

# Economic Outlook

## U.S. Monthly Update

June 7, 2013

# Meeting Details

**Topic: U.S. Monthly Economic Outlook**

**Date: Friday, June 7, 2013**

**Time: 10:00 am, Central Standard Time (Chicago, GMT-06:00)**

**Meeting Number / Access Code: 718 076 430**

**Meeting Password: bbva**

**To join the online meeting:**

<https://bbvacompass.webex.com/bbvacompass/j.php?ED=235184587&UID=1529080427&PW=NYjEyMWUyMWUO&RT=MiM3>

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<https://bbvacompass.webex.com/bbvacompass/globalcallin.php?serviceType=MC&ED=187370482&tollFree=1>

# Sustainable Economic Recovery?

## GDP

Growth stabilizing, but path to sustainability not yet clear

- Slowing activity in 2Q13 as businesses and consumers see lagged impact from January's fiscal changes
- Ongoing housing recovery, though temporary supply constraints holding back sales
- Persistent strength in asset prices

## Inflation

Contained pressures

- Core prices moderating, but upward pressures from shelter and medical care
- Deflationary concerns temporary, long-term expectations remain stable

## Fed

Sticking to the plan, but the debate intensifies

- Slowing of QE3 likely by 2H13 as costs may begin to outweigh benefits
- Still expect first rate hike in 2015

## Interest Rates

Yields accelerating after 2013

- No changes to our short-term outlook: 10YTN ~ 2.3% by 2013 year-end
- Mid-term rates expected to increase at a faster pace but stabilize in the long-run

## Risks

Lower probability

- Domestic: fiscal concerns still relevant, QE3 costs and elevated inflation, slowing demand and production
- Global: deeper European crisis, sharp change in commodity/energy prices, geopolitical threats

# Financial Markets

Risk perception stable, with equity markets near all-time highs

Equity Prices, S&P 500



Volatility, VIX



Corporate Spreads

Basis Points

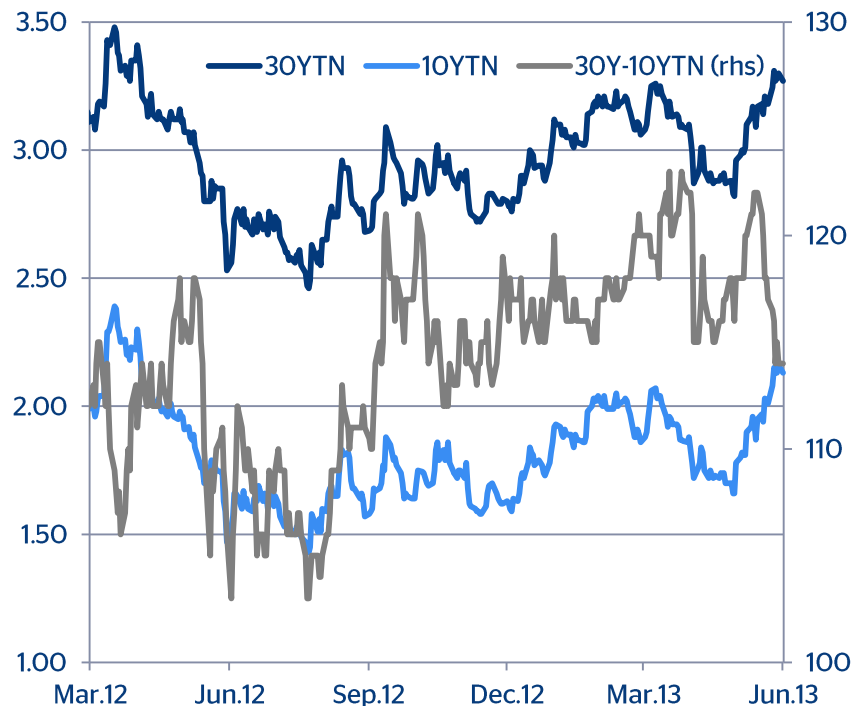


# Yield Curve

Treasury yields have jumped back up in the past month, with moderate yield curve steepening

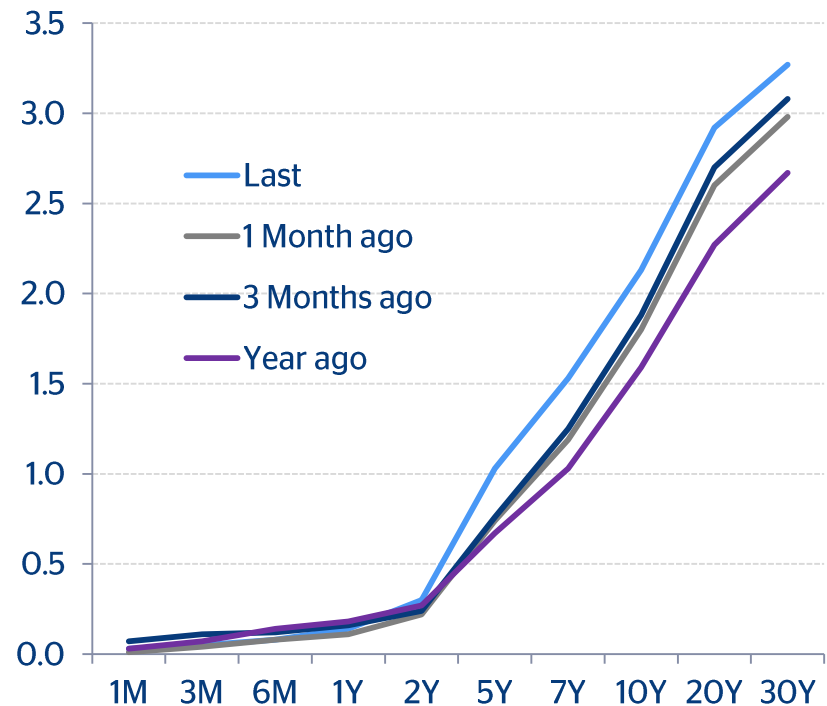
## Treasuries

% & bp


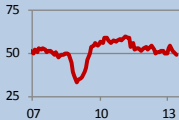

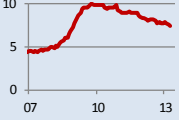

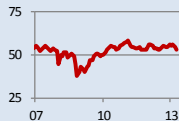

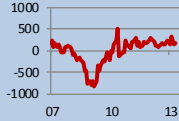

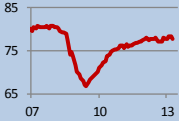

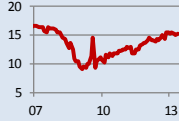

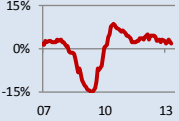


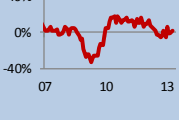
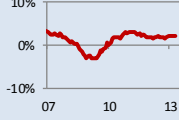

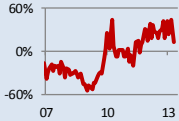
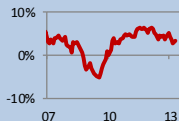




## Yield Curve

%



# Economic Activity

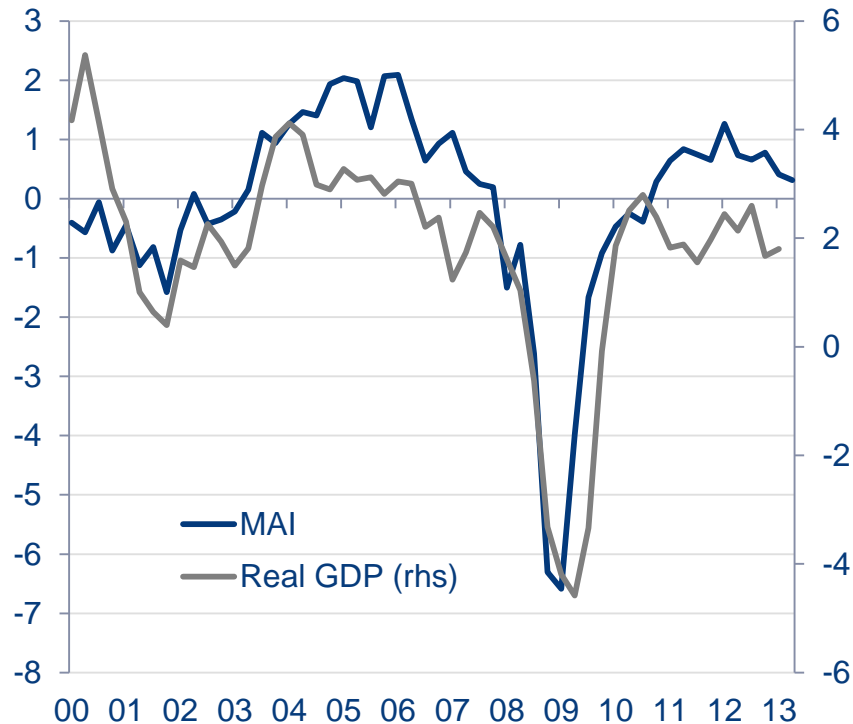
Indicator	Assessment		Indicator	Assessment	
ISM			Unemployment Rate (%)		
ISM Non-Manufacturing			Nonfarm Payrolls (MoM Change in K)		
Capacity Utilization			Auto Sales (Millions)		
Industrial Production (YoY % Change)			Real Disposable Income (YoY % Change)		
Capital Goods New Orders (YoY % Change)			Real Personal Spending (YoY % Change)		
Housing Starts (YoY % Change)			Retail Sales Ex Auto & Gas (YoY % Change)		
Home Prices: S&P Case-Shiller (YoY % Change)			Consumer Confidence Index		

# Economic Activity

Our short-term indicators suggest subpar growth for 2Q13. Weaker economic confidence and low prices reflect slower activity.

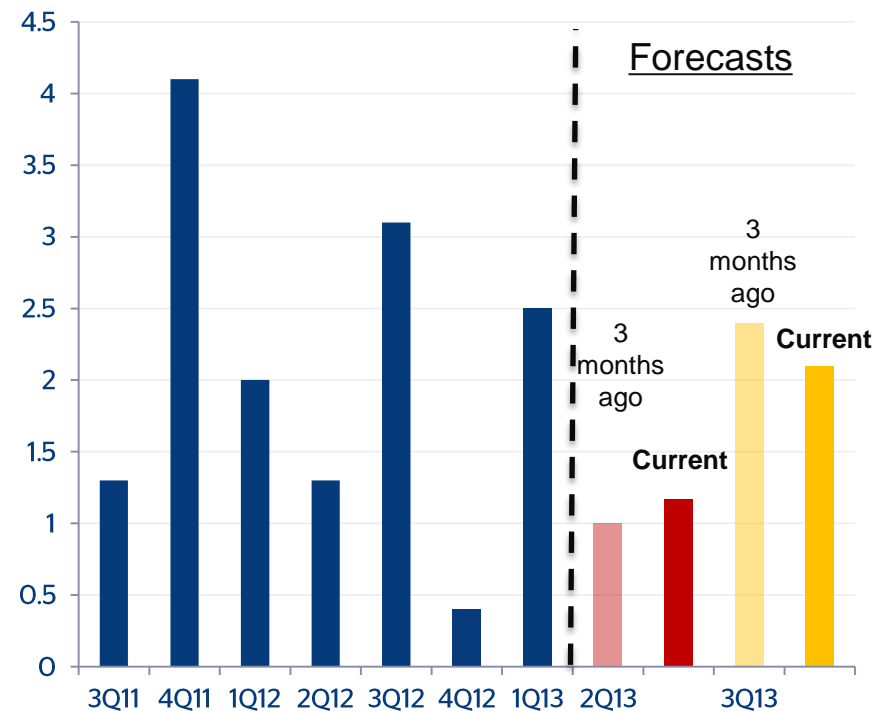
BBVA US Monthly Activity Index

4Q % Change



Real GDP Growth

QoQ SAAR, %

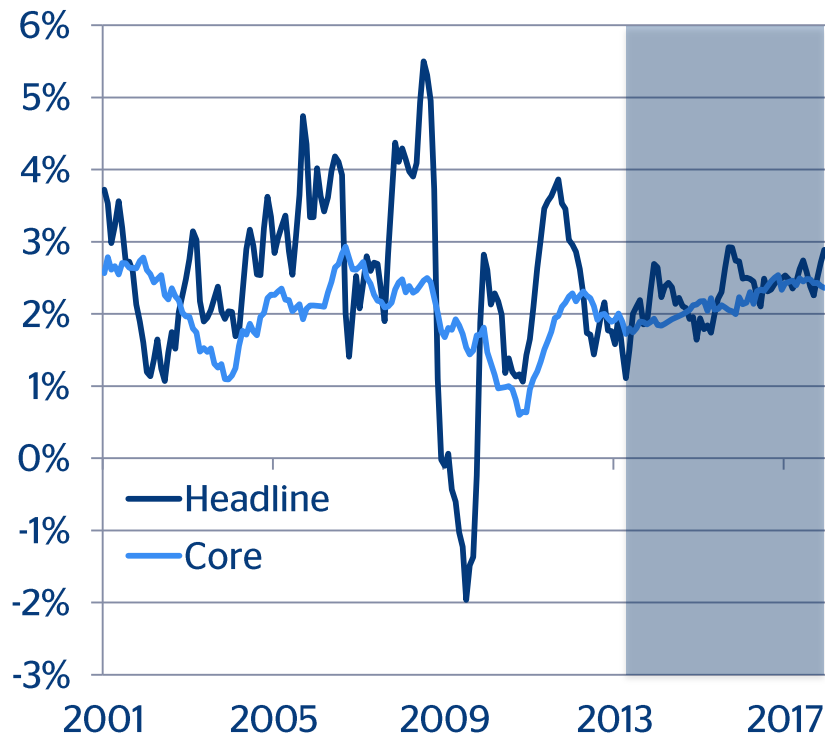


# Inflation

Energy prices have been dragging down overall inflation. Key core components such as housing and medical costs are important to watch.

## Consumer Price Inflation

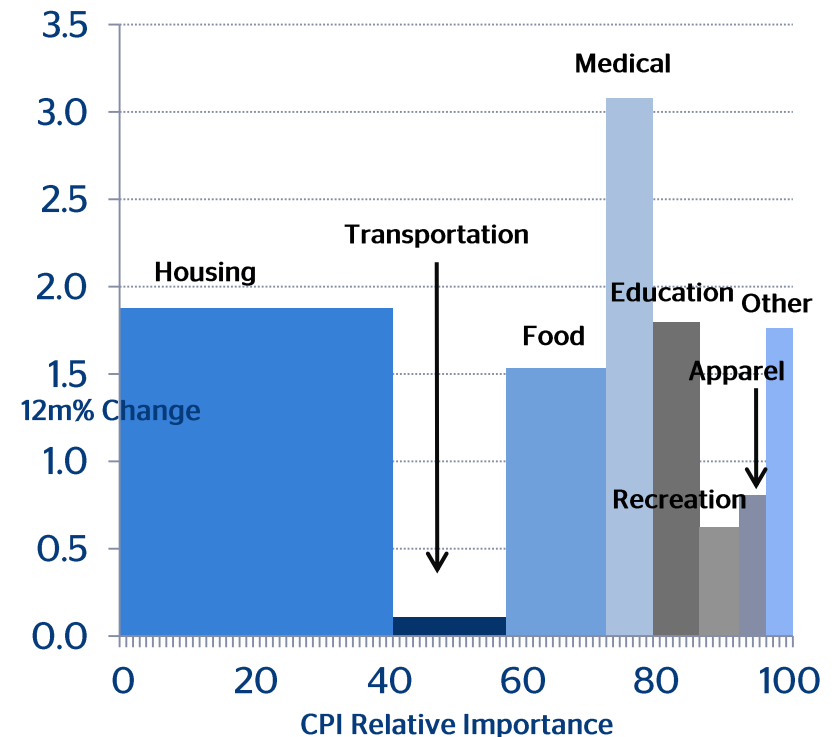
YoY % change



Source: BBVA Research & Bureau of Labor Statistics

## Contributions to CPI

Relative Importance & 12m% change



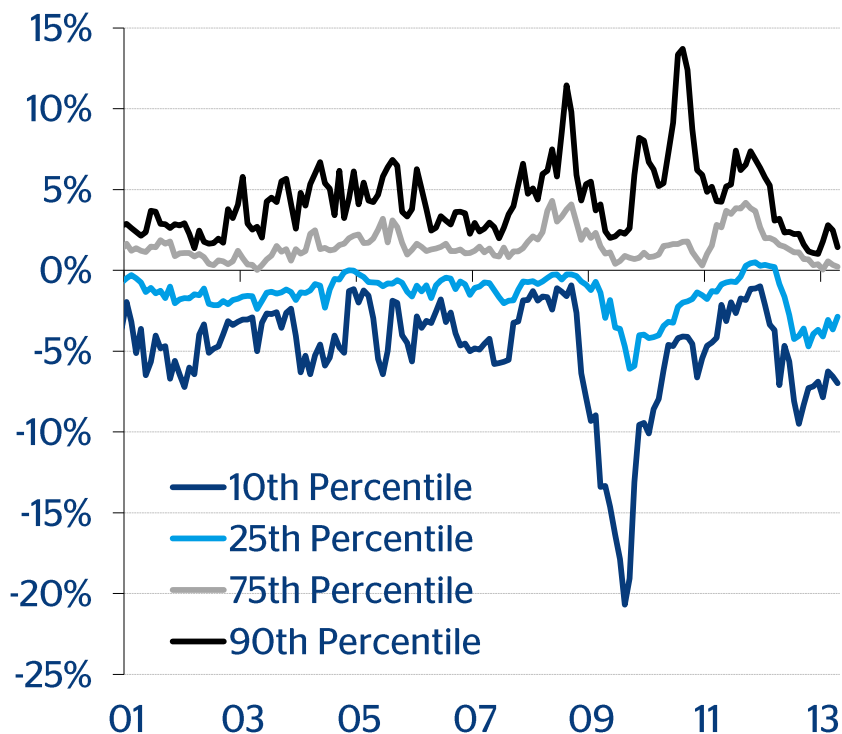


# Inflation

The distribution of price in the CPI suggests more of an increasing central tendency as of late, yet inflation expectations have dropped.

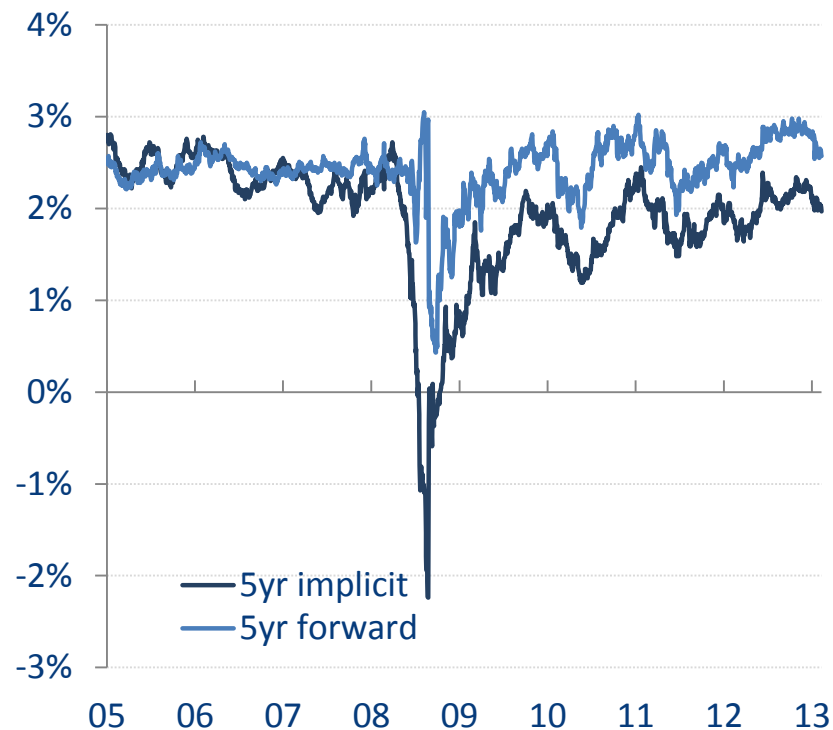
## 12M Relative Consumer Price Distribution

YoY % less year-ago YoY %



## Inflation Expectations

%



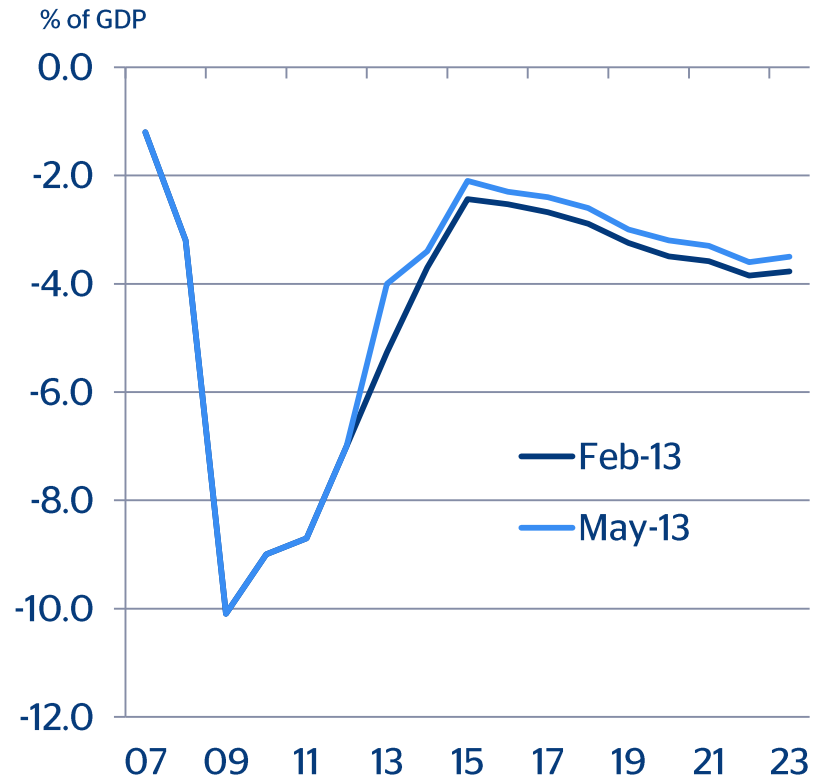
# Fiscal Policy

No major efforts for compromise despite the past few years of intense political brinkmanship

## A Never-ending Story...

- ❖ Sequester approved through FY2013, still a chance to change the automatic spending cuts set for the next decade
- ❖ Budget negotiations in the works, with a September 30<sup>th</sup> deadline
- ❖ Debt ceiling suspension expires May 19<sup>th</sup>, but Treasury can manage to pay off debts until September
- ❖ What comes next? Another summer of increasing policy uncertainty and no “grand bargain” deal

## CBO Budget Projections



# Monetary Policy

FOMC preparing for an exit strategy, but economic conditions do not present a clear enough picture to gauge the end of QE3

## FOMC Minutes: May 1<sup>st</sup> Meeting

- ❖ Fed remains committed to current pace of asset purchase (\$85bn) with strong emphasis on clear communication guidance and transparency of policy
- ❖ *“The Committee is prepared to increase or reduce the pace of its purchases to maintain appropriate policy accommodation as the outlook for the labor market or inflation changes”*
- ❖ Fed funds will remain near-zero until after the unemployment rate hits 6.5%, assuming that inflation is also under control

## Fed Speak

### ❖ Jeffrey Lacker, May 3<sup>rd</sup>:

- ❖ *“The benefit-cost trade-off associated with further monetary stimulus **does not look promising.**”*
- ❖ Growth “appears as if it’s limited, in large part, by structural factors that **monetary policy is not capable of offsetting.** This is why I do not support the current asset-purchase program.”

### ❖ Charles Plosser, May 14<sup>th</sup>:

- ❖ *“I believe that **labor market conditions warrant scaling back the pace of purchases as soon as our next meeting.** Moreover, unless we see a significant reversal in current trends that jeopardizes my forecast of near 7 percent unemployment rate by the end of this year, then I anticipate that we **could end the program before year-end.**”*
- ❖ *“Should inflation expectations begin to fall, we **might need to take action to defend our inflation goal,** but at this point, I do not see inflation or deflation as a serious threat in the near term. However, I do believe that **our extraordinary level of monetary accommodation will have to be scaled back,** perhaps more aggressively than some think, to ensure that inflation over the medium term remains consistent with our target.”*

# Monetary Policy

## 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
<b>Inflation Indicators</b>						
Slope (bp)	186	204	284	321	243	139
10yr Treasury (%)	1.9	2.1	2.9	3.3	3.5	4.4
10yr Inflation Indexed (%)	-0.5	-0.1	0.8	1.3	1.8	2.1
5yr breakeven inflation expectations (%)	2.1	1.9	1.8	1.6	1.3	2.3
5yr forward inflation expectations (%)	2.7	2.5	2.5	2.4	2.1	2.4
3 Spot Commodity Prices(Index,1967=100)	475	506	519	421	392	316
West Texas Intermediate Spot Price(\$)	96.0	94.7	89.2	75.8	82.9	53.2
Consumer Prices (12m %)	1.0	2.4	3.0	1.4	2.0	3.6
Core Consumer Prices (12m %)	1.1	2.2	1.5	1.5	2.0	2.4
<b>Risk Indicators</b>						
VIX (Index)	12.6	22.5	22.3	23.7	33.6	15.8
S&P500 (Index)	1634	1310	1226	1093	1109	1219
FTSE Emerging Markets	757	706	773	682	599	868
US Dollar (Effective, broad Index)	99.8	98.8	98.2	102.3	102.8	111.2
US Dollar (Effective, emerging markets)	125.1	127.5	126.6	131.8	130.7	138.4
Corporate Spreads (BAA bp)	282	313	288	287	106	302
3M Libor-Treasury (bp)	24	36	22	22	243	139
<b>Growth Indicators</b>						
Initial Claims (4wk avg)	337	378	418	493	479	332
Unemployment rate (%)	7.5	8.3	9.1	9.7	6.8	4.7
Private Payrolls (K monthly)	176	155	167	-7	-396	75
Consumer confidence (Index)	68	63	58	53	53	88
Housing Starts	1036	710	572	588	781	1818
Core Logic Home Prices (yoy%)	10.5	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 %)	3.5	4.1	4.4	0.2	-7.0	2.3
ISM Survey (Index)	50.7	52.2	55.9	55.9	43.9	54.1
<b>Credit Markets</b>						
Monetary aggregate M1 (yoy %)	13.7	9.0	6.0	3.9	7.6	5.5
Bank Credit (\$bn)	6235	6013	5870	5967	6081	4520
Bank Mortgage loans (\$bn)	2119	2103	2073	2107	2057	2011
Commercial Paper issuance (\$bn)	78	80	86	88	134	174
30yr Mortgage sprd (bp)	48	84	39	57	155	115
CP 3m spread (bp)	12	14	14	15	95	24
10yr Treasury (%)	190	210	294	334	349	441

\* Pre-Crisis = Nov 2007

Source: BBVA Research & Haver Analytics

## QE3 Expectations

- Current data supports a healthy credit market. There are no data points that underlie overheating given below historical average loan growth, strong diversification, and underlying consumer credit trends such as higher net worth and lower leverage ratios.
- Over the medium-run, it is less clear how the Fed will proceed.
- Still, our QE3 expectations remain unchanged:

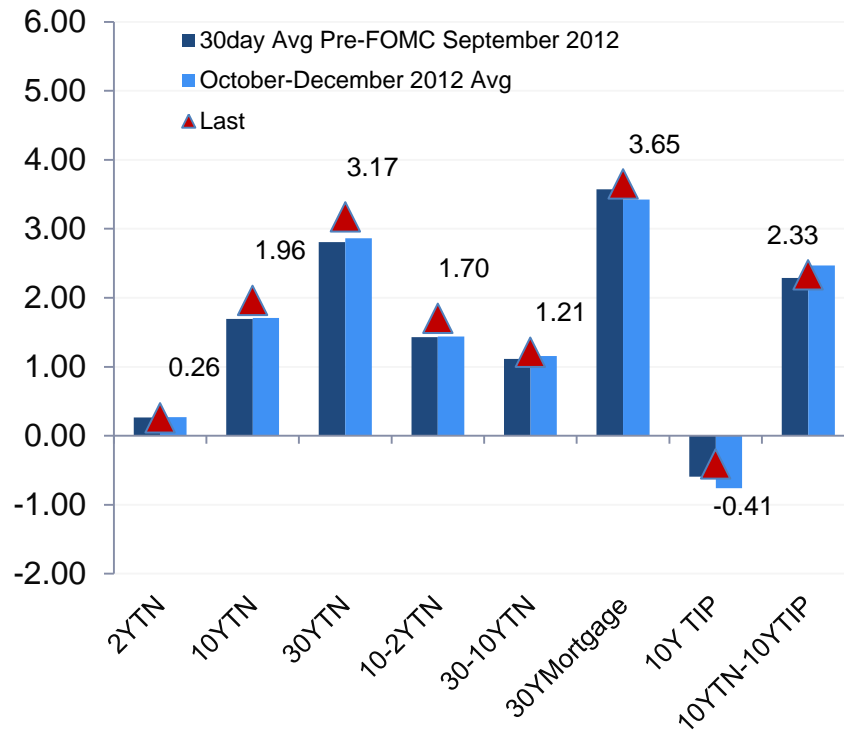


# Monetary Policy

The Fed's balance sheet is expected to hit \$4tr as QE3 comes to an end. Reversing accommodation will be a lengthy process.

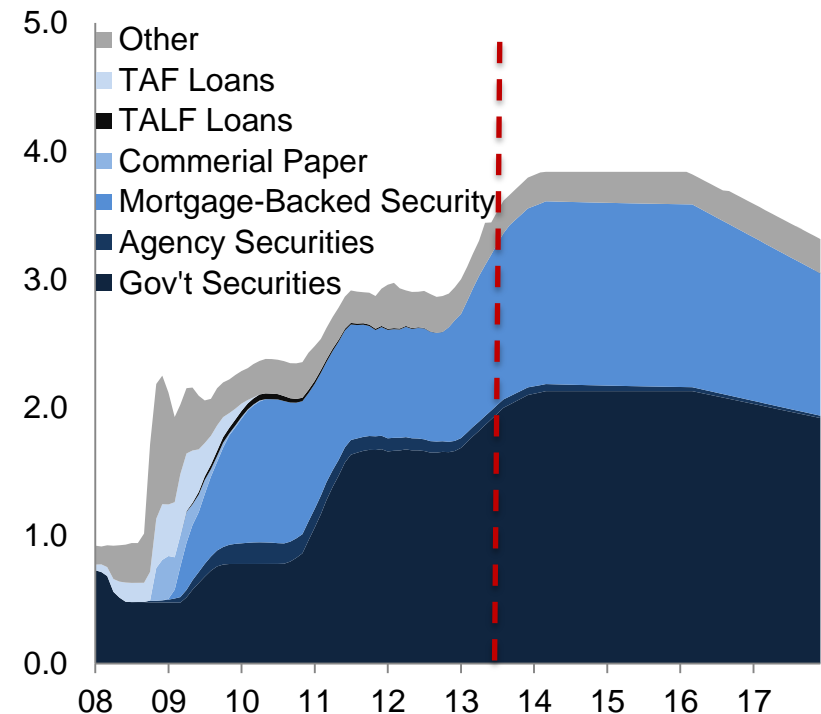
## QE3 Impact on Select Interest Rates

%



## Factors Supplying Reserve Funds

US\$tn

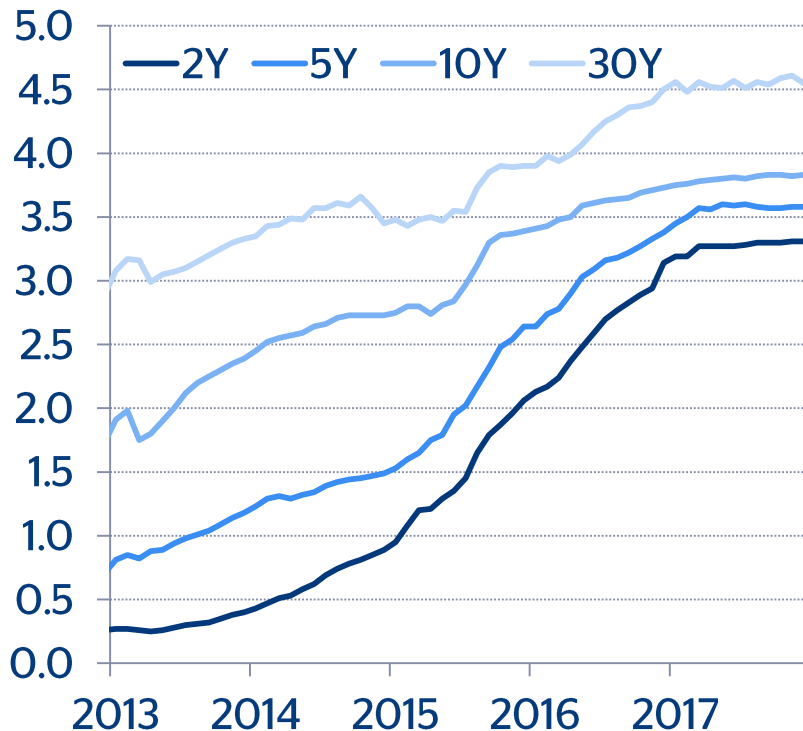


# Interest Rate Forecasts

No expected disruptions in the near-term, but concerns on the radar as our outlook suggests acceleration after 2013.

## Treasury Yield Curve

Internal models, %



## Slope

10YTN-2YTN



# Meeting Feedback

We would appreciate any feedback you have for us.

<http://www.surveymonkey.com/s/6D3S7NV>

Thank you for participating!

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