

Economic Outlook

U.S. Monthly Update

January 17, 2014

Meeting Details

Topic: U.S. Monthly Economic Outlook

Date: Friday, January 17, 2014

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

Meeting Number / Access Code: 716 088 635

Meeting Password: bbva

To join the online meeting:

<https://bbvacompass.webex.com/bbvacompass/j.php?ED=261235372&UID=494946087&PW=NMTTE4ODNmYWU5&RT=MiM3>

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Call-in toll-free number (US/Canada): 1-877-768-4036

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Baseline Scenario

GDP

More surprises ahead?

- As expected, upside risks materialize
- Less fiscal drag after budget deal
- Lower policy uncertainty could boost private investment and hiring
- GDP growth revised from 2.3% to 2.5% for 2014

Inflation

Cautious, but not worried

- Although low inflation has persisted for longer than expected, deflationary risks remain low
- Upside risks in check as economic slack continues

Fed

Policy firming vs. thresholds

- Pace of tapering data dependent
- FOMC debates best strategy for forward guidance
- Fed funds scenario unchanged; rate hike no earlier than 2015

Interest Rates

Trending upward

- Conditional forecasts suggest an orderly adjustment of long-term yields, reaching 4.0% in 2016-2017
- An early exit environment would imply a further 100bp adjustment

Risks

Tilted to the upside

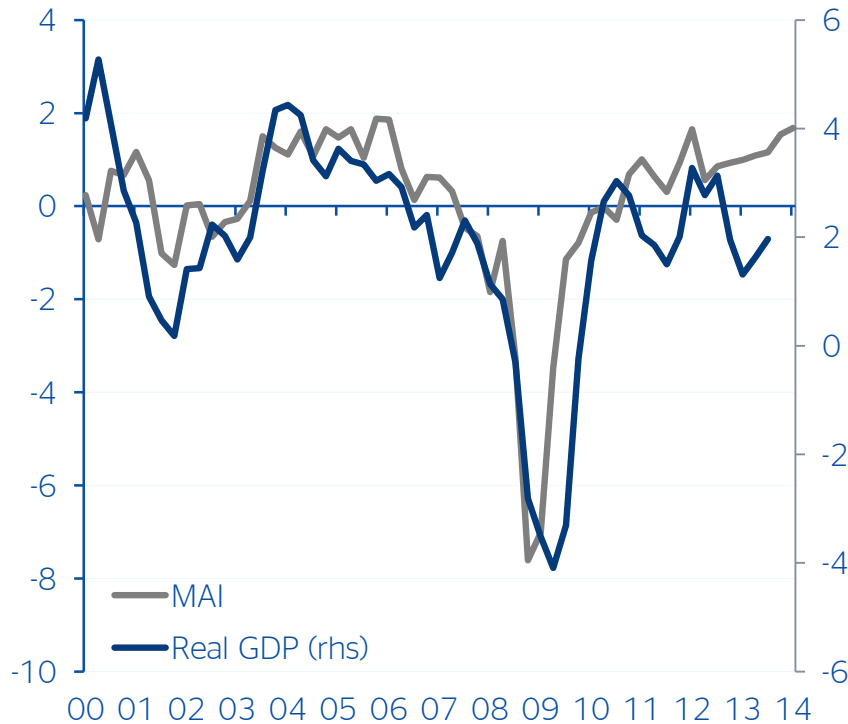
- Upside: productivity shock, energy/high-tech, low policy drag
- Downside: debt ceiling, QE3 disorderly exit, financial instability, demographics
- Global: European/EM crisis, commodity prices, geopolitical

Overview

Better-than-expected short-term data suggest a pickup in growth, but major contributors remain below historical expansionary trends

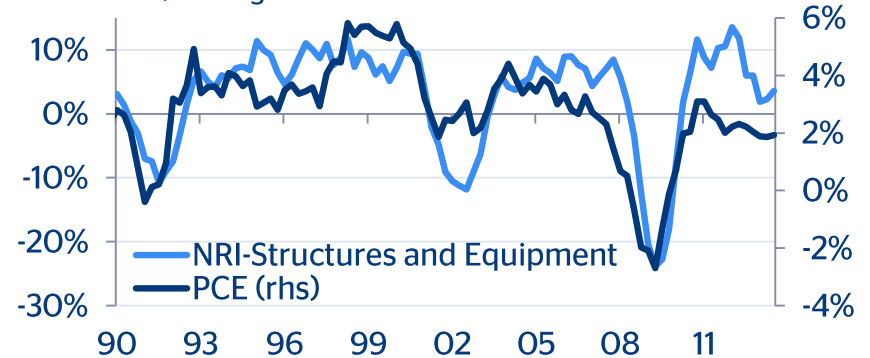
Real GDP & Monthly Activity Index

4Q % Change



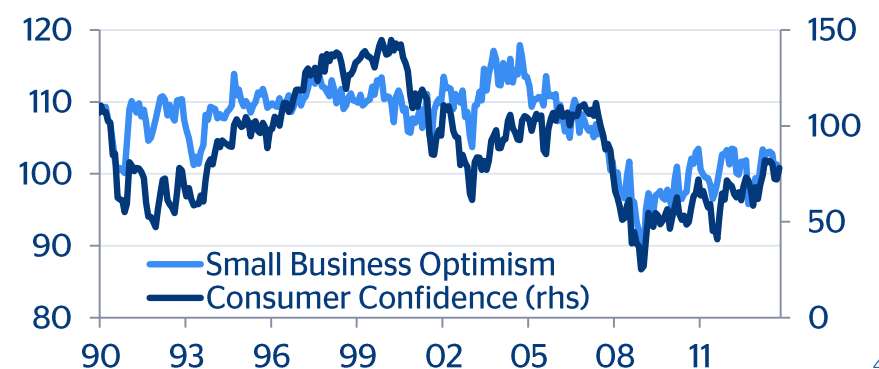
PCE & Nonresidential Investment

YoY SAAR % Change



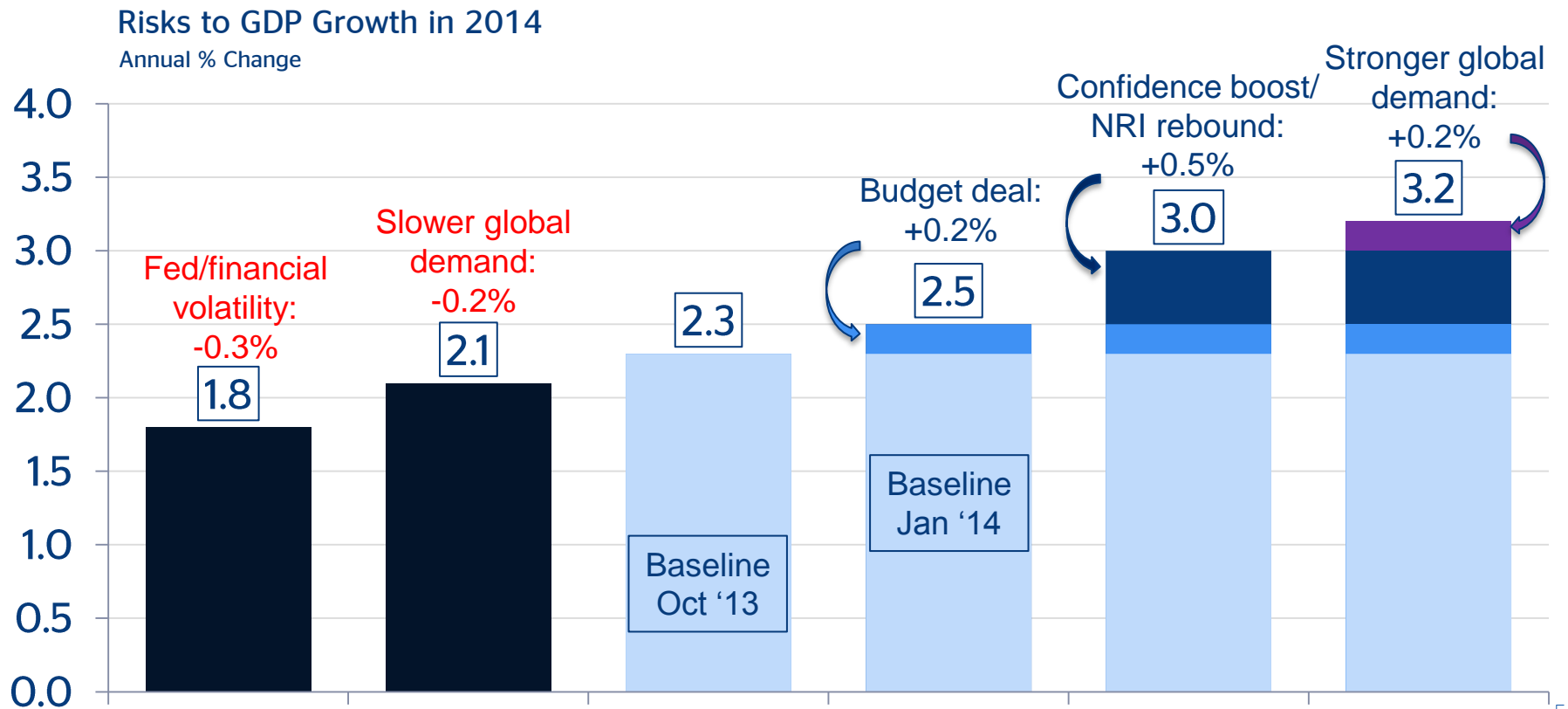
Consumer Confidence & Small Business Optimism

SA Index



GDP

Significant surprises in private investment and/or global demand could alter once again our forecasts

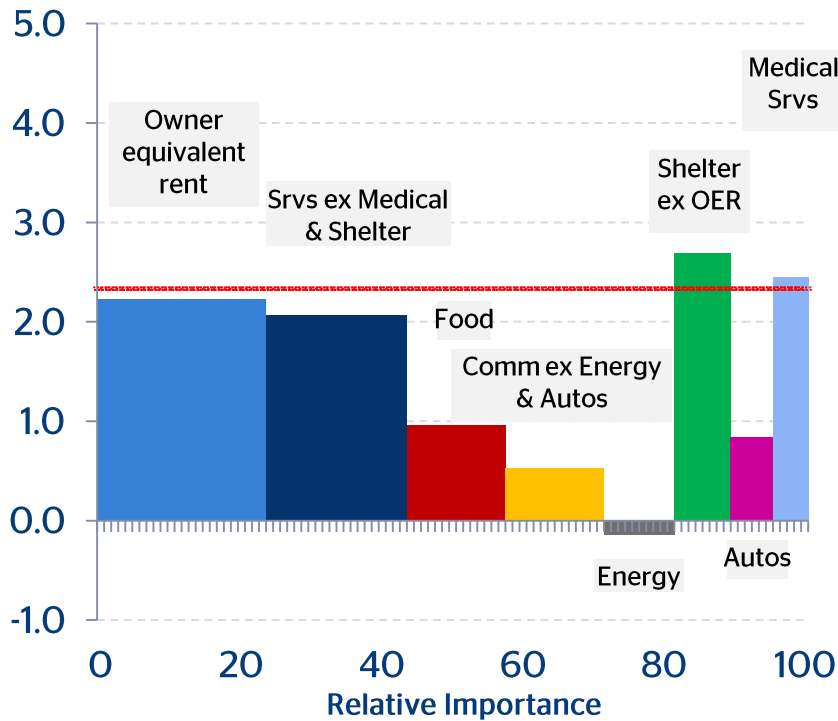


Inflation

The drop in inflation seems to be behind us

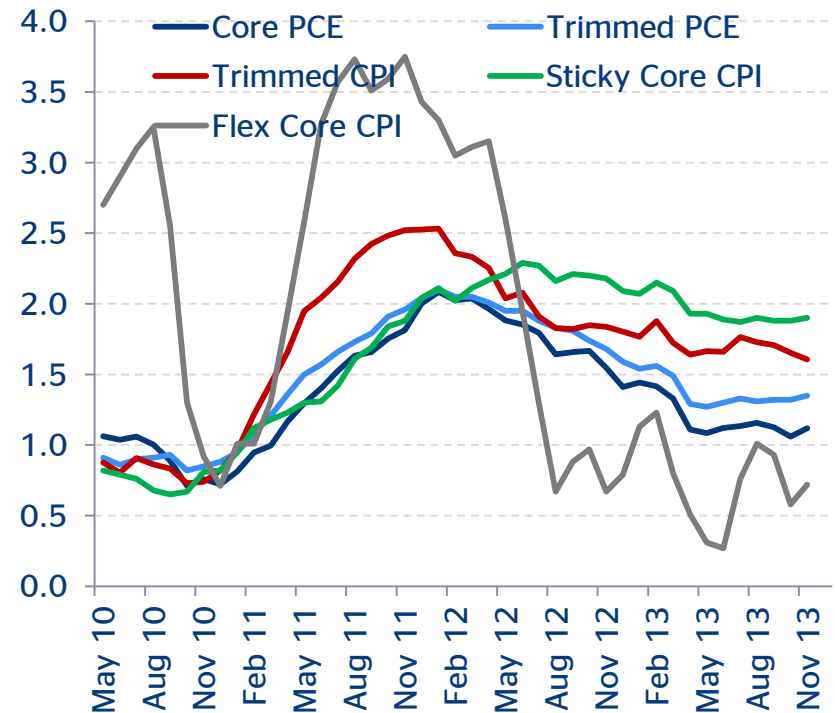
Contributions to CPI

Relative Importance & 12m% change



Inflation

12m % change



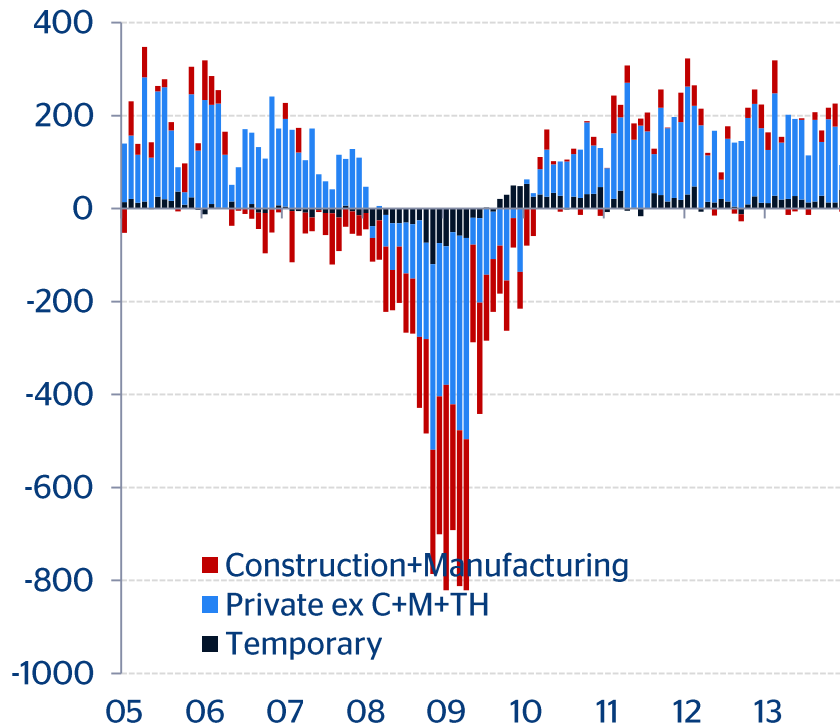
Source: BBVA Research / Haver

Labor Markets

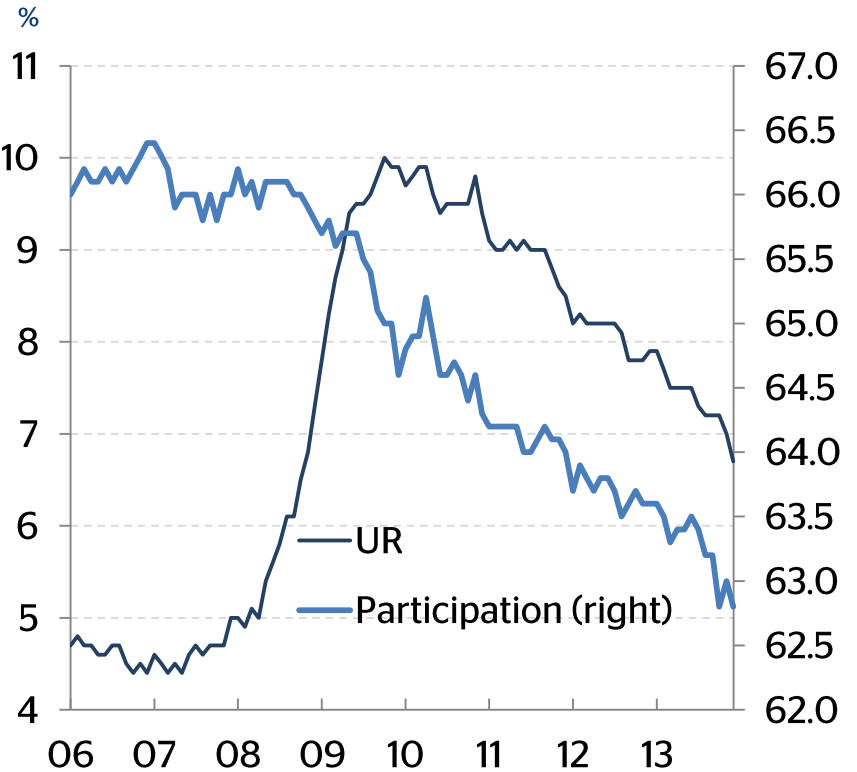
The unemployment rate dropped to 6.7% as participation declined to its lowest level in 35 years

Private Nonfarm Payroll

Thousands per month



Unemployment Rate & Participation Rate



Monetary Policy

FOMC Minutes: December 17th -18th Meeting

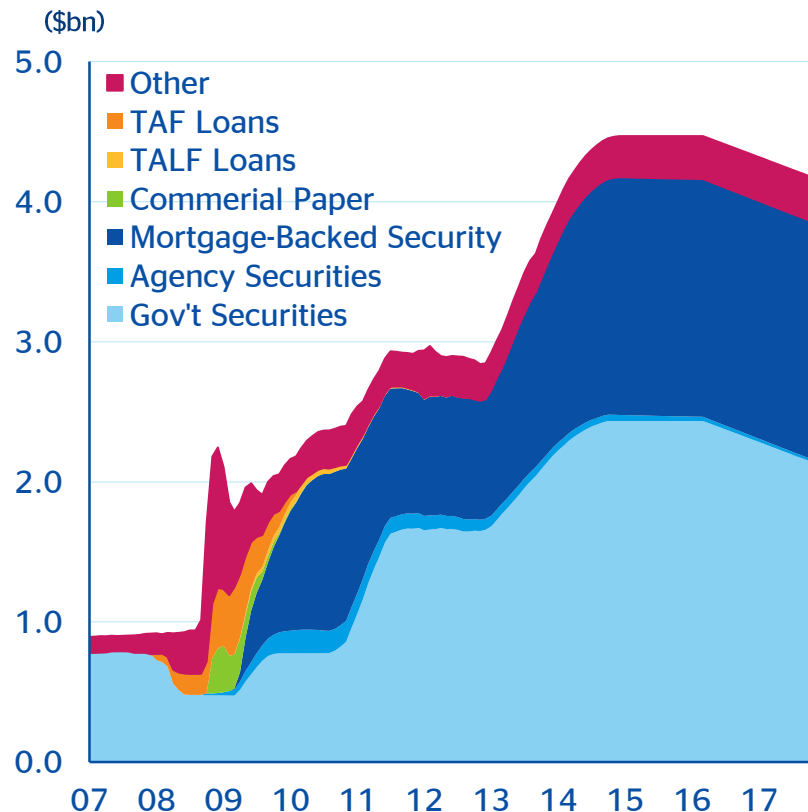
Finally, the Tapering Announcement

- FOMC decision to reduce QE3 based on:
 - Lower risk of “disruptive political impasse”
 - Declining marginal efficacy of QE3
- Data driven, and no “preset course”

Misaligned Forward Guidance?

- FOMC expects UR to hit 6.5% in 2014, but pushed back the expected path of the fed funds rate
- No change in thresholds, though a few favored drop to 6.0% UR
- Most members prefer a later rate hike to avoid premature policy tightening

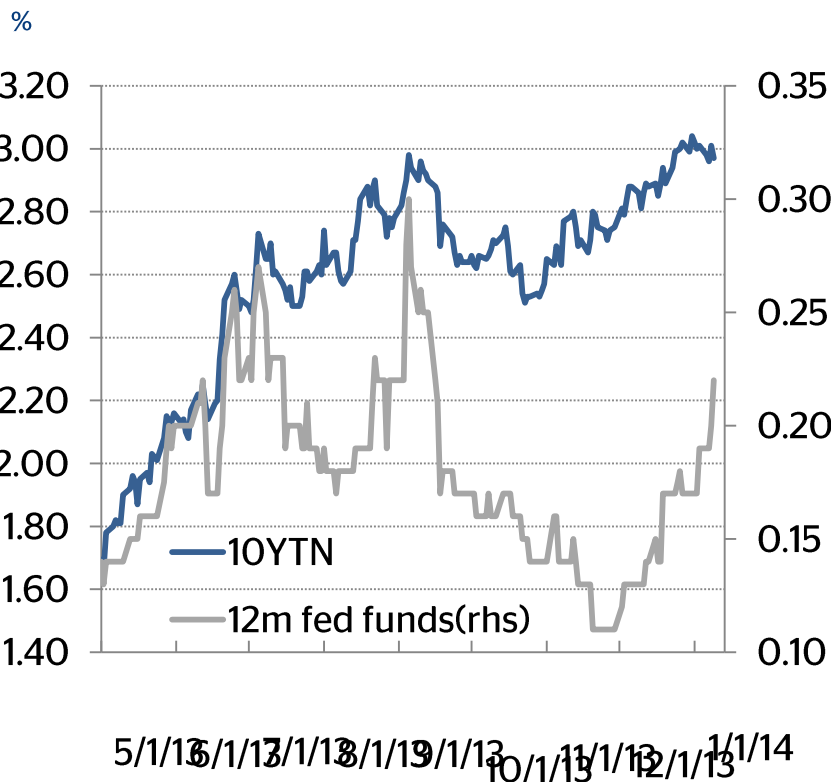
Federal Reserve Balance Sheet



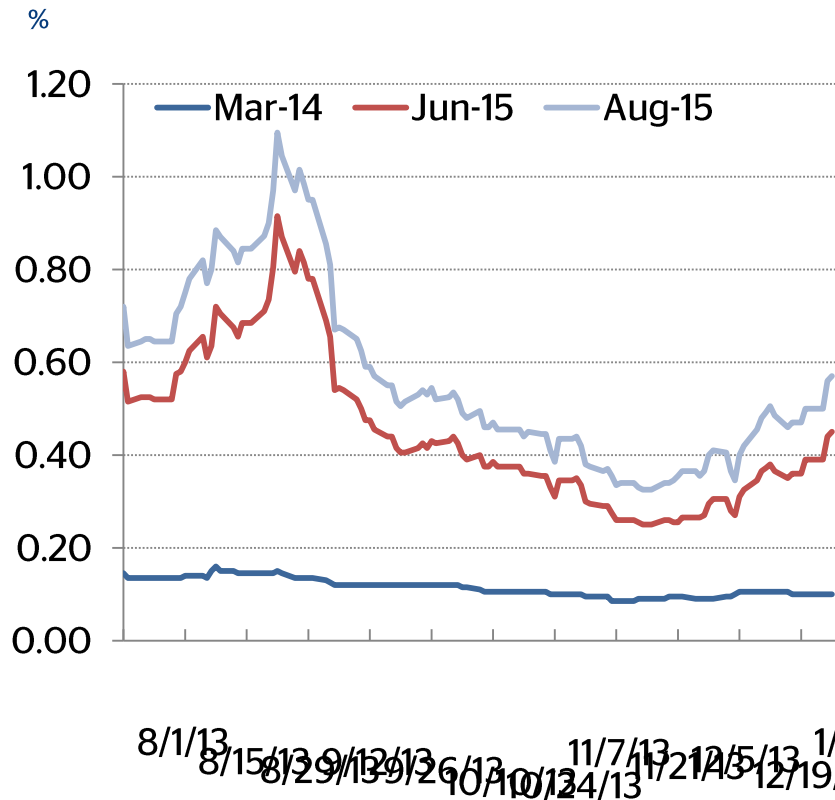
Monetary Policy

A sharp increase in the implied probability of rate hikes; 25bp in 1Q15/2Q15 and another 25bp increase in 3Q15

10yTN and 12-month Fed funds futures



Fed funds futures

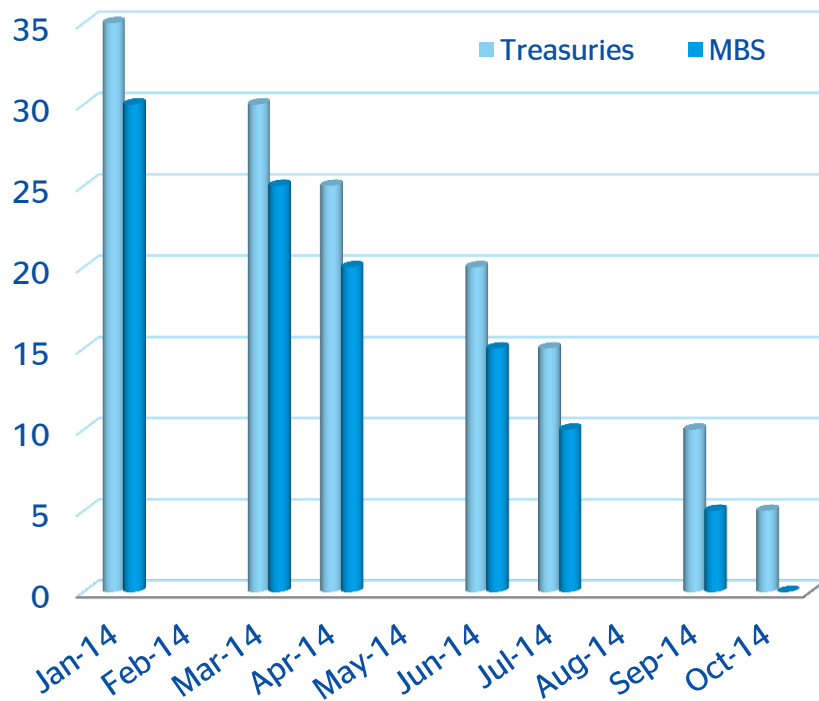


Monetary Policy

If current trends continue, the FOMC will not change its current pace of tapering. Our Fed funds forecast remains unchanged.

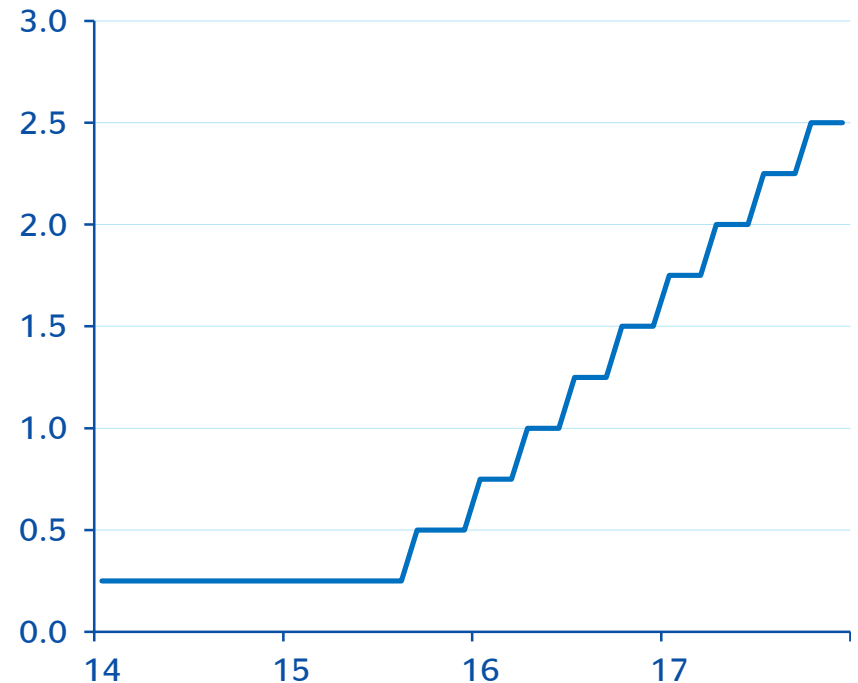
FOMC LSAP Scale-Down Announcements

US\$ bn & FOMC Meeting Dates



Federal Funds Rate, Baseline

%



Monetary Policy

Expectations for Monetary Policy Accommodation

	QE3 Tapering	Wait and See...	Start of Normalization	End of Normalization
Balance Sheet	Measured steps of \$10bn reduction of LSAP until 4Q14	Adjust reinvestment policy	Holding to maturity No reinvestment	Return to around 8% of GDP
Fed Funds Rate	No change	No change	First rate hike in 3Q15	Round 4.0% by 2019
Communication	Underplay importance of thresholds and gain flexibility on forward guidance	Discuss timing of policy firming and adjust thresholds	Eliminate thresholds Focus on pace of tightening	Focus on pace of tightening
Additional Tools	Continue testing and adjusting size of tools	Design road map	Leverage on IOER	Full use of tools

Baseline Scenario

Upward bias to 2014 growth

	2011	2012	2013	2014	2015	2016	2017	2018
GDP new	1.8	2.8	1.8	2.5	2.5	2.8	2.8	2.9
old	1.8	2.8	1.6	2.3	2.5	2.8	2.8	--
CPI new	3.1	2.1	1.5	2.3	2.4	2.4	2.5	2.5
old	3.1	2.1	1.7	2.2	2.4	2.4	2.6	--
Core new	1.7	2.1	1.8	2.0	2.3	2.4	2.5	2.5
old	1.7	2.1	1.8	2.0	2.1	2.3	2.6	--
Fed new	0.25	0.25	0.25	0.25	0.50	1.50	2.50	3.25
[eop] old	0.25	0.25	0.25	0.25	0.50	1.50	2.50	--

* Old as presented in 4Q13 MC Quarterly Revision

Downside Risk

Diminishing risks to growth

	2011	2012	2013	2014	2015	2016	2017	2018
GDP new	1.8	2.8	1.6	1.8	1.9	2.5	2.5	2.6
old	1.8	2.8	1.4	1.2	1.4	2.2	2.4	--
CPI new	3.1	2.1	1.4	1.5	1.9	2.2	2.4	2.5
old	3.1	2.1	1.2	0.3	0.9	1.7	2.2	--
Core new	1.7	2.1	1.7	1.5	1.8	2.1	2.4	2.5
old	1.7	2.1	1.6	0.6	1.1	1.8	2.2	--
Fed new	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50
[eop] old	0.25	0.25	0.25	0.25	0.25	0.25	0.25	--

* Old as presented in 4Q13 MC Quarterly Revision

Upside Risk

Accounting for potential positive surprises

	2011	2012	2013	2014	2015	2016	2017	2018
GDP new	1.8	2.8	2.0	3.2	3.4	3.4	3.4	3.7
old	1.8	2.8	1.9	2.8	3.2	3.4	3.4	--
CPI new	3.1	2.1	1.7	2.5	2.5	2.6	2.7	2.7
old	3.1	2.1	2.0	2.6	2.8	2.8	2.7	--
Core new	1.7	2.1	2.0	2.3	2.5	2.6	2.7	2.7
old	1.7	2.1	2.1	2.3	2.5	2.6	2.7	--
Fed new	0.25	0.25	0.25	0.75	1.75	2.75	3.75	4.50
[eop] old	0.25	0.25	0.25	0.75	1.75	2.75	3.75	--

* Old as presented in 4Q13 MC Quarterly Revision

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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