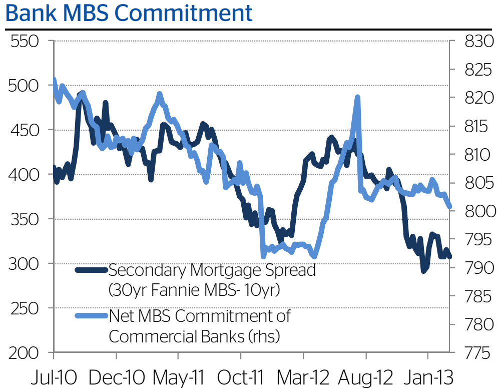
Source: Bloomberg, Haver Analytics & BBVA Research

Chart 2
10year Treasury & Fed Funds futures, (yields & %)



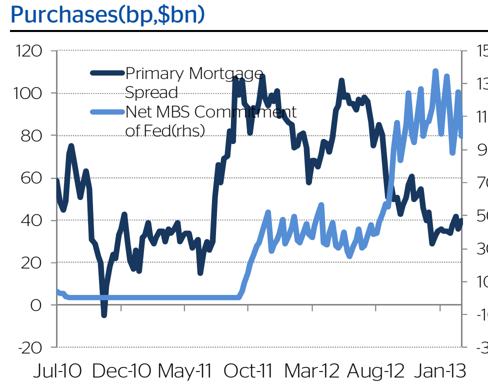
Source: Haver Analytics & BBVA Research

Chart 3
Secondary MBS Spread & Net Commercial Bank MBS Commitment



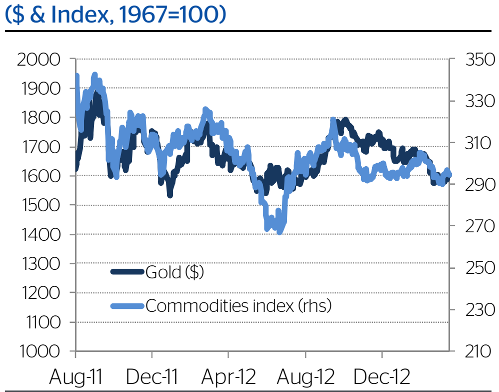
Source: Haver Analytics & BBVA Research

Chart 4
30yr Mortgage Spread & Net Fed MBS Purchases(bp,$bn)



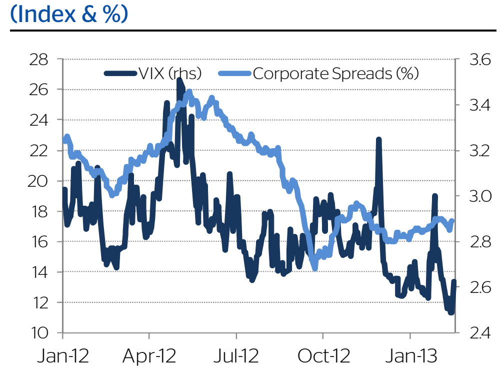
Source: Haver Analytics & BBVA Research

Chart 5
Gold & Commodities ($ & Index, 1967=100)



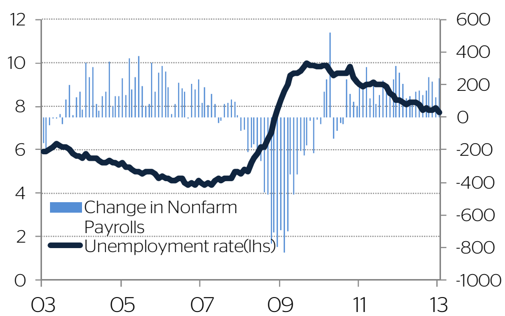
Source: Haver Analytics & BBVA Research

Chart 6
Implied Volatility & Corporate Spreads (Index & %)



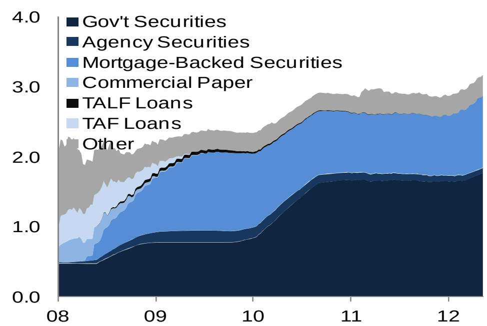
Source: Haver Analytics & BBVA Research

Chart 7
Unemployment & Nonfarm Payrolls (%&K)



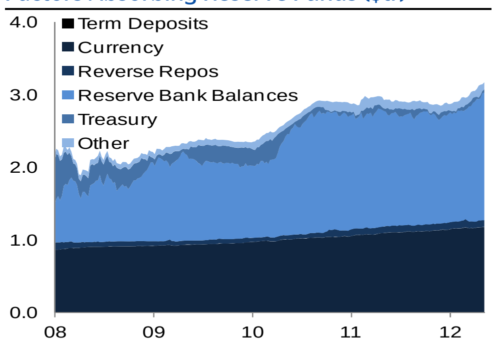
Source: Haver Analytics & BBVA Research

Chart 8
Factors Supplying Reserve Funds ($tr)



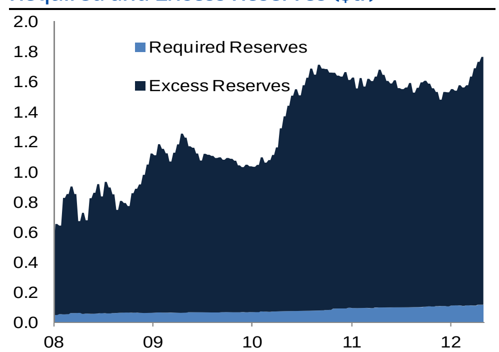
Source: Haver Analytics & BBVA Research

Chart 9
Factors Absorbing Reserve Funds ($tr)



Source: Haver Analytics & BBVA Research

Chart 10
Required and Excess Reserves ($tr)



Source: Haver Analytics & BBVA Research

Bottom line: Risks balanced as external headwinds offset domestic gains

The domestic data in February is beginning to suggest broader economic improvement. In the past, for example, strong private sector job creation coincided with a combination of home prices declines, weak equity performance, high degrees of policy uncertainty or limited credit availability. The discord from the negative impetus led to unsustainable growth and labor market malaise. Now, for the first time in years, domestic risk indicators are low, the housing market is significantly improved, and job creation rates are at levels that could produce sustainable reductions in the unemployment rate. Nevertheless, the period of data that supports sustained economic improvements is short and with the intensification of global risks it is unlikely that the Fed will adjust its policy stance in the upcoming meeting.

Over the medium -run, it is less clear how the Fed will proceed. On one hand, if domestic job creation rates stay around 250K, the unemployment rate will necessarily decline to levels consistent with the Fed's quantitative target rather quickly— assuming labor participation rates remain close to current levels. Moreover, as housing prices appreciate, consumer confidence will improve, boosting household's willingness to borrow. Assuming aggregate risks remain muted, lending will likely rise to meet the growing demand for credit. Under such a scenario it is clear the bias to slow the asset purchases will shift to the near-term. However, unless global growth surprises to the upside, idiosyncratic risks in Europe, Asia and the U.S. decline, and the impact from reduced federal spending is softer than expected, we maintain our baseline scenario of slowing asset purchases no sooner than 2h13.